

Realogy Corporation

First Quarter 2009 Results

Webcast Transcript

May 12, 2009

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Note: *This is a verbatim transcription of the Realogy Corporation First Quarter 2009 financial results conference call via webcast. It has been edited from its original version for transcription errors.*

OPERATOR: Good afternoon and welcome to the Realogy Corporation First Quarter 2009 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 Web site tomorrow morning. A webcast replay will also be made available on the Company's Web site. At this time, I would like to turn the conference over to Alicia Swift, Senior Vice President of Financial Planning. Please go ahead, Alicia.

SWIFT:

Thank you, Tim. Good afternoon and welcome to Realogy's First Quarter 2009 earnings conference call. On the call with me today are Realogy's President & CEO, Richard Smith; and Chief Financial Officer, Tony Hull.

I would like to call your attention to three items.

First, you should have all reviewed a copy of our financial results press release issued earlier today, May 12, 2009, and our 2009 Form 10-Q filed today with the Securities and Exchange Commission.

Second, the Company will be making statements about its future results and other forward-looking statements during this call. Statements about future results made during the call constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and the current economic environment. Forward-looking statements and projections are inherently subject to significant economic, competitive and other uncertainties and contingencies, many of which are beyond the control of management. The Company cautions that these statements are not guarantees of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements.

Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements and projections are set forth under the headings "Forward-Looking Statements" and "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008 and "Forward-Looking Statements" in our Form 10-Q for the quarter ended March 31, 2009.

Third, we will be referring to certain non-GAAP financial measures during the call. Today's press release, which is posted on the investor information section of our Web site, contains definitions of these terms, a reconciliation of these terms to their most comparable GAAP measure, and a discussion of why we believe these non-GAAP financial measures are useful to our investors. Tony and Richard will be referring to EBITDA before restructuring and other costs on this call. These restructuring and other charges – which can include merger, separation and legacy costs – are detailed by business unit on Table 4 of the press release.

Now, I'd like to turn the call over to Realogy's President and CEO, Richard Smith.

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RICHARD SMITH:

Thank you, Alicia. Good afternoon, everyone, and thank you for joining our Webcast regarding Realogy's first quarter 2009 financial results.

The first quarter of any year is historically the weakest for the real estate industry on a seasonal basis, and Realogy is certainly no exception to that rule. Couple the depth and length of the housing downturn with the deepening recession and you compound the difficulties inherent in forecasting the residential real estate business.

Of late, there has been a good deal of optimism expressed in the media about the housing market and where it is in the cycle. The emerging view by some is that we are at or near the bottom and that there are early signs of a near-term recovery. Well, based on our first-quarter results and our leading market-share position in the industry, we believe that some of these reports – and certainly how they are being interpreted – may indeed be overly optimistic. Certainly, we are encouraged by the slight improvement in consumer confidence and the historically high level of housing affordability. That said, the increase in new foreclosures, continued weak conditions in the job market, tight credit markets, a very weak jumbo mortgage market, relatively low consumer confidence, and inadequate housing stimulus programs have made a near-term recovery unlikely.

While Tony will review our first-quarter financial results in detail later on this call, I want to point out that our results illustrate the practical market pressures that we and the industry are experiencing. At the same time, I want to call your attention to several important indicators of the strength of our business model that speak to how efficiently we are managing the Company through this housing downturn and economic recession.

Despite a reported EBITDA loss, Realogy was able to generate positive cash from operations – approximately \$4 million -- in the first quarter of 2009. This was an improvement of \$110 million in cash from operations versus a loss of \$106 million in the first quarter of 2008.

More importantly, if you exclude restructuring and other costs, our EBITDA was down \$44 million on a year-over-year basis relative to a \$354 million decrease in revenue. This is the result of our highly variable cost model as well as our efforts to right-size our business over the past several years.

Our focus on overhead has been successful. Including \$60 million in annualized cost reductions in the first quarter of 2009, we have cut our operating costs by more than \$420 million in the past three years. Our strategic, proactive cost-cutting measures such as office consolidations and reductions in our workforce have positioned us to manage through an extraordinarily challenging operating environment.

The first quarter, apart from the normal seasonality pressures, was substantially impacted by the macroeconomics.

Driven largely by an increasing number of REO (real-estate owned) and short sales throughout our markets and a significant decline in sales at the high end, we experienced a dramatic shift in homesales to the lower price points of the housing market, and a virtual stand-still in the high end. This is in contrast to a year ago in the first quarter of 2008 when the low- and mid-price-point homesales were declining more significantly than the high end and the high end was still relatively buoyant.

