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RLGY - Q1 2014 Realogy Holdings Corp. Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to the Realogy Holdings Corporation first-quarter 2014 earnings conference call via webcast. Today's call is being recorded and a written transcript will be made available in the investor information section of the Company's website tomorrow. A webcast replay will also be made available on the Company's website until May 19.

At this time I would like to turn our conference over to Realogy Senior Vice President, Alicia Swift. Please go ahead, Alicia.

Alicia Swift - *Realogy Holdings Corporation - SVP of IR*

Thank you, Brian. Good morning and welcome to the Realogy's first-quarter 2014 earnings conference call. On the call with me today are Realogy's Chairman, CEO and President, Richard Smith, and Chief Financial Officer, Tony Hull. As a reminder for webcast participants you need to advance the slides by clicking the forward arrow at the bottom right of the screen beneath the webcast player as we move through today's presentation.

Starting with slide 3, I would like to call your attention to two items. First, you should have access to a copy of our financial results press release, our quarterly report on Form 10-Q for the quarter ended March 31, 2014, and our webcast slides which are available on the investor information section of our website.

Certain non-GAAP financial measures will be discussed on this call and these measures are defined and reconciled to their most comparable GAAP measure in our press release.

Second, the Company will be making statements about its future results and other forward-looking statements during this call. Statements about future results made during the call constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and the current economic environment. Forward-looking statements and projections are inherently subject to significant economic, competitive and other uncertainties and contingencies, many of which are beyond the control of management.

The Company cautions that these statements are not guarantees of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements. For those who listen to a rebroadcast of this presentation, we remind you that the remarks are made herein as of today, May 5, and have not been updated subsequent to the initial earnings call.

Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements are specified in our earnings release issued today as well as in our annual and quarterly SEC filings.

Now I will turn the call over to our Chairman, CEO and President, Richard Smith.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Thank you, Alicia, and good morning, everyone. We appreciate you joining our call.

As we review our quarter this morning, you will hear four recurring themes. First, we continue to believe that we are in a long-term housing recovery, but that it will clearly not always be a straight line trajectory, what appears to be developing this year case in point. Thus far 2014 is exhibiting signs of slower home sales offset by higher average prices. The challenges of low inventory at the first-time homebuyer and move-up buyer levels are compounded by tough credit underwriting and the effects of a sluggish economy, which we believe has slowed demand.

Contrast that against the higher end of the market which also has low inventory levels but stronger demand, which we see across the country. While the pace of the housing recovery has slowed as compared to the substantial volume gains in 2013, current industry forecasts have the momentum returning in 2015 with transaction volume increases of 9% to 11% over 2014.

Second, our mix of business is very relevant. Realogy's participation in high-end markets through the strength of its luxury offerings of Sotheby's International Realty, Corcoran, Coldwell Banker Previews and each of its brands capitalizes on the relative strength of the high-end market.

Third, the first-quarter adjusted EBITDA was negatively affected by the year-over-year industrywide decrease of more than 70% in mortgage refinance volume. Although we mitigated and will continue to mitigate some of this impact, never the less we experienced a decline in refinance related volume and earnings at TRG, our title agency company, and the PHH Home Loans joint venture.

Fourth, we continue to grow the business organically while we remain committed to deleveraging our balance sheet. Even in what could be a weaker market, we generate significant free cash flow which we intend to use primarily to pay down debt but also to capitalize on growth opportunities.

So with that said, let's begin.

First-quarter 2014 home sale transaction volume was up 10% year-over-year, which was at the midpoint of our guidance range. As you can see on slide 4, the improvement in our core business transaction volume translated into a 5% increase in net revenue, which was $1 billion for the quarter.

The first quarter in housing is always seasonally weak and as I indicated in my opening remarks, our adjusted EBITDA was lower year-over-year primarily due to the rapid and broad decline in mortgage refinance volume and the resulting impact on our mortgage joint venture and our title agency, TRG.

The seasonality of residential real estate is always most apparent in the first-quarter results and our revenue and earnings reflect that seasonality. Historically, the first-quarter EBITDA is the smallest contributor of the four quarters principally because the fixed costs of the business are largely spread evenly throughout the year, while the first-quarter transaction volume is generally the lowest of the year.

The financial impact of volume gains for the first quarter was offset by fixed acquisition costs, higher year-over-year employee costs, as well as the impact of adverse foreign currency exchange at Cartus.

On slide 5, our 10% transaction volume was driven by a 13% increase in average home sale price and slightly offset by a 3% decline in transaction size. At a 10% increase in transaction volume, we exceeded the national transaction volume trend reported by the National Association of Realtors hereinafter referred to as NAR, for the first quarter of 2014 which was flat for the prior year.

The relative strength of the first quarter was in higher-priced homes. We are strategically well-placed at the middle and high ends of the market both through NRT's footprint in more than 40 of the 100 largest metropolitan areas in the United States and the luxury market leadership of Sotheby's International Realty, as well as the luxury market offerings of each of our remaining brands Century 21, Coldwell Banker, ERA, and Better Homes & Gardens.

This was most evident in the higher-priced homes. 24% of RFG's home sale volume sides times price, was in price points greater than $750,000 for the first quarter this year. That is up from 19% in the same period a year ago. NRT had 52% of its volume in homes priced over $750,000 and that is up from 46% in the first quarter of last year. NRT's first-quarter 2014 average home sale price of approximately $489,000 is double the national average of $240,500.

