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Realogy Holdings Corp. (RLGY)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Alicia Swift
Senior Vice President-Financial Planning & Analysis and Investor Relations, Realogy Holdings Corp.

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

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

OTHER PARTICIPANTS

Ryan McKeveny
Analyst, Zelman & Associates

John Campbell
Analyst, Stephens, Inc.

Stephen Kim
Analyst, Evercore ISI

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Jack Micenko
Analyst, Susquehanna International Group, LLP

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Realogy Holdings Corp. Second Quarter 2019 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 later today. A webcast replay will also be made available on the company's website.

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
Senior Vice President-Financial Planning & Analysis and Investor Relations, Realogy Holdings Corp.

Thank you, Dennis. Good morning and welcome to Realogy's second quarter 2019 earnings conference call. On the call with me today are Realogy's CEO and President, Ryan Schneider and Chief Financial Officer, Charlotte Simonelli.

As shown on slide 3 of the presentation, the company will be making statements about its future results and other forward-looking statements during this call. These statements are based on the current expectations and the current economic environment. Forward-looking statements and projections are inherently subject to significant economic, competitive and other uncertainties and contingencies, many of which are beyond the control of management. Actual results may differ materially from those expressed or implied in the forward-looking statements. For those who will listen to the rebroadcast of this presentation, we remind you that the remarks made herein are as of today, August 8, and have not been updated subsequent to the initial earnings call.

Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements are specified in our earnings release issued today, as well as our annual and quarterly SEC filings. Also, certain non-GAAP financial measures will be discussed on this call and, per SEC rules, important information regarding these non-GAAP financial measures is included in our earnings press release.

Now, I will turn the call over to CEO and President, Ryan Schneider.

Ryan M. Schneider

Director, Chief Executive Officer & President, Realogy Holdings Corp.

Thank you, Alicia. Good morning, everyone. I'm excited to share with you today our financial results, our outlook and a number of proof points on strategic initiatives that makes us optimistic about the future. Even in this competitive environment, we continued to generate sustained profitability with substantial operating EBITDA and free cash flow. We have by far the best combination of scale, partnerships, market position, agents, brands, products and profitability. And you will hear today why we are, and you should be, optimistic about Realogy's future.

We earned $245 million in operating EBITDA in Q2 and generated $147 million in free cash flow, driven by improving volume sequentially, moderating agent commission costs pressure, and strong cost management. We now expect to earn $590 million to $610 million in operating EBITDA in 2019 based on what we know today and subject to macro uncertainty. Our transaction volume trajectory is improving. Our Q2 transaction volume declined 3% year-over-year. This is a substantial improvement compared to the 9% year-over-year decline in Q1.

At the business unit level, our franchise business was down 2% in the quarter year-over-year improving from an 8% decline in Q1. Our owned brokerage business was down 5%, an improvement from its 11% decline in Q1. We faced similar pressures in Q2 as we shared in Q1 specifically the competitive environment and our geographic concentration in California. We are forecasting positive transaction volume in Q3 with sequential improvement in Q4. Our $70 million of 2019 cost efforts are on track. We have executed approximately 60% of the actions so far required to generate these savings and have captured $22 million in the income statement year-to-date. And on our next call, Charlotte will share with you additional information on further cost efforts that will impact 2019 and beyond.

Finally, this quarter, we began to demonstrate results in areas that have been headwinds to top and bottom line growth. First, on agent commission costs, in the past year, we rolled out new commission plans across most of the U.S. Remember, the new local plans leverage our unique data scale, use our machine learning capabilities and include select fees. The goal is to create attractive commission plans to grow our agent base, while better managing/controlling commission costs. We are seeing continued moderation in our agent commission costs pressure, an increase of only 21 basis points year-over-year. This is by far our best result in 12 quarters. We now have two quarters in a row of much better results on this metric and we expect the upward pressure on commission splits to be less than we told you about earlier in the year. We now expect it in the range of 50 basis points to 70 basis points for the full year of 2019.

Second, we're delivering new products, partnerships and technology and data offerings to improve our value proposition. While much of the discussion we have had is around how improving our value proposition will help us better recruit and retain agents, I want to emphasize today how it also helps drive growth, and in some cases, improves margins in the business. In Q2, we have a number of new proof points to share. First, our Listing Concierge product, which provides a great integrated marketing package for agent listings, is now live in about 60% of our markets. Today, agents using Listing Concierge get a higher commission rate on average. We are very excited to help agents win more listings and drive growth with this product, while demonstrating that we can actually add margin back into the business.

