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FINAL TRANSCRIPT

Brookfield Real Estate Services Inc.

Third Quarter of 2018 Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Vitram Seth
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PRESENTATION

Operator

Good morning. My name is Julie, and I would like to welcome everyone to the Brookfield Real Estate Services Inc. Third Quarter of 2018 Conference Call. All lines have been placed on mute to prevent any background noise.

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

I would like to introduce you to Mr. Phil Soper, President and CEO of Brookfield Real Estate Services Inc.

Mr. Soper, you may begin your conference call.

Phil Soper — President and Chief Executive Officer, Brookfield Real Estate Services Inc.

Thanks so much, and good morning, everybody. We appreciate you joining us. With me today is our Chief Financial Officer, Glen McMillan.

On today's call, we'll provide an overview of the third quarter from both an operating and financial results perspective, as well as insight into new initiatives and market developments.

I'm also delighted to announce that the Company has entered into a new amended Management Services Agreement. We are very pleased with the terms of the agreement, which include incremental revenue growth opportunities. More on that later.

Following our remarks, both 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 by such statements.

I encourage everyone to review the cautionary language found in our news release and all of our regulatory filings. You can find these documents on our website and on SEDAR.

On our last call, I commented that the federal mortgage stress test implemented on January 1st slowed the residential real estate market in the first half of 2018, and that the market should normalize in the second half of the year. While still down modestly year over year in the third quarter, national sales activity saw significant improvement from the sharp decline last quarter, and we expect to see this trend continue through the rest of 2018 as buyers continue to return to the market after pausing large purchase decisions, such as housing, in the first half of the year.

When we look at the Greater Toronto Area, the largest housing market in Canada, we are seeing healthy signs that the market correction is in fact over. The GTA market posted a 14.6 percent increase in the quarter when compared to the same period in 2017.

This is a marked improvement from the 26 percent drop we saw in the GTA in the second quarter. More on the national and key market performance areas later in the call.

Year to date, the Company has distributed dividends of $9.6 million to its shareholders. Yesterday, the board of directors approved a dividend payable on December 31st of $0.1125 per share for shareholders of record on November 30th. This indicates an annualized dividend target of $1.35.

The Company has continued to grow its network of REALTORS each quarter this year, and has posted a 3.7 percent increase in its REALTOR network compared to the start of the year. We are continuing to see healthy demand for our brand offerings.

Net earnings for the Company improved to 12.5 million in the quarter, and included a large noncash fair value gain related to the exchangeable units issued by the Company. Again, details on this in our filings.

Overall, royalty revenues in the quarter decreased by 8.9 percent relative to the prior year as a result of lower variable franchise fees in the slower market, and more importantly, the lower premium fees as the last of those very old agreements expired in August. The decline was mitigated by an increase in fixed franchise fees, driven by an increase in the size of our underlying agent network. Our core business continues to perform strongly.

This morning, the Company announced that it has agreed to the terms of an amended Management Services Agreement with Brookfield Services Manager Limited, the corporation which has managed the Company since it was created in 2003. The manager is a subsidiary of Brookfield Business Partners. The amended ten-year agreement comes fully into force on January 1, 2019.

As I mentioned at the top of the call, we are very pleased with the agreement, as it contains amendments that include improved economics and incremental opportunities for the Company to grow. Effective January 1st, the Company will enter into franchise agreements directly with franchisors. Under the previous MSA, the manager would enter into agreements with franchisors, and the Company would subsequently purchase those agreements from the manager.

Entering into agreements directly will allow the Company to earn revenue from the inception of the agreement, as opposed to waiting until that one day every year when the agreements were acquired by the manager. Any franchise agreements owned by the manager on December 31st of this year will be assigned to the Company at no cost.

I'm also pleased to share with you that revenue from a number of products and services developed and operated by the manager outside of the franchise fees earned under the franchise agreements will now flow to the Company under the terms of the new MSA. These revenues include commercial real estate products and services; financial institution referral services; and lead generation, marketing, and supplier management services.

On January 1st, the manager will assign the contracts associated with these ancillary revenues to the Company at no cost. These new revenue streams will result in an immediate increase in company revenue and provide diversification beyond the royalties received under the franchise agreements.

In 2017, the manager earned approximately $3.3 million in revenues from these ancillary services.

