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RLGY - Q4 2013 Realogy Holdings Corp Earnings Conference Call

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PRESENTATION

Operator

Good morning, and welcome to the Realogy Holdings Corporation full-year 2013 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 March 12.

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 Corporation - SVP of IR*

Thank you, Shirette. Good morning, and welcome to the Realogy full-year 2013 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 the webcast participants, you need to advance the slides by clicking the forward arrow on 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 and our webcast slides which are available on the information -- 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 the most comparable GAAP measures in our press release. Also, we will file our annual report on Form 10K for the year ended December 31, 2013 with the Securities and Exchange Commission later this week on Thursday, February 27.

Second, the Company will be making statements about its future results and other forward-looking statements during the 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 the rebroadcast of this presentation, we remind you that the remarks are made herein as of today, February 25, and have not been updated subsequent to the initial earnings call. Important assumptions and other important factors that could cause results to differ materially from those in the forward-looking statements are specified in our earnings release issued today as well as 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, CEO, Pres*

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

We entered 2013 with the expectations that the housing recovery was growing in strength, and a our results demonstrate, that certainly was the case. As you can see on slide 4, Realogy posted strong revenue and adjusted EBITDA gains in 2013, capitalizing on the second year of the housing recovery.

Our improved home sale transaction volume translated into full-year revenue of $5.3 billion in 2013, an increase of 13% over 2012. In addition, our 2013 revenue gains and the prudent management of operating overhead resulted in an 18% increase in full-year adjusted EBITDA to $796 million.

This past year we continued to position the Company for growth by adding franchisees to our brands and completing accretive acquisitions at a faster pace than we did in 2012 while reducing our debt by approximately $460 million since December of 2012. Specifically, Realogy's combined full-year home sale transaction volume, that's transaction sides times average sale price, increased by 18% in 2013.

In particular, the volume increase for our franchise operations with its national geographic footprint was 20% in 2013. This exceeded the National Association of Realtors' 19% year over year volume gain by 1 point, as shown on slide 5.

In total, our franchised and Company owned operations achieved approximately $402 billion in closed sales volume, that's up from $340 billion in 2012. Our a Realogy-wide basis, we maintain our market penetration rate, which means were of the buy or sell side with 26% of all US existing home sale transaction volume involving a real estate brokerage firm in 2013.

We finished the fourth quarter of 2013 with a 7% increase in home sale transaction volume, which was at the midpoint of our guidance for the fourth quarter. We've been expecting a gain of 3% to 4% each on both sides in price in the fourth quarter but instead, our mix of business was more heavily weighted towards average sale price, which was up 5% along with a modest gain in transaction sides, up 2% for the quarter.

Home sale prices were stronger than we anticipated in the fourth quarter, a trend we see continuing into the first quarter this year. Prices responding to strong demand and low inventory levels.

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 is select NRT markets for the fourth quarter of last year. For our franchised operations, RFG's average home sale price gained 7% year over year and home sales sides increased 2% during the fourth quarter.

With respect to regional color for RFG in Q4, price was the key driver in the West, Midwest and South regions, while the growth in the Northeast was balanced between sides and price. Specifically, the Northeast was it the strongest RFG region overall in the fourth quarter with a 6% increase in sides and 6% increase in price.

The South had a 7% increase in price and a 3% increase in sides while the Midwest had a 6% increase in price and a 3% increase in sides. In the West region, RFG experienced an 11% increase in price, which was partially offset by 5% decrease in sides. For our Company-owned brokerage operations, NRT's average home sale price gained 3% in the fourth quarter of last year, and the home sales sides increased 1% year over year.

The Midwest experienced price increases of 7% and sides increases of 5%, while the West region saw a price increase of 2% that was offset by a 6% decrease in home sales sides. The New York Tri-State area, that's excluding New York City, experienced a 17% increase in sides and a 2% increase in price. New York City, which includes the Corcoran Group and our Sotheby's international retail operations, was up 2% on sides and 2% on price, and New England was up 2% on sides and 7% on price.

In Florida, price was up 10% and sides decreased 2%. Our California operating companies reported that their average sale price increased 4% and sides decreased 8%. California in particular is reporting low listing inventory.

Now, turning to slide 6, RFG's domestic franchise sales efforts generated $256 million in gross commission income, or GCI, for the full year, which was a 9% increase over 2012. This includes $76 million during the fourth quarter, which marked our strongest franchise sales quarter of 2013 and our best fourth quarter since 2007.

RFG continues to build upon its global presence. Our franchisees currently do business in 103 countries and territories around the world with approximately for 13,700 offices at 247,800 independent sales associates.

In the fourth quarter, RFG signed agreements with new master franchisors and/or opened franchise operations in Switzerland, Panama, Saudi Arabia, Dubai, Austria Croatia, Kosovo and Sylvania. Sotheby International Realty has been very successful in growing in highly selective global markets, and in the first quarter of 2014 has opened a new franchise in Belgium and signed a franchise agreement for Beijing.

Overall, RFG's franchisee retention rate in 2013 was 98%, that's up from 97% in 2012. This reflects the rate our franchisees have been at the end of 2012 as measured by gross commission income were retained in 2013, and that continues our long track record of retaining our franchisees in the mid to high 90% range.

NRT continued to grow our Company owned brokerage through a series of strategic acquisitions in 2013, most of which were small to midsize firms. For the full year, NRT closed on 15 transactions representing approximately $86 million in accretive GCI.

As a result of these transactions, NRT added 1,000 independent sales associates across seven states last year. And the largest transaction of 2013 was the Frank Howard Allen acquisition in northern California which occurred in the fourth quarter, and we spoke about that in our fourth quarter call.

Our brokerage acquisition pipeline remains strong. So far in the first quarter of 2014, NRT has acquired approximately $72 million in GCI with four brokerage acquisitions adding more than 500 sales associates to its operations of the Southwest and Northeast. This activity was highlighted by NRT's strategic entry into Houston with the acquisition of Martha Turner Properties, a luxury brokerage firm with six offices and more than 220 sales associates which now operates as Martha Turner Sotheby international Realty.