Sales at lower price points are underperforming, which have moderated due in part to a variety of factors including low inventory, difficult credit underwriting standards, and in some parts of the country, the influences of persistently high unemployment.

Across RFG, the volume of home sales at price points under $300,000 in the first quarter this year decreased from 50% to 44% year-over-year as a percentage of total home sale volume whereas the volume of home sales over $300,000 increased from 50% to 56% for the same period.

Given the differences in the results we saw across the country, we thought it would be helpful to take a closer look at the sides and price performance of RFG and select NRT markets for the first quarter of this year. For our franchise operations, RFG's average home sale sides decreased 3% year-over-year and average home sale price increased 12% during the first quarter.

With respect to regional color for RFG in the first quarter, price was the key driver in all regions. The West was the strongest RFG region overall in the first quarter with a 5% decrease in sides and a 17% increase in price. The South was flat on sides but had a 10% increase in price, while the Midwest had an 8% decrease in sides and a 7% increase in price. In the Northeast region, RFG was flat on sides but experienced an 11% increase in price.

Now for our Company-owned brokerage operations, NRT's average home sales sides decreased 2% in the first quarter of this year and home sale price increased 14% year-over-year. The West and South regions both saw price increases of 13% that were offset by 3% decreases in home sales sides. In the Northeast, NRT had an increase of 19% on home sales price driven largely by New York City and a 3% decrease in home sale sides. The Midwest was balanced for NRT and experienced price increases of 8% and sides decreases of 8%.

Looking closer at the NRT markets, New York City experienced flat sides and an average price increase of 37%. The components of that average price increase are Brooklyn at 37%, Manhattan at 31%, the Hamptons at 20%, and our on-site new development projects dispersed throughout the boroughs in the city at 104%.

Northern California had unit declines of 3% and price increases of 22%. Southern California sides declined 17% and price increased 16%. Sides decline in Southern California was the steepest decline noted among all NRT regions.

We are starting to see slight increases in inventory on a national level as one would expect entering the prime season for home sales. NAR reported inventory for March 2014 up 3% versus March of last year. We need to see much stronger inventory growth in the coming months.

Now let's move on to the current industry forecasts which are shown on slide 6. For the full-year 2014, NAR is forecasting a 3% increase in existing home sale transaction volume and Fannie Mae is forecasting a 4% increase in volume. Both forecasts are consistent in that price increases are forecast to more than offset expected unit declines. Distilling this volume forecast into its two components, NAR is projecting 4.9 million existing home sales, which is a 3% decline year-over-year, and Fannie Mae is projecting 5 million existing home sales, a 1% decrease.

As to medium price forecasts, NAR anticipate the 6% increase in 2014 and Fannie Mae expects a 5% increase for the year. Looking longer-term for full-year 2015, NAR and Fannie Mae are both forecasting stronger growth in transaction volume, up 11% and 9% respectively with sides growth catching up to or exceeding price growth presumably as first-time buyer sales increase.

As you know, we do not provide forecasts on a full-year basis but we do give sales volume guidance for the current quarter. As shown on slide 7 for the second quarter of 2014, we expect to see our Realogy home sale transaction volume to be in the range of down 2% to up 2% year-over-year. Based on our closed sales activity in April along with contracts opened in March and April, we expect home sale sides to be down 5% to down 7% year-over-year for RFG and NRT combined and average sale price to increase 5% to up 5% on a combined basis.

As we have moved into our spring selling season, thus far the level of open activity we expected has not materialized particularly as it relates to home sale transaction size. Having said that, we expect our aggregate number of home sale transaction sides to increase sequentially from 260,000 in the first quarter of this year to between 367,600 to 375,500 sides in the second quarter.

As you can see on slide 8, Realogy's second-quarter 2014 volume guidance of down 2% to up 2% is consistent with the NAR and Fannie Mae second-quarter volume forecasts. According to the monthly NAR Realtor Confidence Index survey of brokers and agents, first-time buyers accounted for approximately 28% of home purchases in the first quarter of 2014. That is down from an average of 34% since August of 2009.

Tight credit standards and limited inventory are factors affecting the first-time buyers but we also believe that the high costs of an FHA loan are discouraging first-time homebuyers. The FHA's unusually high mortgage insurance premium structure which was raised to help improve the overall health of the FHA, is now more than double its historic average. In the past year alone, the FHA's loan volume has shrunk almost 15%.

The underwriting pendulum is gradually become more rational although it still has far to go. With refinance mortgage volume dropping considerably, banks are now competing for purchase mortgage borrowers. The Mortgage Bankers Association Mortgage Credit Availability Index is a barometer of credit availability. Higher index values signal that credit is more available while lower index values indicate that mortgage credit standards are tighter. The index rose to 114 in March 2014, up from 108 in March of last year. The MBA's data echo a recent Fed report showing that a larger share of major banks have eased credit standards for prime mortgages as compared to those that tightened credit standards. Mortgage rates have remained historically low as evidenced by the 30-year fixed rate of 4.29% reported by Freddie Mac on May 1.

Additional data from the MBA and others show that mortgage lenders are accepting relatively lower credit scores and reducing down payment requirements for homebuyers. Ellie Mae reported that the average credit score for conventional mortgage borrowers was 755 in March; that is down from 761 a year earlier. Credit scores for purchase loans backed by the FHA dropped to 684, down from 696 a year earlier.

