Bridgemarq Real Estate Services

2018 Fourth Quarter and Annual Results Conference Call

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CORPORATE PARTICIPANTS

Phil Soper
Bridgemarq Real Estate Services — President and Chief Executive Officer

Glen McMillan
Bridgemarq Real Estate Services — Chief Financial Officer

PRESENTATION

Operator

Good morning. My name is Adam, and I'd like to welcome everyone to the Bridgemarq Real Estate Services 2018 Fourth Quarter and Annual Results Conference Call. All lines have been placed on mute to prevent any background noise.

And after the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. And if you would like to withdraw your question, press the # key. Thank you.

I'd now like to introduce you to Mr. Phil Soper, President and CEO of Bridgemarq Real Estate Services. Mr. Soper, you may begin your conference call.

Phil Soper — President and Chief Executive Officer, Bridgemarq Real Estate Services

Thank you, Adam, and good morning, everyone. We appreciate you joining us today. With me this morning is our Chief Financial Officer, Glen McMillan. On today's call, I'll begin with a brief overview of the quarter as well as the year. Glen will then discuss our financial results in detail. Afterwards, I'll conclude by providing some remarks on recent business, operational highlights and market developments. At the end of the call, Glen and I would be happy to take your questions.

I want to remind you that some of the remarks expressed during this call may contain forward-looking statements. You should not place reliance on these forward-looking statements because they involve known and unknown risks and uncertainties that may cause the actual results and performance of the Company to differ materially from the anticipated future results expressed or implied with such forward-looking statements.

I encourage everyone, as always, to review the cautionary language found in our news release and in our regulatory filings with respect to forward-looking statements. All these documents can be found on our website and on SEDAR.

I'd like to begin by acknowledging the career and contribution to our company of the Honourable J. Trevor Eyton who recently passed. As a friend and member of our Board of Directors, he will be dearly missed. Mr. Eyton was formerly the CEO of Brascan, the predecessor of today's Brookfield Asset Management, a member of the Order of Canada, and a Canadian Senator.

If you missed the year-beginning announcement, you may be surprised to see that we have rebranded. The Company now operates as Bridgemarq Real Estate Service. That is B-R-I-D-G-E-M-A-R-Q. You can find us at bridgemarq.com. And the rebranding is designed to clarify the Company's unique position in the market and to avoid any investor confusion with Brookfield itself. There are no operational or organizational changes to the Company. The stock symbol on TSX, which is BRE, remains the same. And finally, the manager remains a wholly-owned subsidiary of Brookfield Business Partners and Brookfield's 28 percent of the Company remains as is. So it really is simply a branding change.

At our meeting yesterday, our board meeting yesterday, the directors approved a dividend of $0.1125 per share, which is $1.35 per share on an annualized basis. The dividend, payable April 30th to shareholders of record on March 29th, is consistent with the 2018 dividend.

In 2018, the Canadian real estate market contracted, driven by low unit sales in our two largest markets, Greater Toronto Area, and what we call the Lower Mainland or Greater Vancouver in British Columbia. In the decade and a half that the Company has operated as a public company, we have experienced economic downturns and real estate market corrections. They're just part of business life.

Our business structure was designed from the very outset to insulate investors from these inevitable cycles and market corrections.

Again, in 2018, as we have in the past, Bridgemarq was able to grow the size of our network in the face of a significant market downturn. Approximately 73 percent of the Company's annual royalties are effectively fixed in nature and are substantially insulated from market fluctuations. What that means is in a downturn, investors are protected, but you should understand that in periods of rapid growth, the Company grows at a more—rapid market growth, the Company grows at a more modest rate. Still, we believe that this structure is well-suited for an income-focused investment like ours.

As at December 31, 2018, the Company's network of realtors grew to 18,725. That's a 3 percent increase compared to the 18,135 at the end of last year. On January 3, 2019, the Company acquired a further 47 franchise agreements, representing 495 realtors across Canada for nominal consideration. And this was all part of the new Management Services Agreement. These agreements are expected to generate an annual royalty stream of approximately $900,000.

