Transcript of
The Real Brokerage, Inc.
The Real Brokerage First Quarter 2023 Earnings Call
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Participants

Jason Lee - Vice President of Capital Markets and Investor Relations, The Real Brokerage, Inc.
Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.
Michelle Ressler - Chief Financial Officer, The Real Brokerage, Inc.

Analysts

Darren Aftahi - ROTH MKM
David Marsh - Singular Research
Wyatt Swanson - D. A. Davidson

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Real Brokerage First Quarter Earnings Call. At this time, all participants have been placed on a listen-only mode. And we will open the floor for your questions and comments after the presentation.

I will now turn the call over to Jason Lee, Vice President of Capital Markets and Investor Relations at the Real Brokerage. Sir, the floor is yours.

Jason Lee - Vice President of Capital Markets and Investor Relations, The Real Brokerage, Inc.

Good morning, everyone, and thank you for joining us today for Real's first quarter 2023 earnings call. With me on the call today are Tamir Poleg, our Chairman and Chief Executive Officer; and Michelle Ressler, our Chief Financial Officer. This morning, Real filed its financial statements and management discussion and analysis for the first quarter ended December 31, 2023, on SEDAR and EDGAR. These documents, along with the accompanying earnings press release can be found on both SEDAR and EDGAR.

Before I turn the call over to Tamir, I'd like to remind everyone that the company will be making statements about its future results and other forward-looking statements during this call. Our actual results may differ materially from these forward-looking statements, and the risk factors that could cause these differences are detailed in our Canadian continuous disclosure documents and SEC reports. Real disclaims any intent or obligation to update these forward-looking statements, except as expressly required by law.

Now with that, I'd like to turn the call over to Chairman and Chief Executive Officer, Tamir Poleg. Tamir, please proceed.

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Good morning, and thank you Jason.
Q1 of 2023 was a tough quarter for our industry once again, with elevated mortgage rates continuing to weigh on affordability for buyers and U.S. existing home sales down 26% year-over-year and 16% quarter-over-quarter. Against this difficult backdrop, we're pleased to announce that Real continued to see exceptionally strong growth. Our revenue for the quarter was $108 million, a 75% year-over-year increase and 12% sequential growth from the prior quarter. January tends to be the slowest month in real estate, and we are pleased to report a strong consecutive revenue increase in both February and March.

Driving this growth was our accelerating agent attraction. During the quarter our agent base grew to just over 10,000 agents, a 120% year-over-year increase. This represents a nearly 1,800 net addition, the largest increase in our company history. In fact, we've seen an impressive acceleration in agents choosing to join our platform, with nearly 1,500 agents added in Q4 and 1,100 in Q3. This growth drove an improvement in transaction volume, despite productivity levels that are affected by the challenging housing market. Total transaction sides improved 75% year-over-year to 10,963.

These results come during a difficult period for agents across the industry, as evidenced by shrinking agent bases at many other brokerages. What's clear to us is that our agent attraction model is working and our technology and value proposition is resonating with agents that want to be successful—we're seeing this anecdotally in the conversations we have with our agents and prospects, and ultimately we're seeing it in the number of agents that are making the choice to join our platform.

Our gain in market share has not gone unnoticed. I'm proud to report that we were recently recognized as a top brokerage by RealTrends, T360, RISMedia, and HousingWire. We have been working hard to build a tech-powered brokerage where agents are excited to join and thrive. Our inclusion in these rankings highlights the pace of growth we have experienced in just a few short years, and we are pleased to have been recognized for our achievements.

On the geographic expansion front, we launched operations in Delaware in May, which strengthens our presence in the Mid-Atlantic region, and brings our total state count to 46. Also in May, we expanded into Manitoba in Canada, growing our total presence in that country to four provinces, including Alberta, Ontario and British Columbia.

Back in December, we announced the addition of Sharran Srivatsaa as President of the company. He is focused on all aspects of growth, including agent attraction and education. In April, we hosted our first REALx annual virtual summit, a two-day agent event led by Sharran that assembled our industry's best thought leaders and inspired thousands of attendees. We also announced our second annual agent conference called RISE which is scheduled for October 22-24 in San Diego, California.