Despite recent price and mortgage rate increases, affordability remains high. NAR's Housing Affordability Index was approximately 176 in February, which is consistent with the full-year 2013 average. The US economy added over 500,000 jobs in the first quarter and consumer sentiment rose in April to its highest levels in nine months according to Thomson Reuters/University of Michigan Index.

On the legislative front, the GSE Reform Bill authored by Senators Johnson and Crapo is capturing the headlines so we think it is unlikely that meaningful GSE reform will be addressed prior to the midterm elections in November.

Now let's turn to slides 9 and 10 and review some noteworthy operational highlights and actions that will set the stage for future growth.

RFG had its strongest domestic franchise sales quarter since 2005 with approximately $107 million in gross commission income or GCI. This was a 56% increase over the first quarter of last year. We have a strong sides sales pipeline and we are confident in our ability to continue to add quality franchisees throughout the year.

Franchise sales for our Sotheby's International Realty brand have been particularly strong. For the seventh year in a row, the brand won Franchise Business Review's Best in Category award for franchisee satisfaction among real estate companies and was ranked third overall among all franchises.

For the 17th consecutive year, NRT was ranked as the nation's number one residential real estate brokerage company in the annual REAL Trends 500 report in both closed sales volume and closed transaction sides. In 2013, NRT's sales volume of $151 billion on a pro forma basis was approximately 2.5 times higher than the next company on the list.

NRT's two most recent larger acquisition, Martha Turner Properties in Houston, and Frank Howard Allen in Northern California, have been very successful and our pipeline of perspective acquisitions remains strong.

NRT is continuing a long-term investments we mentioned on our last call regarding lead generation strategies which are intended to produce incremental web sourced leads and higher conversion rates.

On slide 10, Cartus recently entered into a strategic alliance with Learnship, an innovative provider of online language training that is based in Germany and delivers live training in virtual classrooms on a 24/7 basis over the Internet. This new relationship greatly enhances Cartus' existing language training capabilities for the most commonly used business languages in the world.

Finally, at the enterprise level, we are proud that Realogy was recognized among the World's Most Ethical Companies by Ethisphere Institute, the third consecutive year in which we have received this honor.

In conclusion, the premise of our business model remains unchanged. We believe that long-term demand for housing and the growth of our industry are primarily driven by the affordability of housing, the health of the US economy, positive demographic trends such as population growth, the increase in household formations, historically low interest rates, job growth, the inherent attributes of home ownership versus renting, and the increasingly influential local market dynamics of supply versus demand. The requisites for future growth continue to develop, although the pace appears to be slowing in 2014 as compared to 2013.

We continue to be focused on growing our Company, strong cash flow generation, deleveraging our balance sheet and ultimately enjoying the flexibility that lower debt will afford us, namely being in a position to return capital to our shareholders.

With that, I will turn the call over to Tony, our CFO.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Thank you, Richard. Turning to slide 11, let me make some comments about the first quarter.

Revenue was up 5% driven by higher home still transaction volume at NRT and RFG while adjusted EBITDA was $53 million, down from $71 million in the first quarter of 2013. Although transaction volume increased, it was not enough to offset approximately $20 million of lower EBITDA from reduced mortgage refinancing activity relative to the same period in 2013 along with added fixed costs from acquisitions completed at NRT and higher year-over-year employee-related costs. The Company recorded a net loss of $46 million which includes charges of $10 million for the early extinguishment of debt.

Slide 12 shows our current capitalization table on a pro forma basis for the financing activity in April 2014. The Company completed the repricing of its term loan and repurchases of $44 million of senior notes in the first quarter. In April, the Company issued $450 million of 4.5% unsecured notes and used the proceeds to repurchase $354 million of senior notes for aggregate consideration of $387 million, before accrued interest.

To date in 2014, the Company has reduced its senior note balance by $398 million. We continue to opportunistically improve our capital structure and the latest refinancing of a portion of the 7.875% notes to 4.5% notes, lowered our annualized cash interest expense by approximately $25 million to $215 million. We expect to continue to capitalize on opportunities to reduce our overall leverage.

Next, I will discuss our key revenue drivers for the first quarter on slide 13.

RFG home sale sides decreased 3% year-over-year in the first quarter and average home sale price gained 12%. As Richard discussed, both RFG and NRT average sales price are benefiting from increased activity at the middle and high end of the market. RFG's average sales price increase was influenced by Sotheby's International Realty franchisees who experienced a 15% increase in home sale sides and an average sales price increase of 15%.

RFG's first-quarter net effective royalty rate was 4.49%. Based on our current outlook, we continue to forecast that our 2014 net effective rate will be approximately 4.5% for the full year.

RFG average broker commission rate was 2.53% in the quarter declining 3 basis points from the first quarter of 2013 due to increased volume of higher-priced homes in the quarter. Average broker commission rate is heavily influenced by the price of the home, so with increases in average sales price we would expect to see modest pressure on the average broker commission rate.

NRT home sale sides decreased 2% year-over-year compared to 2013 and its average home sale price gained 14%. The increase in average sales price is due to NRT's concentration in major metropolitan areas and higher than average national sales price. NRT's average broker commission rate was 2.50% declining 2 basis points from Q1 2013. As with RFG, this decline is expected given the volume of higher-priced homes in the quarter.