As part of the recently announced MSA, Management Services Agreement, the manager transferred, to the Company, a number of contracts under which Bridgemarq will earn ancillary revenues. These revenue streams outside of our core franchise revenue streams come from mortgage referral businesses, commercial brokerage, which was previously not part of Bridgemarq's sphere, and revenue from lead management support services. In 2018, the manager earned approximately $3.8 million from these ancillary revenues, net of direct costs. The addition of this almost $4 million revenue stream provides Bridgemarq with future opportunities to grow.

There are several factors that dampened demand for housing across Canada in 2018. In addition to cyclical activity driven by supply and demand in regional real estate markets, in particular, the overshooting on price that we saw in British Columbia and Ontario, a number or regulatory policy changes at the federal and provincial and even municipal level were put in place.

Most notably, changes to mortgage access rules across Canada went into effect on January 1, 2018, which made it more challenging for people to get a mortgage. We call it the stress test, and essentially, it is aimed to protect people when interest rates rise and return to more normal levels. In British Columbia in particular, the provincial government introduced a series of new taxes charging the real estate market that have caused significant drain on, or drag on, market activity in that province.

In the second half of 2018, we saw significant improvement in consumer confidence in Canada's largest real estate market, the Greater Toronto Area. The GTA market increased 4 percent in the second half of 2018 compared to the same period a year previous; so that's up 4 percent. This is in sharp contrast to the first half of last year where we saw year-over-year decrease of 34 percent. So down 34 percent in the first half of the year, up 4 percent in the second half of the year. In the early stages of 2019, we're seeing the continued recovery occurring in the GTA market.

Greater Vancouver, on the other hand, continues to see softened demand after several years of rapid home price appreciation, while the most affordable major city in Canada, Montreal, continues to expand at a very healthy rate. Glen will speak to these markets and the statistics that are driving them in more detail shortly.

Finally, a few minutes ago, the Bank of Canada announced that it would be holding its target bank rate steady at 1.75 percent. This is in response, of course, to a slower growth but also geopolitical activities in the United States regarding trade and other friction. It is, from the standpoint of the Company, a prudent measure to keep the target rate steady at this point in time, and the real estate market, of course, is very susceptible to changes in interest rates. So a steady rate should be supportive of the market overall this year.

With that, I'd like to turn the call over to Glen for a look at our financial performance and a deeper dive into the major markets.

Glen McMillan — Chief Financial Officer, Bridgemarq Real Estate Services

Thank you, Phil, and good morning, everyone. For the year, net earnings were $17.4 million, or $1.30 per share on a fully diluted basis, compared to net earnings of 12.4 million, or $1.31 per share in 2017. Increased net earnings were due in part to a gain of $6.5 million on the determination of the fair value of the exchangeable units issued by the Company. This gain is determined with reference to the trading price of the Company's restricted voting shares on the Toronto Stock Exchange, which ended the year at $14.57 per share, down 12 percent from the start of the year.

This reduction in the Company's share price is consistent with the drop in the overall market. For comparison, in 2017, we recorded a loss of $2.5 million on the revaluation of the exchangeable units as our share price increased over the course of 2017.

Royalties for the year were $42 million, a 5 percent decrease compared to 2017, and cash flow from operations was $30.5 million, or $2.38 per share, compared to $2.55 per share in 2017. The decrease in CFFO was mainly driven by the decrease in premium fees and slightly higher administration expenses. The reduction in premium fees was due to the expiry of the obligation of certain brokerages in the Greater Toronto Area to pay these fees during the year. The increase in administration was due to onetime costs associated with the review and negotiation of amendments to the Company's Management Services Agreement, which were completed in November.

For the fourth quarter, the Company generated net earnings of $8.8 million, or $0.24 per share on a fully diluted basis, compared to $0.30 per share in 2017. These results included a gain on the valuation of exchangeable units of $7.3 million in the quarter.

Royalty revenues for the quarter amounted to $8.9 million, down from 9.5 million in 2017 due to lower premium fees partly offset by increases in variable and fixed fees. Fixed fees are directly tied to an increase in the number of realtors in the Company network. The increase in variable fees is due to improved markets relative to the last half of 2017, higher aging counts, and the incidence of fee capping. As a result of weaker markets throughout the year, many of the realtors who may have capped during the second or third quarters of 2017 didn't cap until the fourth quarter of 2018, pushing revenues into the fourth quarter.

