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Realogy Holdings Corp. (RLGY)

Stephens Fall Investment Conference

CORPORATE PARTICIPANTS

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Ryan M. Schneider
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MANAGEMENT DISCUSSION SECTION

John Campbell
Analyst, Stephens, Inc.

All right. Good morning, everyone. We're going to get started here. Thanks for joining us. We got Realogy here joining us. I don't think they've done a whole lot of conferences in the past. So, we're thrilled to have these guys. Fairly new CEO, still Ryan Schneider and then we've got the two IRs as well with Alicia and Daniel. So, really happy you guys could join us. We're going to make this session as interactive as possible, so definitely wants you guys to come out with some questions.

Now we're going to let Ryan kind of kick us off with a business state of the state. I'll do one or two prepared questions, and we'll see if you guys have questions and just kind of get this thing going.

So, with that, Ryan, go ahead.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

Thanks. It's great to be here. Thanks, everybody, for coming. I'm happy to take any all of the questions that you have. It is an interesting time for the housing market in terms of kind of where it's going to pivot and where it's going to go. The first half of the year was frankly pretty strong for us and for a lot of our competitors, but it was all coming from price not only from transactions. And then in August, everything started to slow down and September was an incredibly challenging month. And kind of how this market transitions I think it will be pretty interesting to see. Do we get to a more balanced sides and price plays.

The West is kind of leading both the challenge and this transition. And so I think we can – we all probably have our own different views about where the market is going to go. I think that's going to be a critical determinant right now. We also live in a world where the competition for agents and just the competitive intensity in the brokerage business is incredibly high and you see that through acquisition multiples, you see that through agent recruiting, you see it through agent and commission challenges across the board. And we're – all kind of confronting that. But I like where Realogy is even if our results so far this year have suffered with some of the kind of factors that

I just talked about – you know we still have and are kind of got the industry-leading market position in both owned and franchise brokerage. We make over $0.5 billion in franchising, which I think gets kind of under talked about kind of in our model and I have a strong hypothesis not just talk about it more but to grow that business including launching a couple of new franchise brands going forward. We've got the brands that we have which seemed to play well in the market. And again, we're going to keep expanding them on the franchise side.

And then finally, there is the kind of mega trend affecting this industry albeit I think behind other industries by a few years. What's happening with the use of technology and data to both enhance agent productivity make agents more efficient and to help companies in this industry kind of run better. And you know we got the technology and data scale I think to be a winner in that. I don't think anyone in this industry Realogy included has either great technology or great use of data to date, which creates an opportunity for whoever can kind of win that race and get there first.

And I think we're increasingly living in a world, where bigger companies with the data scale and the technology scale have as much or more chance of leading that race and doing the things they are going to drive value in this case for agents as much or more is kind of some of the disruptors do. So we're excited on what we're trying to do there.

Finally, even in a year with a little bit of challenges on the owned brokerage kind of P&L side, our free cash flow remains strong. Our balance sheet pretty spread out and we've got $1.4 billion revolver, so we got a deep liquidity. And we've been trying to get capital back to shareholders. We see the M&A environment not to be very attractive right now with the multiples and given where our cost of debt is around 4.9%.

We've thought that the right thing to do is to try to get capital back to shareholders and have already announced that we're going to continue to do that here in the fourth quarter. So it's – it's a pretty intense and incredible time to be in the real estate industry and to have joined at this time, but I'm excited to be here and I'm excited by what Realogy has in front of it, the potential for the future. And I'm excited to take whatever questions are here, including the ones from anyone in the audience. So with those opening remarks, I'll turn it back over to you.

QUESTION AND ANSWER SECTION

John Campbell
Analyst, Stephens, Inc.

Q

Yeah. So, before we get into, I guess the company and fundamentals, tell us a little bit more about your background, why you elected to join Realogy, some of the – I guess early positive, negative surprises you saw kind of in early stages?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Sure. So, I'm actually an economist by training. I've got a Ph.D. in Economics. My thesis advisor was actually Robert Shiller, who won the Nobel Prize, and he does all of his work basically in housing. And so I actually have some roots in the housing industry from an academic standpoint from the 1990s. I had a career at McKinsey and then at Capital One for a very long time, and I was really excited to come to Realogy for a lot of the facts that I mentioned, the chance to kind of lead a market-leading company with great brands, technology, and data scale and a strong kind of free cash flow. I thought there was a lot that could be done both with the company and in the industry that we're in here.