In 2013, Martha Turner achieved its strongest year with more than $2 billion in closed sales volume. According to real trends, Martha Turner properties ranked as number 8 in the nation in 2012 based on closed sales volume per agent with an average of more than $7 million in sales volume per agent. As the nation's largest residential real estate brokerage company for each of the past 16 years, NRT now operates in more than 40 of the 100 largest metropolitan areas in the United States and has approximately 42,300 independent sales associates.

Moving to slide 7, Cartus assisted in approximately 166,000 relocations in more than 150 countries for more than 1,000 active clients last year, and that includes half of the Fortune 50. A key contributor to the Realogy value circle, Cartus delivered real estate referral leads our Company-owned and franchise brokerage affiliates, resulting in 57,000 closings in 2013.

TRG's strategic focus on improving its capture rate for purchase title and closing units on the NRT home sales proved highly effective in 2013. The Company increased its capture rate on NRT sales to 42%, a 2 percentage point improvement over 2012.

For full-year 2013, TRG's underwriter reported a 17% increase in net premiums year over year. Once again, TRG's underwriting claims experience for the year substantially outperformed the industry average loss ratio of 6% to 7%.

As we move into 2014, we believe that we continue to be in the early stages of a housing market recovery and that there is a long runway ahead for continued growth. As evidenced by current industry forecasts, however, the rate of growth is expected to moderate in 2014 as compared to the very strong 2013.

The National Association of Realtors is currently forecasting a 5% year over year increase in home sale transaction volume in 2014 with the gains being entirely driven by sale price increases. Fannie Mae is forecasting an approximately 8% increase in volume for 2014, with almost 2 points coming from unit growth and 7 points from price gains.

While these two forecasts are below last year's pace of a 19% volume increase, on average they are consistent with the long-term historical volume growth rate for the existing home sale market. Which brings us to the current operating environment.

The first quarter is seasonally the slowest of any year, and we believe it is not a good litmus test for the full year. It's too early to know how the year will progress, but we remain optimistic that the strength in home sale prices will continue to have a positive effect on home buyer and seller confidence and that inventory levels will increase as we move into the spring selling season. With an improving economy, declining unemployment, low mortgage rates and the expected increase in listing inventory, the existing home sale market should continue to grow year over year in 2014.

We were recently encouraged to see the announcement that Wells Fargo, the nation's largest mortgage lender, plans to lower its minimum credit score for certain mortgages. The bank will begin originating purchase loans with credit scores as low as 600, down from its previous limit of 640, a sign that mortgage lending standards may be starting to normalize.

With respect to the first quarter, it is fair to say that the weather patterns across much of the country had an impact on home sales this winter, but we believe this is a timing issue. The metrics we follow remain strong and we believe the impact will be temporary.

One measure of the pent-up demand is consumers search activity on the Internet. In the form-up period from October 2013 through January 2014, the number of unique visitors to our brand websites was 10% up had for the same period in late 2012 and early 2013.

By the same measure, RFG website traffic in January was up 42% month over month from December. These metrics are an indication of how the spring housing market may evolve over the next months.

In conclusion, we are pleased with the strength of our financial and operating results for 2013. It was a terrific year for our Company. Our shareholders, our franchisees, clients and employees.

Our management team has executed well against a short and long-term strategic goals. Long-term, we remain bullish on housing and continue to believe that Realogy is the best pure play investment for those interested in the long-term prospects of the US housing market.

With that, I'll turn the call over to Tony Hull, our CFO.

Tony Hull - *Realogy Holdings Corporation - CFO*

Thank you, Richard. Let me first talk about some brief highlights in 2013, starting on slide 8.

Revenue was up 13%, driven by higher home sale transaction volume in NRT and RFG. Full-year 2013 adjusted EBITDA increased by 18% to $796 million. Net income for the Company totaled $438 million and includes an approximately $240 million income tax benefit due to a $341 million benefit from the reversal of our domestic tax valuation allowance, offset by approximately $100 million for the current year book tax expense. In addition, 2013 net income includes charges of $68 million for early extinguishment of debt and $47 million related to stock-based payouts under the Phantom value plan.

Realogy free cash flow totaled $421 million for the year, or $2.89 per share, due primarily to the strong gains in operations and lower interest expense. This was not impacted by the reversal of the tax valuation, allowance or book tax expense. Our financial leverage, which was 5.9 times at the end of 2012, improved to 4.6 times at the end of the year and was below the 4.7 times we forecasted this past November.

Next, I'll discuss our key revenue drivers for the full year on the far right of slide 9. RFG home sales sides increased 10% year over year in 2013, and average home sale price gained 9%. RFG's royalty per side increased to $276 in 2013, which we expect will continue to increase of the housing recovery.

In 2013, our 250 largest franchisees continued to perform exceptionally well and represented 60% of RFG royalty compared to 57% in the full-year of 2012. Due to the shift in mix of business, RFG's full-year 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% as a result of management actions as well as adjustments we made to the rebate thresholds for 2014.

RFG home sales sides increased 9% year over year compared to 2012, and its average home sale price gained 6%. As we have discussed previously, this difference in volumes compared to RFG, or even NAR, is due to NRT's concentration in major metropolitan areas and higher than average national sales price.

The general trend for NRT over the year was that growth in sides outpaced growth in price due to mix shift. A greater number of homes are being sold at NRT's comparatively lower priced markets.

For the first quarter of 2014, we expect to see overall home sale transaction volume to increase by 8% to 12%. Like NAR and Fannie Mae's forecast, we expect our first quarter volume to be driven primarily by average sales price. Based on closed activity in January and month to date in February, along with January and February open contracts, we expect transaction sides to be down 3% to 5% year over year and average sales price to be up 13% to 15% for RFG and NRT combined.

