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RLGY - Q2 2015 Realogy Holdings Corp Earnings Call

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CORPORATE PARTICIPANTS

Alicia Swift *Realogy Holdings Corp. - SVP IR*

Richard Smith *Realogy Holdings Corp. - Chairman, President, CEO*

Tony Hull *Realogy Holdings Corp. - EVP, CFO, Treasurer*

CONFERENCE CALL PARTICIPANTS

Will Randow *Citigroup - Analyst*

Brandon Dobell *William Blair & Company - Analyst*

David Ridley-Lane *BofA Merrill Lynch - Analyst*

Mike Dahl *Credit Suisse - Analyst*

Ryan McKeveny *Zelman & Associates - Analyst*

Stephen Kim *Barclays Capital - Analyst*

Tony Paolone *JPMorgan - Analyst*

John Campbell *Stephens Inc. - Analyst*

Rob Rutschow *CLSA - Analyst*

Jason Deleeuw *Piper Jaffray & Co. - Analyst*

Jason Weaver *Sterne, Agee & Leach - Analyst*

PRESENTATION

Operator

Good morning and welcome to the Realogy Holdings Corporation's second-quarter 2015 earnings conference call via webcast. Today's call is being recorded and a handwritten transcription will be made available in the investors information section of the Company's website later today. A webcast replay will also be made available on the Company's website until August 14.

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

Alicia Swift - *Realogy Holdings Corp. - SVP IR*

Thank you, Sean. Good morning and welcome to the Realogy second-quarter 2015 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 shown on slide 3 of the presentation, the Company will be making statements about its future results and other forward-looking statements during this call. These statements are based on our 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. Actual results may differ materially from those expressed or implied in the forward-looking statements.

For those who listen to the rebroadcast of this presentation, we remind you that the remarks made herein are as of today, July 31, 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 annual and quarterly SEC filings.

Also, certain non-GAAP financial measures will be discussed on the call and, per SEC rules, important information regarding these non-GAAP financial measures are included in our earnings press release.

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

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Thank you, Alicia; and good morning, everyone, and thank you for joining our call. Let me begin my comments by stating that overall observation is that the housing recovery continues to gain strength. The National Association of Realtors' -- which I will refer to as NAR -- report on existing homesales for June point to the highest pace of sales in more than eight years.

While inventory levels have essentially remained flat year-over-year, demand continues to outstrip supply. According to NAR's latest release, properties typically stayed on the market for 34 days in June, the shortest time since NAR began tracking this metric in 2011.

In a change that we believe is necessary for a more robust housing recovery, first-time buyers represented 31% of all existing homesale transactions during the second quarter of 2015, which is up 3 percentage points from the same period last year. Mortgage rates continue to be appealing; mortgage credit is more available today than in recent years; and housing affordability continues to be attractive. An improving job market and the positive trends in household formation all bode well for the continuation of the housing recovery.

Our second-quarter results reflect the improved market conditions and the strength of our model. Our business units have performed well against both their short- and long-term goals and objectives.

And the free cash flow characteristics of our business model continue to deliver, generating $273 million free cash flow for the quarter. Operationally and financially this was a strong quarter.

Our second-quarter results continued the momentum from the first quarter. Looking at our segment results, as you can see on slide 4, the Realogy Franchise Group, which I refer to as RFG, posted a sales volume increase of 10% in the second quarter, which was comprised of a 5% increase in transaction side and a 5% increase in average sales price year-over-year.

For NRT, our Company-owned brokerage segment, sales volume was up 9% with a side increase of 13%, and slightly offset by a 4% decrease in average sales price. The increase in NRT's transaction side was bolstered by the strategic addition of the Coldwell Banker United and ZipRealty brokerage operations, which have lower average sales prices. NRT's average sales price would have been flat excluding these acquisitions.

In terms of regional color, RFG experienced the strongest sales for gains in the West and Midwest with increases of 20% and 10%, respectively. The other two regions also showed volume gains, although in the low- to mid-single digits.

Now let me discuss some operational highlights from the quarter. Turning to slide 5, the ZipRealty technology development and rollout plan is proceeding as scheduled and we are very pleased with our progress thus far. We have a substantial backlog of franchisees who have already registered to receive the proprietary technology we call Zap, which you will recall is a single, integrated, end-to-end technology platform. The rollout is on schedule, and at the minimum we will have about 300 franchisees operational by year-end.

As to our franchise sales growth, RFG added new franchise and sales production to its five residential brands representing $85 million in franchisee gross commission income, which we refer to as GCI, during the second quarter and continues to manage a strong pipeline of prospective new franchisees. Through the first half of 2015 RFG has achieved new franchise sales and sales production representing about $155 million in franchisee GCI.

As to our existing franchise base, our broker retention rate exceeds 98%. As a result of its recruiting efforts and acquisitions over the prior 12 months, NRT ended the second quarter with 46,700 sales associates compared to 43,000 at June 30, 2014; and its retention rate of its top-two quartile sales associates remained above 90%.