The Company generated $6.2 million in cash flow from operations for the , or $0.48 per share, as compared to $7 million, or $0.55 per share last year, reflecting the lower royalty revenues.

The residential real estate market saw its share of volatility in 2018. However, as Phil noted, it is important to remember that the Company's revenue is driven by long-term franchise agreements, and our royalties are weighted towards fixed fees. For the year, the Canadian market closed down 15 percent at $224 billion compared to $262.5 billion in 2017. This reflects a 4 percent decrease in price and a decrease of 11 percent in the number of units sold.

During the first half of 2018, the national housing market decreased 20 percent compared to the first half of 2017, while the second half of 2018 was down a smaller 7.5 percent year over year. The Greater Toronto Area market saw significant volatility, which largely reflects a decline in unit sales activity in the first half of the year. So for the full year, the Greater Toronto Area closed down 20 percent at $61 billion, driven by a 4 percent decrease in price and a 16 percent decrease in units sold due in part to the impact of government policies, which Phil referred to earlier.

The Greater Toronto Area market's relative performance in the second half of the year reflects consumers returning to the market as year-over-year unit sales activity improved. This was most evident in the third quarter as the GTA market closed up 15 percent year over year, driven by a 10 percent increase in units and a 5 percent increase in price. The fourth quarter was again down and closed at $14 billion, which is a 6 percent decrease over the previous year, driven by a drop of 10 percent in unit sales, partly offset by a 4 percent increase in average selling price.

And in the Lower Mainland for the year, the market closed down 30 percent to $26 billion, driven by a 32 percent increase in units sold partly offset by a 2 percent increase in price.

In 2018, the Greater Montreal Area closed up 9.2 percent year over year at $18 billion, reflecting a 4 percent increase in average selling price and a 5 percent increase in unit sales. The Greater Montreal Area has expanded by almost 35 percent over the past two years.

I'll turn it back over to Phil to provide additional insights into the markets and an update on our operations.

Phil Soper

Thanks very much, Glen. One of the most important drivers for the real estate industry is the unemployment rate. When Canadians have jobs, they buy homes. We say in the industry that jobs turn renters into buyers.

In November, Canada's unemployment rate hit a 40-year low. Going into 2019, British Columbia's unemployment rate was 4.7 percent, leading the nation, followed by Quebec at 5.4 and

Ontario at 5.7. Economists widely accept 5 percent as an economy operating at full employment. Canadians in our most populous provinces are working, and that does drive real estate activity.

According to data released by Statistics Canada last Friday, a 1.2 percent rise in compensation for employees boosted household disposable income by 0.8 percent in the fourth quarter, a very healthy rate. This, coupled with a lower nominal household consumption spending rate resulted in a 1.1 percent increase in household savings. This derisks our economy.

Canadian economic growth slowed in the fourth quarter of 2018. Overall GDP growth was only 0.4 percent on an annualized basis in the quarter. After a very strong 2017, that puts growth for 2018 at a more modest 1.8 percent. This is, at least in part, what drove the Bank of Canada to keep its target rate steady, as I mentioned earlier in the call.

The central bank projects real GDP will be essentially flat this year at 1.7 percent with significant economic expansion beginning again in 2020 when the economy's anticipated to expand at greater than 2 percent.

Population growth drives real estate markets, according to Statistics Canada. Using its medium-growth scenario, the Canadian population is expected to reach 44 million by 2036. We're at about 37 million today. That is a significant growth and maybe the fastest growing—we may be the fastest growing advanced nation on Earth.

According to the Ontario provincial government, the Greater Toronto Area's projected to be the fastest growing region of the province with its population expected to increase by nearly 3 million people or 40 percent to reach 10 million in 20 years. So on a longer-term basis, the continual growth in population and, therefore, household formation, is a very healthy indicator for the future of the real estate brokerage industry in general.

During the fourth quarter, our Royal LePage business continued to make enhancements to the consumer-facing website, royallepage.ca, which is Canada's most popular real estate company website. Earlier this year, the brand launched Royal LePage lifestyle match on the site, which enhances a homebuyer's property search through personal scoring criteria matched to the perfect neighbourhood. It's proving to be very popular.