The marketing product we launched in partnership with Facebook and Instagram in Q1, named, Social Ad Engine, continues to get traction with thousands of marketing campaigns launched that have already delivered over 85,000 leads for our agents. This product is only available through Realogy and is another innovative product example designed to drive greater volumes.

We recently launched TurnKey, a collaboration with Amazon, to create a fantastic home-buying and moving experience for the consumer. The program has the potential to generate high-quality leads and drive growth for Realogy-owned brokerage agents and franchisees. TurnKey transactions are expected to drive greater margins and it is just beginning. We launched in July and are only in 20% of the U.S. market today. On our capital-light, iBuying partnership continues in three cities. We've expanded our early efforts to now include select franchisees and we like our early learnings and look forward to moving to additional cities soon.

Finally, we have grown our owned brokerage agent base for the first time in a while. This growth has occurred and accelerated in the past four months, because of the combination of our new commission plans and our value proposition changes. Our NRT agent base is up about 2% from Q1, and we like our recruiting momentum. So, pulling way up, we anticipate earning $590 million to $610 million of operating EBITDA for full year 2019. We anticipate moving to positive transaction volume growth in Q3 and we continue to expect sequential transaction volume improvement in Q4. And looking ahead, our agent commission pressure is moderating. We're creating products and partnerships designed to drive growth and to add margin back into the business. We are growing our owned brokerage agent base and NAR is now forecasting 8% transaction volume in 2020. Putting all those things together, you can see why we are more optimistic about our top and bottom line trajectory.

I will now turn the call over to Charlotte for a deep dive into the financial performance.

Charlotte C. Simonelli

Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

Thank you, Ryan. Good morning, everyone. Before we get into the details, let me start with a few comments about our financial results for the quarter. We delivered a solid quarter of financial performance, exhibiting sequential improvement across several key financial metrics. We continue to execute upon our strategy, which includes new products and partnerships that leverage our leading market share to grow our business profitably, while improving the transaction process for the industry overall. We remain diligent and focused on expense management, both actioning and identifying incremental operational efficiencies across the business.

At the same time, we are implementing even more best practices and process automation, which we look to further scale across the enterprise. The strong focus on cost management is starting to gain momentum and favorably impact the income statement year-to-date. We reported slightly lower operating costs and already actioned approximately 60% of the $70 million cost savings program for full year 2019. We also returned to positive free cash flow in the quarter and are committed to reducing our leverage until we achieve four times and below.

Now, let's jump into Q2 2019 consolidated financial results on slide 5. Total net revenue in the second quarter was $1.7 billion, a decline of $85 million versus prior year, primarily due to lower NRT revenue. Operating

EBITDA was $245 million, a decline of $31 million from Q2 2018. Expenses decreased by approximately $50 million due to lower commissions and operating costs. Operating costs improved slightly in the fourth quarter primarily due to office footprint optimization.

Q2 2019 net income was $69 million compared to net income of $123 million in Q2 2018 due predominantly to an increase in interest expense of $35 million and the decline in transaction volume. The interest expense increase was driven by a $24 million mark-to-market loss on our interest rate swaps versus no change to mark-to-market in Q2 2018. Adjusted earnings per share was $0.83 compared to an adjusted earnings per share of $1 in Q2 2018.

Now, let's turn to cash flow and the balance sheet. Free cash flow was $147 million in the quarter as the business moves into the peak cash generating season, driven by higher cash from operations and we reduced net debt by $113 million in Q2. We ended Q2 2019 with total liquidity of $1.4 billion. We continue to pay down the revolver borrowings, which were $265 million as of August 6. We remain committed to using our free cash flow to reduce leverage until we achieve net debt leverage below four times, while making prudent investments in the business with no near-term debt maturities.

Now, let's move into Q2 2019 year-over-year review of segment operating performance on slide 6 and 7. RFG revenue of $234 million decreased slightly due primarily to lower intercompany royalties from NRT. Excluding intercompany royalties from NRT, RFG revenue was up slightly. RFG operating EBITDA was $163 million, a decline of $10 million. NRT revenue of $1.3 million was down $77 million from Q2 2018 due predominantly to lower transaction volume, especially in California where NRT is geographically concentrated and faces intense competition. Operating EBITDA was $47 million, a decrease of $14 million, due to lower revenues partially offset by lower agent commissions and lower intercompany royalties to RFG. Q2 2019 agent commission splits were up 21 basis points year-over-year, the lowest year-over-year increase in 12 quarters. On a like-for-like basis, splits were up 40 basis points.