For the second quarter of 2014, we expect overall home sale transaction volume to change from down 2% to up 2% for RFG and NRT combined, made up of an expected sides decline of between down 5% to down 7% year-over-year offset by an expected increase in average sales price of 5% to 7%.

At this point, RFG and NRT expectations for Q2 are different. RFG transaction volume is expected to come in at or above the high end of the minus 2 to plus 2 range, while NRT transaction volume is currently expected to come in at or below the low end of the range.

Looking out beyond Q2, you may recall that in the third quarter of 2013 our home sale transaction volume increased 29% year-over-year at RFG and NRT combined. This growth was driven by accelerated closings to fears at the time of rapidly increasing mortgage rates which caused transaction sides to increase 18% in the period. While we do not know how much volume was affected by the sudden rise in mortgage rates, we believe it could make for difficult comparisons in the third quarter of 2014.

Average sales price has increased so far this year and we believe it will continue to be positive in the third quarter.

At TRG, Q1 2014 purchase unit volume decreased 3% which was consistent with NRT home sale declines. Average fee per transaction improved 30% given the shift in mix to home purchase transactions from refinancing transactions. TRG's refinance title and closing units decreased 71% in Q1 2014 compared to 2013 which was consistent with industry refinancing trends. This will continue to be a difficult comparison in the second quarter of 2014.

Now let's look at revenue and EBITDA for the business units for the first quarter of 2014 as shown on slide 14.

Our overall revenue growth of 5% was driven by NRT and RFG. While NRT and RFG revenue grew 9% and 7% respectively, primarily due to transaction volume, TRG revenue declined 19% year-over-year causing Realogy's overall revenue to increase less than transaction volume increases.

EBITDA at RFG improved $7 million in line with its revenue gains of $9 million as higher revenue was partially offset by an increase in employee expenses. RFG's EBITDA margin increased to 55% in Q1 2014 from 53% in Q1 2013. EBITDA margins at RFG generally peak in the second and third quarter of any given year due to seasonality.

NRT EBITDA decreased $12 million for the quarter. Historically, NRT has experienced seasonal operating losses in the first quarter, the industry's weakest quarter. Fixed costs of the business are spread evenly throughout the year and the first quarter normally has the lowest transaction volume, which makes these expenses difficult to offset.

NRT results were adversely impacted by the decrease of $12 million in our equity and earnings related to our PHH Home Loans joint venture. We currently expect the PHH Home Loans venture to generate between $4 million and $8 million of EBITDA for NRT in 2014, the majority of it seasonally in the second and third quarter.

Cartus EBITDA in Q1 2014 decreased $3 million from Q1 2013 because of the $1 million revenue increase and $2 million of net impact from foreign currency exchange rate losses in the first quarter of 2014 compared with gains in the first quarter of 2013. The decline in revenue was due to lower domestic relocation volume which was partially offset by an increase in referral fees due to the growth in our affinity transaction volume.

TRG EBITDA decreased $9 million in Q1 due to $19 million in lower revenue driven by a 71% decline in refinance volume coupled with lower purchase volume and underwriting revenue. The decline in revenue was partially offset by the decline in variable costs associated with lower refinance volume. As a result of the decline in refinance volume, TRG implemented headcount reductions of approximately 350 employees between the fourth and first quarters. TRG continues to scrutinize its staffing and costs to address the decline in refi volume.

Looking more closely at NRT EBITDA on slide 15, NRT gross profit increased $15 million in the first quarter but was offset by declines in PHH Home Loans, increased fixed costs related to acquisitions, employee-related costs, and marketing expenses. Because the acquisitions were completed in seasonally weak Q4 and Q1, related fixed costs reflected at NRT work greater than the gross profit they produced. For the full year, we expect that the acquisitions will contribute positively to NRT EBITDA and provide incremental royalties to RFG.

As with RFG, NRT's EBITDA margins are generally highest in the second quarter and third quarter of any year. NRT's commission splits were 67.8% for the quarter. We continue to expect that NRT commission splits will be approximately 68% for 2014.

2014 could be a challenging year especially if transaction volume growth continues to slow throughout the prime selling season. Specifically, if transaction sides continues to decline year-over-year and average price increases moderate, we would expect to see pressure on our EBITDA margins for the year. This potential margin decline would be driven by a combination of moderating growth in transaction volume, lower mortgage refinance related EBITDA, and acquisition-related fixed costs being added to NRT's cost base in 2014.

In this scenario, we would expect Realogy's 2014 adjusted EBITDA margin to decline between 50 and 90 basis points from its level of approximately 15.1% in 2013. This outcome would be net of the cost reductions that we have cautiously undertaken this quarter and will continue through the balance of the year.

Moving to slide 16, before discussing cash flow items for 2014, let me review Q1 cash movements. Our net corporate debt was $3.9 billion at the end of the quarter. This is approximately $200 million higher than at the end of 2013. The first quarter is our weakest in terms of cash flow generation and it is when many year-end accruals are funded. Specifically, cash in Q1 was used to fund the following: $23 million in acquisitions; $44 million to repurchase high-cost debt; $58 million to reduce obligations under our securitization facilities; and $79 million to fund year-end accounts payable and accrued expense balances such as 2013 bonuses and manager and franchisee incentive payments. Both of these were timing related.

