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Realogy Holdings Corp. *(RLGY)*

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CORPORATE PARTICIPANTS

Anthony E. Hull
Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good afternoon, everyone. Thanks for coming today. So, we're going to kick it off with our first panel post-lunch. From Realogy, we have Tony Hull, the company's Chief Financial Officer, and we have some members of the IR teams for questions afterwards.

So, with that, I'll turn it to Tony.

Anthony E. Hull

Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

Good afternoon, everybody. I'm going to take you through the official IR presentation of Realogy Corporation. And just by way of background, I'm sure most of you know we went public last October 10, and we've pretty much refinanced all but a couple of billion of our balance sheet or $1.5 billion of our balance sheet.

And let me take you through the highlights of the company. The company is basically – we're in four businesses. Our largest EBITDA contributor is our franchising business, we have six brands that we franchise not only to our owned operations, but to third parties across the country. We have 3,000 companies who franchise with our brands. The franchising business makes up about 54% of our EBITDA.

Our largest franchisor – our largest franchisee is NRT, which is our owned real estate business. We have about 700 offices in 35 metropolitan areas, obviously including Chicago, and they operate under most of our franchise brands plus Corcoran and Citi Habitats.

We're also in the relocation business. Any self-respecting brokerage company has a relocation business because relocation is a real estate transaction at the end of the day. So we're the largest real estate transaction in the world with Cartus.

And then we also settle our own transactions through a business called TRG. So instead of using third parties to settle all our transaction, we do it ourselves and obviously capture the profitability from doing that. And so biggest part of the business is RFG in terms of EBITDA contribution, and then the owned Cartus and then TRG.

This is how a – just to make sure everyone's level is set on how our real estate transaction works. This is an example of how real estate transaction works and how we make money. So, in this example, we are transacting a $200,000 home. The seller pays the commission, so the commission in this case is 5%. 2.5% of the commission goes to the agent representing the buyer and 2.5% of the 5% goes to the agent who is representing the seller, but again the seller pays the full 5%.

So in this case, we're representing the seller, we have a listing. We're representing the seller. We get 2.5% of the commission on a $200,000 sale which is $5,000, the first 6% of that goes to RFG, our franchising business for use of the trademark and the franchise brand so that's $300 in this case. Although, that doesn't seem like a big number. We did that $300 for this transaction, we did that 1.3 million times in 2012, so it obviously adds up.

As we were the broker and our agent transacted this transaction, we get the remaining $4,700 of the $5,000 of gross commission income of which 65% generally for our business gets paid to the agent so that's about $3,100 and then the broker, which is NRT, our owned operations retains about $1,600 in this case. Again, not a huge number but we did it 289,000 times in 2012.

And then the way the other businesses work are integrated in our value circle is TRG closed about – I cannot read that screen there so I'm going to have turn around every time – 54,000 transactions last year. And so basically what NRT does about half their transactions, we'd represent the sell-side, half the transaction, we represent the buy-side. So of the buy-side transactions, which again is about half of the 290,000, we were involved in 54,000 helping our buyers close their transactions 54,000 times.

And then Cartus moves around transactions either they get transactions from our owned operations or franchisees or they deliver them through referral programs and that's what – they generate a big chunk of their EBITDA by doing that. In terms of the housing market, there were six million homes or five million homes sold last year.

About 300,000 of those were new homes and the rest 4.7 million were existing homes, that's the market we generally play in. Of that 4.7 million homes, about 12% of folks did it themselves and the remaining 88% used a broker. And of that 88%, we were involved in about 26% of all transactions and we're – it's basically, one out of every four transactions either are owned-operations or one of our franchisees is involved in that transaction.

So two things to point out on this page is everyone says the Internet is taking over the world. It's clearly not the case. In fact, just the opposite is true. If you look at the bottom there, we have non-broker assisted sort of trend. So you can see from 2001 to 2012, the people not using brokers actually declined from 21% to 12%. And then on the right, you can see in the bars there is the number of agents we have worldwide versus our nearest competitors. So if you add them all up, we're still bigger than all of them combined.

Just moving quickly to RFG. The most important thing about it are – the most important things about RFG is it's nationwide. We have multiple brands. We're the only company that has multiple brands under one umbrella so they're very good synergies in terms of shared service efficiencies there.