Another popular website enhancement that is now available is a school search where a consumer can search for homes in a specific school catchment area. It works like this. If you want your children to go to a specific school, going to royallepage.ca will now allow you to bring up only those properties that qualify your child to attend that school. Or conversely, looking at it the other way around, if you want to live in a specific neighbourhood, you can use our online tool to show the list of schools that your child would be qualified for if they were to live in that neighbourhood. This is only a few weeks old, and it's already proven to be extremely popular with Canadian home shoppers.

One of the more significant launches in 2018 was Royal LePage's new lead management solution for realtors. Using highly advanced technologies, this business service ties into our CRM or client relationship management system and is designed to improve consumer lead conversion through automating best practices across the nation. This has taken a considerable amount of training and fits right into our core strength with an in-house adult learning department—learning services. We expect continued growth in this area.

Also, in 2018, Royal LePage launched brand and media campaigns designed to heighten brand awareness across the consumer-facing web world, network-facing websites, and social platforms as well as the national and regional media. As an example, the brand launched a social media Facebook campaign for brokers that focused on recruiting new and experienced realtors.

Additionally, the brand launched a new resource on its network-facing website for realtors to pursue new accreditations that were made possible by a partnership with the National Association of Realtors in America in an efficient manner and at a discounted cost for our network.

In 2018, our Via Capitale business announced a new partnership to promote its network listings in China. And earlier this year, the brand launched new training sessions and videos for brokers, promoting the brand's tools, including maison vedette and courtier vedette products. Via Capitale also launched an agency tool to support brokerages themselves with online promotions.

In 2018, the Royal LePage brand received two awards from the International Association of Business Communicators, including the 2018 Ovation Award of Excellence for our Peak Millennial research and media campaigns. This research focused on attitudes towards real estate and housing and buying projections in this key demographic. We know that the Millennial cohort, which is our first-time buyers in Canada, is the largest group of people in Canadian history. We also received an award, an ACE Award from the Canadian Public Relations Society for the Royal LePage House Price Survey, a service that we provide Canadians that dates back many decades.

In 2018, the Company generated 2.7 billion consumer impressions across all forms of electronic print and new media. This represents a lead of over 1 billion consumer impressions over our next nearest competitor. Our Royal LePage business is trademarked the Voice of Canadian Real Estate, and with results like this, it is obvious why.

In conclusion, despite a contraction in the Canadian market, the Company was able to grow the size of our REALTOR network, which bodes well for our future revenue growth, through organic recruitment improvement and retention practices.

Nationwide, our brands continue to attract engaged and motivated professionals as they look for the best operating models and the best products and service to support their personal real estate practices.

Our business structure, which effectively insulates 73 percent of our royalties from fluctuations in the real estate market, allows us to provide shareholders with strong and stable dividends. Canada's low unemployment rate and the historically low bank rate has supported key real estate markets. While GDP growth has slowed, the Bank of Canada's expecting GDP to trend upwards, increasing from 1.7 percent in '19 to 2.1 percent in 2020.

We would also like to take this opportunity to inform you and invite you to our annual meeting of the Company. The AGM will be held on Tuesday, May 7, 2019, at 10:00 a.m. Eastern Standard Time. It will be located in the Inverness Room at Vantage Venues in the 27th floor of 150 King Street West in downtown Toronto. All of that information is available on our website, bridgemarq.com.

With that, I'd like to turn the call back to our Operator and open up the line to questions.

Q&A

Operator

Thank you. As a reminder, at this time, if you do want to ask a question, just press *, then the number 1 on your telephone keypad. And if you do want to remove yourself from that question queue, just press the # key. And we'll pause for just a moment to compile the Q&A roster.

And once again, it is *, 1 on your telephone keypad to ask a question.

And we have no questions at this time. So I'll turn the call back over to Mr. Phil Soper for our closing remarks.

Phil Soper

I wish to thank everyone once again for participating in today's call and look forward to updating you with a formal presentation on the industry and business, again, May 7, 2019, at 10:00 a.m., when we hold our annual general meeting. Thanks, all.

Operator

And this does conclude today's conference call. You may now disconnect.