Now to touch on some new products and initiatives we're excited about. The home buying experience has been a focus for us in recent quarters. We understand that the future of real estate lies in taking this very complex process of buying a home and wrapping it into a single, well crafted, easy to understand product.

As part of bringing this vision to life, we will be launching an initial limited beta version of our consumer facing app in a few weeks, focusing on streamlining the mortgage application process. In a few days, we will also be launching Fast14 - a program that provides homebuyers with a guarantee that they will be cleared to close on their mortgage within 14 days of submitting their mortgage application. We believe that the certainty provided by this program as well as the speed to close will be attractive to many buyers. We expect Fast14 to be embedded into our consumer facing app later this year.

We pride ourselves on our nimble development culture, which is why we immediately recognized the revolutionary potential that recent advances in AI and machine learning models offer. This led us to announce the development of Leo earlier this month, a new AI virtual assistant that will be fully integrated into our reZEN transaction management platform that will answer agent questions in real time 24/7, leveraging Real's extensive proprietary knowledge base to create a completely customized experience. This will save time for our agents and make our already lean support team even more efficient, which fundamentally aligns with our core philosophy of becoming the premier brokerage by building scalable solutions for our agents. We expect to roll out an initial version for testing by the end of Q2.

We are also happy to announce on this call that today we have launched Real Signature to all of our agents, a proprietary electronic signature tool built fully inside reZEN. This feature will benefit agents by allowing them to save time by creating document templates for future transactions and to save money by avoiding third-party subscription fees. Further, by developing this tool in-house, we will also own all of the data associated with the transaction experience which we can leverage to better automate the transaction process and create better user experiences over the long term. It is an important building block of the one-stop shop consumer product we are developing.

Subsequent to the end of the quarter, on April 4 we announced Sentry Residential merged its military-focused national brokerage into Real, adding to Real's existing 500-plus military-focused agents. Real plans to leverage our growing presence to launch a Real Military Division, the first of several planned divisions of practice. This is a great milestone for the company as we create a specialized pillar of our community to focus on military veterans and their clients.

On our prior earnings call we were optimistic that Q4 was the bottom for us given record open transaction volume on our platform in early 2023. As of today, our open transaction volume has reached new records once again as we enter the seasonally busiest time of the year in our industry. As a result, we are confident that the tremendous market share growth and the recently announced changes to our model will have a growing impact on our financials. We believe these will have an even more significant effect as per agent productivity accelerates with increased macro environment stabilization, as our platform now boasts considerably more agents.

We remain focused on aggressively gaining strong market share by providing the best ecosystem for agents. Given our accelerating performance and the progress witnessed thus far this quarter, we now expect to reach our goal of becoming adjusted EBITDA profitable in Q2, earlier than our prior target of reaching adjusted EBITDA profitability in the second half of 2023. As we scale our title and mortgage businesses, we continue to lay the foundations for an industry-changing consumer experience and will begin testing initial versions of a consumer-focused application with a select group of agents and clients early in the second half of 2023 that will feature mortgage pre-approval. While we anticipate that it will take another year to iterate to a full consumer-facing product, we want to prioritize growing sustainably while executing our long-term vision.

And with that, I'll turn it over to Michelle for the financial update.

Michelle Ressler - Chief Financial Officer, The Real Brokerage, Inc.

Thank you, Tamir; and thank you, everyone, for joining us. I'll start by reviewing some of our key financial results for the first quarter.

For the quarter ended March 31, the total value of homes transacted over our platform reached $4.0 billion, which represents a 66% increase compared to the same period in 2022. The total number of transactions on our platform during the quarter increased to 10,963, a 75% year-over-year increase. The median sale price of properties sold by our agents was $350,000, which represents a modest 1.4% increase compared to Q1 2022.