I have been truly, truly struck by the competitiveness of this market, and just how low the barriers to entry are. I knew that intellectually coming in but kind of the every single day kind of competitive competition for agents, for listings, for technology leadership, it is very different than many of the other industries that I'm sure some of you have covered in the past or look at today or that I come from.

And – but it's exciting, because on the flip side, we are spending our time with regulators or those kind of issues. We're spending our time focused on the agent, focused on the customer, focused on the market, and it's just a fascinating industry with great entrepreneurs out there as agents. And in a world where there is a lot of talk about technology and data including for myself, this is a people-driven business and Realogy needs to be a great

agent focused company that's great at technology, being a technology, the company alone in this industry actually I don't think will drive success, given just how much the agent continues to play a role even though we all would have thought over the last 30 years that, that might go away. The stability of it is phenomenal and so we stay very focused on that.

John Campbell
Analyst, Stephens, Inc.

Q

Still on that the – probably in the third quarter [indiscernible] would you understand what was the set of results they were trying to achieve and why [indiscernible] ?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Sure. Yeah. And what's your name by the way?

John Campbell
Analyst, Stephens, Inc.

Q

John.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

John, well thanks for the question, John. Look, I think the board recognized that Realogy had kind of all the subject matter expertise in real estate you possibly could have and still does, even with some of the leadership changes that I've had to drive and what they realized that there were three things that would be very important for the company. So, one was to really drive kind of operational excellence just in pure execution. And I've got whatever track record you want to assess on that, but I think that was one thing that they were absolutely looking for in the leader of the company.

Second, I think they did recognize that there is a big opportunity and a big future in how the technology and data transformation of this industry is going to work. And if you've gone through transitioning a big company on the technology and data side which I've had the luxury of being a big part of in the past, it's a very do – it's not an easy thing because you get legacy systems and stuff like that, but is it a doable thing and again, I believe the world is increasingly shifting the competitive advantage to the big companies that have the data, that have the technology. So, I think they were looking at that.

And then third, I think they wanted kind of a fresh strategic pair of eyes who would come into an industry that is probably easier to learn than some other industries and drive – and kind of be willing to kind of reassess what's been done and make changes whether it's, being willing to open it up and let franchisees do multi-brand franchising, which we have done whether it's, take a fresh look at should we buy or sell different parts of the company that I did in kind of the first half of the year or even kind of the pretty big shift away from the acquisition strategy that bluntly didn't drive a lot about, didn't drive operating leverage and was really just covering up for loss of underlying market share.

So, I think those were the three factors that I've kind of gotten is feedback from the – from the board is as what they like about bringing in someone with a different background. And I've tried to bring in a mix of people especially in the technology side who are kind of best in class at what they do even if they're not from the real estate industry, leverage some real estate veterans at Realogy and then a few cases like the leader of our relocation business, look for the best kind of in that case kind of a private equity company CEO I could find to come in and run a business on that operational excellence kind of approach.

John Campbell
Analyst, Stephens, Inc.
Q

So related to that. I mean obviously operational excellence being effective, basically executing underlying leverage, right. And then somebody with a fresh advice and somebody is willing to make the change so you come in, you've done tons of realignments, it seems like there's lots of new leadership positions that you've announced. Maybe walk through like a handful of those and then talk about $50 million of cost reduction efforts that you...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.
A

Yeah. So if you think about the first couple of months of the year when I started in this role there were three or four different objectives that I – you want to have kind of as a new leader I tried to have one, was you want to make sure that you've got the best talent that you can get for what you're trying to accomplish. And for me that was the need to kind of go outside on the technology front, find a new Chief Technology Officer and a few other kind of key technology roles, it was find the best couple of folks within the company to elevate on the real estate side who I thought could actually achieve the right kind of operational excellence kind of bar.

And then third, look for like I said before some other outside talent you know for our relocation business. So there was some thinking around that. Second thing was to kick-off a lot of different strategy work that kind of came to fruition in our June strategy offsite with the board, most of much of which we'll never see the light of day, because it was stuff we decided not to do, but that includes you know the questions of you know which pieces of company are core which aren't some of the parts all those kind of things as well as you know should we go down the acquisition path should we stay on also we good on the organic growth path which capital allocation, so there's a whole set of strategy stuff there.