The fee structure paid to the manager will also change on January 1, 2019. Firstly, the Company will pay the manager a fixed management fee of $840,000 per month. This fixed fee is paid in lieu of the Company purchasing franchise agreements from the manager.

Second, the variable management fee paid to the manager will be increased to 23.5 percent of cash flow from operations before management fees for the first five years of the agreement and 25 percent for the next five years of the agreement. The manager will have an opportunity to earn a higher variable management fee if the Company’s market capitalization exceeds certain thresholds, aligning their interests with those of our shareholders.

As a point of comparison, in 2017 the Company recorded $16.3 million from management fees and the acquisition of franchise agreements from the manager. On a pro forma basis, if the Company had applied the management fee structure under the amended, the new MSA, and benefitted from ancillary revenues, the payments to the manager net of those ancillary revenues would have been approximately the same amount.

The Company believes that these changes to the MSA serve three important purposes: First, to increase and diversify the revenues earned by the Company; second, to simplify the relationship with the manager; and third, to improve alignment between the Company and the manager.

At this point, I'd like to turn the call over to Glen for a look at our third quarter financial performance and some more financial details on the new MSA.

Glen McMillan — Chief Financial Officer, Brookfield Real Estate Services Inc.

Thank you, Phil, and good morning, everyone. The Company generated net earnings of $12.5 million in the quarter compared to net earnings of $5 million last year. On a year-to-date basis, the Company generated earnings of $8.5 million compared to earnings of $9.6 million last year.

Net earnings for the quarter were positively affected by a large noncash gain on the fair value of our exchangeable units, as Phil mentioned. This noncash gain is the result of a decrease in the market price of the Company's restricted voting shares, which is used to determine the fair value of the obligation associated with those exchangeable units.

You may recall that in the second quarter, we recorded a noncash loss of $7 million on the fair value of those units as a result of our share price increasing significantly in the second quarter.

On a year-to-date basis, we've recognized a noncash loss on these exchangeable units of less than $800,000.

As Phil mentioned, despite an increase in the number of REALTORS representing our brands, royalties decreased by 8.9 percent to $11.1 million in the quarter compared to $12.2 million in the third quarter of last year. On a year-to-date basis, revenues are lower by about 5.6 percent.

The decrease in royalties negatively impacted cash flow from operations, or CFFO, which is a measure of the amount of cash generated that is available to pay dividends, distributions to exchangeable unitholders, and cash taxes, as well as meet the working capital requirements of the business.

CFFO for the third quarter was $8.3 million compared to 9.2 million for the same period last year. On a year-to-date basis, our CFFO was 24.2 million compared to 25.7 million last year, a decrease of 5.8 percent.

As Phil mentioned earlier, in the third quarter the Canadian residential real estate market closed down 2 percent compared to last year. This is a significant improvement from last quarter, which posted a 19 percent year-over-year decrease. The total transactional dollar volume during the third quarter was $58.2 billion.

Unit sales in the Greater Toronto Area during the third quarter rose 9.7 percent year over year. This boost in sales, alongside the region’s 5.3 percent increase in average selling price, resulted in a 14.6 percent increase in transactional dollar volume in the Greater Toronto Area.

The GTA, for reference, represents approximately 25 percent of the national housing market.

Greater Vancouver continued the struggle to absorb its second wave of government initiatives in the past two years designed to improve affordability. These policies introduced in the 2018 British Columbia Budget included new tax policies focused on foreign buyers, homeowners of properties that have a value of more than $3 million, and homeowners who reside outside the province.

Despite a 4 percent increase in average selling prices, the greater Vancouver market closed down 36 percent at $5.8 billion in the third compared to 2017, as a result of its continued low sales activity.

In conjunction with the signing of the new MSA, which Phil alluded to earlier, the Company has agreed to certain amendments to its banking arrangements with CIBC, subject to the completion of definitive documentation. Some of these amendments were necessary, due to the recharacterization of certain payments to the manager under the new MSA: Specifically, the introduction of a fixed management fee and the elimination of payments to acquire franchise agreements.

In addition, the Company took the opportunity to increase available capital, improve flexibility, and to extend the term of its facilities. The Company has increased its maximum borrowings to $80 million from the current 78 million and extended the term of its banking facilities to December 31, 2023.