On July 1 Title Resource Group, TRG, completed the previously announced acquisition of Independence Title, which was the largest independent title agency in Texas. This positions TRG to capitalize on NRT's acquisition of the Coldwell Banker United brokerage operation in April.

Independence Title has 55 locations and about 350 employees throughout the state of Texas. TRG now has over 100 office locations across the state, and that's including its existing Texas American Title Company operations.

Cartus, our employee relocation company that serves half of the Fortune 100, recently added two new companies from that list, highlighted by Caterpillar along with a Fortune 50 company in the technology sector. In the first half of 2015 Cartus assigned a total of 48 new companies to its global client roster.

As our press release indicates, that we are providing adjusted EBITDA guidance for the full year at the close of the second quarter, as opposed to the end of the third quarter as in previous years. Based on guidance we anticipate that we will end the year with a cash and cash equivalents balance of approximately $650 million, and our net debt to adjusted EBITDA ratio will be at or below 4 times.

In summary, the key housing indicators are supportive of the widely held view of an improving, healthy, and sustainable housing market. In concert with the positive macro environment, we are pleased with the progress we have made on our strategic objectives year to date. The ZipRealty strategy is well underway, and the strong demand from our franchisees reinforces our decision to bring Zip into the Company more than a year ago.

In addition, our acquisition strategy continues to perform as expected, and our organic growth initiatives continue to create long-term value. Our business model is producing substantial free cash flow, which we believe, given our capital allocation discipline, will permit us to drive long-term growth and value in our business, the focus on which is to delever the balance sheet and create shareholder value.

With that I'll turn this over to Tony Hull, our CFO, for a discussion of financial results. Tony?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Thanks, Richard. Before getting into a more detailed discussion of the quarter I'd like to highlight several key areas of Realogy's Q2 performance on slide 6. Revenue increased 9%, driven by transaction volume gains of 10%. Adjusted EBITDA was $282 million, an increase of 5% compared to the second quarter of 2014.

Net income was $97 million compared to $68 million in the prior-year quarter, an increase of 43%. And we generated $273 million of free cash flow, up $75 million from the same period last year, which equates to $1.86 per share in the second quarter.

As to second-quarter adjusted EBITDA, its increase of 5% trailed the revenue increase in the quarter mainly due to performance incentive accruals, which were $20 million higher in Q2 2015 than Q2 2014. This is the result of the achievement of higher performance levels in the current year as well as the reversal and reduction of certain bonus accruals in the second quarter of last year. This headwind was the most prominent it will be for the year in the second quarter and will be substantially reduced in the third and fourth quarters.

Another item worth mentioning is that we settled some outstanding litigation during the quarter, subject to court approval, which totaled approximately $5 million. This charge is reflected as a corporate expense. In settling the litigation we avoided future litigation costs we would have had and incurred in defending our position.

Now let's take a few minutes to drill down into a little more detail on the second-quarter results. First, I will discuss our key revenue drivers for the second quarter, which you will see on slide 7.

Average broker commission rate, ABCR, decreased 1 basis point at both RFG and NRT. Commission splits at NRT improved 10 basis points to 68.6%, and RFG's net effective royalty rate increased 2 basis points to 4.48% in the second quarter of 2015 versus 2014. For the full year we continue to expect commission splits and net effective royalty rates to be approximately flat to 2014 levels.

RFG homesale sides increased 5% year-over-year, and average home sale price increased 5%. NRT homesales sides increased 13% compared to the second quarter of 2014, and its average homesale price decreased 4%.

As we discussed last quarter, the acquisition of ZipRealty and Coldwell Banker United are expected to have certain impacts on the comparability of NRT and RFG to the prior year, as shown on slide 8. In the middle portion of the slide you can see that NRT's transaction sides increased 13%, with sites gains from Zip and CB United more than double NRT's organic gains.

You will recall that we shared our expectations that NRT's average sales price would decrease, and in fact that occurred. The average sales price for the acquired transactions in the second quarter was approximately $279,000, well below NRT's core average sales price of over $500,000. The addition of those entities to NRT's overall mix had the expected impact on its average sales price.

Excluding the impact of these two acquisitions NRT's transaction sides increase was 4%. Many of NRT's high-end markets saw sides declines or flattening versus last year because of inventory constraints. Specifically in New York City sides were down 8%; New England was down 4%; Florida was down 2%; and California was flat. Conversely, the lower price Midwest region had transaction sides gains of 8%.

NRT's average sale price was flat year-over-year because of this geographic shift in the mix of business and tough comparables against Q2 2014, when NRT's higher-priced markets were performing quite well. In fact, NRT's average sales price reached about $512,000 in that period, which was the highest quarterly average sales price since 2007. Given that tough comparison, NRT's average sales price remaining flat year-over-year on a same-store basis is a noteworthy accomplishment in itself.

As to RFG, shown on the top portion of slide 8, the shift of sides to NRT from its acquisition of the CB United franchisee reduced RFG's sides increase from 7% to 5%, but modestly increased its average sales price.