And then the third piece was to go out of the gate relatively strong with at least something on the restructuring side to make it really clear that part of you know getting operating leverage and driving that kind of operational execution to John's question led me to answer included you know having to focus on cost, and we went out with kind of $50 million number for this year. Basically that offsets inflation plus a little bit more. Some of that this facilities and closed offices some of that is people, some of that is vendor things and it cut across the business and it was both as much as it was about actually you know getting those dollars and actually changing some of our cost trajectory in a few areas.

It was equally about sending a message to the company about here's how we want to operate on this dimension. And you know we want to be proactive on these moves not wait until you know we're kind of forced into them. And so those are three things on you know on talent, on strategy and on cost kind of right including the restructuring right out of the gate that we're I think important things. The internal symbolism even more than anything that comes to you as owners or potential owners.

John Campbell
Analyst, Stephens, Inc.
Q

And so some of the impact of the $50 million, it seems like Cartus clearly was a big driver.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.
A

Yes.

John Campbell
Analyst, Stephens, Inc.
Q

And a source of those, I guess calls efforts. What other segments have been impacted? What segments do you continue to look at, as I think additionally just kind of a starting point for the $50 million, do you expand this over time? It sounds like you're sending the message, but any additional points...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.
A

Yeah. Cartus did a really nice job and was the one business that probably had the biggest impact on their P&L, on a relative basis was Cartus, because I think they went deepest and they needed to go the deepest given their revenue trends. The other place where we actually did a lot, even if it doesn't, it's been kind of swamped by other results is what we did in the own brokerage business around kind of office closures and some of the cost reductions there, we're going to need to do more of that. We have 700 offices, the world is changing and we're a little bit handy – we're a lot handicapped by just kind of the lease timing that we've inherited and that we have.

But when offices come off lease, we're not doing a lot of renewals and you should know that. Any of you who live up in the Greenwich area, we just took our two Greenwich offices and kind of combined them into one, that one is smaller than either of the other two. We just relaunched that office. That's going to work out well on the P&L side and on the agent's satisfaction side. And so the office footprint I think is an opportunity how big it is and how deep we go in that is kind of a question bluntly depending on how the market goes. Because when you do the office stuff you do sometimes have some revenue kind of hits on that vis-à-vis agents and so you've got to really be balancing that and in a tougher market you have more room actually to do more of that. In a better market, maybe you want to be a little conservative and go less, but that's probably the biggest bucket that even though it's going to be swamped by other results was an important piece of the $50 million and it is probably

a more important piece of the future than people might think?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.
A

Yeah, absolutely. So, you guys have talked about kind of real estate office footprint or kind of saturation of the office footprint. But I think you guys have said about 67% or so is occupied, do you mage to a particular number over time, what do you want that...?

John Campbell
Analyst, Stephens, Inc.
Q

Well, this is one of those examples again back to John's question of kind of how you get operating leverage. A year ago, at the start of the year, I think we were at 64% occupancy in the offices, we're right now at about 66% or 67% and that's because we've grown our agent population a bit, which is good because we've kind of been trended in the other direction on both of those metrics. But it's just an example of where, if we with an organic growth focus can get more success on the top line in terms of agent recruiting and growth, it's not like we have to add cost there, right. We have plenty of room. We could get that number up into the 90s before we'd actually feel any sort of pain.

And what, we all know the world is changing like people desire to go and sit in an office is less and less and less. And our agents work best when they're out there with clients. But having that anchor point does actually matter often for them and for clients, but it's another reason why I think we can subject to just the geographic kind of limits have over time fewer offices, drive that occupancy higher. But the best way to drive at higher will be actually to succeed on the positive revenue growth, recruiting the retention side with different innovations there than just by reducing the denominator. But we're still going to be focused on both.

John Campbell
Analyst, Stephens, Inc. Q

One more for me and I'll kick it back to the audience. Going back to the, I guess the board the offsite meeting you guys had, you talked about discussing what's core what's not?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp. A

Yeah.

John Campbell
Analyst, Stephens, Inc. Q

We've had lots of questions in the past and still today from investors around splitting up the business.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp. A

You're right.