As Tamir mentioned, while many other brokerages in our industry are struggling, we are pleased with the impressive growth we are witnessing. Revenue increased to $108 million, a 75% increase compared with Q1 2022. Meanwhile, gross profit increased 84% year-over-year to $10.8 million. Our gross margin expanded to 10.0%, up from 9.5% in Q1 2022. The increase was driven by a continued drop in the percentage of agents that have reached their cap, which is a result of the generally lower market activity compared to prior periods. As of March 31, 2023, 8.2% of our agents had exceeded their cap, down from 8.9% at the end of 2022. The capped cohort represented 43% of commission revenue in Q1, compared to 44% in Q4 2022.

The improved margin also reflects our agent growth and some initial impact from the increased fee structure. As a reminder we increased our U.S. fees for new agents beginning on February 1 and for existing agents on April 1. The majority of these changes will begin to impact our financials more materially beginning in Q2.

Looking at the geographies we operate in, 8.2% of our U.S. agents ended the quarter with capped status, down marginally from 8.5% in Q4. Our Canadian capped agents experienced a more meaningful drop, with 7.9% ending the quarter with capped status vs. 14.1% at the end of Q4. We believe this reflects the more acute downturn in the Canadian residential real estate market. Canada residential sales activity in Q1 was 38% lower and average sale price was 17% lower year-over-year according to the Canadian Real Estate Association. This compares with a 26% volume and 1% price drop to U.S. existing home sales figures over the same period, as reported by the National Association of Realtors. However, Canada represents just 9% of our agents, up slightly from 8% as of Q4. Canada represented 11% of commission revenue in Q1, a decline compared to 14% in Q4 and 13% in Q1 2022.

Our highest-earning Elite Agents at the end of the quarter declined to 0.5% of our agent base, compared to 0.9% in the prior quarter. These agents were responsible for generating 8.5% of total commission revenue, down notably from 12.7%. The requirements to achieve and maintain Elite status are reserved for our most productive agents, and a sustained period of market weakness is evident in this decline. Overall, we believe Real continues to be the winning solution for productive agents looking to be as efficient as possible, even during a market downshift.

In Q1, 59% of commission revenue was generated by our agents representing the buy-side, 36% was on the sell-side, and 5% was from dual-agency representation. This is essentially unchanged from the same quarter in 2021, and does not include revenue that we book related to agent referrals, which accounts for approximately 2% of the overall total.

Commission revenue per productive agent, a core measure of agent productivity, moderated to $26,000 in Q1 from $27,200 in Q4 and $29,400 in Q1 2022. The number of transactions closed by this cohort eased to 2.7 from 2.8 in Q4 and 3.0 in Q1 2022. To strip out the effect of new agents joining, we also track the commission revenue per productive agent already on our platform at the beginning of the quarter. This is similar to a same-store sales figure reported by the retail industry. For these existing agents, the average commission revenue in Q1 was $29,800 compared to $30,300 in Q4, and the number of transactions closed by the existing agent cohort held steady quarter-over-quarter at 3.1 which gives us confidence that productivity is stabilizing. The lower productivity overall is largely a factor of the macro-economic environment, and our agent growth has more than offset the impact. We look forward to recognizing the full financial impact resulting from the large influx of agents we experienced in Q1.

Despite heightened growth across the board, we did experience a slight uptick in the number of agents that left our platform. Our revenue churn, which we define as the dollar amount generated by churned agents over the prior two quarters, rose to 4.3% compared to 2.4% in Q4. Meanwhile our agent churn increased to 8.3% from 4.4% in Q4. However, part of the uptick is related to previously announced increases to certain fees paid by our agents that resulted in some agents choosing to leave the platform. While this is regrettable, I want to reiterate that we made these changes with extensive input from our agents and the churn we experienced as a result was effectively contained to just two notable teams and occurred primarily in January and February. Additionally, there is a seasonal component to churn and some of this is related to what is happening more broadly in the industry, even as our platform growth more than offsets it. Nevertheless, we monitor this closely and are actively working to improve our training programs to better reduce churn.