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The net effect of this shift in the mix of business caused a significant reduction in the year-over-year average homesale price, particularly at NRT, our company-owned real estate brokerage business. NRT's average home sales price declined 32% compared to the first quarter of 2008. To put this in context, NRT's average sales price at the end of the first quarter of 2009 was approximately \$356,000, compared to \$527,000 in the same period of 2008. While NRT's sales price is still well above the national average, a year-over-year decrease of \$171,000 in average sales price clearly demonstrates how the evolving mix of business is negatively impacting our company-owned offices, which operate primarily in major metropolitan markets. One other important fact about NRT's first quarter drivers, if you exclude REO sales, the average sales price was \$399,000, or about \$43,000 higher than the overall NRT average.

By comparison, the Realogy Franchise Group (RFG) saw its first-quarter average sales price decrease by 15% year over year to approximately \$183,000. RFG's franchise affiliates operate in every state in the U.S., and, historically, the sales price of RFG's affiliate networks trend more in line with the national median sales price as reported by the National Association of Realtors.

Year-over-year homesale transaction sides declined by 15% at RFG and were down by 12% at NRT compared to the first quarter of 2008. While we did experience some markets with increases in unit activity such as California, Arizona and Florida, it was triggered by significantly lower average sales prices almost entirely attributable to the sale of foreclosed homes. Overall, our unit declines were reflective of industry trends.

In addition to strategically managing our operating costs, we have continued our focus on investing in long-term growth opportunities – both within our proven existing business model and, where appropriate, in alternative business lines that are either opportunistic or counter-cyclical in nature.

In the first quarter of 2009, **the Realogy Franchise Group** had \$101 million in new franchise sales as measured by gross commission income, which is an increase of 5% over the first quarter of 2008. In April, Rand Realty, a leading brokerage company ranked in the national Top 60 by *REAL Trends*, left a major franchise competitor in order to join our Better Homes and Gardens Real Estate system. Now operating as Better Homes and Gardens Rand Realty, the firm added approximately 20 offices and 800 agents serving New York's Greater Hudson Valley to our newest franchise network.

While each of our brands in the Realogy Franchise Group are continuing to expand their reach through new franchise sales, this BH&G announcement is particularly noteworthy. With closed sales volume of \$1.3 billion last year, Rand Realty thus far is the largest company to affiliate with Better Homes and Gardens Real Estate, and with respect to all of our brands, is one of the largest in the past 10 years.

The Franchise Group continues to invest in technology to better serve its brokers and agents. During the second quarter, RFG will roll out an enhanced version of LeadRouter, our proprietary, Web-based lead-management system that enables brokers and agents to receive and respond to Web-based leads from potential clients within minutes from almost any location. Now in its fourth full year of deployment, nearly 5 million sales leads have been processed in the system and distributed to Realogy-affiliated sales associates, including a record 150,000 leads in March 2009. The soon-to-be-released LeadRouter 3.0 provides lead-management capability to our brokers and agents with a practical approach to managing sales leads over extended periods of time. Approximately two-thirds of the sales associates affiliated with the Realogy brands in the U.S. are currently using our LeadRouter technology.

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At NRT, our company-owned real estate brokerage business, management has continued to focus on its occupancy costs, one of its largest operating expense lines. NRT now has 793 office locations across the 35 major metropolitan market areas it serves, down from approximately 1,100 offices at its peak in 2005. One of its most strategic moves is the reorganization of its 23 regional back office support centers into 8, leveraging its support and technology centers and significantly reducing its related costs.

Let me give you an example of just how much of a positive impact NRT's operating efficiencies have had on our Company in this environment. On a year-over-year basis, NRT's first-quarter revenues declined by \$276 million, but its EBITDA before restructuring costs only decreased by \$8 million. By any definition, that is a considerable accomplishment and speaks well of the resiliency of the business model.

NRT has also made significant strides in expanding the reach of REO Experts, its asset management company, to meet the growing market demands for these services. Our REO operations facilitate the maintenance and sale of foreclosed homes on behalf of lenders and servicers. The profitability of this business is countercyclical to the current housing market.

Before we leave the discussion about NRT, I would be remiss in not mentioning that in April, for the 12th consecutive year, NRT was named as the No. 1 residential real estate brokerage company in the nation by *REAL Trends* magazine in the rankings for both sales volume and transaction sides.

At Cartus, we continue to add new domestic and international clients. With the U.S. economy in a recession, Cartus' corporate clients, who represent over half of the Fortune 50 and approximately one-third of the Fortune 500, have reduced their domestic relocation activity. This has been somewhat mitigated by Cartus' new clients and expanded services to existing clients, especially as it relates to international operations.