John Campbell
Analyst, Stephens, Inc. Q

Could there be potential spinoff opportunities, clearly from a multiple standpoint. You can see the rationale right like the franchise business

the franchise business would definitely get a bigger multiple and RT would go over, right? So, is it core for you guys? Can you maybe walk through why you have elected to retain it, why you want to keep it together?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp. A

Sure. Yeah, absolutely. We looked at a lot of different options there. It's – like I said, last year we made about $560 million from our franchise business. We're on a similar trajectory this year. And obviously, our company doesn't get any multiple on that even though that exists and that's fine. But, the number of people who have asked me the question why don't you just get rid of the own brokerage thing and reduce your direct exposure to real estate. It's a very good question. The challenges and what I still hunger for both when we've looked at it ourselves and we've had outsiders. On the banking side take a look at it and even when we've asked big franchisees and others to look at it is we've got a few places where we're a little bit trapped in what way. I think most people miss on it is of that $560 million franchisees, we make $300 million of it from our own business.

So we charge ourselves a 6% royalty fee and that generates $300 million of EBITDA for us and our average royalty fee to our franchisees is about 4.4%. And we can charge ourselves at 6% because it's us, but it's also good to charge at 6% because it sets kind of the price that we start our negotiations with on the franchise fee side. So there are some good reasons to do it. But it's created this interesting dynamic and I know some of the restaurants have the same thing which is, if we did sell our own business – our owned business or try to franchise it to someone, no one's going to pay a 6% franchise fee and we've tried. There is two geographies in the U.S. I tried to sell in the first half of the year. And the issue actually comes down to – of the business of that size maybe look at our tables that are public.

The actual franchise fees someone is likely to pay is like 3% or even less. And so whether you use the 4.4 or you use the 3%, there is like $150 million to $100 million of EBITDA, that could just, would walk out the door if we just try to find a way to refranchise that and have that franchise be reset to a market rate. We get a little bit and then also we're pretty integrated on our title business with our own business and we get a lot of benefit from home field advantage on that, same thing on the relocation business.

But you got to find someone who wants to buy it and can buy it. You've got to find someone who's going to franchise it instead of keep it and put it in their own name. You've got to find someone who will pay a franchise fee and how much are you willing to discount on that versus the 6%, it's going to be a lot. And then you actually have to make sure that someone will run it at least as well as you've run it because if they shrink it, then you lose that franchise revenue.

Realogy had one example about in the last decade where they actually did sell a piece of the business and ended up having to buy it back because the buyer didn't do a good job with it and the economics just kept shrinking and shrinking because the franchise fee that they paid which was nowhere near 6%, just kept shrinking and the economics just turned out to be terrible.

So we're open to a lot of different things here. We are very integrated. Our title business benefits a lot, but we've taken hard looks at this and what it really means is, we've got to be on our front foot and we should be on our front foot much more actually getting operating leverage from the own business that we have. It is disappointing in the results and even though it's a challenging market and we are overexposed to New York and California which are two of the harder markets, but still we've got to get better operating leverage there and I think it's there in terms of organic growth, in terms of what we could do with technology and data to help our agent recruitment and retention.

And boy, if we did that in any sort of kind of normal housing market, we should be able to not just reverse it to get some positivity on the trend that we've been dealing with here, but the – but – but I still hunger for someone to actually have a great idea of how to do the refranchising kind of thing. And again I know a bunch of them – I've talked to people actually at the quick service restaurants who they kind of, they charge more and rent often for their own proper – for their owned properties effectively to themselves same kind of phenomenon makes it hard for them sometimes to franchise those things when they want to. We're in a little bit the same conundrum, but we look at it and we assess what we think we can do organically and the opportunity, and we like at least the approach we put out for right now.

We're always open to changing if marketing conditions change or creativity kind of rears its head somehow. But I get that question a lot. So, thank you for asking and I'm a listener and so if people have creative ideas I love to hear them. But we've – we really chased that went into the corner a few times and it's – it's – it's been a very hard one to come up with an economic thing that would be good for any of our owners to kind of go down that path especially given its low priority thing and like I said when we've done it in a couple of regions, it's – it's – it's been very, very hard to find something that you guys would think is a good idea.

John Campbell
Analyst, Stephens, Inc.

Q

That's helpful. Yeah?