The facilities were scheduled to mature in February of 2020.

The Company has also renegotiated its financial covenants. The minimum ratio of EBITDA to interest expense has been decreased from 5:1 to 3:1, while the maximum allowable ratio of indebtedness to EBITDA has increased to 4.4:1 from 2.5:1.

Under the amended terms, the Company will be obligated to make limited principal repayments if the ratio of indebtedness to EBITDA exceeds 3.4:1. As a point of reference, the Company's current ratio of indebtedness to EBITDA is approximately 2:1.

These amended financial covenants provide the Company with greater flexibility to finance its operations into the future.

Phil will now provide some additional insights into the markets and an update on our operations.

Phil Soper

Thanks very much, Glen. Turning to the economy and its impact on the real estate market.

Statistics Canada reported that in August, GDP rose for the 7th consecutive month. The national unemployment rate in October dipped slightly lower to 5.8 percent. In the 12 months to October, 206,000 jobs were added, with 173,000 of those jobs in full-time employment.

When consumers are employed and are confident in the long-term health of the job market, this confidence extends to making large purchases, such as buying a home.

We mentioned earlier that policy changes aimed at the real estate market had a dampening effect on buyer activity in 2018; most notably, the implementation of the mortgage stress test. Largely, Canadian real estate markets have adjusted to this change.

The other significant drag on the real estate market this year has been the blow to consumer confidence that accompanied the very public and heated American trade negotiations. People are less likely to make large financial decisions when they are worried about their jobs. We believe that the recently announced US-Mexico-Canada Trade Agreement is contributing to an improvement in consumer confidence that should benefit the market on a go-forward basis.

Of course, with the new trade deal the Bank of Canada was in a position in October to reduce monetary stimulus with an increase in the bank rate. While the increase was small and interest rates remain very low compared to historical norms, any increase in mortgage rates impacts housing affordability, muting buyer demand.

Finally, it should be noted that back in the fourth quarter of 2017, real estate sales saw a year-over-year bump as a result of a pull-ahead (phon) effect. A material number of buyers opted to purchase in late 2017 to avoid the stress test measures that shaped the real estate market in the first half of this year.

As we examine year-over-year data, in the fourth quarter of 2018 these atypical volumes from last year may make year-over-year comparisons look weak in comparison. I will touch on this in the next quarterly update.

To wrap things up before questions, the Company continues to invest in products and services that successfully attract and retain top-performing brokers and agents. Highlights from the quarter include an agreement with America’s National Association of Realtors, where our Royal LePage brand has launched an extensive new professional development program.

We also announced new breakthrough home search technology. Consumers who want their children to be able to attend a specific school will now be able to go to royallepage.ca to discover which properties qualify, or if they want to know which schools service an area in which they would like to live, they will be able to start with the area and produce the qualifying schools list.

We are constantly improving the ways in which our brands help Canadians search for real estate. Our Via Capitale brand announced a new partnership to promote its listings in China in order to serve the growing market of Montreal real estate investors from that country.

The Company has continued to drive brand awareness, industry-leading public relations, and media awareness programs. In addition to publishing the Royal LePage House Price Survey, a significant driver of quarterly website traffic and media impressions, Royal LePage also published a release on baby boomer trends, which was very well received by both the media and our REALTOR network.

The survey research conducted with our partner, Leger, shows that 1.4 million baby boomers expect to buy a home within the next five years as they transition from traditional family homes.

Royal LePage also launched its 2018 brand campaign, Home. It's Who We Are, across consumer-facing platforms this quarter.

Also, Via Capitale launched a new brand campaign online and through television broadcast medium in the Province of Quebec.

In conclusion, while still in recovery, the Canadian market has improved significantly. We expect upward market momentum to continue on the heels of ongoing positive economic fundamentals and the new trade agreement. Higher interest rates should keep major market home prices from spiralling out of control again.

Demand for the Company's brands continue as our network grows. Our core renewable franchise royalties business continues to perform strongly, and our outlook for the Canadian market is positive.

Finally, with a new 10-year Management Services Agreement in place, the Company stands to benefit through revenue diversification, alignment with the manager, and improved (unintelligible) efficiency.