Inventory levels are still low and continue to put upward pressure on sale price as demand is outstripping supply. Still, the first quarter is seasonally our slowest quarter and is generally not a benchmark for full-year results.

At Cartus, initiations for 2013 increased 5% and referrals increased 15%. We continue to see growth in the affinity business and international relocation services, both of which generate low revenue per initiation, and domestic relocation services. Which is why our initiations are up without commensurate revenue growth.

At TRG, 2013 purchase unit volume increased 10%, which was consistent with NRT home sale gains and reflects improved capture rates. JRG's refinance title and closing units decreases 15% in 2013 compared to 2012, which was expected, given the lower refinancing trend. This will continue to be a difficult comparison in the first half in 2014. Average fee per transaction improved 10%, given the shift in mix to home purchase transactions from refinancing transactions.

Now, let's look at revenue and EBITDA for the business units for the full year 2013 as shown on slide 10. Our overall revenue growth of 13% was driven by NRT which contributed about 70% of the Company's total revenue for the year and grew by 15%. RFG revenue, which represents about 12% of total Company revenue, grew 14%.

Cartus revenue was down 1% while TRG revenue increased 11%. Revenue increases do not near transaction volume increases due to the heavy influence of NRT in our total revenue and the differing growth rates at TRG and Cartus.

EBITDA and RFG improved $84 million, in line with its revenue gains of $86 million. RFG's EBITDA margin increased to 65% in 2013 from 60% in 2012, primarily driven by higher revenue, lower legal expenses, primarily due to the settlement of legal matters in 2012, and reduced bad debt expense compared to 2012.

NRT EBITDA increased $41 million and its margin remain flat for the year. NRT's margins were adversely impacted by the decrease of $36 million in our equity and earnings related to our PHH home loans joint venture and overall commission split increases of 55 basis points to 68.2% for the year compared to last year.

Excluding the PHH Home Loans JV earnings, NRT's margins improved by 2 percentage points from 3% to 5%, showing the continued operating leverage in the business. As a result of actions management continues to take, we forecast that NRT commission splits will be approximately 68% for 2014.

As we indicated last quarter, PHH home loans -- our joint venture with mortgage originator PHH, has taken a number of cost-cutting actions that will act to stabilize its earnings over the coming year. However, we expect comparisons of the first half of 2014 will be difficult due to the strong refinance activity that drove JV earnings in the first half of 2013.

Cartus EBITDA in 2013 increased $1 million from 2012 because the revenue decrease was offset by lower operating expenses due to lower volume. In 2013, Cartus saw a decrease in employer sponsored relocation volume. This decline was offset by an increase in non-relocation referral business. Non-relocation referrals generate real estate transactions through our affinity programs and among our network brokers from which Cartus earns a referral fee as referring broker.

As the economy continues to improve and corporate clients' business prospects improve, we expect to see growth in our corporate relocation business. TRG EBITDA increased $12 million, or 32% from 2013, due to higher purchase transaction volume, higher average fees and an increase in underwriting premiums.

On the next couple of slides, we take a more in-depth look at incremental margins for the year at RFG and NRT. On slide 11, which relates to RFG, we've excluded marketing fund revenue since it has no impact on EBITDA. You can see that for the year after adjusting for that, the incremental margin for RFG was 100%.

The incremental margin benefited into 2013 from a decrease in legal expenses year over year. When 2012 legal expenses are normalized, the incremental margins for RFG was 80%. In addition, in 2014 we will continue to invest in RFG's business, which we believe will drive profitable growth over the long-term, but will modestly impact short-term margins.

On slide 12 you can see that NRT's incremental margin was 19%, factoring out the decrease in PHH Home Loans earnings and the year over year split rate increase. Looking at 2014, NRT has a number of technology initiatives underway that are expected to improve search engine optimization and help generate incremental referral leads and improved commission splits. While we believe this will modestly impact NRT's incremental margins in 2014, we believe the investment in the business will generate incremental EBITDA at 2015 and beyond.

2014's incremental margin will also be impacted by added employees and brick-and-mortar costs from the larger acquisitions completed over the past few months. We will highlight these beginning next quarter.

Looking at Q4 results on slide 13, revenue increased 3% and adjusted EBITDA declined 10% in 2013 compared the fourth quarter of 2012. As we indicated during our last call, results in the fourth quarter faced some challenging comparisons to the strength in the fourth quarter of 2012 from strong refinance volume and sales volumes, particularly at NRT, related to year end 2012 tax motivated selling of high-end homes.

In the fourth quarter of 2013, the 3% increase in revenue was heavily influenced by NRT sales volume growth of 4%, offset by declines in refinance related revenue at TRG. The EBITDA decrease was further impacted by a $15 million reduction in our share PHH Home Loans earnings in Q4.

Turning to other items on slide 14, we to continue to deliver our balance sheet at a meaningful pace. Our net corporate debt was down to $3.7 billion at the end of the year, and we ended the year with a 4.6 ratio of net debt to adjusted EBITDA. The benefit of $2.1 billion of net operating losses at the end of 2013 which minimize cash payments for income taxes until the NOL is utilized will help us enhance cash flow and reach our target leverage goal more quickly.

Moving to slide 15, here is some cash flow guidance for 2014. Capital expenditures are expected to be about $65 million. Cash interest expense is expected to be $240 million.

Working capital is expected to be a use of $40 million to $60 million. This includes a temporary use of about $40 million in funds to support our Cartus securitizations, primarily due to a single large group move by one of our clients. Cash legacy items are expected to be $10 million to $20 million.

For the full year 2013, the Company recorded an income tax benefit of $242 million that was primarily due to a $341 million release of the domestic deferred tax valuation allowance, partially offset by approximately $100 million in 2013 book income taxes. Going forward, we expect to incur a book income tax rate of approximately 41% for federal and state taxes; however, our $2.1 billion of NOLs will continue to shield us from being a significant taxpayer. We will continue to pay federal alternative minimum tax state and foreign taxes on earnings with approximately $10 million to $15 million estimated for 2014.