Shifting over to Opex, our total operating costs for the quarter, including revenue share, were $17.8 million. This represents 16.5% of revenue, compared with 16.4% in Q1 2022. Our operating expense per transaction, excluding revenue share, which is a core component of our agent incentives, declined 5% year-over-year to $1,132. We continue to be laser-focused on optimizing our already efficient cost structure given industry headwinds, and in line with our goal of reaching positive adjusted EBITDA in Q2 of this year as Tamir had mentioned.

Our revenue share, which is our largest single operating cost, was $5.4 million, or 5.0% of revenue for the quarter compared to 4.4% in Q1 2022. However, the revenue share expense per agent was $543, down 9% from $594 in Q1 of 2022. This expense is highly sensitive to the growth of our agent base, and specifically the growth of productive sponsorship trees as our sponsoring agents are highly incentivized to nurture the agents in their downlines to unlock the program tiers. We treat this as a marketing expense but note that we believe the benefit of our sponsorship structure not only helps attract new agents, but also drives retention and higher productivity across our platform.

Our headcount efficiency ratio, which we define as full-time brokerage employees excluding Real Title and LemonBrew employees divided by the number of agents that are currently on our platform, continued to improve, rising to around 1 to 114, from 1 to 98 as of Q4. The upcoming roll-out of our virtual assistant Leo is expected to help drive this ratio higher.

As expected, our transaction processing team continues to execute on further improvements at scale. Our 9 employees supporting this function processed the nearly 11,000 transactions that closed on our platform during the quarter, or 1,218 transactions per employee. We expect to be able to continue to scale up materially without significant headcount additions.
We believe these metrics best highlight the efficiency and scalability of our platform that is made possible by the strength of our tech stack. We believe this is ultimately one of the biggest competitive advantages for our business, and this will become even more apparent as we continue to scale.

Real's net loss for the quarter was $7.4 million compared to $4.3 million in Q1 of 2022, translating to a loss per share of $0.04 compared to a $0.03 loss per share for the same period in 2022. Adjusted EBITDA loss for the quarter was recorded at $792,000, compared to a $577,000 loss in Q1 of 2022. Note that we revised the methodology for reporting this metric, which now adds back the non-cash expense associated with shares allocated to our agents in connection with Real's share purchase program. For more information on the changes and historical impact please reference the summary table in our Management Discussion and Analysis report that has been filed and also posted on the investor relations section of our website.

Turning to our financial position, we had $11.0 million in un-restricted cash on the balance sheet and an additional $8.5 million in short-term investments to bring our total liquidity to $19.5 million as of March 31, 2023. This represents a $728,000 increase from Q4. We continue to have no debt and no need to raise debt in the near-term.

In conclusion, we expect a strong pick-up in our financial results going forward, and as such we are revising our previously-communicated target of reaching adjusted EBITDA profitability in the second half of this year. We now have confidence that we will reach this milestone in the current quarter. This conviction factors in the impact from our new fee structure, our accelerating agent growth, seasonal tailwinds picking up, and the operational efficiencies we've built into our

platform. We are excited at the growth we experienced over the quarter and are even more excited for what's to come as we work to usher in the future of real estate.
This concludes my financial remarks. I will now ask the operator to open up the line for Q&A. Operator, can you please poll for questions?

Operator

Certainly. Ladies and gentlemen, the floor is now open for questions. [Operator Instructions]. Your first question is coming from Darren Aftahi from ROTH MKM. Your line is live.

Q: Hey guys, good morning. Thanks for taking my questions and nice job on the results. I have kind of two big picture questions here. First, just the productivity per agent, I think was 2.7 in the quarter and I think you said people on the platform was 3 to 3.1 which was flat year-on-year. So in light of how poorly some of your peers are doing, I guess my question is you scaled the business fairly quickly from hundreds of agents to now 10,000. As you scale from 10,000 to 50,000, how does that productivity measure in your mind kind of move around and I guess more near-term, do you feel like that transaction per agent number is maybe troughed for the intermediate term?

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Hi, Darren. Thank you. I think that as a company we're focused on production versus just agent count. So I think that those productivity metrics are sustainable as we grow to 10s of 1000s of agents. Obviously, there will be a little bit of movement here or there, but I think that those numbers are the numbers that we are actually focusing on generally as a company. So I expect us to continue and post this type of productivity per agent just because we are focused on having productive agents on the platform and helping them close deals.