As to comparisons to NAR, recall that its data is based on national surveys and has often been restated, whereas our aggregated data is based on a combination of RFG, which is national in nature, and NRT, which is heavily concentrated in certain markets with average sales prices that are twice the national average. As a result, it is relevant to compare RFG's results to those reported by NAR rather than our combined results.

For the second quarter and for the next several periods, RFG comparisons to NAR are further complicated by the switch of CB United from RFG's drivers to NRT's. On an apples-to-apples basis with those sides restored, RFG's pro-forma transaction sides increase 7% compared to NAR at 8%, and RFG average sales price increases in the quarter came in at 6%, a point higher than what NAR reported. Overall, RFG's pro-forma transaction volume increase of 13% was at the same pace as NAR's in the quarter.

Now let's look at revenue and EBITDA at the business-unit level for the second quarter of 2015 compared to the prior-year period, as shown on slide 9. RFG revenue increased 9% as third-party domestic franchise volume increases of 10% were modestly offset by lower international revenue. RFG's EBITDA increase of 7% was below its revenue growth, as higher revenue was partially offset by $6 million of incremental employee costs, including an increase in performance incentive accruals and staffing costs related to the Zap platform rollout.

NRT revenue increased 9% versus Q2 2014 due to NRT transaction volume increases of that amount in the period. NRT EBITDA increase of 7% trailed its revenue increase, as higher gross profit and a $2 million increase in PHH Home Loans joint venture earnings were partially offset by a $13 million increase in acquisition-related costs and $8 million of incremental performance incentive accruals.

Cartus EBITDA increased $3 million due to an increase in referrals as well as positive impacts of foreign exchange rates on expenses. Finally, TRG EBITDA increased $3 million, primarily due to higher purchase and refi volume.

Corporate expense decreased $6 million year-over-year; but recall that the 2014 quarter included $17 million of early extinguishment of debt charges. Excluding those, corporate expense increased $11 million compared to the prior year due to $6 million litigation acquisition-related expenses, $2 million of ZipRealty corporate expenses, and $4 million of increased performance incentive plan accruals at the corporate level.

Slide 10 provides cash flow guidance for 2015, which is similar to what has been provided in the past. But to point out a few highlights, we continue to expect corporate cash interest expense to be approximately $210 million for the year. Year-to-date it was $105 million compared to $123 million in the year-earlier period. Capital expenditures remain projected at about $85 million for the year.

Looking at our expectations for the third quarter of 2015 on slide 11, we forecast that homesale transaction volume will increase in the range of 7% to 10%, with 5% to 7% coming from homesale sides growth and 2% to 3% from average sales price growth. We expect NRT sides and price will move in a similar manner to what we saw in Q2.

Slide 12 depicts transaction volume forecasts from five industry forecasters for full-year 2015. We saw a pretty sizable increase in a number of full-year forecasts in July.

NAR remains the highest, with projected transaction volume growth of 14%, whereas the other forecasters are looking for existing homesales gains of between 6% and 12%. The average of the five forecasts has increased 3 percentage points to 10%, compared to 7% at the time of our last call.

Turning to slide 13, we currently expect our full-year 2015 volume growth to be in the 8% to 11% range, although we have very limited visibility into the fourth quarter at present. As shown on slide 13, with these anticipated transaction volume gains we forecast Realogy's adjusted EBITDA will be between $810 million and $840 million for the full-year 2015 and expect our adjusted EBITDA margins will be between 14.1% and 14.3%.

Our net debt to adjusted EBITDA ratio was 4.4 times at June 30, 2015. Given our high cash flow conversion, we expect this ratio will be approximately 4 times at the end of the year.

To summarize: with the continuing strength of the housing market in concert with our anticipated strong cash generation, we expect to continue deleveraging the balance sheet while simultaneously making strategic investments in the business. With that I will turn it over to the operator, who will open this call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Will Randow, Citigroup.

Will Randow - *Citigroup - Analyst*

I guess in terms of the NAR data, I mean, we saw transaction volume up about 14% in the second quarter. In addition, some of the forward-looking data in terms of contracts as well as closings, we're seeing closings up 15% in terms of transaction volume in July, and that cadence hasn't slowed in contracts.

So what are you seeing differently versus some of the national indicators we're seeing?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

The NAR data is based on surveys, and we've seen this pattern before where they get it -- in a recovery year, like if you look back in 2012, we sort of lagged them. If you look at 2012 we sort of lagged them for the first half of the year and then we ended the year actually exceeding their volume when they came out with actual numbers.

So it's really just a difference -- it's just their methodology, which is based on surveys, versus ours, which is based on surveys for the historical -- and then a black box for the forecast versus ours, which is based on our actual results for the first half of the year.

And our forecast is based on what we're seeing with our opens in July and our closes in July. So it's really just a question of we're well within the range of the average of the forecasters for the year.

Will Randow - *Citigroup - Analyst*

Got it. I guess if we also look at transaction data, it's only about two-thirds of the US though. So those numbers I just mentioned, that's what we're seeing. In addition, when you think about the fact in terms of splits and average brokerage commission, how do you feel about those going forward?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Well, we expect splits to be flat to last year for the full year. And ABCR, as price increases -- as we said many times -- we expect there to be some pressure on ABCR, and that's what we are seeing.