Turning to slide 16, our sides and price volume Q1 2014 guidance of eight -- of up 8% to 12% is driven by continue price gains. While we expect higher transaction volume will be a positive driver in the first quarter, it is important to remember that in the first quarter 2013, we benefited from a favorable refinance environment which aided earnings at our PHH JV and at TRG, which will not be prevalent this year.

Looking ahead at full year 2014, we draw your attention to existing home sale volume forecasts detailed on slide 17 from NAR and Fannie Mae. As you can see, as Richard mentioned, NARS forecasting of 5% volume growth for 2014 and Fannie is at 8%. While you can pick which one follow, it is clear they both point to continued gains in 2014.

Volume growth, along with strong free cash flow generation, will allow us to delever further in 2014 to get closer to our goal of returning capital to shareholders when our net debt to adjusted EBITDA reaches 3 times. Simultaneously, we will continue to focus on margin improvement while modestly investing in the business to enhance our profitability over the long-term.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

First question comes from Dan Oppenheimer with Credit Suisse.

Mike Tall - *Credit Suisse - Analyst*

Hi, it's actually Mike [Tall] on for Dan.

Tony Hull - *Realogy Holdings Corporation - CFO*

Hi, Mike.

Mike Tall - *Credit Suisse - Analyst*

I was hoping you could follow on those last comments about the industry forecasts for 2014, and kind of relative to your guidance for 1Q and some of the comments you made suggesting they're seasonally low, their weather impacts. We think things will get better.

Do you think, if you looked at NAR, if you look at Fannie Mae, do you think they are low right now? Would your expectation be that Realogy would outperform those numbers in 2014?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

That's always our hope. That's to be determined. This is Richard. We're not -- listen, this is the worst time of the year to forecast the year and in good and bad times. It's just -- given the seasonality in the business, it's just not the best time to forecast the year. It is somewhat compounded with the bad weather.

Listen, we think our volume guidance for the first quarter is the right range and at the close of the first quarter, as we see inventory levels build, will have a better feel for what the balance of year is going to look like. I think it stands to reason that between NAR and Fannie and also Freddie, that's probably about a range that they're comfortable with now. But that is going to be subject to all those dynamics that will play out over the next, certainly the end of this quarter and early part of the second quarter. To be determined.

Mike Tall - *Credit Suisse - Analyst*

Thanks. I guess on the 1Q guidance specifically, could you -- the numbers you talked about, breaking down regional for 4Q were really helpful. Can you help us understand if there's anything impacting whether it's geographic mix impacting that price forecast? Just that, again, it's a bit higher than some of the other data that's been out there.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

No, it's a great question. Real estate is starting to revert to the norm, which essentially means it is subject to local market dynamics, and that is apparent in all the price forecasting around the country. California, as an example, has some markets pretty severe inventory level declines, and that's reflected in the price. New York City is another example of that. So, it's a very spend market. This nothing that stands out as a national issue.

Price and sides are reacting to local market dynamics, population growth, income growth, job growth, unemployment rates, per capita income growth, all those things that are important to valuing real estate. We gave the color because this is going to become more and more apparent as time passes. And even in a stronger recovery you're going to see metrics that are going to change, literally market by market, state by state. And this is the beginning of that.

Mike Tall - *Credit Suisse - Analyst*

Okay, but there is nothing that's a big shift towards the west, given the tougher weather that you are seeing in other parts of the country?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

No. The northeast and the Midwest are clearly impacted by weather. This is an industry that is, in fact, impacted by weather trends. So, I don't -- other than that, I don't see -- and the inventory shortages, which we mentioned, other than that, I don't see anything moving the market one way or the other.

Tony Hull - *Realogy Holdings Corporation - CFO*

I would add one thing to that, which is, if you look at the NAR release in January, the first-time buyers were down to like 26%. They were at 30% pretty much all last year and they should be up 40%. I think one of the reasons why you were seeing the trend that we gave you guidance for the first quarter is -- which is a mix shift to higher-priced homes. There is fewer sides and there is the move-up buyer and et cetera, are buying more the homes. So, that's having a pretty dramatic impact on price, 13% to 15%.

I think in terms of if there's any national trend, I think is lack of inventory and first-time buyers are -- hopefully some of the things that Wells Fargo is doing and others are doing will help that as the year progresses. But at least as far as the first quarter is concerned, that's why you're seeing such an extreme spread between sides and price.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

That's a great point on the first-time buyer. They're noticeably absent from this stage of the recovery. There are a number of factors, we think, creating that circumstance. So, we are hopeful and optimistic that that will improve.

The other point Tony makes is a very good one. There are markets where you've had big run-up in price and as a result, price is moderating and it's not going to be a strong as other markets. So, that's not a national issue, not a structural issue, that is a local market issue. But I think Tony is correct.

The only structural issue is first-time buyer. Which we watch closely, and we started talking about that in the last half of last year.

Mike Tall - *Credit Suisse - Analyst*

Really appreciate the color. Thanks.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Yes, sir.

Operator

Your next question comes from David Ridley-Lane with Merrill Lynch.

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

Sure could you maybe describe the reason why you still have the declines in home sales on the West Coast? Is it that home prices there are stomping out the first-time home buyer, or is it just extremely low inventory? Or maybe would you put it down to the tough comp, particularly in California?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

It depends on the market in California. I think the state is a burden with very low inventory levels. Some markets that have had big run-ups in price, and that's reflected in their current pricing forecast for the balance of the year.

So, I think it's principally -- we don't think there's any other issue, it's not a structural issue. It's literally a lack of inventory.

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

Got it. And then you talked about inventory coming on -- inventory levels increasing in 2014. Is this a story of underwater homeowners getting back to positive equity, or is an increase more in the prevalence of move-up type buyers? Any comment -- color there?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

That's a great question. There is a little bit of that. CoreLogic produces a great report on the foreclosure inventory and also the shadow inventory. I think more relevant point is that percentage of homes emerging from the negative equity category. And that has improved rather materially year-over-year, and we make the assumption that some of those folks will get back into the real estate market. But none of our forecasts depend on that entirely.