Q

What are your expectations for splits [indiscernible] (00:21:09) seen it stabilizing and what do you think is trending up over time?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

I think they're going to keep trending up a little bit over time, our splits kind of, we had about three years of no split increases and we lost a lot of agents. We lost a lot of market share, and so we've had to have a lot of violence on splits in the last kind of 18 months in particular to try to get back to the market. I think we're pretty close to being back to the market, and you can see that our increases have started to decline on a quarter-to-quarter basis and I'm public that I think that will continue, I don't think it's going to end up some day at zero unless we do have a housing downturn. Housing downturn would help all brokers get some of the market power back on agent commissions. But my consistent message is odds are moderating, but I think in this industry there is still going to be a bit of upward pressure on splits. But I look a lot less violent than ours look at the last few years or some of our competitors of what go over a longer period of time.

And some of the things that we need to do better around the technology we provide agents, the leads and the data things like that will actually should be able to help against that headwind because splits are just going out because agents are making more money all right . I mean splits are going up because agents are taking higher splits and they're paying others to run their business. They're paying for online advertising, they're paying for technology, they're paying for coaching, they're paying for a lot of things that brokers could be providing them but typically aren't and especially a large broker like us with our scale and some of our assets should be providing more to them.

Splits are also going up because the team phenomenon is out there I don't think that genie is going to go back in the bottle. But that's good because teams do drive higher productivity. So we like teams. And so they're still going to be I think some upward pressure. But it shouldn't look anything like the violence we've had in the last 18 months and again ours is continuing to moderate quarter-over-quarter. And I'm happy to get into the split thing and the market forces as much as folks want though it gets incredibly detailed and boring potentially. So I'll let you guys ask.

Q

Yeah. I'm going to ask [indiscernible] (00:23:21-00:23:26)

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah.

Q

[indiscernible] (00:23:27)

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah. Well, I mean the commission for agents is intense. And in every market or nationally in a case or two there always somebody who is making offers that look on economic everybody else and

in every market or nationally in a case or two, there is always somebody who is making offers that look on economics everybody else and there – in some ways, there is nothing to do about that except live with it and kind of don't make dumb decisions and follow someone down that path even if there's a little bit a near term pain. But we retain about 94% of our top two quartiles of agents, that's about 90% of our GCI and that's pretty good.

I mean that's about where we want it to be, any higher than that we're probably over pain. And I said, like to talk about we've kind of grown agents about 1% year-over-year in our owned business about the same in the franchise business that's good in terms of treading water but we got to aspire for more there. The bigger phenomena I think than the recruiting in many ways other than a couple of these kind of competitors doing things kind of out at end of the bell curve. The bigger phenomenon driving up agent commissions is actually just your own base and the forces that I just mentioned.

So you look at the amount of spending that agents now do in terms of online advertising. If you take zillow.com and realogy.com, Zillow makes whatever $750 a year million on – from agents on agent advertising. Five years ago, that was almost zero, right. And three years ago, the average agents spent $3,000 on Zillow and now they spend $9,000. And so as agents are paying Zillow or they're buying third-party technology around lead generation or social media stop or whatever to run their business, they're demanding a little more from us, so they can pay those other people and again we should be doing a better job of providing more to them as part of our value proposition to blunt some of that. But that, there it's – the retention kind of cost of existing agents is actually I think contributed more to the increase than just the people paying more and poaching each other's agents even though that is a very intense thing out there.

Q

Do you think there is an opportunity to partner with Zillow or some of the other data providers, if you think it's better to source...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

I mean it's a really a mix. I mean, we do all kinds of stuff with is Zillow today. Zillow's kind of in that frenemy zone. I think not just for us but for our agents and for brokers. Actually with our agents actually Zillow's in the enemy zone. Our agents say all the time, why don't you do something to put Zillow out of business. And my answer is that window was like seven years ago and the industry missed it and so we're going to have to deal with it. But we do things with them all the time. It's interesting though that they – we have very different types of data, right. I mean they just dominate consumer online search, but something like 80%, 90% of real-estate transactions still happen through an agents' sphere of influence, not from consumer online search, even though the consumer has done the research there.

And so they have this pool of consumer online search data that's really valuable that they leverage. We have – we have the actual kind of agent and customer interaction data, transaction data, listing data, open house data kind of stuff that covers a lot of things that Zillow doesn't. And while we've actually had many conversations about putting our data together, it's actually not clear what we would do together with putting the data together. And so – and look they don't want to open up somewhat they do to us. We don't want to open up somewhat they do to them. But we have – four or five places where we work pretty closely together, but core data sharing actually is probably one of the biggest issues, whenever we do something with Zillow to make sure that we both have some pretty strong Chinese walls on data, because we know, we both know how valuable the asset is, but it's so much more valuable to each of us separately. We don't want to give it to each other frankly.