Cartus revenue of $97 million decreased $8 million, primarily due to decreases in international revenue and lower referral revenue, including lapping a large group move from Q2 2018. Operating EBITDA was $27 million, a decline of $7 million as the revenue decline was only partially offset by favorable operating expenses. TRG revenue of $160 million was down $2 million, primarily due to lower resale revenue. Operating EBITDA was $32 million, an increase of $1 million, as the decline in resale revenue was more than offset by an increase of $5 million in GRA mortgage JV earnings. We now expect GRA to generate approximately $10 million in operating EBITDA for TRG in full year 2019.

Before I discuss our efficiency efforts, let me stop for a minute. As I believe, everyone would benefit from more clarity on the net royalty per side driver in our franchise financials. As you know, we moved to net royalty per side as a key driver for our franchise business in 2017. This metric has the benefit of showing the impact of all incentives, including those designed to help our franchisees grow. In Q2 2019, net royalty per side was $331 compared to $336 in Q2 2018.

The $5 year-over-year decline in net royalty per side was primarily driven by three factors. First, in 2018, we introduced a royalty fee cap in one of our brands to drive more franchise growth. This different pricing structure allows us to compete more broadly across the market. Second, we continue to use incentives to help franchisees grow through acquisitions, mergers, recruiting and also to extend franchise agreements and convert new franchisees to our brands. And third, our top 250 franchisees continue to grow at a faster pace and earn larger rebates. Our top 250 represent approximately 70% of RFG GCI in Q2, which is up from Q2 2018.

Turning to slide 8, we continued to make progress on our $70 million cost savings initiatives previously identified for the year. To-date, these savings have largely come from workforce and office optimization. Through Q2 2019, 60% of our actions have been completed and $22 million has already been realized through the income statements. We are on track to deliver our full year target. Making Realogy much more efficient is and will remain a very strong priority for me. Since my arrival in late March, I have launched new efforts that will drive additional savings both in 2019 and 2020, and I intend to share more details with you on our next call. During the quarter, we incurred $9 million of restructuring costs associated with these cost savings initiatives and we now expect $54 million of restructuring costs through 2019.

Wrapping up, I am pleased with our second quarter performance, which I believe highlights that we are on track with our plan and are executing the necessary steps to improve our financial performance. We are approaching our business decisions with even greater financial rigor and speed that will allow us to drive improved performance across the business. In the near-term, we will remain balanced with our use of free cash flow to both drive better business performance and lower our overall leverage.

With that, I'll turn the call back to Ryan for some closing remarks.

Ryan M. Schneider

Director, Chief Executive Officer & President, Realogy Holdings Corp.

Thanks, Charlotte. In closing, let me step back and make a few competitive points. First, even in the current competitive environment and a pretty tough housing market, we generated $245 million in operating EBITDA and $147 million in free cash flow in the quarter. Those are massive absolute dollar amounts in an industry where there's a large amount of capital deployed without profitability. When I joined Realogy 20 months ago, they were three to four "disruptor companies" we got a huge number of questions about. Today, one of those companies is gone, proving how easy it is to make a big splash as a disruptor and spend a lot of money and how hard it is to build a sustainable business.

There are still multiple competitors in our industry who are investing a ton of capital to compete with us, which, first and foremost, we think is strong evidence of the fundamental attractiveness of our business. We have by far the best combination of scale, partnerships, market position, agents, brands, products and profitability. We have significant financial resources from our substantial internally generated free cash flow, which allows us to invest in the business to de-lever and to compete successfully.

We're here to stay. We fully intend to strengthen our position in this attractive market. We believe our trajectory will improve and we like a number of our results this quarter as proof points. Looking ahead, our agent commission pressure is moderating. We're creating products and partnerships designed to drive growth and to add margin back into the business. We're growing our owned brokerage agent base and NAR is now forecasting 8% transaction volume growth in 2020. Putting all of that together, you can see why we are more optimistic about our top and bottom line trajectory.

With that, Charlotte and I will take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question is from the line of Stephen Kim with Evercore ISI. Please go ahead. Stephen, your line is open. Hello, Stephen Kim? Your line is open. Please go ahead with your question.