The dramatic increase in home foreclosures have created opportunities that we are uniquely positioned to pursue. Recently, Cartus launched a new business line dedicated to asset recovery services – focusing primarily on pre-foreclosure assistance, often referred to as a “short sale.” Our unique approach to short-sale management leverages Cartus' expertise in home marketing and inventory disposition with its experience in individual counseling and process management. Modeled on similar real estate programs that the company managed for financial institutions in the early 1990s, the Cartus Asset Recovery unit is designed to offer dramatically shorter resolution timeframes -- 200 to 400 fewer days -- and reduced costs -- somewhere in the neighborhood of \$20,000 to \$40,000 per loan -- for clients with a stake in non-performing assets. We are up and operational -- and optimistic as to the program's prospects.

At TRG, our title and settlement services company, the first quarter saw continued success in its diversification strategy, principally through its lender channel, where it serves major financial institutions by providing their mortgage divisions with its seamless and unique “mail-away” closing and settlement services.

Through its National Lender Services Division, TRG has secured Preferred Vendor status for one of the top five residential mortgage originators in the United States. TRG earned preferred status among only a handful of providers due to its consistent delivery of high level operational and customer satisfaction results.

Like NRT and Cartus, TRG has moved quickly to fill a demand for services related to increased REO volume. As an example, TRG was recently selected as a primary title and settlement

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services provider for a county government in South Florida, which recently received a significant grant to buy foreclosed properties.

In addition, TRG has benefited from the current spike in mortgage refinance activity. Notably, TRG had a 78% increase in refinance title units during the first quarter of 2009 compared to 2008.

So as you can see, across each of our businesses we are adapting and creating new ways to capitalize on the opportunities created by these very challenging macroeconomic conditions.

While current market conditions have made forecasting an exceedingly difficult exercise, we continue to look to Fannie Mae for its macro view of housing, supplementing the view we have through our RFG and NRT footprints.

As of its April report, Fannie Mae is forecasting home sales to decline 3% for the full year 2009, and increase by 9% in 2010. As for price, Fannie Mae forecasts the median price of homes will decrease 12% for the full year 2009 and another 7% in 2010.

A broker survey in March by the National Association of Realtors showed first-time buyers accounted for 53 percent of all sales, which in part explains the apparent impact of the government's tax credit of up to \$8,000 for first-time homebuyers as well as the market shift to the low end of the market. The limited success of the first-time homebuyer tax credit highlights the need for more government action. We believe the current tax credit program is too limited in scope and inadequate to stimulate a broad recovery in housing. We strongly advocate a tax credit of up to \$15,000, available for all homebuyers, without any caps on income. The rationale is that if stimulating a small segment of potential buyers (that is, first-time buyers) has a visible, positive effect, then by applying the tax credit more broadly to the entire home-buying population and increasing the incentive, the government would be creating a true demand-side stimulus for the housing market and the overall economy.

We have also been, and continue to be, proponents of a government mortgage buy-down solution that would ease the volatility of mortgage rates by keeping 30-year mortgages at a fixed low rate, 4.5% or lower, for a set period of time, perhaps up to one year. We believe that a government guarantee of a fixed rate would create a sense of urgency among home buyers qualified under today's more stringent lending standards and thus get those buyers off the fence and into the market. We do not believe that a fixed rate program would result in a spike in home prices. To the contrary, still high inventory levels and an economy still in a recovery phase should keep average pricing under pressure in the near term. We would expect to see modest increases occurring in the two- to three-year time frame.

We commissioned a national consumer survey in early April, and it showed that among those adults who were considering the purchase of a new or existing home during the next 12 months, 68% of respondents said the combination of a fixed mortgage rate, 4.5% or lower, and a \$15,000 tax credit for all homebuyers would somewhat or significantly increase their decision to buy a home in the next 12 months. In a separate survey, 81% of our affiliated franchisee broker owners agreed that such a combination would significantly stimulate home sales activity.

Nearly one-quarter of consumers surveyed who were not considering the purchase of a home at the time of the survey responded that the combination of fixed mortgage rates of 4.5% or lower and an increased homebuyer tax credit would somewhat or significantly increase their decision to buy a home in the next 12 months.

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We firmly believe that these actions would create a sizable stimulus to the housing market and the economy. With the right short-term incentives in place, we believe the pent-up demand for housing would put the housing industry, and our economy, back on track.

Now I'll turn the call over to Tony, who will provide you with a more detailed look at our first quarter financial performance.

HULL: Thank you, Richard.

Before I begin my discussion of the first quarter, I want to remind you that both the industry and our business are subject to seasonal fluctuations. Historically, revenue and earnings for our business operations have been strongest in the second and third quarters of the calendar year.