It is helpful and I think valuable that the foreclosure inventory's declining dramatically, it's down 31% nationally as of the latest CoreLogic report. And I think what's particularly important about negative equity is about half of what it was several years ago. Those improving metrics will lend well to increasing inventory and purchase activity in the year. But none of our forecasts depend on that entirely.

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

Got it. Thank you very much.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Yes, sir.

Operator

The next question comes from Eli Hackel with Goldman Sachs.

Eli Hackel - *Goldman Sachs - Analyst*

Thanks, good morning. One, maybe just for Tony. You talked a little bit about the incremental investments, both in NRT and RFG. Can you just provide a little bit more context about the magnitude of some of these investments? You talked about lower incrementals, but is it just a little bit, is it a lot? Just trying to understand a little bit the magnitude there.

Tony Hull - *Realogy Holdings Corporation - CFO*

Sure. It's $2 million, $3 million for each of them, I think at the end of the day. Maybe a little bit more for RFG, but it's not a huge amount of money, and we think the returns look very strong for some of these investments.

A good example is HomeBase is being rolled out for our franchisees. So, I think that's going to be an important long-term driver of franchise sales, as well as retaining our existing franchise -- franchisees. So, I think that's a modest investment that RFG is looking for to roll out this coming year. I don't think we'll see a return from that this coming year, but I think it over the next couple of years, we will see a nice return from that.

They have some other projects, another initiative that they had last year, that they piloted last year that was very successful is they looked at their low quartile franchisees to [C21] and started focusing on them much more than they had in the past. And it yielded very strong results in terms of improvement of royalties that were paid from those franchisees, so they're stepping up the project this year.

That's going to -- that kind of thing, it's very modest investment in a couple of employees, that sort of thing. But driving those players can add up pretty significantly into improved EBITDA for -- and it also helps in that effective royalty, obviously, as those are mostly 6% players.

Those are the types of things that RFG -- the big story at NRT is really what I talked about, is they have three or four initiatives to improve the search optimization on the website and also to, we have talked about before, delivering leads to agents who specialize in dealing with what we call e-leads. And those sales associates are at more favorable splits, so that helps the net effective royalty rate. But obviously, it turns those leads much more effectively into cash as opposed to just leads that never get followed up on, that sort of thing. Modest investments and great return over the next 2 years.

Eli Hackel - *Goldman Sachs - Analyst*

Great, and maybe just one additional one. Clearly, the M&A environment for you seems to have heated up, franchise sales are doing very well. Can you give an overview of what your backlog looks like for an M&A and maybe for the full year? I think you commented in the past M&A recruitment could add 1% to 2%. Is that what you think the case could for 2014, or is it plus (multiple speakers)?

Tony Hull - *Realogy Holdings Corporation - CFO*

I think it's in that -- I don't think it's outside that range. I think it's 1% to 2% for both NRT and RFG.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Tony is right. I agree with that. The one point I would make is it's a strong pipeline. Brokerage firms have come to the realization that they weather the storm. They've improved their P&L, their balance sheet looks little better than it has historically, and they are at the age where they would like to exit.

We've been watching and monitoring that for quite some time. As you know, we've been inquisitive over the year. So, we know the market quite well, and it's a very healthy pipeline for 2014 and beyond.

Eli Hackel - *Goldman Sachs - Analyst*

Great. Thank you very much.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

You're welcome.

Operator

Your next question comes from Anthony Paolone with JPMorgan.

Anthony Paolone - *JPMorgan Chase & Co. - Analyst*

Thanks, good morning.

Tony Hull - *Realogy Holdings Corporation - CFO*

Hi Tony.

Anthony Paolone - *JPMorgan Chase & Co. - Analyst*

Hi. You mentioned your fourth quarter side of the price came in with your guidance, but the components of it were a bit different. Just trying to understand what changed and when. Because it seems like when you gave the guidance, you probably had some pretty good visibility and you probably just had, it seems like maybe December left. So, was it December that changed a whole bunch? Just trying to understand how quick the business maybe shifted on you.

Tony Hull - *Realogy Holdings Corporation - CFO*

I think what happened of the fourth quarter on sides we did want to get into this level of weeds in the script, but we sort of lost a business day. That's the way we look at it. Because we came in a couple of points up on side, we said it could be 4 points up on sides, 3% to 4% and every business day is about 2 points. So, we came in at 2 instead of 4, so we deduct -- deduced from that we lost about a business day.

And the reason we lost a business day was because, first of all, Thanksgiving was at the end of the month as opposed to it's usually a week earlier. Christmas and New Year's were on a Wednesday as opposed to a Thursday or Friday.

So, you put all that -- we just didn't -- we hadn't -- I guess for, whatever, seven years, we hadn't seen that kind of lineup of business days and holidays and stuff like that. So, we think that influenced the sides piece of it, but obviously, it also was impacted by the stuff we are seeing in the first quarter, which is low inventory and obviously, price came in a lot better than we thought. Not a lot better, but 1 point better than we thought.

I think those were kind of the factors that we didn't anticipate in early November when we reported -- we still had two months to go at that point.

Anthony Paolone - *JPMorgan Chase & Co. - Analyst*

Okay, got you. And then, it was helpful to walk through some of the puts and takes on the incremental margins and NRT, but I'm just trying to sum it all up. Does 2014 incremental margins for NRT, is it above or below the 19% for 2013?

Tony Hull - *Realogy Holdings Corporation - CFO*

Well, it will depend -- I guess it'll depend on how the year -- the one factor that we don't forecast having is a headwind is split rate because we expect split rate to be pretty modest. I think the one headwind we are going to have is still PHH Home Loans because the first half, we're still going to have tough comps in the first half. But we will continue to show it with or without that as we progress during the year.