Okay. We'll move on to the next question, from the line of Ryan McKeveny with Zelman & Associates. Please go ahead.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Hey. Good morning and nice job on the quarter. So, I have a two-parter, related to TurnKey. So, the Amazon part of that, kind of the consumer touch point, obviously, got a lot of the focus in the headlines. I guess can you give us some color on the infrastructure that you've built at Realogy with TurnKey? Maybe, kind of the technology that you're leveraging, what's going on back office-wise? Also would love to hear about OJO Labs and how that's being integrated on the AI side, and just bigger picture integration with Cartus. So, that's kind of the first big picture one, on just the infrastructure that you guys actually have.

And then the second part, just with kind of online lead generation in general, there's always this trade-off out there over quantity versus quality. So, I guess on the decision to embark on TurnKey, what do you think about as far as how the leads that you can generate could compare with other sources in terms of potentially better quality, better converting, do you think that's the case and if so, why? Thank you.

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

A

So, let me start with your second question. Look, the world is awash in incredibly low quality, low conversion online leads that the lead tends to be nothing, but an email address effectively. And so, we're really excited by TurnKey because we think it will be an incredibly high quality lead because it's both a live customer ready to talk to an agent incubated by our OJO Labs partnership if they're not ready at the moment, but it's also a customer who's excited about the value proposition of Amazon Home Services both on the smart home and the move-in support and help kind of thing.

And so, in the spectrum of the quality of leads out there, we think this will be a really high quality lead. It will be incredibly valued and very differentiated from the low quality leads that are just out there in kind of en masse. So, we're really excited about that. From an infrastructure standpoint, this is kind of one of the examples where I think the scale and uniqueness of Realogy really helps.

So, Ryan, if you think about any national partnership, whether it's – in this case what we're doing with Amazon or something else, all right, we're the one player in the market who has national coverage across all geographies between our owned and our franchise business. We've got multiple brands for consumers and partners to choose from. And we already have an infrastructure through our Cartus Broker Network of very high quality proven agents, kind of a subset of our overall agents, on a national basis that can support already the existing national kind of lead things that we do on the affinity and the relo side that our agents and franchisees really value.

So, we and Amazon together built some technology for the consumer experience part through Amazon.com/TurnKey, we've built some interaction with OJO as an incubator for people who aren't ready for the human conversation yet, but want be in the program and for when the time is right. But the lion's share of what we built this on, was already part of our company and was an example of leveraging both the technology scale and the geographic scale of our company, which we feel is almost uniquely possible to do with us, but with no one else in this industry, given those things that we have that the rest of the folks don't, which is why in my comments I tried to remind everybody how much in this very attractive industry, we have the best combination of market position, scale, agents, brands, et cetera, partnerships that can get leveraged for national things like this.

So, that's how I'd answer both parts of your question, Ryan.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Thank you very much. That's very helpful.

Operator: Your next question is from the line of John Campbell with Stephens, Inc. Please go ahead.

John Campbell
Analyst, Stephens, Inc.

Q

Hey, guys. Good morning. Congrats on a great quarter.

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

A

Good morning, John.

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

Good morning.

John Campbell
Analyst, Stephens, Inc.

Q

Hey, I just want to go back one more time to the Amazon partnership. That seems like a pretty interesting opportunity for you guys. Just at the highest of levels, how do you define success there? I mean, is there a certain level of transactions where you say hey, this is working better than we originally expected?

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

A

Look, we've got big dreams for the thing and we want it to be as big as possible. While we do a little bit of investment to get the thing going from a technology standpoint, as Ryan's question talked about, the economics of this basically are a function of closed transactions. So, when we close a transaction through TurnKey, then we deliver the Amazon Smart Home Services and the Amazon Home Services as part of it. So, the economics are very kind of marginal cost here and not fixed cost in a lot of ways. But we think it could be very large. Obviously, we've got a partner who does things very large on this and we want it to be as big as possible.

And so, we're only just getting started, right? We're only in 20% of the U.S. right now. We're in our early days and, bluntly, we launched in July, which is kind of late in the year to launch. And so if you think about the momentum, I'm even more excited about what it could look like in 2020 as we have our learning, we haven't even really started marketing yet. But imagine going into the prime housing season next year, with six months of marketing behind it, all the learnings you get from kind of your shakedown cruise and your growing pains of doing this stuff and we want it to be as big as it can be.

John Campbell
Analyst, Stephens, Inc.