In discussing our first quarter 2009 financial results I will be referring to the tables in the press release as well as several pages of the 10-Q.

Looking at Table 1 of the press release, total net revenue was \$697 million in the first quarter of 2009. The breakdown by revenue category is as follows:

- Gross commission income totaled \$472 million at NRT.
- Service revenue totaled \$134 million, primarily from Cartus activities and TRG revenue relating to purchase and refinance closing activity as well as title underwriting revenue.
- Third-party franchise fees totaled \$50 million which consists of RFG's domestic and international franchisee fees.
- Other revenue of \$41 million includes marketing fees that RFG collects from its franchisees and management fee revenue from NRT's REO asset management business.

In terms of expense reductions, comparing first quarter 2009 results to 2008:

- Total commission expense of \$292 million decreased 40% year over year due to lower transaction volume and higher profit margins, which improved 300 basis points.
- Operating, marketing and general and administrative expenses of \$432 million declined approximately \$116 million or 21% year over year as we realized the concrete benefits of storefront and other pro-active cost reduction initiatives executed throughout the previous 12 months.

Next I would like to discuss our key business drivers for the first quarter from Table 3 of the press release.

Year over year, RFG home sale sides and average home price each decreased 15% in the first quarter of 2009. The decline in sides was exacerbated by about 4 percentage points as a result of the termination of non-performing franchisees. This was partially offset by incremental revenue from new franchisees. Price declines reflect the impact of the relative prominence we saw at the lower and mid-market portions of the housing market and are consistent with reported industry trends.

The impact of the shift to the lower and mid-market was much more pronounced on a year-over-year basis at NRT where average sales price decreased 32%. We saw continued weakness at the high end of the market which has historically been one of NRT's market strengths. While we began to see this in Q4 of last year, the impact in Q1 of 2009 was more severe as sales of homes priced at or above \$750,000 declined about 50%, as compared to the first quarter of 2008. Recall that in Q1 2008 the issue facing housing was credit availability for lower- and middle-price-point buyers and the high end remained strong. This year the reverse was true: the pervasive financial

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crisis of the last 7 months particularly impacted the high end, whereas the low end was relatively strong given low mortgage rates, affordable homes and available financing. This is consistent with past cycles. In a recovery the low end corrects first, followed by the mid market -- and later in the recovery, the high end corrects.

As it relates to April activity, sides and price declines at RFG were similar to those in Q1. At NRT, we saw a modest lessening in sides declines, but average prices were at levels similar to those we saw in Q1.

For the first quarter at Cartus, we experienced a 16% decrease in initiations due to lower domestic volume. At TRG, purchase units declined 22% consistent with declines experienced at NRT, but lower-margin refinance volume increased 78% compared to the first quarter of 2008.

We will now turn to revenue and EBITDA by business unit for the quarter ended March 31, 2009. This information is provided on Table 4 of the press release. On a consolidated basis, EBITDA in Q1 of 2009 was negative \$24 million when you exclude the highlighted adjustments of \$38 million shown on Table 4.

Total revenue at RFG was \$105 million in the first quarter of 2009 compared with \$152 million in Q1 of 2008. The 31% revenue decline was due to lower sides and average price shown on the driver table along with reduced intercompany royalties from NRT. Domestic royalties from our third-party affiliates were aided by a 10 basis point increase in our net effective royalty rate and a 7 basis point increase in average broker commission rate charged by our franchisees. Due to the revenue decline at RFG, EBITDA before restructuring and other costs was \$45 million in the first quarter 2009 compared with \$80 million in 2008. Reduced expenses of \$9 million positively impacted the quarter.

At NRT, 2009 first quarter EBITDA was negative \$59 million before restructuring and other costs. Revenue declines of \$276 million due to lower unit and price activity at NRT were all but offset by lower commissions and royalties, and improved gross margins, along with \$54 million of marketing and operating expense reductions.

EBITDA before restructuring and other costs at Cartus was \$5 million, up from break-even in 2008. While revenue was off due to our exit from the government at-risk relocation activity and lower broker referral volume, EBITDA was positively impacted by \$35 million of cost reductions related to at-risk business exit and \$9 million of lower operating expenses.

At TRG, revenue decreased 16 percent as a result of lower unit volume and EBITDA decreased \$2 million before restructuring and other costs. The reduction in revenue was offset by \$10 million in lower cost of sales.