We were lucky that during the 2011 through 2014 period ABCR stayed pretty constant even though prices were going up. But at this point that's catching up to us a little bit, so there's some pressure on ABCR. But very -- obviously it's 1 basis point so it's a very modest decline.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

This is Richard. It's very competitive, and management works very hard to manage that in all the markets in which we operate in. As you know that's only relevant to NRT. Our franchisees deal with that on their own.

So it's very competitive; no more than it has been in prior periods. And if we can manage to this to a single basis point swing one way or the other, that's a good outcome.

Will Randow - *Citigroup - Analyst*

All right. Thanks, guys, and good luck on the next quarter.

Operator

Brandon Dobell, William Blair.

Brandon Dobell - *William Blair & Company - Analyst*

As you look at the July opens and, I guess, closes, how does the behavior or trend with first-time buyers look relative to how the second quarter came in for that specific kind of transaction?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

At this point we don't have that kind of data. We don't have that kind of stratification until we get further in, until we have a full quarter's data.

But the trend this year is clearly -- which we all think is very important for a sustainable recovery in the housing market -- is that the first-time buyer is coming back. They certainly in the 2012 to 2014 period, they were not big players in the recovery. But the fact that they're strengthening as part of the recovery this year is very important and critical for a good housing market recovery over the next several years.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

This is Richard. If you look at the public comments made by a lot of the builders, most -- I mean, Horton, KB Homes, Lennar, a few others -- all speak to the growing strength of the first-time buyer in their product mix. So they tend to be pretty bullish on that.

As we have said over a number of quarters, for the recovery to continue to gain momentum and strengthen you need the first-time buyer more relevant, and they are slowly becoming more relevant,, as we predicted. It's nice to see that the public builders speak favorably about the rising increase in the first-time buyers. So it's a necessary part of the recovery and we are happy to see it.

Brandon Dobell - *William Blair & Company - Analyst*

Is there a point -- you talk about 31% of buyers as first-time. Is there a point where that percentage becomes a noticeable tailwind to the key metric that you guys would think about that they should be influencing? Is it 35%, is it 40% for them to get back to where we were pre-crisis, for that metric to really make a difference for the P&L?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

I think we hope that eventually it gets to somewhere around 40%. Other think it's higher as we speak. But I think the NAR report is probably more relevant.

So we're 31%. We'll pick up a few points here and there, and I think we'll eventually get to about 40% of the market will be first-time buyer, which I think is about a normal market.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

But the bottom line, Brandon, is, again as I said earlier, the higher percentage first-time buyers, it's a much more normal housing market and it speaks to a much more sustainable housing recovery and one that's going to go for a lot longer than ones in the past.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Yes, the one thing we call out is that, as you I'm sure recognize, the growing importance of the first-time buyer, that's going to be at a lower price point. So across the market, across the board in all markets, they tend to have much lower average sales price than the midmarket.

Brandon Dobell - *William Blair & Company - Analyst*

Right. Then final one for me. It doesn't sound like you changed any of your spending expectations around technology for the back half of the year versus where you started out thinking they would be at the outset of the year. But just want to make sure we're all on the same page with the dollars that you guys think are going out the door to support the Zip rollout and other technology initiatives in the back half. Thanks.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Yes, we are right on were we forecasted. The Zip, between the corporate and RFG, is going at $[60] million for the year, which is about a $12 million increment versus last year.

Brandon Dobell - *William Blair & Company - Analyst*

Okay. Thanks, guys.

Operator

David Ridley-Lane, Bank of America.

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

Richard, you alluded to increasing mortgage availability. Could you provide some details on what you're seeing in the market?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

More what? I missed that.

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

Mortgage availability.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Oh, yes. No, it's -- I think it was the mortgage index that indicates that it's improved a couple points. So it's not that it's easy, but it's a bit more available than it has been in the recent past.

So we're seeing -- the standards are still tough but manageable, so we're seeing a bit improvement. I think the balance of the industry is seeing the same thing.

NAR has commented on this as well, that mortgage credit is more available than it has been in the recent past. So we're encouraged, but that's not because the regulations have changed. It's because lenders have gotten more comfortable with their underwriting standards.

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

Got it. Then the net effective royalty rate in RFG continues to be up a bit. Is this the trends between the smaller franchisees maybe playing catch-up versus the larger franchisees? Or are there other factors in play that are helping that?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Not yet. I think that will become more relevant when we get to 5 million, 6 million, 5.5 million home units nationally. But what we are seeing now is the impact of us raising the threshold to get rebates, which we've done over the last two years. So I think that you're seeing the benefit of that.

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

Got it. Then just a quick numbers question. What's the rough benefit to the TRG segment from the Independence Title acquisition in Texas?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

It's about a $10 million annual EBITDA run rate.

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

Thanks very much.

Operator

Mike Dahl, Credit Suisse.