Q

Yeah, makes sense. Thank you. On the 2% growth in NRT agents, that was really good. I felt that you've seen some others in the space who I think seen more of a challenging run of late. So, if you could just maybe talk to, I guess A, is that mostly U.S. agents? And whether that growth is driven by better retention or maybe faster gross adds? And then secondly, how does that 2% growth look versus the last few quarters? It sounds like that you slid a bit there, but maybe that's a good bit better, just kind of looking for the degree of improvement there.

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

A

Yeah. So, first off, it's 100% U.S.-based. For NRT, it's a U.S. thing. So, it's a 100% U.S. And we think it's kind of the combination of bringing some of those new commission plans to make it more attractive. I would say most of the growth is the combination of kind of new agents joining at a higher rate and then kind of keeping about the same level of retention as we have in the quarter before. But with different things like TurnKey or Listing Concierge, et cetera, we're now delivering better leads and more high quality leads for agents. We're doing things that I think are enhancing the value proposition. I think that helps a lot. And then it's funny, so the 2% is 2% compared to a year ago, it's 2% compared to the start of the year, and it's 2% compared to the start of Q2. So, we gave the 2% and so, we've kind of been going down for a while, then we were flat for a while, and now we actually have a data point going in the direction that we're all rooting for.

John Campbell
Analyst, Stephens, Inc.

Q

Great to hear. Thank you.

Operator: Your next question is from the line of Stephen Kim with Evercore ISI. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah. Thanks. Sorry about that earlier, technical issues. I had a couple of questions on splits, if I could. Obviously, encouraging what we've seen here and I just wanted to clarify you said that you're looking for a split to be up 50 basis points to 70 basis points on a year-over-year basis for the full year, Ryan, or was that just in the back half of the year?

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

A

No, that's for the full year. We had talked to you about kind of 90 basis points to 110 basis points early at the start of the year. Obviously, we've been doing better than that. And we're thinking 50 basis points to 70 basis points for the back half of the year, that's still a little higher in the back half than the first half. But because we're getting some momentum on recruiting and we see the sequential growth happening, we do think one of the things that will happen is our agents are going to be working their way more up their productivity tables, and so there'll be a little bit of higher splits from that in the back half of the year. But we've had two quarters in a row of better than probably we thought and we like that. We'd love to keep that trajectory, but we don't want to go too far with it yet.

And so, we thought we should tell you kind of where we've recalibrated in our heads on that, and we're excited to stay very focused on it. We've had 12 quarters of results that looked a heck of a lot worse than that massively. And so, we're pretty excited to see those kind of numbers now for two quarters in a row, both because of our new commission plans influencing them and help pay off it, but also just that we're seeing it actually – we're seeing some of our actions kind of deliver a different number that bluntly has been the number one question you and others have asked us. And now, we have two quarters in a row of delivering something that looks very, very different than the past 12 quarters before that.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah, absolutely. I mean, as you pointed out when you took charge, splits – keepings splits low alone is not the goal. The goal was to improve the productivity and the revenue. So, that's important. In that vein, we did notice that once again in both NRT and in RFG, both on the price and on the volume side, the number seemed to be a little lower than what NAR was indicating and I know you gave a good – NAR gave a good forecast for 2020. But relative to NAR or relative to what the industry is doing, do you see the potential to get that – your relative performance year-over-year to close the gap with the industry or maybe even to gain some share back. And then just one other housekeeping item on the mark-to-market on the interest expense, can you remind me how much of your floating exposure you have hedged?

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

I can take the mark-to-market thing real quick just to put that out so that it's – we have a 70/30 ratio, so 70% is hedged.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks.

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

A

Yeah. So, on the [ph] shortfall to (29:59) NAR, great, great question. Look, and so two things. First off, we closed the gap this quarter, right? Last quarter, we had a 500-basis-point gap to NAR. This quarter, we had a 300-basis-point gap to NAR. And some of that is the fact of how over-weighted we are in California and even in Q2, California performed worse than the rest of the U.S. But also, we talked about some competition stuff last year. So, the forces are kind of the same, but you can see we closed the gap from 500-basis-point to 300-basis-point. Obviously, as we move to positive transaction volume in Q3 and Q4, we hope that we continue to close that gap.

We'd love to get past the gap and be on the positive side of that and that's why we're focused some of our efforts on things like TurnKey, things like our Social Ad Engine product, like the recruiting focus, et cetera. And anything we can do to create products and partnerships that drive growth for agents, drive the recruiting, that's going to translate to both better top-line and better bottom-line. And some of the proof points this quarter, Stephen, is why we're more optimistic. But we should be – I want to be really clear. We did – the gap did close this quarter and we view that as a very good thing even if some of the gap is still driven by just geographic difference between us and NAR, especially vis-à-vis California.