Q

Four years and I think the relationships with Zillow...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

It's less than 20 now than it was five or six years ago, because bluntly our industry created Zillow by giving Zillow the listings that we have, right, and we still do that today. But it's gotten less, because Zillow is increasingly going direct to the MLSs. And within a few years I think they have like 70% cover to the MLSs now. In a few years, they'll be at 100% coverage and then they won't need any listing data from brokers. And so that dependency has been declining or keep declining. On the flip side, the agent interactions will – I think continue to be intense because they are such a dominant presence. I mean, that's why when agents say, we should get this – just find a way to put Zillow out of business, because agents don't like paying Zillow, they don't always think they get the great returns for it. We show – I'm like, look guys, there are like three times as big as the number two, [ph] reorder.com. And so, they're unlikely to go anywhere.

So, the listing dependency or the data dependency will be less in three years and probably won't exist anymore. But that hasn't really been a huge value driver for them the way it was five years ago when they absolutely depended on it. And then I think the other things will probably continue to be about where they are, again they own the consumer search on line and that's powerful. But we own all the other stuff or feed brokers like us own all the other things, which is actually where 80%, 90% of the transactions come from. So I think they're going to keep doing well what they do. And when people say will Zillow become a broker, my answer is I don't know. But if I was them, I sure wouldn't, because bluntly they seem to have the high margin parts of the business right now. I don't know why they want the lower margin parts of the business that we and others have, but that is a strategic thing that we watch. Could they turn into that kind of direct competitor, but that would be a real appending of their business model. So, I think, we'll end up being frenemies in three years also, but maybe a little less integrated than we are today.

Q

You've talked about technology and data?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah.

Q

Can you give some examples on what you think will be the first way...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah. So, I'll just give you some examples, some of the steps that we've done and you know the market will judge how good they are in terms of agent retention, agent recruiting, and change made in agent productivity. So at the start of the year we tried to step back with some of our new technology leaders and engineers and focus on some high priority products that we think will help make agents either more productive or more efficient.

We started piloting four of them by the end of April, we killed one of them pretty quickly, and with the other three are actually all out there, and a couple have been expanded to run the whole population. Second you know we invested in a couple of technology companies to provide, one is lead generation, the other is online notarization to support our agents and their customers. The lead generation is an increasingly powerful thing. Obviously, the more we can do with that that would be great.

And then the online notarization is trying to get ahead of that, kind of digital closing experience that you know we have you know $1.5 million of every year and a ton of them are in our entitled business and so we've now got those two out actually working with a subset of our agents, not 100% yet, but those two are out live and then the last quarter we did a partnership with Home Partners America that we're going to pilot in three southern cities, that's about arming our agents with a cash offer for the house. So if the homeowner wants to take an I buy your offer, they have it.

Our agents will get to be part of the buying of the house and then they will sell the house or home partners. They will still get a commission. The commission across those two things will look about like a normal single house commission for them

The commission across those two things will look about like a normal single house commission for them, which will make them very happy, because it's – there is almost no work to those compared to a normal thing. We'll get our share of that that and home partners is putting up the capital, of which they had a lot to do this that's their business, if they're very good at. And so we need to keep doing those kind of things. The one thing we haven't done that I would have predicted at the start of the year we would do is that, we would buy a technology company or to a small line to take their product and give it to our 200,000 agents to take some company's product and go from zero to market to the 16% we cover.

But frankly, when we've looked at a lot, but it gets back to my opening comment that actually it's very hard to see anyone with real distinctive technology in this industry, both in big brokerages like us but also even among many of the startup things that are trying to serve this market, because if we could. If I found a couple that I thought were good and would be worth sharing with 16% of the agents out there, we would have done it. We've got the free cash flow to do it and there's a lot of options out there but it's – it is an interesting market and with a little less technology forward evidence than I would have thought there was at the start of year. So that's the one thing we haven't done.

John Campbell
Analyst, Stephens, Inc.