Mike Dahl - *Credit Suisse - Analyst*

Tony, I just wanted to go to the guidance for a second. You made the comment that within the transaction guide you expect NRT sides and price to move similarly to 2Q. Was that meant to be -- so should we expect right in that up 13%, down 4% type of range? Or was that relative to like the 2x the rate of RFG that we were seeing in 2Q? If you could just break those out.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

It was the former, not the latter. So it's going to be sides up in the teens and price down a couple percentage points.

Mike Dahl - *Credit Suisse - Analyst*

Okay, got it. Then on the split rates, obviously there's a lot of mix shifts going on in NRT right now. So you've managed the business to about flat year-on-year like you've got it to.

Just wanted a sense of what the benefit from mix is that you are seeing, just given some of the softer trends in the high-price high-split markets, plus some of the acquisitions that are layering on. I guess just a sense of what's same-store versus mix.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Well, I think it's more mix towards the Zip transactions, and those are at much more attractive splits, and all the activities we are pursuing in terms of getting more transactions to be e-lead -- as we talked about at Investor Day, e-lead transactions.

So I think those two things are having the portfolio shift effect that we anticipated. But just to be very clear, it's competitive out there especially at the high-end markets for agents. So I think that we are managing it really well, I think, and NRT is doing a great job of manage this us to flat.

I think, again, just to the point earlier, I think at some point you're going to see -- again when we get to a 5.5 million, 5.6 million units, you're going to see some of the third- and four-quartile agents do more of the business, and that should further take pressure off splits. So short term we are managing with a portfolio shift to the lower split transactions, and over time I think we'll get to just a shift in who's doing the business.

Right now 90% business is being done by the top-two quartile agents. That should float down to 85%, 86%, 87% over time, and that will further take pressure off of splits.

But that's going to be a longer-term. But between the two we have a stable outlook here for a pretty good runway.

Mike Dahl - *Credit Suisse - Analyst*

Sure. That makes sense. One last clarification, just on the guidance. You mentioned to the last question that TRG acquisition was a $10 million run rate. Is that full $10 million included in the $810 million to $840 million guide?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

No. It would be less than that.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

For this year.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

For this year.

Mike Dahl - *Credit Suisse - Analyst*

For this year, even though there is typically the pro-forma adjustment made?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Right. But a lot of the -- not a lot, but a portion of the $10 million is going to come from synergies, and that's not included in that pro-forma adjustment.

Mike Dahl - *Credit Suisse - Analyst*

Okay. Got it. Thank you.

Operator

Ryan McKeveny, Zelman & Associates.

Ryan McKeveny - *Zelman & Associates - Analyst*

First question on the acquisition pipeline for NRT. Maybe you could just update us on what you are currently seeing from a competitive standpoint. And for this year, given the Coldwell Banker United Realtors acquisition, how would you think about other acquisitions this year, and then next year, just comparing acquisitions versus other potential cash uses?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

This is Richard. From a competitive standpoint the usual competitors are showing up, although rarely. So we don't find a lot of competition for the traditional acquisition model.

The few that we do see, we find the target less interesting for a variety of different reasons. As you recall, we make every effort to acquire companies in the markets in which we exist, so that we capitalize on the synergies that are realized in those acquisitions.

Coldwell Banker United was a departure from that because we want to grow into a market that we see as a very strong, growing housing market, and that's the Texas market, Southeast and the Southwest. And that has proven to be exactly what we thought it was going to be, the opportunity to add tagalong acquisitions in those markets.

So it's a robust pipeline. We are very disciplined in our approach. We never overpay for any of these, and we're pretty encouraged by what we see on the horizon. So it's the market we expected it to be.

Ryan McKeveny - *Zelman & Associates - Analyst*

Great. Thanks. With the United Realtors, I think we had discussed before, but it seems like that was maybe more of a one-off or it just turned out to be the right deal. But there's no meaningful strategy shift to really take franchises back into the NRT segment, correct?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

No, no. We intend to grow both simultaneously. We only buy a franchisee out of necessity.

In this particular case the only way we could substantially enter that market was through the acquisition of what was the seventh largest brokerage firm in the United States. So if we hadn't acquired him we couldn't have gone into that market under the Coldwell Banker name. So he was a necessary acquisition, but he's the exception.

Ryan McKeveny - *Zelman & Associates - Analyst*

Great, thanks. So just last one on PHH. We've heard lately the CFPB has been pressuring some lenders to stop marketing service agreements with some realtors as part of their interpretation of RESPA. Is there any impact or potential impact on you guys from either the brokerage standpoint or the mortgage joint venture with PHH?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Nothing significant.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Nothing on the mortgage.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

The JV is RESPA-compliant and it's permitted under RESPA. It's not an MSA, so that continues fine. And the MSA numbers are very minor.

Ryan McKeveny - *Zelman & Associates - Analyst*

Okay, perfect. Thanks.

Operator

Stephen Kim, Barclays.