Stephen Kim
Analyst, Evercore ISI

Q

Great. Thanks very much, guys.

Operator: Your next question is from the line of Chris Gamaitoni with Compass Point. Please go ahead.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

Hi. Good morning, everyone.

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

Hello, Chris.

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.
A

Good morning.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

I wanted to ask first question on TurnKey. So, the success of it will really be about consumer engagement. Who controls the marketing approach to it and who pays for that?

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

So, we'll be funding the marketing primarily. And the marketing, there's both marketing we can do outside of Amazon channels. There's marketing we can do inside of Amazon channels. Obviously, anything we do inside the Amazon channels needs to be something that we're both supportive of and excited of. But we're primarily funding the marketing for the thing. We'll access people out there in the world in general. We'll also access it through Amazon kind of – within Amazon kind of marketing channels.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

Do you envision marketing being Internet-based approach, TV ads, just trying to understand how to get the message of it.

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

This is an industry where I think TV is not a winner. I mean, I come from a financial services company where I had like $300 million – had a massive TV spend in the last company that I worked at and I feel like I understand that pretty well. I don't think this is an industry where TV is necessarily the way to go. I predict it will be much more Internet-based. Obviously, our partner in this, Amazon's whole model is Internet-based. And so the fact that we can market through their channels and on our own through Internet things is likely where we're going to invest our marketing dollars.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

All right. And then on the new agents joining, you mentioned same level of retention in more new agents, are these – do the profile of these agents coming from other brokerages or are they new agents entering the industry?

Ryan M. Schneider

Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

We're large enough. We have every profile, like every single year, we have a ton of new agents who join us across the country both in our owned business and our franchise businesses. And we have agents across the whole spectrum that join us every year. I would say like the growth we're having is kind of across the whole spectrum. And our sweet spot is probably the – in terms of recruiting into us, what we're trying to do is recruit people who we think have the most potential.

So, we're recruiting a lot of people in their three years to five years as an agent kind of criteria. I've talked before on calls that the first machine learning model we built kind of scans all the public agent data and our private data, and tries to figure out who we're going to target that we think has the most growth potential, independent on most of their current production. And so, that's probably where we're targeting the most, but because of our size, we kind of get it across the whole spectrum. And the growth we've had in the last quarter, there's no one group that stands out as disproportionate. It's a little bit of just broader success across the spectrum for us.

Chris Gamaitoni

Analyst, Compass Point Research & Trading LLC

Q

All right. Thank you so much.

Operator: Your next question is from a line of Jason Deleeuw with Piper Jaffray. Please go ahead.

Jason S. Deleeuw

Analyst, Piper Jaffray & Co.

Q

Good morning. Thanks for taking the question. It's good to see some of the key fundamental drivers improving here. And I was wondering if we could get a little color on the agent competition trends. Any change there? Have the competitors lightened up a bit or not? And then also just kind of the agent recruiting conversation, is that changing at all or is it still just all splits or some of these lead generation opportunities and those things that you can bring to the table, are those having a bigger influence?

Ryan M. Schneider

Director, Chief Executive Officer & President, Realogy Holdings Corp.

A

Yeah. On the agent competition side, I would say no change. It remains very, very intense, right? There are geographic variations. I talked on our last call about how especially in some of the California cities and Chicago, for example, the competition intensity is Spinal Tap 11 kind of thing. And I don't think there's really been a change between last quarter and this quarter on that. So that's the answer to your first question.

On the conversation, I mean, there are certain markets and certain agents where it is nothing but about the money and as I've told you guys before at the end of the day, if it's a choice between losing money and letting someone go, we're not going to lose money just to retain people. But even with this competition, you saw our NRT agent growth here in Q2 and for the earlier question kind of first time in a long time and versus even a down trajectory in the past.

But we had the conversation really on multiple dimensions, right? I mean we are a full-service traditional brokerage. Our value proposition isn't just the money because if you want the highest split possible, you can go to [ph] RE/Max (36:57) and you're going to have a higher split than you're going to have here or any other traditional brokerage.