These modest investments -- the only other thing I would point out, and I referred to it in the script, and we'll get more granular on it as the year progresses, when we buy two companies very quickly like we did with Frank Howard Allen and Martha Turner, you have the bricks and mortar costs of those acquisitions in. Like for the first quarter, they're going to be in as if we -- it's one quarter of their full-year fixed cost, but obviously it's a slow periods so that's going to -- you are not going to get a lot of revenue on that -- on those fixed cost. It's going to have a disproportionate effect. You are going to feel it, especially in the first quarter.

When you get to the second and third quarter you won't feel it as much because that's prime time for NRT. So, you won't -- so they're getting the revenues, you won't really feel the impact that much in the second and third quarter. But in the first quarter, it might be exaggerated a bit.

So, I think those kind of things, we will keep pointing those out as the year progresses. But I think that's -- overall, everything being equal, we think that the incremental margins are still in the high teens type area for NRT.

Anthony Paolone - *JPMorgan Chase & Co. - Analyst*

Okay. And then last time you had mentioned online traffic maybe as a potential early indicator of spring. Is that something that you guys have used historically? Has that been a good indicator?

Tony Hull - *Realogy Holdings Corporation - CFO*

It certainly was -- it's certainly something we watched last year, and our traffic was way up and obviously, our volumes up 18% last year, it was a good indicator. I think it's -- I think we sort of focused on it now because it's so -- the visibility, whether it was 2012 or 2011 or 2010, it's hard in our business to have, other than the forecast from the various NAR and Fannie Mae and et cetera, it's hard to have visibility beyond the quarter we're in.

So, when we're in this kind of slow quarter, it is probably the best indicator. I don't think in the summer or in the selling season we will focus on it that much. But I think in this year, it's the best thing -- in this year and any winter season of our business, it's the best thing to look at to see what consumers are doing and what they're thinking about and they're getting ready to launch activity for the spring.

It's usually about a two to three month lag between when they -- when the activity increases and when we start to see it and open and then obviously closes 50 days later or whatever.

Anthony Paolone - *JPMorgan Chase & Co. - Analyst*

Okay, great. Thank you.

Operator

You next question comes from Adam Rudiger with Wells Fargo Securities.

Adam Rudiger - *Wells Fargo Securities, LLC - Analyst*

Good morning, thank you. I was wondering if you could comment on any kind of impact you've seen from any regulatory changes from the GSEs. And then also on that same note, I think the NAR, when they put out their most recent press release, talked about some flood insurance issues impacting some buyers. I was wondering if you talk about if that impacted the market at all either.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Sure, I'm happy to. Let's start with flood insurance.

We are well aware of the importance of that to the industry. It affects you are if you are in those markets. Outside of that, it has little, if any, impact on you, which is -- as you know, the vast majority of our operations are not in those markets.

But that said, there will be a house bill introduced tomorrow on the floor. We think will be similar to the Senate version of that bill. There is a great deal of optimism on the Hill that it will be signed into law, and we can't predict that's going to happen or not.

But there's a lot of optimism that the flood bill will be reset and will not be as onerous as it is in the bill that was signed into law by Maxine -- as the Maxine Waters bill in 2012. So, we feel pretty good about that.

As to GSE reform, as you well know, very controversial subject. We see no chance, or little chance that there will be a resolution of GSE reform before the midterms. We are doubtful that it will occur before the presidential election in 2016.

I think the consensus of the people who follow this issue and we pay a lot of attention to, the consensus is that this will be an issue for the next administration, not the current administration. So, we see no near-term issue and by the time this becomes a law at some point, it will be a very different version from virtually everything you have seen floated in the marketplace. We have no near-term concerns at all with respect to GSE reform.

There are no other regulatory issues. The one issue that I hope will be resolved soon is the last remaining issue under Dodd-Frank, that's QRM, qualified residential mortgage, conclusion as to the required down payment. We are increasingly optimistic that the down payment requirements will not be as onerous as the original bill required, so we're encouraged by that. And I see no other near-term regulatory issues that concern us.

Adam Rudiger - *Wells Fargo Securities, LLC - Analyst*

Okay, that's helpful. Thank you.

Tony at couple of follow-up, just modeling questions. You mentioned some incremental higher expenses in the first quarter due to the acquired operations. Can you give us guidance on what may be operating expenses in G&A should be? And then can you help us what the GAAP interest should be as opposed to the cash interest? And while you're at it, just tell us if (multiple speakers)

Tony Hull - *Realogy Holdings Corporation - CFO*

(Laughter) We don't give guidance. So, it's hard for me to -- I just think -- there will be, I don't know, 10 additional offices that we had in this first quarter that we didn't have last, so you could probably back into some numbers there. And the interest will be -- the GAAP interest probably will be $10 million or $15 million -- excuse me, $20 million higher on the full-year than the cash interest.

Adam Rudiger - *Wells Fargo Securities, LLC - Analyst*

Okay. Thank you.

Tony Hull - *Realogy Holdings Corporation - CFO*

It's fees and amortization, that sort of thing.

Adam Rudiger - *Wells Fargo Securities, LLC - Analyst*

Okay, thanks.

Operator

Your next question comes from Stephen Kim with Barclays Capital.

Stephen Kim - *Barclays Capital - Analyst*

Thanks very much, guys. Encouraging news here on the 1Q.

I wanted to ask you a question about listings, because I agree with you, that that is one of the most interesting aspects of this sides we're seeing because we just haven't seen a lot of existing home inventory.

But typically in a normal year, can you give us a sense for what percent of the total listings that occur in a year occur in the first quarter versus, let's say the second quarter or the third quarter? Can you give us some sense of what that cadence looks like?

Tony Hull - *Realogy Holdings Corporation - CFO*

First quarter is the lowest. The only other thing I would point out is, you can track it on a national front, NAR put out monthly inventory numbers. It's encouraging that from December to January they went from, I think 4.3 months, which was staggeringly low, I think there were 4.9 months in the latest report last week.