We expect to generate significant free cash flow for the balance of the year and intend to reduce net debt for the balance of 2014.

Here is some cash flow guidance for 2014; capital expenditures of approximately $65 million; cash interest expense of approximately $230 million for 2014, a reduction of $70 million compared to 2013; we paid cash premiums of $39 million for the debt repurchased in the first quarter and in April; working capital use of between $20 million and $30 million; cash legacy items of between $10 million and $20 million; and cash taxes of $15 million to $20 million which are minimal due to our $2.1 billion in net operating losses.

As a reminder, Realogy's book income tax rate for the year will be approximately 41%.

Turning to slide 17, while 2014 could be a challenging year relative to 2013, this is a result of the current macroeconomic environment, difficult year-over-year comparisons and what we view to be temporary credit and inventory restrictions rather than a structural shift in the housing market.

As the 2015 forecasts from a variety of sources indicate on this slide, existing home sales transaction volume growth is expected to improve by 10% next year and for Realogy, comparisons on refinance-related EBITDA and NRT's cost structure should be more favorable. We expect that this will allow us to resume the margin improvement from operating leverage in our businesses as we experienced in 2012 and 2013. In the meantime, lower interest costs and strong cash flow generation will allow us to continue to reduce our leverage which directly benefits our shareholders.

With that, I'll turn it over to the operator who will open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Stephen Kim, Barclays.

Stephen Kim - *Barclays Capital - Analyst*

Sorry about that. Apologies. Thanks very much, guys. Obviously a lot going on this quarter but obviously you are doing a good job in light of that difficult environment.

I am curious about your comments about the entry-level buyer. Obviously that is something that folks on the home-building side are talking a lot about. I have a view that maybe a little bit more optimistic than yours and so I wanted to get a sense from you. Included in your guidance, what sort of assumption do you make for the improvement at the lower end of the market? Do you include an assumption that it begins to improve noticeably this year or do you imply that it really isn't going to be until a 2015 event before you see a pickup in that end of the market?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Our current forecasts for 2014 are not assuming any significant increase in first-time buyer activity. But I think most people are expecting some increase principally because -- we hope -- change in credit underwriting for next year. So I don't expect to see a material change in first-time buyer activity this year but we do expect to see some change -- some improvement next year.

Stephen Kim - *Barclays Capital - Analyst*

Okay. That is great. So my next question relates to commission splits. So you did about a 67.8 in the first quarter and your guidance was 68 for the full year and you're still kind of looking for prices to continue migrating upwards on a year-over-year basis. Typically we see the commission splits at their lowest level in 1Q and so your 68% for the year doesn't really seem to leave a whole lot of room for splits to migrate upwards over the course of the year.

Can you just sort of talk a little bit about what your expectations are? Is that because of relatively a weaker year in 2014 relative to what you may have thought entering the year? Can you just give some color around the expectation for the annual commission split?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

68% is what we expect for the year. I think the first quarter was influenced again in the seasonally low period of the year. There was more West Coast activity in the mix so that West Coast splits are higher than the rest of the country. So I think that had an influence but that will be less pronounced as we go through the year and again, we think 68% we are confident that is going to be the number for this year.

Stephen Kim - *Barclays Capital - Analyst*

Okay, great. Thanks very much. That is very helpful.

Operator

Tony Paolone, JPMorgan.

Tony Paolone - *JPMorgan - Analyst*

Thanks. Good morning. I was wondering if you can give us a little bit more color around maybe why you think your numbers were so much stronger than NAR in the first quarter but it seems like in 2Q that may not be the case.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

I think our first-quarter numbers were very influenced by where our franchisees and where NRT is located so I think that it's the higher price market whereas NAR is a national average. So I think that influenced the outperformance. I also caution as we always do that NAR numbers are subject to revision and our numbers are actual. So if you just look back if you want to do the research if you look back in the first quarter of 2013, the NAR numbers seem very strong to us so they are working off of those comparisons.

Then going forward I think I would assume NAR is going to constantly revise their forecasts for the year so -- and for the quarter I think that will influence, we have some more visibility maybe than NAR does at this point in what the spring selling season is looking like.

Tony Paolone - *JPMorgan - Analyst*

Was there anything on the price side because your price growth in 1Q was substantial, it was a lot higher than what you had in any of the quarters in 2013 but then it seems like it drops back down again here in the second quarter. It just seems like the first quarter is a bit of an outlier.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Again, the first quarter, the high end was really strong in the first quarter and the lower part of the market was as we talked about weak and it is just most pronounced in the first quarter because of the lower volume levels and the seasonality. I think as the year progresses that gets diluted as we get into our principal season.

Tony Paolone - *JPMorgan - Analyst*

Okay. Richard, you had mentioned mortgage insurance kind of being a bit of a fly in the ointment and for over a year now, we have heard about just inventory. I guess what gets you comfortable that this isn't just a demographic matter or there is not something more fundamental and why the existing home sales figures just remain sort of depressed here?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Principally because nothing else has fundamentally changed. The same building blocks for a successful recovery in housing that existed last year actually just in 2012 continue to exist today. So listen, we had 40% growth in two years. This is perhaps the market just pausing to absorb and digest the growth. That said, we are still only at about 1999 to 2000 unit levels so we have a long ways to go.