So we really – we've got to be competitive on that, but we're also trying to emphasize the benefits that we bring with the kind of partnerships and products that I've described in the call, with the power of kind of some of our scale, referrals, things like that. And again, it's a tough market out there. We're going to keep fighting on it, but in a world where we've been losing agents and then per the earlier question kind of flat for a year or so to actually get some meaningful growth felt good. And since we disclose those numbers every quarter, we obviously wanted to talk about them here.

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Q

Great. And then just on the outlook, the positive transaction volume growth in the third quarter and better in the fourth quarter. Is that for both RFG and NRT or is that just on a combined basis and what's the visibility on that? I know you see the opens for the third quarter for most of the third quarter here but just help us think about kind of the visibility you have on that outlook.

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

A

Yeah. We've got to – look, we think they're both going to keep improving but the positives on a combined basis, we'll see how it plays out just based on some of the competition and market forces you talked about.

We feel good so far after July. We've seen our July numbers. We haven't seen the market numbers and we feel good that we're on that trajectory. Keep in mind last year July, it was a pretty good month, right? Last year in July, I think the market was up like 5% or 6%. And then August was like a flat month and September was down like 10% and then Q4 was down about 5%.

So, we are actually transitioning in this quarter from what had been kind of a normal type of growth year in terms of volume growth to the time period last year when kind of things fell off a cliff. And so we feel good about our guidance and our trajectory, the details of the decimal point numbers kind of by different parts of the business. There's still a little bit of volatility around those based off the market, but we like the overall trajectory and are optimistic about it.

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Q

Thank you.

Operator: Your next question is from the line of Bose George with KBW. Please go ahead.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey. Good morning. Can you give us an update on trends you're seeing in the iBuyer market and competition in markets where iBuyers are very active?

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

A

Sure. Yeah. There's a lot of capital has been poured into iBuying. It's a big phenomenon. Phoenix is kind of the biggest area where I think the iBuying market share is something like 4% or 5% of the market. Don't hold me too much to that, that's a month or two dated, but we look at that market pretty closely.

And a lot of the iBuyers now are using agents including – some of the iBuyers are using our franchise agents for example. We use agents in our pilot so the model shifted a little bit where there is the idea that commission economics are disappearing is less [ph] violent (40:30) than people had predicted.

The other thing that I will say is it is changing and a few of those markets the consumer conversation, you find a lot of people shopping, will get an iBuyer offer at the same time that they're talking to an agent about selling their house. And as some of the iBuying people have talked about, in the vast majority of cases people turn those offers down because bluntly part of that I believe is a lot of the offers are bid at a pretty good discount above and beyond the service fee.

So, it's a little bit of a change in the consumer conversation. I think agents, not just at our brands and others, are adjusting both in a few cases by being part of it, but more importantly by continuing to win the vast majority of listings with the value proposition of frankly helping people get the best price, which is the real thing. I mean you can sell your house through an iBuyer, but you're often – if you look at the market data, you're taking a 15-plus percent hit on price. And so, that's a little bit of what's out there.

Look, we're testing it in three cities. We're going to expand soon to some other cities to keep doing some more testing on it. We've expanded to our franchisees to let their agents have access to it in some of those cities. We like the learnings, the path to profitability I think is very unclear probably for everybody at this point. But we like our capital light way of participating in that and learning a lot.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. That's helpful. Thanks. And then just switching to the earning, in the TRG segment, the margin was up despite lower volumes. Is that just the cost-cutting side paying off?

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

It's a little bit of cost-cutting, but it's also the GRA. So as I called out a bit, we are now making money on our GRA joint venture and we're feeling really good about the progress there.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Good. That makes sense. Thanks. And then actually one – just last one on capital management. Is there any thought there to cutting the dividend and using that to deleverage? Or is that just not meaningful relative to your free cash flow?

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

A

Look, our focus is investing in the business and paying down debt. And obviously we're pretty excited about the quarter, the $245 million operating EBITDA, $147 million free cash flow. We paid down debt by about $113 million and you can hear in Charlotte's remark, we paid down the revolver even further since the end of the quarter. And we like the cash generating capacity of the company.

Look, we keep evaluating the dividend in the context of our capital allocation. But the biggest thing we've been focused on is making sure we're investing in the business and what we're doing on paying down debt. So, we'll keep you posted on that.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc. Q

Okay. Great. Thank you.