Q: Great. And then could you just speak to the general macro, at least in some of the bigger markets that you're in? And maybe kind of compare the trailing 12 quarters or excuse me, four quarters and kind of how the movement in your business like do you think, if I'm hearing you correctly, it sounds like, and I know things pick up in the Springtime, but aside from that dynamic, the broader macro, do you feel like we bottom? There's still not enough inventory like how do you feel in general about the broader macro?

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Sure. I think we came into 2023 pretty cautious about the macro environment of the real estate space in general. And what we've seen is that right now the market has stabilized. I think that we bottomed in the fourth quarter. We are seeing a lot of the same phenomenon that we have seen in the first half of 2022 of bidding mores and multiple offer situations. We're seeing very strong demand in many, many markets. Obviously, there are some softer markets, but I think that overall this will be a great Spring season for the real estate in general.

Q: If I can squeeze one.

Tamir Poleg – CEO & Co-Founder, The Real Brokerage, Inc.

Go ahead, go ahead.

Q: I was just going to squeeze one last one in. Just in light of your comments about EBITDA being pulled forward a quarter on a positive basis, can you just talk about the attach rate for Title, which I think is now Real Title and LemonBrew and how that's going to impact attach rates and how that kind of impacts the profitability of the business going forward. Thanks.

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Sure. At this point, those ancillary services still do not have meaningful contribution to our margins or our revenue in general. In terms of Real Title, what we're seeing is that we are experiencing great success on the JVs, those structures that allow our agents to become partners in Title company and those JVs, we have about 300 agents at the moment, and we see attach rates of around 70%, which is super high. We are now expanding those JVs to seven additional states. So we expect Real Title to continue and grow revenue and eventually have a meaningful impact on our margins and financials.

But when we talk about the adjusted beta profitability, this is mainly based on the brokerage performance at this point, and obviously as mortgage and title kick in, then it will have an even more positive effect.

Q: Helpful. Thank you.

Operator

Thank you. Your next question is coming from David Marsh from Singular Research. Your line is live.

Q: Hi, guys. Thanks for taking the questions. First on the SG&A side, were there any non-recurring items in the SG&A line in the quarter?

Michelle Ressler - Chief Financial Officer, The Real Brokerage, Inc.

Hi, thanks for joining today. Thanks for your question. No, generally, our OpEx is pretty sustainable quarter-over-quarter. There were no non-recurring items that we reported.

Q: Okay. Will the cash operating expenses moderate at all throughout the remainder of the year or is this kind of like a new run rate kind of level that we should expect as we're moving forward?

Michelle Ressler - Chief Financial Officer, The Real Brokerage, Inc.

Yes, great question. There's a seasonal component to our OpEx. Typically, the first quarter is higher. So in Q1, it was 16.5% of revenue. However, if you look at 2022, our OpEx dipped in Q2 and Q3 to 12% and 11.5%. So the total for 2023 was 13.5% and it reflects our operating leverage kicking in throughout the busiest times of the year. We can expect the same trends for 2023.

Q: Perfect. That's really helpful. And then just with regard to the macro environment and sort of the banking, the banking situation in the U.S. Have you guys seen a major pullback by any of the banking sector in terms of their willingness to lend? Or is it generally business as usual? Or could you talk about maybe you could even talk about the spread for fixed rate loans kind of over the 10 year seems like it's hovering a little bit higher than it historically has and perhaps what might drive that back down towards like a 200 basis point type spread that we've typically seen?

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Sure. I would say that what we are experiencing on the mortgage side or financing side is pretty much business as usual. We haven't seen any pullback from major lenders. We haven't also seen an uptick in terminated contracts due to problems with financing. I think that buyers have a lot of alternatives right now and there's still money out there looking to go into the housing market. So I think that the banking crisis has not impacted residential real estate yet.