So, the cadence is, it improves as the year goes on and then sort of cools off obviously in the fall. But I don't have anything -- we can pull something together on that, but I don't have anything.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

The only thing I would add to that, you look for the trend line in the first quarter. So, the strength of the increase in inventory will give-- be a strong indication as to how robust it will be in the second quarter and towards the beginning of the third quarter. So, we look for the trend line more than anything else, and again, Tony points out the NAR forecast, which is a good benchmark, if you will, for what's happening with listing inventory.

Stephen Kim - *Barclays Capital - Analyst*

Great.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

If you wanted to get more granular you can look at the state associations, they can become sometime a bit more granular. You can be market specific. If you look at the California Association of Realtors and a few others, they give you a more granular view of what listing inventory looks like in very specific markets. And that too can be a good research for determining what is going to happen to listing inventory in the first half of the year.

Stephen Kim - *Barclays Capital - Analyst*

Okay great. That's very helpful, thanks. The second question I had relates to the NRT incrementals. I guess a couple of things, one, when I'm hearing you talk about the incremental investments being made in, let's say the NRT business from -- I know you are working on the web initiatives and so forth. We also -- and we also heard you say that web traffic was up. What that tells me is that that business obviously comes at a much lower increment -- a much higher incremental margin, much lower commission split.

It seems to me that there should be some offset. Certainly you are making investments in the web, but you are also getting more web traffic, which should be an offset to it. So, I'm trying to figure out what the impact, obviously. Because you talked about some weakening impact on the incremental margin in NRT. And I'm excluding the PHH segment here.

Last quarter's conference call you gave a range and said if splits were flat next year versus this year you would see a 20% to 25% incremental margin range. I think after that you have sort of talked about an 18% to 22% range if you take into consideration inflation, and now today I hear you say high teens.

I'm curious, when you say that you're going to have these investments which are going to temporarily depress the incremental, are you talking about an incremental in NRT ex- PHH maybe below that 18% range in the first part of the year, and then maybe a little higher, but not up into the 20%s in the back half? I'm trying to get some sense of where you are expecting things to be if splits are flat.

Tony Hull - *Realogy Holdings Corporation - CFO*

Just to clear, 20% to 25% was all else remaining constant, and that's what we talked about when we finished -- so that's not only -- that's splits remaining constant, no salary increases. I think you had it right, but I just want to make sure. And then it seems like we got some pushback on using that metric because things don't remain constant, which is true.

So, with inflation, obviously we lowered it, in other things not remaining constant, we lowered it into the high teens. I don't think the incremental investments, maybe it's like 1 point of incremental margins. It's not a big -- these are not big investments, so it's not going to have a big impact.

Again, to my point before, I think the bigger thing we have to -- that we will focus everyone's attention on going forward is the impact of M&A, especially since we did two large deals on incremental margin. I actually think that's going to be a slightly bigger impact.

But we will keep you posted on the -- the thing you have got to remember is when we do an acquisition like Martha Turner or Frank Howard Allen, the biggest beneficiary of those acquisitions are -- is really RFG, because they get 6% off the top. It helps their incremental margin and obviously their royalty from NRT, but it kind of leaves the NRT system, right, that first 6%. And we're talking about a pretty low margin business to begin with.

So, you have those 10 offices, you have the expense. You have got to pay the agents, you have got to pay the 6%. So, you are not going to see, when we do acquisitions on NRT, it's going to have a little bit more of a negative impact on their incremental margin, but we get the benefit elsewhere at Realogy. We get the benefit at TRG from sides, we get the benefit of Cartus from referrals, we get the benefit, obviously the huge benefit at RFG from the 6% going over there.

I just think it's something, because we did two large -- they're not huge acquisitions, they're relatively small, but they will be impactful. And we will just keep you posted as the year progresses on what impact they're having at NRT and how they're benefiting the other business units.

Stephen Kim - *Barclays Capital - Analyst*

Great. That's very helpful. Thanks guys.

Operator

Your next question comes from Will Randow with Citi.

Will Randow - *Citigroup - Analyst*

Hello, good morning, and thanks for taking my questions.

Tony Hull - *Realogy Holdings Corporation - CFO*

Hello, Will.

Will Randow - *Citigroup - Analyst*

A lot of my questions have been asked, but I'm curious from the perspective of, and you talked about this in the past, based on the data you are looking at under the hood, when you see cash sales as a percentage of total US home sales as well as distressed and investor activity declining, are you guys seeing, I wouldn't necessarily say a benefit, but would you expect a difference in volumes for you relative to NAR data because of that shift?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

The shift away from investors and more towards cash?

Will Randow - *Citigroup - Analyst*

No, the shift away from --

Tony Hull - *Realogy Holdings Corporation - CFO*

It's a good question. First of all, we were 1 point -- our Q is a point ahead of NAR last year, and maybe some of that was because of -- we don't necessarily play in the foreclosure. We've never meshed up to the national foreclosure numbers just because were at the higher end in many of our markets.

So, as foreclosure has gone down, that's benefited us, so maybe that's one of the factors that impacted us being out performing NAR last year. I think as foreclosure goes down, it should help effect -- as that continues this year, should help us relatively. But obviously, franchise sales at RFG also helped them outperform NAR and Sotheby's in the mix being -- certainly helps us on price. So, there are a lot of factors out there.

The investor side is -- it is still -- it's an important developing industry, but it's -- we are still at 100,000 whatever units versus the 1.4 million sides that we were involved in last year. So, it's not that big a factor.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Will, the investment component of the market is just about back to normal, which is somewhere in the range of 19% to 20% of the transactions are investor purchases. And so that corrected rather quickly, and I think -- and bear in mind, that's not just institutional investors. That's literally mom-and-pop local companies acquiring and holding small properties for rent.