Stephen Kim - *Barclays Capital - Analyst*

I guess the first thing I would say is thanks very much for the adjustments, the acquisition adjustments. That was very helpful. Also, if you could make those available for let's say 1Q, 4Q, and 3Q last year, that would be also I think very useful for us as we model going forward. So just a comment.

I guess the first question I have is about your overall marketshare. Because the adjustments that you talked about really don't change or affect or influence one of the metrics we look at, which is your total Company combined share of sides.

If we look at that metric, what we see is that it generally drops pretty significantly in the second quarter, which can be a distortion and can make this quarter look very bad. But even if you look back going to 2010, there is a downward trend just generally in that series and -- which would suggest that you're basically slowly losing marketshare relative to NAR's existing homesales data.

So my first question is, have you observed such a trend? Do you think that -- and if you can provide any color around why you may think that is happening.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Actually, I -- first of all, we get paid on total volume and actually we've beaten our last year by 4 percentage points on total volume. I think if I recall for Investor Day since 2010 we've beaten NAR by 30 percentage points in that period. So I think we're doing --

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Stephen Kim - *Barclays Capital - Analyst*

That's sides plus price, right, Tony? That's sides plus price?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

That's what we get paid on. So I don't -- so long-term we are doing just fine.

I think in the second quarter -- again, you'll have to wait a year to see what NAR does with its 2015 numbers to judge how we did. But again, if you compare RFG volume to NAR's volume in the second quarter, we were exactly the same as them.

And again if you go back to -- 2012 is a good example. You can see that we trailed NAR in the first half and then we beat them for the full year.

And the same thing happened in 2013. In the third quarter when we had that big rush because mortgage rates went up we were below the NAR-reported number. But by the end of the year we outperformed NAR.

So we're just doing -- I think we're holding our own, improving with our franchise sales and M&A, so I think we're in good shape. We're beating NAR by a point or 2 every year over the long term, and that's what our goal is to do.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Stephen, another point as you do your modeling. Builders are gaining share with their product as builders are -- the new construction is growing. Off a very low base, but it's growing, so that's one observation you may want to pay attention to.

Stephen Kim - *Barclays Capital - Analyst*

Yes, good point.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

And the second would be, we've never ever positioned this Company as a marketshare story because the business models are so diverse. We have no interest whatsoever in being concerned with the business models that are paying 100% commission to agents; that's not our business.

So that you've got to -- we've always been based on profitability, always. And we've made that clear in every single meeting with every single investor: that's the purpose at the end of the day.

So the real measure of our success is, are we regenerating the cash flow that we predicted we're going to generate?

Stephen Kim - *Barclays Capital - Analyst*

Great. No, I really appreciate that. That's helpful.

I guess the second question I had relates to Zip and some of the things you guys are doing there, which seems very exciting. I know that the hope longer term is that the work you're doing on that side of the business is going to be a benefit to both the Company overall as well as individual agents and so forth.

One of the metrics of course the Street is going to be looking at is the splits, right? So I was curious if you could give us just some range -- not a range but an idea of, if the Zip platform ultimately proves to be very successful and it really gains momentum,, the impact that we might see from that on your splits, could it be as big as a percentage point or 2? Or is it likely to be much more incremental than that?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

I just want to break down your question into two pieces. The first is, we are seeing the impact on splits at NRT from Zip. I mean, Zip is doing -- the Zip brokerage operation is performing extremely well.

It's ahead of where we thought it was going to be in our model. So we're very happy with that.

On the Zap platform going to our franchisees, split is not a relevant factor because, again, we get paid off the top from our franchisees. What's important is, can their agents -- can the agents of our franchisees use that platform to become more productive?

And I think the measure is, again if 50,000 or 100,000 -- let's say 50,000 of the agents can do one more transaction and we're making $300 a transaction, then RFG's royalties will go up whatever the math is there. So that's really the -- it's increased productivity that's really going to be the driver of its success on the RFG side.

And as we've said, it's going to be -- it's going to happen, but it's going to take several years for it to really pay off in terms of the return in terms of that increased productivity.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Let me just reinforce one point. Tony's absolutely right. On the NRT side we've been very pleased with the operating results and the financial results of the Zip model at NRT. In fact, so much so that we have a number of markets that are new markets that we will accelerate opening in those markets because of the success of that model.

So it's going to be very relevant to NRT; has no impact whatsoever on the franchise side except to increase the productivity of the broker and the agent. So we are pretty bullish on that front as well.

Stephen Kim - *Barclays Capital - Analyst*

Great. Thanks very much, guys.

Operator

Tony Paolone, JPMorgan.

Tony Paolone - *JPMorgan - Analyst*

First Tony, just to clarify, in the $282 million of adjusted EBITDA, does that -- did that or did that not add back these legal costs that you highlighted?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

It did not. Did not.

Tony Paolone - *JPMorgan - Analyst*

Okay, got it. Then if you think about your EBITDA guide for the year and the implicit revenue, and think about incremental margin, it looks like about 10%, thereabouts, year-over-year on the incremental side. I know you've got the incremental costs and comp and stuff like that but -- and I guess in this legal item too.