So we have about 60% EBITDA margin last year in this business and at the peak it was 75%. Our franchisees are happy with what we provide them, the brands we provide them and the services we provide them, because we retain about 97% of our GCI year in and year out. GCIs are the revenue of our franchisees. So only 3% are unhappy and usually 2% we're unhappy with them and we terminate them, and 1% either retire or that sort of thing. We have long term contracts. So this is a recurring revenue stream, very low CapEx. And the way we make money is – and this is the most – you'll see in the driver sort of company, is it's the number of sides that our franchisees are involved in times the price, times the broken commission rate at 2.5% per side is basically that's their revenue and then we take a royalty of about 5% off that and that's how we generate revenue at RFG.

NRT is, as I said, they're the largest franchisee of RFG. They have about 41,000 agents in 35 top U.S. markets, 710 offices as I've talked about. Notice that the average price of – average sales price of an NRT home is about $445,000 which is twice the national average. This is because we've located – we're located in the best real estate markets in the country, in the highest price real estate markets in the country. We're over three times larger than our nearest competitor. We have a mortgage origination joint venture, so we are able to add that service for our client, for our buy-side clients. And our top two quartile agents, the top 50% of our agents generated about 90% of our revenue. So, we are very keen to retain those, and our retention rate for those is about 94%.

This is to show you where we're located. You can see we're primarily, our office are primarily located in New York, New England, Florida, California, and the Midwest. Technology again, technology has been changing for the better. We're able to – we've been able to reduce the cost of distributing and advertising our listings significantly over the last several years, over the last five or six years with using the Internet and using websites that are our own websites, our brand websites and obviously the Trulia, realtor.com, and Zillows of the world.

So basically, our desire and goal is to make sure our listings are presented in the best light as easily – maximize the ease of a consumer to find those listings and once they get those listings, we get the lead and we're able to transact with the customer. But the bottom line is the Internet has been very, very constructive, and productive for the business.

Cartus is our relocation company. Again, real estate – a relocation is a real estate transaction because the person who's moving from say Los Angeles to Atlanta normally has a house to sell in Los Angeles and a house to buy in Atlanta. And we basically make referrals fees on those transactions plus an upfront fee from our clients to move their employees. So it's very integral to our overall business and we happen to have the largest one in the world and we move our clients – we probably have a unique global footprint for this business that no one else has, so we can – whatever our clients' needs are we can meet those needs across the globe.

And then TRG as I said, we help buyers close their transactions. We offer them title insurance and then we work on behalf of lenders to close their refi transactions. So those are the three legs of the stool of TRG for that business.

Just in terms of the industry update a lot on this slide. But the main points I want to make is, obviously at the peak of the market there were 7.1 million units sold in United States existing home sales. The average price is about – the medium price was $220,000. During the crisis, the mortgage meltdown, et cetera, we found out what the bottom is for our industry. It's 4.1 million to 4.3 million units sold in the worst possible economic situation. And then last year, we started to see improvement, as I said earlier, there were 4.7 million homes sold last year, and you can see on the right sort of the quarterly progression, you can see that – on the left is units, and on the right is price. Overall, unit volume for the last 12 months up to March was up 17.6%, about half coming from unit sales, which were up 8% every quarter except for the fourth quarter last year, they're up 13%.

And then, you can see price because of inventory declines, as it continually increased momentum as time goes on. And because of the unit activity, inventory levels have shrunk to six-year low levels, as you can see on this chart. So we're down to about just under five months of inventory at this point, whereas a year ago, we were at nine-plus months, and before that, obviously, we're a lot higher. But that has really been supportive to price as well.

The reason why – the important thing is you can see a little uptick at the end of that chart. So we're starting to see, as we normally see every year, at this time an increase in inventory so that's happening again this year. But it certainly got very low during the first quarter of this year. The reason why the demand is so high is mortgage rates, as you all know, are very attractive and affordability, which is NAR's measure of how affordable it is for the average family to own a home is at an all-time high of 205. So, the average family in the United States has twice the income necessary to buy the average price home, with a 20% downpayment, et cetera.

Just quickly on inventory because that's kind of one thing we've been focused on it's seasonally it's usually as you see here – this is over 10 years of what we see in months of inventory as the year progresses. Our business is very seasonal. Folks want to be they want to sell their house move into their new house before their kids go back to school in September. So our season, our Christmas season is really from March until October and that's when people list their houses and that's when people buy houses mostly during the year.