Operator: And today's final question will come from the line of Jack Micenko with SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna International Group, LLP Q

Hi. Good morning. Ryan, following up on that prior question and looking at the free cash flow, you've got a better outlook for the year and you mentioned that obviously that's a big priority for you. How should we think about debt pay down through the balance of the year given the better outlook? I know you've got some severance charges coming through and that sort of thing. And how do we think about the pecking order of the debt pay down?

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

I'm sorry Jack. Could you repeat that and possibly you speak up a little bit or get closer to mic? I had a challenging time hearing you but that might be my hearing going though.

Jack Micenko
Analyst, Susquehanna International Group, LLP Q

Is this better?

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

It's a little better.

Jack Micenko
Analyst, Susquehanna International Group, LLP Q

Okay. Just talk through free cash flow through the balance of the year with a better outlook. And how much [ph] debt seems to (44:28) pay down between now and the year-end if the guidance range kind of holds?

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp. A

Yeah. So, we're not really giving guidance on where we're going to be at least from a leverage perspective at the balance of the year. A lot of it does depend on the housing market that can make it a lot better. And so, we feel comfortable that the trend will be very consistent with what we had last year. We always deleverage as we go throughout the year because we generate free cash flow and that won't be any different this year.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay. Okay. And then bigger picture on tech spend, it seems as if the pivot is maybe more to partnerships with Facebook, Instagram, Amazon now. Does that mean over time that maybe tech spends – does the spend go down? Can you maybe send more of that to debt pay down or does the mix of tech spend internal versus partnerships just shift?

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

A

I think it's probably a little more the latter. Our tech spend, we don't expect just to go up in any sort of material way. I still think even after 18 months work with the team, we still have opportunities to reallocate and spend our tech differently and better to be even more on the forefront of product development. But we're going to do some tech development [indiscernible] (45:48) own products. We're going to do some integration with third parties, whether it's partnerships or third-party product providers because we're kind of more focused on trying to deliver an open architecture so that our agents and franchisees can access the best products out there. But I think we're going to want to keep investing but probably more at the same rate than any sort of a different rate on the tech side.

And we like some of the products that both we're providing and others are providing because again, we think they can drive growth and hopefully add some margin back into the business. And then again, we're going to keep rotating our spend. We're getting out of the datacenter business and into the cloud business. And on a net basis, the cost probably will be a little bit cheaper on that, Jack but not in some sort of a transformative way. But the benefits of being faster and quicker speed to market and more real-time data for our agents and franchisees, we again hope those benefits translate onto the top line.

Most of the places where we're going to drive efficiency, as Charlotte talked about, are more in the office optimization and some of the redesign stuff we're doing there, kind of [ph] ops in the (47:20) future type of work as well as in kind of the three or four different ways. And she'll talk more on the next call about this. Just getting a little more efficient in some of the more classic places as we kind of take our kind of sprawling holding company and try to run more as a single company over time.

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

And just to build on that too. We've just gone through a process of like rationalizing the products we offer our agents. And so, we've rationalized almost 90% of the products that we offer to them to give them a better product. And that's another example of how we drive efficiency because there was a lot of ad hoc products that maybe only a few agents would use here or there. And we're redirecting that spend to have more bang for the buck.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Charlotte to the point, just a quick follow-up. It looks like maybe call it two-thirds of what you realized so far is dropping to the bottom line. I'm just thinking about like $22 million off the $35 million or $40 million. Is that the right way to think about the net savings on the rest of the $70 million as well as whatever is coming in the third quarter or does that – can that go up or down?

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

Yeah. So basically, the whole bit of the savings is dropping to the bottom line. It's just other investments that we're making in the business that are offsetting it. I mean, I think from a ratio perspective, we don't expect any wild swings in our investments versus how the savings are coming through. As you know more of the savings will come through in the back half of the year, just due to the fact that we wait for the big season to sort of wind down before we implement some of these changes. So, it's really more of a timing thing, but they all drop to the bottom line. It's just what we choose to invest quarter-by-quarter that offsets that.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay. Thanks for fitting me in.

Charlotte C. Simonelli
Executive Vice President & Chief Financial Officer, Realogy Holdings Corp.

A

Thank you.

Operator: And at this time, there are no further questions. Please continue with any closing remarks.

Alicia Swift
Senior Vice President-Financial Planning & Analysis and Investor Relations, Realogy Holdings Corp.

Great. We thank you for joining the call today and we look forward to speaking with you over the coming quarter. Thank you.

Operator: Ladies and gentlemen, thank you again for joining the Realogy Holdings Corp., second quarter 2019 earnings conference call. You may now disconnect.