Any way you can tie that together as to what it would have been without some of these incremental costs? And whether that's something that you think is more normalized as we look ahead?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

I haven't looked at that specifically because it's not -- again, we think we gave you all the -- we gave you what we think the margin's going to be overall and what the EBITDA is going to be for the year. But obviously we talk about the acquisition cost coming in, it's tough with -- I guess you could try to back out all those things.

But again I think the incremental margin is kind of -- we've been trying to stay away from that because of the M&A and the headwinds from the bonus issue cloud it. But we're trying to get you there with giving you the margin, which is -- and hopefully enough information on those costs for the year that you can do the analysis.

Tony Paolone - *JPMorgan - Analyst*

Okay. I guess another follow-up to that, though, in terms of thinking about the rollout of technology. As you look out into next year, do you think there's another incremental step-up as the rollout expands? Or is this -- is the numbers you've outlined for this year it, and that's the new run rate?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

I think it will be much more modest than what we're seeing this year as we're just -- once we lap it will be maybe a couple million; I don't know, we haven't done our budgeting for next year. But from what I'm hearing in terms of the requirements for the rollout, it shouldn't be that much of an incremental cost.

Tony Paolone - *JPMorgan - Analyst*

Okay. In terms of the net effective royalty rate, I think you addressed this a little bit and some of the puts and takes there. But did the CB United moving from RFG to NRT have any appreciable positive impact on that?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

It definitely had a positive impact on it. But it's one of the many factors that we discussed.

Tony Paolone - *JPMorgan - Analyst*

Okay. Then just last thing in terms of -- you gave a cash balance for the end of the year, but is there anything else from a balance sheet point of view you anticipate doing? Or is this just cash build until the prepayments open up next year?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Well, just to remind you, 15 days after the end of the year our high-cost debt becomes callable. So we are very focused on that.

Tony Paolone - *JPMorgan - Analyst*

Okay. It sounds like there's not much then to contemplate until that occurs. Like, we shouldn't expect you trying to do something early.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

We may position ourselves to be able to deal with those issues next year. But that's it.

Tony Paolone - *JPMorgan - Analyst*

Okay. Thank you.

Operator

John Campbell, Stephens, Inc.

John Campbell - *Stephens Inc. - Analyst*

On the NRT commission rates, I know that was down modestly year-over-year. But I think you guys put up the first sequential gain from 1Q -- I mean, I think that was the first time in like five years or so. And I know you guys touched on this a few minutes ago, but was that sequential improvement aided at all by United or the Zip acquisition?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

In the first quarter?

John Campbell - *Stephens Inc. - Analyst*

In the second quarter.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

No, it wasn't material. Well, a little bit from Zip but probably not from CB United. They had similar splits.

John Campbell - *Stephens Inc. - Analyst*

And that was just more a product of a little bit lower average homesale price?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

No, it's more impacted by who's doing the business, which of our agents is doing the business.

John Campbell - *Stephens Inc. - Analyst*

Got it, got it. Then just as a follow-up, just looking at the industry, there's two questions here. First, can you guys provide any kind of update on Project Upstream?

And then secondly, just related to Zillow's recent acquisition of DotLoop, does that change anything with respect to your ongoing relationship with either of those companies?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

No, probably not on the Zillow side. I think it may be more relevant to individual franchisees who may have relationships with other providers. There's DocuSign; there's a number of different companies in that space, so there's nothing that unique about it.

It's a good product and we trust that Zillow will make it even more attractive to franchisees. But we'll see. But it has no immediate impact on our relationship.

As to Upstream as best we can determine it continues to progress. I don't think it's had any meaningful impact on the relationship with Zillow or anyone else for that matter.

So I think that's something that will be more relevant next year. It's not really relevant this year.

John Campbell - *Stephens Inc. - Analyst*

Got it. Thanks for that. Then if I could squeeze in one more, do you guys feel pretty comfortable getting your leverage down to 4 times by the end of next year?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

By the end of this year.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

By the end of this year.

John Campbell - *Stephens Inc. - Analyst*

Excuse me, this year, yes.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Yes, we feel very confident.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

Yes, we're very focused on that.

John Campbell - *Stephens Inc. - Analyst*

Thanks, guys.

Operator

Rob Rutschow, CLSA.

Rob Rutschow - *CLSA - Analyst*

A couple follow-ups on the Zap rollout. Is that helping some of your lower-tier brokers more than it would help more established or a top-quartile broker?

And how would we think about the impact on broker splits if it's successful and it helps your brokers be more productive?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

We are focused initially on the smaller brokerage firms because we believe they need the technical assistance, and they also need to displace the cost of otherwise using disparate systems that are not integrated. So we're focused there.

But it's interesting: we have the same level of interest coming from our larger brokers. So we're trying to accomplish the rollout to both small brokerage firms, midsize brokerage firms; but a number of large ones have asked to be part of the initial rollout as well.

Remember, this has no impact on the ABCR. The splits that they realize with their agents really doesn't impact the relationship with us, because royalty is off the top.