With that, I will turn the call back to our Operator and open up for questions.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, please press *, then the number 1 on your telephone keypad. Again, that's *, and then the number 1.

Your first question comes from Vitram Seth with Foresight Securities. Vitram, your line is open.

Vitram Seth — Foresight Securities

Thank you. Thank you for taking my questions. I was trying to get at this fixed management fee which you are kind of paying close to 10 million a year. What kind of revenues are you looking to add on January 1, 2019, with this? And going forward, what do you see the run rate of additions based on this fixed payout that you're doing?

Glen McMillan

Vitram, it's Glen McMillan calling. So let me address each of your questions. With respect to the additional revenues that will be coming into the Company, in 2017, which is the last full year number that we have, the manager generated about $3.3 million in revenues from those ancillary revenues. So that's what we expect to be coming in.

With respect to the fixed management fee, yes, it's a little over $10 million per year, but one of the obligations that the Company will no longer have is the obligation to purchase franchise agreements from the manager. And if we take a look back over the past five years on average, the amounts that were paid by the Company to the manager to acquire those agreements was in the range of $10 million. So it's important to note that that obligation does go away.

With respect to the future growth of the Company, we would anticipate continuing to grow at a level that we've seen over the past several years, on average. We had a few years that have seen significant growth and a few others years that have seen smaller amounts of growth, but we see a similar pattern to growth from an agent growth perspective going forward.

Does that answer all your—

Vitram Seth

It does answer it partially. What I was getting from the press release was that you have some visibility of what's coming on in January 1, 2019, so I was trying to get at what revenue number you were looking at for 2019 for which you would not have to pay? And that was the first part of the question. And the other part is what incentive does the manager have from this point to keep getting in that? Because you're essentially paying $10 million, and I'm just wondering whether there is any requirement for them to get a certain amount of franchise agreements in in return for this fee payment?

Glen McMillan

So with respect to the fee payment, the amounts are being transferred in at a nominal amount, and the press release did not disclose what those values would have otherwise been. We've not determined that amount.

With respect to the fixed fee and management's focus and growth in the future, so the manager is 100 percent dedicated and devoted to the Company. And its responsibility is to grow all aspects of revenue of the Company. And that includes not just agent growth because there still is, remember, a variable component to the management fee, but not just the growth in the number of agents, but also the growth in these other ancillary revenues.

And so we see a broader opportunity for growth for the Company in the future as a result of the revised fee structure under the Management Services Agreement.

Vitram Seth

Okay. So you are not disclosing what kind of revenues would be coming in in January 1, 2019, which you are otherwise purchasing. And just to follow up on that, there is no thought of internalizing management of this thing? I mean, in a sense the manager is internal with the linkages you all have, but I'm just thinking in the sense of paying 23.5 to 25 percent of your revenues every year, that seems on the high side, I would think, of any management agreement?

Glen McMillan

No, the—

Phil Soper

Remember, Vitram, just a quick comment. The management fee pays for the creations (phon) of the country's largest real estate company. So it's not a fee in the traditional sense. It's operational costs. And they are virtually the same as they would … if we used 2017 as a pro forma, they're virtually the same.

The big difference is the fee expense that we had in the past was very lumpy. It went up and down. It was challenging for us to manage. It was also very challenging for the manager to manage. So in a way, this provides a more stable cost structure for running the Company, and still excellent margins that allows us to pay the substantial dividend that has been at the heart of this as an investment.

Vitram Seth

Okay. And getting to the other part, you are not disclosing what revenues are coming in as a result of purchasing any franchise agreements like you would have otherwise earned on January the 1st? That's what I was looking to get some clarity on how much you're looking to … how much does this translate for 2019?

Glen McMillan

So, Vitram, you raise a good point. We've not disclosed that information. We will take it back and review that, and determine whether we should disclose it.

Vitram Seth

All right. Thank you so much for taking my questions.

Glen McMillan

Thank you.

Operator

Again, if you would like to ask a question, please press *, 1 on your telephone keypad.

We have no further questions at this time. I will turn it back over to Phil for closing remarks.

Phil Soper

Thanks so much. And thank you, everybody, for signing in. Wish you the very best of the holiday season and year-end festivities, and look forward to updating you again on the Company's progress in the new year.

Operator

This concludes today's conference call. Thank you for your participation, and you may now disconnect.

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