Q

So, on executive compensation, can you just walk through kind of what the performance targets are? What you guys are kind of managing to and then maybe if you can get down to maybe like the regional, like the manager level like what is it revenue, is it retention into EBITDA?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yes. Okay. Yes. So from an executive standpoint, everyone including my own bonus is a function of our annual EBITDA against the target that we and our board set this year. You won't be surprised to know that from our – with the guidance that I put out last week that nobody's getting paid a lot this year that's for sure. And then from a

long term standpoint, a few folks including myself have some have options but most of our, including my own long-term kind of compensation is anchored in performance on a TSR metric and a free cash flow metric. The TSR metric, given our stock performance not just in 2018 but in 2017 and 2016 has paid out at zero for the last couple tranches, the tranche coming up in this January or this first quarter of 2019, that'll pay out of zero also.

Our free cash flow metrics done better than that because we had generated a pretty robust free cash flow, that's paid out or will pay out kind of between 65% and 100% of its target. And so, those are the three big performance metrics that we have.

If you go down to kind of a regional or branch level, life is a little bit about everyone thinks they can do compensation and move plans around a lot in human behavior. At the end of the day, we mostly pay people in the past on the profitability of their office period. And the shift that we have made this year is to actually shift the compensation away from just the profitability office to more of it being around the actual growth of the office in terms of agent recruiting, retention and actually the top line growth. In the world we live in with the ability to actually get operating leverage, our path to success does need to be driven by better organic growth than we've had in the past.

And so, we're going to focus more on that that's part of the tech and data stuff, it's part of the different pricing structures and commissions. We've got to create an environment where we got an easier chance to recruit and retain people in than we had in the past. And so, we're shifting the incentives on that. There are occasionally lifts. There is a small piece just for transparency for 2019 that we will incent a little bit like the regional level Dallas or Austin on things like title and mortgage capture, but those are pretty small. The core thing in the past has always been just office profitability. But what that's led to is a lot of offices that are profitable, but static or even declining a little bit.

And we need to get to a situation where we're much more incenting growth out there. And that's the big change in our kind of regional/branch manager level compensation. So those are some thoughts on executive comp and branch level comp. I'm happy to talk more if that's sort of the question.

John Campbell
Analyst, Stephens, Inc.

Q

No. That's very helpful. So back to the splits, I know there is a lot of kind of nitty-gritty below the surface moving parts there, but you did sequentially decrease splits.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah.

John Campbell
Analyst, Stephens, Inc.

Q

How much of that, if you can just maybe do an elevator pitch of like what drove that? Is that seasonality, is that regional mix shift?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

So, it wasn't really regional mix shift or seasonality. Frankly, what it was is – a lot of what it was is just kind of – kind of catching up to just kind of giving to market. I've told this story before and you guys can see in the data that our splits were basically flat at 68% for about three years, but we lost 300 basis points of market share on kind of the same-store sales basis.

We disguised a little bit of that with acquisitions, but even with the acquisitions, we still lost market share and we lost a lot of agents because we were pretty far off the fairway. In the last 18 months, we have gone to try to get to the fairway. And that's been both with existing agents, people we recruit and there's been a little bit of headwind from the new development business contributing to that. It's kind of pause here in 2018, but most of it is literally trying to get there. And now that we think we're there, the year-over-year increases are joint going to be less because the biggest piece of the year-over-year increase for example was in Q1, by Q3 we had more of it behind us for example, so the number was about half of what it was in Q1 and that trend is going to continue to moderate.

And then my belief, because we're net positive on recruiting now, we're neutral though up a little bit on market share and our retention of top agents is in the 94% range, not the 90% to 92% range like it used to be that we're kind of now – in 2019 going to be more just subject to the market forces that David's kind of question asked about, which I think still is going to push the number up for everyone in the industry including us, but it's another – but we – if we can get on our front foot from an organic growth standpoint and do a better job driving agent recruiting, retention helping on the headwinds with better technology and lead generation and data insights like, we can fight that somewhat.

And the revenue growth, higher splits are not bad if we had more – if we could drive a little more of the organic growth because of the leverage in the model, we could pay a higher split in the lot of places and make more money if we had a little bit more growth with it and that getting that if is kind of our core challenge and a lot of what we have to focus on in both good and bad housing markets.

John Campbell
Analyst, Stephens, Inc.

Q

So through the drivers of splits that I don't think get too much attention, but probably new development business.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yes.

John Campbell
Analyst, Stephens, Inc.

Q

And then you did have a kind of hiring blitz in 2016, you had bonuses a year, amortizing expenses, right. So, there's – you should be weaned off that at some point. If you can walk through...