That said, we suspect that this technology will help them achieve more favorable splits, but that's something they'll have to manage through. We'll give them the tools; they'll have to manage accordingly. And we're optimistic that it will help accomplish that, and in a way that may be meaningful to their brokerage operation but again has no impact on our top-line royalty.

But it's progressing very well. We've got a lot of interest from our franchisees. It's been phenomenal as to the level of interest.

We are currently -- I don't know we haven't made any announcements. We currently have about 75 brokerage firms operational now; that includes about almost 6,000 agents using the technology.

And it's been very well received. So we're very bullish on the rollout next year.

Rob Rutschow - *CLSA - Analyst*

Okay, great. Then just one bigger-picture question. It seems like that if I look at the number of branches and the number of brokers at NRT, you've been growing the number of brokers per branch.

Does that mean that some of the excess capacity you talked about at the time of the IPO is being taken out of the system? And how should we view that, if it's relevant at all?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

I don't -- no, I don't think that's --

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

The capacity utilization has improved a couple of percentage points, but there's still more to go there. So there's still more opportunity there.

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

And remember, NRT is peculiar to the markets they operate in. So the national data doesn't really -- it's not really relevant to them.

Also something to think about, although agent headcount is an interesting metric, it's really productivity per agent that's more relevant at the end of the day. And that's going to be more so as technology has a bigger impact on the productivity of each individual agent and the brokerage firm in general.

Rob Rutschow - *CLSA - Analyst*

Okay. Thanks for taking my questions.

Operator

Jason Deleeuw, Piper Jaffray.

Jason Deleeuw - *Piper Jaffray & Co. - Analyst*

Question on the EBITDA margin guidance for the year. You guided to the upper half of the range. Is that simply because the revenue and volume expectations are now coming in at the higher end of your expectations? Or has there been any change to your expense expectations for the year?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

It's just what falls out when we looked at our forecasts for the year.

Jason Deleeuw - *Piper Jaffray & Co. - Analyst*

But has your expectations for volume, has that come in a little bit higher than what you guys were originally expecting?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

We never really gave an original expectation, so it's hard to compare to that. But were just very happy that it's coming in, especially compared to 2014, at the 8% to 11% range. I think that's a great outcome for the year.

Jason Deleeuw - *Piper Jaffray & Co. - Analyst*

Okay. Then on the inventory constraints in some of the markets that you guys pointed out, do you think those will persist for a long period of time? Are these -- is this an intractable issue, or is this something that you think eventually gets sorted out over time?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

We think it gets sorted out over time. I don't think there's any structural issue here. It's just timing.

It is a quandary. I mean we, in various different markets, whatever -- if you list a home and it's properly priced it sells pretty quickly. The turnover is terrific. The demand is substantially greater than the availability of the inventory.

So I think it corrects over time. We see no structural impediment to inventory becoming more robust.

Now bear in mind, it's at about five months; in some markets it's substantially lower than that. San Francisco, as an example, is less than two months of inventory. New York City -- I mean just virtually every major market is having pressure on inventory.

But eventually that will correct and we'll get back to that six-month inventory norm that the industry has enjoyed for a very long time.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

But, Jason, the good news is when a listing comes on the average days on market is incredibly low. So there's demand to absorb the inventory when it comes on, so I think that's hugely beneficial.

Jason Deleeuw - *Piper Jaffray & Co. - Analyst*

Yes. Then lastly, I don't think we got an update on the international buyer trends or international sales trends from international buyers. Can you just give us an update there and what you're seeing in some of your key markets?

Richard Smith - *Realogy Holdings Corp. - Chairman, President, CEO*

It's down. The international buyer is not as robust, as you can imagine, in the markets where they were previously very robust. Florida; California, specifically LA and San Francisco; New York City -- have seen a decline in the foreign buyer activity. And we expect no significant change to that this year given the world economic conditions.

Jason Deleeuw - *Piper Jaffray & Co. - Analyst*

All right. Thank you very much.

Operator

Jason Weaver, Sterne Agee.

Jason Weaver - *Sterne, Agee & Leach - Analyst*

I wanted to ask about the full-year volume forecast that you've put out there and see if you can ballpark or quantify the impact of increasing interest rates on demand for the latter part of that year, and what that forecast incorporates as far as that.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO, Treasurer*

Well, I think at this point of the year the increase in mortgage rates, which has been oft worried about but never materialized and has not -- by this time everyone expected it to have materialized, and this year obviously has not come. I think if we do see an increase in mortgage rates this year it will actually have a beneficial effect in 2015.

Because what we've seen in the past is if there's a somewhat meaningful, like 50 basis point increase in rates, you see your unit activity accelerate. So I think it would actually be -- perversely it would be a positive for this year.

Jason Weaver - *Sterne, Agee & Leach - Analyst*

Okay. Thank you.

Operator

(technical difficulty) question-and-answer session. Alicia, I turn the call back to you.

Alicia Swift - *Realogy Holdings Corp. - SVP IR*

Thank you. We thank you for taking the time to join us on the call and we look forward to speaking to you over the quarter. Thank you.

Operator

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