At least not for the average buyer. Maybe for investors, I think that sure I mean there's more risk and the risk is factored in and this is reflected in the spreads at the moment. But as investors' confidence in real estate comes back and once people understand that real estate is stable and there's a lot of demand and people are still transacting. I think that those spreads will go back to historically average or normal. So I think that we are not too far from that happening in maybe a few weeks to a few months.

Q: That's really helpful color, Tamir. I appreciate that. Just last one from me. Just a quick little housekeeping item on your CapEx really, really low only like $140,000 of PP&E purchases in the quarter. Could you give us an expectation for your PP&E purchases for the balance of the year, just in terms of your capital budget?

Michelle Ressler - Chief Financial Officer, The Real Brokerage, Inc.

Sure. So the majority of that reflects capitalized R&D expenses throughout our development phase. We don't expect that to increase materially. You can expect the same run rate for the remainder of the year.

Q: Great. That's all from me. Thanks guys.

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Thank you.

Operator

Thank you. [Operator Instructions]. Your next question is coming from Tom White from D.A. Davidson. Your line is live.

Q: Hey, this is Wyatt Swanson on for Tom. Thanks for taking our questions. I have one related to the overall agent value proposition and you drove nearly 1,800 agents to the platform this quarter, which is great, but thinking more over the next few years, could you maybe talk about how you anticipate the overall agent value prop evolves and improves to continue adding value and attracting agents to the platform?

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Sure. Hi,. Thank you for the question. I think that overall, when you think about the reasons why agents join us, we can look at a few things. One is the favorable economics. Second is the technology that we offer them and help them run their businesses and streamline transaction. The third is culture, which is very special here and attracts a lot of agents because there's a lot of collaboration versus competition. And the fourth would be financial opportunities. I think that we continuously add more and more value through technology.

So just this morning we announced Real Signature, which is a system that allows agents to create document templates and send them for review and signature for their clients and that saves them a lot of time and money. We also announced willable Rev Share, which is the ability for agents to actually nominate a beneficiary for their revenue rev share component if they have one. And if something happens to them, then we will continue to pay their family.

So we continuously add more and more value to the platform and I think that that will continue and resonate with a lot of agents and will continue to help us with growing the agent count on the platform. And as we are currently seeing, we are the fastest growing company in the industry. We are the only company that actually posted revenue growth year-over-year. And I think that if we look at the coming years, the number of agents will only increase.

Q: Great. Thank you for that color. And then maybe a follow-up on how Real Brokerage can make sure it capitalizes. When it comes to the smaller independent brokerages out there that might be struggling to stay afloat given the market slowdown, how could you benefit from bringing their business over to your platform?

Tamir Poleg - CEO & Co-Founder, The Real Brokerage, Inc.

Good question. And we are, in fact, engaged in a lot of conversations with small and medium sized brokerages, folks that are closing 100s of millions of dollars in volume to over $1 billion. What happens at the moment is that they're closing fewer transactions and they still have a lot of fixed cost. And the benefit of joining Real is just providing more value to their agents. We take away some of their fixed cost, we streamline their transactions and we just allow them to operate more efficiently.

So that drives a lot of attention and conversations at the moment. And I think that we will continue to onboard more and more brokerages. Obviously, we are not spending money on acquisition of brokerages. So we do not engage in M&A activity for cash or equity. We just think that the value proposition will attract them to us. And we are actually seeing that in action right now, also because of the market conditions.

Q: Great, thank you very much.

<u>Operator</u>

Thank you very much. Mr. Lee, there appears to be no further questions.

<u>Jason Lee - Vice President of Capital Markets and Investor Relations, The Real Brokerage, Inc.</u>

Thank you. If you have any additional questions on today's earnings release, please feel free to contact me directly. Operator, would you please give the conference call replay instructions once again. Thanks.

<u>Operator</u>

Absolutely. In order to access the replay, you need to call 877-481-4010 with a confirmation code of 48269. Once again, the phone number is 877-481-4010 with confirmation code of 48269. The replay will be available at 02:00 p.m. Eastern today. Ladies and gentlemen, this does conclude today's conference call. You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.