Turning to the balance sheet on page 6 of the 10-Q, we ended Q1 with a cash balance of \$421 million which includes \$386 million of available cash and \$35 million of statutory cash required for our title business. Our net revolver at March 31st was \$214 million when you deduct the available cash from the \$600 million outstanding on our facility. At April 30, 2009 our net revolver balance increased to approximately \$420 million. The increase in April was due to the payment of our semiannual interest payments and the funding cycle of our securitization facilities.

To shed a bit more light on that funding cycle you can see on the balance sheet that relocation receivables decreased to \$608 million and securitization debt totaled a greater amount -- \$621 million. Typically the level of relocation receivables exceeds the amount of securitization debt by about 15%. In March this was not the case. This anomaly was due to the fact that we held a cash

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balance at quarter end from liquidated receivables that, in accordance with our securitization agreements, we used to pay down \$104 million of securitization debt in April. As to the UK Relocation Securitization, the over funding issue discussed in prior quarters has been eliminated since the majority of UK clients have agreed to self-fund. As for the at-risk business, we have worked off all but \$8 million of these homes, down from \$183 million at the end of 2007.

Turning to cash flow on page 7 of the 10-Q, in the first quarter of 2009 Realogy generated \$4 million of cash from operating activities compared with negative \$106 million in the first quarter of 2008. Capital expenditures in the first quarter were \$9 million versus \$11 million in 2008. Similarly, M&A spending dropped from \$5 million during the first quarter of last year to \$2 million this past quarter, and it was mostly earn-out payments.

Although we are not giving earnings guidance for 2009, let me update you on certain cash flow item expectations for the year:

- We expect our corporate cash interest to total \$465 to \$485 million;
- Capital expenditures are expected to be under \$50 million;
- Working capital and restructuring costs are forecasted to be between \$70 and \$80 million;
- Reductions in relocation assets, net of changes in securitization borrowings, are expected to generate between \$30 to \$40 million of cash;
- Net funding of legacy issues is expected to be \$25 to \$35 million for the year, which does not include potential costs related to resolution of the Credentials case -- an old Cendant case currently under appeal -- during the period. Realogy's portion is reserved at approximately \$64 million.

On page 46 of the 10-Q, we present the senior secured leverage ratio calculation. Adjusted EBITDA is calculated based on reported EBITDA for the 12 months ended March 31, 2009. The first three adjustments shown after the trailing 12-month trailing EBITDA calculation in the right hand column are merger, restructuring, and former parent legacy costs and the 2008 impairment charges. With those non-operational items adjusted out, the starting point for the trailing 12 months' EBITDA is \$367 million. To that we add a total of \$289 million of adjustments that are prescribed in our credit agreement and result in Adjusted EBITDA of \$656 million. The cost saving and business optimization adjustments included in that calculation were all executed before the end of the quarter.

At March 31, 2009, total Senior Secured Debt as defined in our credit agreement totaled \$3.34 billion. That divided by Adjusted EBITDA results in a senior secured net debt to Adjusted EBITDA ratio of 5.1 to 1, maintaining compliance with our credit agreement. In addition, we were in compliance with respect to our securitization facilities at the end of the quarter.

Let me conclude by addressing several recurring questions:

- The fixed and variable breakdown by business unit for 2008. RFG and TRG are split approximately 70 percent fixed to 30 percent variable. Cartus is the opposite with a split of approximately 30 percent fixed to 70 percent variable. NRT costs are approximately 75 percent variable and 25 percent fixed.
- As to the Cendant legacy tax matter, which is an examination of Cendant tax years through 2006, we believe that the matter will not be resolved until 2010, and any potential payment of that liability would be in late 2010 or 2011.
- Securitization assets and cash flows. Securitization activity has predictable patterns. If the relocation receivables balance decreases in any given month, we pay down the securitization facility the following month. If the receivables balance increases, based on revised asset levels in the securitization, we borrow on the facility in the following month.

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- We continue to hold a cash surplus rather than pay down the revolving credit facility and expect to continue this practice through at least the remainder of the year. Also, as a reminder, the second and third quarters are historically our largest operational cash generation quarters.
- And finally, our focus on costs is ongoing. In Q1 of this year, we reduced our annualized costs by \$60 million which included the consolidation of 42 NRT offices and continued optimization of the businesses overall.

With that, I'll turn it over to Alicia for some concluding remarks.

SWIFT: Thank you, Richard and Tony. I have two quick points of information to add, and then we will conclude today's call:

- First, we will make a transcript of this call available on the Investor Information section of the Realogy.com Web site tomorrow morning, May 13.
- Second, we anticipate announcing our Second Quarter 2009 results in August, with the exact date still to be determined.

We thank you for taking the time to join us on the call, and we look forward to speaking with you in August. Thank you.

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