And you'll see our EBITDA and our revenue is strongest during those two quarters every year but anyway that's just traditionally what happens, the other thing that's happening in this market that's a little bit unusual that we haven't seen before when there's a tight inventory situation is that obviously with the mortgage meltdown and prices being down 30% et cetera.

There were a lot of underwater homes in United States. Or probably about $9 million underwater homes in United States at this point. So some people try to sell those homes, it's called a short sell but others just want to hold until they get positive equity and if prices go up, last year $1.7 million attained positive equity from the 6% increases on prices nationwide and then about 2 million or only 5% or less underwater. So to the extent that prices continue to rise, those homes will become available. And some portion of those, owners will decide to list their home and that will help the inventory situation.

The other thing is the number of home, new homes being built is increasing as you're aware. And that obviously helps the inventory situation of existing homes because usually a new home buyer is a move up buyer so they have their first-time home which they put on the market to buy their new home. So that will free-up some inventory for first time buyers as that progresses. So those dynamics will help the inventory situation.

In terms of longer term forecast for the business, there are lots of sources out there. You can go for who will give you their view on what the macro is for the existing home sale market and obviously that has a lot of relevance for us. Just – the brown bars are Fannie Mae's forecast for the next two years and the green bars are NAR's forecast, so you can see Fannie Mae is forecasting a 22% increase in sides and price for 2013 and 2014, and NAR is forecasting a 25% increase, 15% this year and 10% next year.

The drivers of price and units are obviously prices: high rents, tight housing market, good affordability, those are the big drivers on price. And units, we've had five years where obviously, the number of units has been significantly less than the norm, and so there are a lot of renters who are qualified to buy a home a lot more than they were in 2005. We have this measure where we compare the number of existing homes sold to the number of households in United States. That number is tracked about 4.5% for the last 25 years. Over the last 5 years, it's been sort of 3.5%. So just getting back to that normal number with 1 million-plus homes sold in United States.

And not only that, we have – where a country adds households, adding 1.2 million households per year, so assuming 65% of them are homebuyers, that's also are going to be a driver of home sale activity as well. So a lot of positive drivers and especially after the decline we've experience over the last five years, there's a lot to even get close to even where we were five years ago. Not that we ever necessarily need or want to get there, but because obviously mortgage issues – mortgage lending was very lax at that point and at this point, it's a lot more strict. And the fact that we're seeing this kind of growth in units, given the fact that mortgage and underwriting savings are as strict as they are is pretty encouraging because if mortgage lending standards were to ease up even back to 2002-2003 levels that would unleash a whole another group of potential buyers out there.

Financial update, our peak revenue was $7.1 billion. In 2005, our peak EBITDA was about $1.2 billion that year. The market, the housing market dropped 50% from that level to the lows we saw over the last couple of years and our revenue dropped accordingly from $7.1 billion to $3.9 billion. The reason we are able to keep about $600 million of adjusted EBITDA during that period, maintain that kind of level, was A, our biggest cost is, a variable cost which is the commissions we paid to our NRT agents. That is in this lighter green line here, in green bar there and so that dropped from $3.8 billion to about $1.9 billion from 2005 to 2009.

And the other thing is we eliminated about $500 million of costs during the downturn by closing offices, consolidating offices, and reducing head count. So I'll go into that a little bit more detail later. But those two things allowed us to maintain about $600 million of EBITDA despite 45% decline in our business, in our revenue.

The other thing to point out on this page is the lighter green line or green bar here is our CapEx. You can see our CapEx is very low relative to our EBITDA or revenue, very low CapEx model that we have. For the first quarter of 2013, our revenues were up 9% and our adjusted EBITDA was up 34% to $71 million. The drivers of that, just like the rest of our business, was really a 14% increase in – or 15% increase in sides and price combined RFG and an 11% increase at NRT sides and price. Again, main drivers of our business are sides and price of NRT and RFG.