I don't see anything else that has changed or impacted the market with the exception of the first-time buyer. The first-time buyer continues to be under pressure from a cost perspective. I mean the FHA loan is extraordinarily high, the insurance premiums are very high, up about twice what they have been previously. I think that is an impediment to many first-time buyers.

Then the dynamic that is interesting in the midmarket is the midmarket has a certain amount of frustration in that if they can sell their house, there is little inventory to select from to move. So we see that playing out in most of the NRT markets in particular where midmarket sellers are saying they would be more than happy to contribute to the inventory but they are most concerned about where they are going to move and as you know, builders are building at the high end, not the midmarket.

So I just see more demand than perhaps any of our comments would suggest. But it is tempered by all those things we just discussed which is a sluggish economy and some of the other things that seem to be dampening the appetite of both the seller and the buyer except at the high end, the high end continues to be exceptionally strong.

Tony Paolone - *JPMorgan - Analyst*

Okay. And then just last question, the $107 million of additional GCI that RFG picked up in the first quarter, is that a net number or is it just kind of the new stuff?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

No, that is the gross sales number.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Before terminations but terminations are very low at this point -- we have a 98% retention rate.

Again, we have said that franchise sales should add 1% to 2% of growth above the national average at RFG. So that is kind of our -- that would be our annual pick up on sides and growth based on our franchise sales.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

This is Richard. Franchise sales went very well for the quarter and we are pretty bullish on franchise sales for the balance of the year.

Tony Paolone - *JPMorgan - Analyst*

I understand. But just thinking about it a different way, if we see something like that, $107 million of GCI it is as simple as saying 4.5% and so this basically picks up about $5 million for you. Is that fair?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Yes, over time but there is some breakage on agents when they convert, but very modest, and it takes a while for that to impact. That $107 million, it will take a while for that to impact which means that the franchisees who have signed up have to change their signs and go live, that sort of thing. So that doesn't happen overnight, it takes months to do that so we will see the benefit later in the year of that.

Tony Paolone - *JPMorgan - Analyst*

Got you. Thank you, guys.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

You are welcome.

Operator

Adam Rudiger, Wells Fargo Securities.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Good morning. Thank you. I wanted to ask about GRG and what the -- you think given the significant decline in refi units, what the margin profile this year could look like relative to last year?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

They will probably be 100 basis points worse or so for the year based on the loss of refi because it is not as dramatic as you think because the average fee per refi is much lower than the average fee for purchase. So the margin on that is lower so it will have an impact on the margins but not overly dramatic.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Can I just speak to that a second because it is important that we at least mention this. TRG is very adept at flexing up and down to accommodate the refinance volume. When the refinance volume is available, you want to capitalize on it, take advantage of it so they are very good at staffing up, staffing down and adjusting rather quickly which they have done and continue to do. So this is something that they are used to so they flex their cost structure up and down pretty quickly so they are pretty good at that.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

The last point on that, Adam, is their sides on the purchase piece of the equation also mimic what happens to NRT sides because they are getting the buy sides from NRT. That is where they get their purchase closings so that will move that as well.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Okay. And then the second question is can you just talk a little bit about how you saw trends throughout the quarter progress as the spring in some places started showing up and any comments on what you are seeing more recently? I think there is some people that are still hoping for a later more exaggerated spring selling season in places where they had crummy weather and so I'm just wondering what you thought about that?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Well, we love your optimism.

Adam Rudiger - *Wells Fargo Securities - Analyst*

I said that was what some people were thinking. I didn't say it was my view.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

I didn't hang it on your head. There are those who believe that this is going to be a delayed spring especially in the Northeast and major parts of the Midwest. The jury is still out on that. We don't foreclose that as a possibility but we tend to be more conservative than that so based on what we are seeing today we are assuming that is not going to happen. If it does happen, it is upside.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Thanks for taking my questions.

Operator

Dave Katz, JPMorgan.

Dave Katz - *Jefferies & Co. - Analyst*

Good morning. I was hoping to come back to some of the topics that the previous callers focused on specifically the disconnect between the entry buyer and the higher up buyer. I think you guys talked about what would happen if it ended optimistically. But with the high cost of the FHA loan and with the higher costs they are facing if that situation doesn't resolve optimistically, what do you think the longer-term implications of that are for the housing recovery?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

This is where we have faith in the private sector so let's say FHA continues with its onerous minimum premium obligations which are very onerous by any definition, this private sector will step in and capture that market share that otherwise would not be available if FHA were more reasonable. So you can see examples of that as FICO scores are starting to decline, Wells Fargo as an example has made it clear they are going after business they haven't tackled in the past by reducing the down payment requirements. They are more I think reasonable in their underwriting. So still have a long ways to go but they are getting there.

So if this persists, we are of the view that the private sector will jump in and be more relevant to the first-time buyer. That is not going to happen overnight but it will happen as industry shift gears. Remember the mortgage industry is trying to recover from the downturn in refinance as well so they are going to be aggressive in going after purchase money and we see that now so we just expect they will become more aggressive.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

You have seen several banks in addition to Wells talking about getting more aggressive in the purchase markets.