Will Randow - *Citigroup - Analyst*

Appreciate that. And then just sticking to the data, it seems as if winter impacted -- sorry, extreme increment -- inclement weather has impacted sales in some ways. Quantitatively, when you look at areas like the mid-Atlantic, could you speak to that by, for example, pending home sales actually improving while existing is declining because the backlog got dragged? And then are you seeing any uptick in, call it the recent weeks of sales?

Tony Hull - *Realogy Holdings Corporation - CFO*

I don't know about the mid-Atlantic specifically, but I can tell you its pretty -- we get obviously daily opens reports and we look at them summarized weekly by region. And you can see when there's a big storm in the Midwest, all of a sudden we're -- you can see we're down 10% versus forecast. And then the weather clears up and all of a sudden, a week later we are on forecast.

It's pretty amazing how it reacts. But it corrects, it's not -- it seems to be timing. It's not a permanent issue. It's just when the weather clears up, the activity ramps up. I think that is why Richard made a comment in his remarks that we think this is timely because we're seeing that kind of evidence that the minute the weather clears up, all of a sudden opens are right back on the forecast. Presumably, that will continue.

Will Randow - *Citigroup - Analyst*

Thanks for that, guys, and congrats on a great 2013.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Thank you, Will.

Operator

Our last question comes from Brandon Dobell with William Blair.

Brandon Dobell - *William Blair & Company - Analyst*

Thanks for sneaking me in. Is there any quantitative way or evidence you can give us to help us understand how much more efficient you guys are getting on lead conversions, especially through some of the e-channels? I know you mentioned some initiatives that you have going on this year, but I'm trying to figure out how much more sophisticated, how much better at conversions you've become in 2013 versus 2012, or maybe on a longer timeframe.

Trying to get at how efficient you could be with your marketing dollars or how efficient the agents can be with their marketing dollars.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

That speaks to the investments that Tony mentioned, both at NRT and also RFG. So, we are leveraging the investments we've made over the years and accelerating the prospective impact that those various forms of technology may have on not only our sourcing of leads, but more importantly, our closure of those leads. So, those investments are intended to increase the closure rate.

I think when you're looking at us or anybody in the business, there are some industry norms as to what the closure rate is. Generally speaking, it's fairly low. What we all try to do is figure out how to significantly increase that closure rate and thus, our investments.

We're fairly optimistic as to the prospective impact that that will have on our closure rates. We've not disclosed any of the specific investments for the obvious competitive reasons, but we are very optimistic. Now, if you want to model something, Zillow, Trulia, a variety of realtor.com, they all sort of predict the closure rates for the industry, and those are pretty good guidelines for how you might model the business.

Brandon Dobell - *William Blair & Company - Analyst*

Okay, and then final one, last quarter on the call you talked about some of the negotiations around individual agent commission rates and splits, especially at -- through the January timeframe, but also on anniversaries. Any color on how the negotiation of those conversations went in January, if there was any movement around those split rates that's appreciable for the market?

Tony Hull - *Realogy Holdings Corporation - CFO*

We are forecasting 68% as the split this year, so that incorporates all those -- were are still forecasting that. We haven't changed our view on that.

Brandon Dobell - *William Blair & Company - Analyst*

Thanks guys. Appreciate it.

Tony Hull - *Realogy Holdings Corporation - CFO*

You're welcome.

Operator

At this time we have no further questions. Are there any closing remarks? I'm sorry, you do have one final question. It comes from Michael Kim with CRT Capital Group.

Michael Kim - *CRT Capital Group - Analyst*

Hi, good morning, everyone, thanks for taking the question. Nice quarter.

Operating expenses came in lower than we had expected, and I was wondering if you would talk about embedded operating leverage. Just based on the composition of your Company-owned outlets, presumably most of that operating leverage comes from Coldwell Banker. Not sure if that's truly the case.

But are there certain geographies that provide more incremental margin contribution? Is it just the higher priced coastal regions or would it be more focused on the lower priced Midwest region based on where we are today? How should we think about this?

Tony Hull - *Realogy Holdings Corporation - CFO*

The incremental margins are definitely better, kind of from the Midwest and east than they are from the Midwest and west just because of the competitive environment in those markets. And you've got to pay splits to the local market. You can't try to vary from that to be competitive in that market.

It is just historical that the splits are more favorable from the Midwest to east that they are on the west coast. If we grow -- obviously the incremental margins helped by growing on the east coast rather than the west coast.

Michael Kim - *CRT Capital Group - Analyst*

Okay that's helpful. Thank you. And you guys talked about mortgage credit availability. I know you cited Wells making some changes to its mortgage lending standards. Do you expect others to follow suit?

With refinancing activity down, do you think other originators are going to look to modify their standards to support mortgage credit availability, and you think the timing of these changes may be impactful to the prime spring selling season?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

I think the most important point you make is timing. With the substantial decline in refi volume, most lenders are scrambling to replace that book of business with purchase money. So, they are, I think, becoming more reasonable and practical and certainly more normalized in their underwriting standards.

I think that, coupled with the last remaining issue under Dodd-Frank will make it, I think more practical underwriting and thus, more credit availability. To be determined, but we see people like Wells Fargo becoming pretty aggressive trying to replace that refi volume. We expect other lenders to follow.

Tony Hull - *Realogy Holdings Corporation - CFO*

And average FICO score that Sallie Mae reports, they continue to creep down. It's painful to watch, but they were down to 727 in December. So they're going in the right direction, but we all wish it would happen faster. It is happening, slowly but surely.

Michael Kim - *CRT Capital Group - Analyst*

Understood. All right, great. Thank you very much. I will follow-up with more questions later.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO, Pres*

Thank you, Mike.

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

We thank you for taking the time to join us on the call, and we look forward to speaking with you over the next quarter. I would also like to tell investors that we will be hosting a Realogy investor day on Friday, May 9 at our headquarters in Madison, New Jersey. All who are interested in attending should contact Jennifer Pepper in our Investor Relations office. Thank you.

Operator

Thank you for participating in today's conference call. You may now disconnect.