Just in terms of some of the head – of the cost reductions and how permanent they are, we cut our cost about $500 million in a couple of ways. One, we reduced our number of employees from 15,000 to about 11,000 and we've reduced the number of offices from 1,100 to 700. When we reduced offices, we usually got rid of assistants of the office and we got obviously got rid of the brick and mortars and lease cost of those offices, but we tried to maintain the agent presence. So we'd moved if there's an office that was two miles from another office. We combine those two offices. We tried to keep the agent production but get rid of the overheads.

So that's what we – that's what most of the saving were about from both the head count and bricks and mortar costs. And we expect – right now, we're about 60% capacity utilization on our current office footprint. So we could grow our number of agents pretty significantly and obviously could grow volume pretty significantly without adding any of those cost backs. So we estimate that about 80% of the cost savings were sustainable.

Our model is pretty simple to forecast and just to get your arms around. Again, we're driven by volume, especially in NRT and RFG. For every point of increase or decrease in unit volume sides or price, our EBITDA goes up or down by $12 million. So what we have done here is just taking a snapshot – this was the number in 2012, it was $12 million. It was $11 million in 2011. As we get a little leverage as the market improves. I think the peak was like $16 million per point back in 2005.

But the point is NAR is forecasting that – back to that chart I showed you before that sides are going to grow between 2013 to 2014 sides are going to grow 12% and prices are going to grow 13% in those two years. So we should have from 2012 level, they're forecasting a 25 percentage point improvement in the market. At $12 million per point, that would equate to $300 million of incremental EBITDA if everything else remained static.

So everything else being our cost structure, the royalty rate, the commission rate, the amount we pay our agents, if all that has remained constant, we'd have – and magically, we had done 25% more business in 2012, our EBITDA would've been $974 million instead of $674 million. So that's just – so it's just a good way to get your arms around how to look at our what's going to happen to our EBITDA as the macro market improves or gets worse.

And I think that's – the important point is everything else remains constant and this is really an annual – it's hard to do this on a quarterly basis. There was a little bit of feedback on that in the first quarter because, obviously, the first quarter being the weakest quarter, you don't get that kind of leverage. You really have to look at 12 million per point as an annual type of number.

So just to sort of say what does this metric mean, how to – let's extrapolate those numbers to what Realogy's free cash flow could be in the future. We look at this chart. So just to keep in mind, obviously, as the market – we are very driven by the macro market and which is something we can't control. We can control a point or two based on stuff we do but most part, the housing market is going to do what it does. And we'll benefit as it goes up and, obviously, our EBITDA will suffer if it goes down. But going forward, very – the four important points to recognize are obviously, as the market improves, our EBITDA goes up. Our interest expense is down to – this year our interest expense is going to be $300 million post IPO and all the stuff we've done in the capital structure. We have very low CapEx and we're not going to be a tax payer other than sort of some AMT type nominal amounts over the next several years.

So a big chunk of our EBITDA will flow into free cash flow. So you can see just going back to that 2012 example, we did not generate $274 million of free cash flow last year because our interest expense was like $600 million. But if you took our EBITDA last year against what our interest expense we now know is going to be $300 million this year. We have generated to $274 million of cash flow even last year's kind of volume levels.

If you look – so in 2013 and 2014, our saying that we're going to see an increase in volume of 25%. If you use that 12 times 25 example, you get to that $974 million of EBITDA of which $564 million is free cash flow. So, on a free cash flow per share or leverage ratio here, you can see that we double those statistics. If NAR is right, those statistics double everything else remaining constant.

And then 50%, we actually exceed our peak EBITDA at a 50% improvement in volume. Actually the breakeven is about 40%, so we get to about our peak EBITDA if there's a 40% improvement. So we're just to put that into perspective. But I mean the question, what is 50% mean in – can we ever get beyond 50% is a valid question and if just a way to look at it is if we did 4.7 million homes, so if 30 points of that 50 points is from unit volumes improvements that means we get to 6.1 million homes sold. The peak was 7.1 million, so we're still 1 million below. Let's say the remaining 20 points of that 50 points is from price, we're about 1.77 last year. That means if we go to 2.12, the peak was 2.20 so we got the 2.12 in price and 6.1 million units which is not really hard to get your head around. You get to this extrapolation of EBITDA and free cash flow. So obviously it's not – that's not going to happen this year or next year but over time, that is definitely achievable and we're still well below the peak levels we saw on 2005 and generating more EBITDA than we did back then. Thanks largely to the $500 million of cost takeout that we did.