Dave Katz - *Jefferies & Co. - Analyst*

Do you think that there is a requirement that FHA's dedication to keeping costs where they are and keeping it as onerous as it is is necessary to engender a home sale move by the banks?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Perhaps not. That is a good point. The banks may move to capture more of the first-time buyer whether FHA reacts in a reasonable manner or not. Let's assume they are not. Everything in the FHA takes a long time to turn around so I am assuming they are going to continue to be difficult in both their underwriting and the upfront premiums which as you know is both an annual premium of upfront fee and a monthly which can be difficult.

So I think the lenders having no need to bulk up an otherwise weak balance sheet, i.e. FHA, that major banks could see this as an opportunity.

Dave Katz - *Jefferies & Co. - Analyst*

Okay. And then on Cartus, the revenue came in a little lower than we would have expected on a year-over-year basis given the number of initiations and referrals. And I was hoping you could just talk to what caused that. I heard you said something about the domestic aspect of it but I didn't get the granularity.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

The biggest strength right now at Cartus is really the affinity business with USAA and some other providers plus broker to broker referrals. That shows up as initiations and referrals because there's some parts of those transactions that are in both categories. So that is really the strength we are seeing this year. The domestic relo business is pretty much on target this year but it is really the affinity business that is growing and that is what is causing the initiations and the referrals to increase.

Dave Katz - *Jefferies & Co. - Analyst*

And those have a lower revenue component than the underlying businesses had in the past?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Lower revenue but higher margins.

Dave Katz - *Jefferies & Co. - Analyst*

Okay, excellent. Thank you.

Operator

Dan Oppenheim, Credit Suisse.

Dan Oppenheim - *Credit Suisse - Analyst*

The NRT business and you think about that in terms of some lower volume in California where your average price was much higher, how do you think about that in terms of the mix impact as you are sort of talking about the ASP for NRT, how much that mix shift is impacting it?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

We sort of missed the first part of your question. Could you repeat that for us just one more time?

Dan Oppenheim - *Credit Suisse - Analyst*

Sure. Sorry about that. Just if we look at California where the price point is much higher than NRT overall and given the slowing volume in California whilst the other markets seem to bring down the ASP. So when you think about your guidance in terms of the ASP for NRT, how much of that is really a regional mix issue that is occurring there as opposed to just moderation in pricing?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Much of NRT's average sales price is mix. Two things to think about. NRT is a collection of acquisitions dating back more than 15 years so they specifically acquired brokers with strong presence in high-end market. So by design, these brokerage firms go after the mid- to the high-end of the market and they do it very successfully.

Now in California, California obviously has a much higher average sale price in virtually every market excluding Sacramento and then the balance on the East Coast is New York City, with an extraordinarily high average sale price. So for NRT, it is definitely skewed towards the very high end of the market.

Not so also necessarily with RFG although they are influenced by high-end because they have franchisees who specialize in the high end of the markets as well. So NRT is absolutely the strength of the high end and that is because they are principally in those high-end markets and that is definitely mix.

Dan Oppenheim - *Credit Suisse - Analyst*

Right now I guess the point is the volume in California is weakening by more -- slowing by more than other markets and the price (inaudible) higher in California, how much that is impacting your overall ASP?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

Because of price on the West Coast, it is not -- maybe in Southern California it is weaker but Northern California is still very strong. The weakness that we are seeing on units is not just in California.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

This is Richard again. Remember Southern California had sides down 17%, price up 16%. So it is sort of balancing. One could clearly argue that price in Southern California is getting to the point where it is creating more balance than you have seen in the past but Northern California, to Tony's point, average price is up 22%. Now happiness is a low base but it is up 22%, sides are only down 3%, so it is clearly price is having an impact on volume in California.

Dan Oppenheim - *Credit Suisse - Analyst*

Now when you talked about Northern California being volume down 3%, that was inclusive to the FHA (inaudible) correct?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Yes, that is correct.

Dan Oppenheim - *Credit Suisse - Analyst*

Thank you.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

You are welcome.

Operator

David Ridley-Lane, Merrill Lynch.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Thank you. Just wondering now that the quarter is over what you would estimate the weather drag was on sides in the first quarter? And if you do expect those delayed sales to show up, would you expect those to be more in the second quarter or in the third quarter?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

You are sort of muffled. We could barely hear you there.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

I am fighting a bit of a head cold here. How much would you expect the weather drag was on sides now that the first quarter is over and then would you expect those to show up more in the second quarter or in the third quarter?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Weather clearly had an impact both in the Northeast and the Midwest. To what extent we do not know, most forecasters believe that there will be more inventory as those markets return to a normal sort of spring season. We haven't seen it as of yet.

As we indicated, we saw slight increases nationally on inventory, inventory still nationally is about 5.2 months. That is only up from five months previously. To get to a balance we need to see six months of inventory and I would represent to you that a good bulk of that is going to have to come from the Northeast and the Midwest. It hasn't shown up yet but if in fact there is a delay, it will show up late in the process. But again as we said earlier, we haven't seen it as of yet. We are optimistic but it is not in our forecast.

Just to put that in perspective on a national basis if you need some numbers, that would require a 15% increase in inventory nationwide to get to six months.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Obviously a larger increase in the Midwest and Northeast.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Arguably they were under the most pressure from a weather perspective so you would see the bulk of the growth I think out of the Northeast and the Midwest but we will see.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Okay. And then a quick follow-up. Definitely heard the guidance you expect NRT to be at the low end of transaction volume in the second quarter. Does the geographic mix sort of trump the higher-priced home skew in that segment or just sort of looking for a little bit more color on why you expect it at the low end of the transaction volume?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

I think it is more about the comps to last year than anything else just because they had a very strong Q2 and Q3 so I think it is -- especially on price so I think that is more of the issue there is that they were pretty high on price in the second and third quarter last year. So that is probably a bit of a limiting factor which is why we think they are going to be at the low end of that range.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Okay. Thank you very much.