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah. So, the amortization expenses are three-year amortization. We said bonuses we're talking like $10,000 and $20,000 numbers to kind of get people who might have to leave listing behinds over to us that wasn't the $0.5 million or $1 million bonuses, you hear some people offering out there in the world. So, those are three-year amortized and we did that program ran into the early part of this year. So what some of the upward pressure still is, is actually the first time those show up in our numbers, but on a year-over-year basis, we're now getting to the point where you're not going to see that impact anymore because it will kind of lapped to itself.

[indiscernible] (00:39:45) was the big deal of the 294 basis points increase year-over-year in Q1, 60 basis points was the new development and new development is a great business. We love it. I want as much of it as we can get, but it's episodic and for any of you to actually live here in New York, you see the buildings going up and we get about a 70% split on new development. We keep 70%. Because it's – us actually helping the developer design the building, market the building. We put our agent in there, but because we're putting – we're giving the listing basically to the agent to sell the building, we have such market power that we get the 70% split, the agent gets like 30% or something like that.

And in 2017, we had a pretty – very strong year and a couple of properties kind of got their occupancy in the fourth quarter of 2017 that we thought were going to be in 2018. So it would be, that was great. But what it meant is, we just had very few properties come to market in 2018. There'll be some more in 2019 and we have a pipeline kind of out through the kind of mid-20s. But compared to 2017, 2018 was a $25 million kind of EBITDA drop from that business and that EBITDA drop all shows up in the split line that we just talked about and so that was, in that first quarter case, it was like 20% of the increase kind of on a year-over-year basis. So, we like the business. It's got great market power on age and economics for us. It does good. It does – we like the P&L of it, but it is episodic and again

We like the P&L of it. But, it is episodic and again – who live here just can watch the construction and kind of know sometimes things get delayed a little bit, sometimes they close a little earlier. But most of our buildings are presold, at least a piece of them even before they you know are ready for occupancy and art and we don't just do the selling, we do the design with the developer. We help them price it and it's a nice business, but it's episodic and it did create some P&L and some split violence this year because of the dynamics I just mentioned.

John Campbell
Analyst, Stephens, Inc.

Q

I think we have time for maybe one or two more for you if you guys. I guess it's just to wrapping up. Clearly, you're going to have little bit of pressure on splits next year, the market, who knows what the market does. But you've got cost reduction efforts. You guys are still kind of early stage since your business transformation. What does it take as far as driving EBITDA growth? Do you need the top line growth? Is there enough cost that you can offset some of the splits? Are you needing revenue growth I guess mainly at the RFG to do things we can grow EBITDA next year?

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

We need – we actually need sort of a couple of things. There is no scenario where just pure cost reduction can kind of offset, kind of agent commissions which I sometimes just refer to as like the price of gasoline for an aero line at one level all right. We're going to cut some costs and we're going to make some of that up, but there is no path where we can just kind of cost cut our way to greatness here. We have got to drive more positive organic growth in the own brokerage business period. And you know watching our metrics on things like the number of agents and agent recruiting and whether some of our technology data things are helping on agent productivity or are the kind of revenue things I would encourage you to watch as we roll forward here because in a world where those things go well, we can totally offset the kind of split increases we're talking about and actually drive positive leverage out of it. If those things don't go well then that split increases eat into the P&L the way that you've seen for part – over a chunk of this year.

The other thing we need to do I want to do is keep expanding the franchise business. That's a longer timeline thing but whether it's opening up our franchise business with people who have multi brands, REMAX in here next. If someone's got to REMAX franchise and they want to have a CENTURY 21, I'm all for it. Now, before that it didn't used to be the case and we kind of had a narrower box that we were hunting and because of that, but I'm at peace with multi-brand franchising and then we are making the investment to launch some new brands even if they won't pay off tomorrow, we are very well-served by having launch Sotheby's and Better Homes and Gardens in the previous decade. For a medium term perspective we will be very well served by launching Corcoran and Climb and expanding and making that franchise business an even bigger part of our company, whether it's from a multiple standpoint or just from the power of the earnings of it. And so we are very focused on that also in a world of there's a lot of near-term pressure, we're not losing sight of kind of medium term.

John Campbell
Analyst, Stephens, Inc.

Okay. Thanks for the time.

Ryan M. Schneider
Director, Chief Executive Officer & President, Realogy Holdings Corp.

Okay. Thank you everybody for your time and your questions. Thank you.