Anyway, I still have nine minutes left so I'm on my last slide so I went nice and quickly. Okay. So cap just on where capital structure looks like, you could see this is the actual we have $4 billion of debt at year-end. And there was a lot of expense of debt in here that we heat outstanding so that is, as of next Tuesday, that is all gone and we still have the only unsecured debt will have as $500 million of three-year debt here and then the rest will be secured and our cost of debt, which was 8-plus percent last year, it's now down to about 5.5% based on all these movements.

As I've talked about, we had $300 million of cash interest this year that includes a quarter of having a lot of this expensive debt. So if you take out all that it goes well below $300 million on a sort of a run rate basis. Our leverage 3.8 on a senior secured SSLR basis secured 5.36 times, with all the cash flow we're going to generate on this, page, all the free cash flow we're going to generate, we expect to reduce our overall leverage by about a turn or so every year. So again, we'll continue to attack the balance sheet and continue to try to get rid of our most expensive debt first which we've done successfully so far and then we'll continue to do that as opportunities arise in the future. But our goal is to get to investment grade which – or if not investment grade at least three times debt to EBITDA. And then we'll see what happens after that but that's our near-term goal is to use most of our free cash flow to pay out debt, and to get to that three times leverage level.

And that's it. I'll answer any questions you might have. Sir?

QUESTION AND ANSWER SECTION

Q

Given the benefit you've seen from low interest rates because it's really moved some help in the market. How concerned are you about the rise in interest rate, sort of not to forecast interest rates in general but how do you think about that as a threat or benefit to your business going forward?

Anthony E. Hull
Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

A

With affordability at 205, I'm not that concerned about it. I think the stat that I saw was for every 100 basis point increase in interest rates or the affordability the affordability gets hit bit gets by 10 points so interest rates could go up a lot without impacting affordability too much. And if interest rates go up, it's probably because the economy is in better shape. Unemployment is lower and GDP growth is higher, et cetera. So we're in a better economic situation than we are now so I think on the demand side, the release of the pent-up demand and the filling of the pent-up demand would be much more powerful than any negative impact of rates.

Q

There's been a lot of talk in DC around getting rid of the mortgage deductibility, how concerned are you on that whether it actually goes through or if it does go through in terms of impacting your business?

Anthony E. Hull
Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

A

I think we find – this is not me this is a sort of company why we find it anything that would be harmful to the recovery of the housing market would not be in the interest of most members of the Congress. So I think the only way something like that is going came in to effect broadly is if there's a much bigger change to the overall rate structure.

So if rates came down to 15% but they got to rid of MID I think it would be – it wouldn't have any impact because you'd more than make up the lost deduction on lower overall rates. So it really depends on what the package is and what the appetite is for just timing the recovery in the housing market which has been the biggest bright spot in the economy over the last couple of years. So we'll see if – I know I'm not that concerned just because of the practicality of Washington at the end of the day.

Q

Can you talk a little bit about what has happened in some of the competitors over this past cycle? And had some of them started to get more aggressive in commissions et cetera for your people as things start to improve?

Anthony E. Hull
Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

A

The nice thing about – first of all of our franchisees they manage their agent population, however they see fit, we don't have any say over that. We're on our money off the top from their revenue stream, obviously we give them training and guidance but they're local entrepreneurs in most part. And they run their business how they see fit.

In terms of the nice thing about having 41,000 agents of which 20,000 are producing most of the revenue is we can and we do have a lot of turnover and there's no one who's – if we lost them – usually a star agent, if we lost them, then we're not making a lot of money off of them anyway. So it doesn't have – and then, we'll recruit three more in their place, so there's constant churn in agents. But as opposed to commercial where there's superstar agents, and if you lose one of those agents, it can be the make or break for a company with 41,000 agents, it's not the case with us.

So we remain competitive and we do – every market is different in terms of what split gets paid. I mean, Los Angeles is much different from Chicago, which is much different than Westchester or whatever. And we adhere to local markets and there's always some competitor in every market who wants – who'll do anything for market share, and we just don't play that way. And we'll find some other agents to fill the void there. So that's what managers – every office has a manager and that's what they do all day, it's to manage that process.

Anthony E. Hull

Chief Financial Officer, Treasurer & Executive VP, Realogy Holdings Corp.

That's it. Great. Thank you very much.