Operator

Eli Hackel, Goldman Sachs.

Eli Hackel - *Goldman Sachs - Analyst*

Thanks and good morning. Richard, there is a new head at the FHA that brings some opportunity for change. Have you had any conversations made with Mel Watt or any (inaudible) in Washington? And to give maybe some commentary about perhaps there is a general acknowledgment that the first-time buyer is suffering a little bit -- do you have any indications that Washington is maybe prepared to do a little bit more to encourage that?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

It is a great question. We have had some of those conversations even over the weekend. So it is a recurring theme as to what the government should do to stimulate the first-time buyer. I think there is very little appetite to do anything extraordinary. FHA is under a lot of pressure by housing groups including this company to become more reasonable in their pricing. I see no indication that they're going to move off the dime because they think they need this to shore up again as I said previously, their balance sheets.

Listen, over time the market will determine whether or not they become more reasonable or not. Again I think we have reason to believe that if they persist, this is a big opportunity for the private sector to jump in and assess reasonable fees and attract the first-time buyers. So we are not waiting for FHA to become more reasonable although I think over time with Mel Watt's appointment and other pressures on them, they may see reason to become a bit more reasonable in their fees. We will see.

You know they have made some adjustments for certain buyers but they have not made adjustments for buyers across the board.

Eli Hackel - *Goldman Sachs - Analyst*

Great. Then just one quick one for Tony. The $4 million to $8 million for PHH, does that include all costs (inaudible) or is there more to come and on a run rate basis, it would be higher than that?

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

I think there is some severance and cost reduction expenses hitting that number this year. So I would expect it to be somewhat higher over time. If you look back at previous years, it has been higher than that. This is one of the lower ranges we have seen even when refinance wasn't a strong factor.

So the other thing impacting it, Eli, is because of the competitiveness of the purchase business this year, the gain on sale margin is impacting even the purchase business so over time that should alleviate itself too.

Eli Hackel - *Goldman Sachs - Analyst*

Great. Thanks very much.

Operator

Sean Kim, RBC Capital Markets.

Sean Kim - *RBC Capital Markets - Analyst*

Thanks for squeezing me in. Just regarding -- I think in the past you said your potential to return capital to shareholders, you are looking for 3 times net leverage but if you look at your business, cyclicality of your business, do you think that 3 times may be a little aggressive and how do you think about that level in the future when you are considering capital returns? Thanks.

Tony Hull - *Realogy Holdings Corporation - EVP, Treasurer and CFO*

That is exactly why we only get to 3 times. We think given the strong cash flow that we generate at this business, in this business because of the fee for service nature, etc. we think 3 times is the right level to weather cyclicality in the business and also return capital to shareholders so that we will hopefully mitigate some of the cyclicality in the business by returning capital to shareholders at that time. So we think it is the right level to weather both of those things.

Sean Kim - *RBC Capital Markets - Analyst*

Okay, thank you.

Operator

Tony Paolone, JPMorgan.

Tony Paolone - *JPMorgan - Analyst*

Thanks. Just can you guys maybe talk a little bit about distressed and nondistressed sales because it seems like distressed sales have dropped off pretty dramatically. And just wondering if there is any way to think about how that plays into your business because I would've thought that perhaps a lot of the distressed stuff was court house steps types of things where there wasn't really a commission to be had anyhow and that that might actually I don't know, distort sort of the comps and you guys would be able to do a little bit better. But just wondering if you could talk to that at all?

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

Sure. As you know, foreclosures are down, serious delinquencies are down. I mean just about every category distressed properties, sales were down I think rather materially all indicating a stronger economy than we had when this process began.

There is an argument that the distressed assets which were previously being purchased by the most part institutional investors are now as a result of that there was less inventory for first-time buyers. In some markets that may have been the case but more broadly that is clearly not the case. I think if those institutional buyers are not there because I don't think they are in a meaningful way as they were in the past, that inventory will go into the first-time buyer market and contribute to inventory gains in at least certain states like New Jersey, Florida, New York and others that have had previously had high foreclosure rates.

So couple that along with the homes that are returning to positive equity and if you look to CoreLogic, which was a great data source for data like that, a substantial percentage of the homes that were previously under water in their equity are now in the money. Those two arguably at some point are going to be both first-time buyer inventory as well as move-up inventory.

So all of those trendlines are very, very positive getting better by the day and we don't think that is going to change and that will in part contribute to the inventory increases in many of the markets in the United States. We see that as a positive trend on a negative.

Tony Paolone - *JPMorgan - Analyst*

Okay. Thank you.

Richard Smith - *Realogy Holdings Corporation - Chairman, President and CEO*

You are welcome.

Alicia Swift - *Realogy Holdings Corporation - SVP of IR*

I think that ends our Q&A. We thank you for taking the time to join us on the call and we look forward to seeing some of you at our Investor Day this Friday, May 9. Thank you.

Operator

This concludes today's conference call. You may now disconnect.
