Moody's

# News

## MOODY'S CORPORATION SECOND QUARTER 2021 EARNINGS CONFERENCE CALL

**WEDNESDAY, JULY 28, 2021**

**ROBERT FAUBER, MARK KAYE, SHIVANI KAK**

Shivani Kak:

Thank you. Good morning, and thank you for joining us to discuss Moody's second quarter 2021 results and our revised outlook for full year 2021. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the second quarter of 2021, as well as our outlook for full year 2021. The earnings press release and a presentation to accompany this teleconference are both available on our website at ir-dot-moodys-dot-com.

Rob Fauber, Moody's President and Chief Executive Officer, will lead this morning's conference call. Also making prepared remarks on the call this morning is Mark Kaye, Moody's Chief Financial Officer.

During this call, we will also be presenting non-GAAP, or adjusted, figures. Please refer to the tables at the end of our earnings press release filed this morning for a reconciliation between all adjusted measures referenced during this call and GAAP.

I call your attention to the "Safe Harbor" language, which can be found toward the end of our earnings release. Today's remarks may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In accordance with the Act, I also direct your attention to the "Management's Discussion and Analysis" section and the risk factors discussed in our Annual Report on form 10-K for the year ended December 31, 2020 and in other SEC filings made by the Company, which are available on our website and on the SEC's website. These, together with the "Safe Harbor" statement, set forth important factors that could cause actual results to differ materially from those contained in any such forward-looking statements.

I would also like to point out that members of the media may be on the call this morning in a listen-only mode. I will now turn the call over to Rob Fauber.

Rob Fauber:

Thanks, Shivani. Good morning and thanks to everyone for joining today's call.

I'm going to begin by providing a general update on the business, including Moody's second quarter 2021 financial results. Following my commentary, Mark Kaye will provide further details on our second quarter 2021 performance, as well as our revised 2021 outlook. After our prepared remarks, we will be happy to take your questions.

Moody's delivered strong financial results in the second quarter of 2021. Revenue growth of 8 percent and an increase in adjusted diluted EPS of 15 percent highlighted the robust demand for our best-in-class integrated risk assessment offerings.

Favorable market conditions and heightened M&A activity provided the backdrop for sustained leveraged finance issuance in the second quarter and supported growth in our ratings business. The ongoing expansion of our risk assessment solutions combined with strong retention rates drove MA's significant recurring revenue growth.

Top-line performance, as well as expense discipline, contributed to adjusted operating margin expansion, and our cost efficiency initiatives continue to fund key investments in product innovation that should support ongoing growth.

As a result of our solid execution in the quarter, we have revised our full-year 2021 guidance and now forecast Moody's revenue to grow in the low-double-digit percent range. Additionally, we have raised our adjusted diluted EPS guidance to be in the range of $11.55 to $11.85.

Turning to second quarter results, MIS revenue grew 4 percent despite the tough comparable, while MA achieved its highest ever quarterly revenue, up 15 percent from last year. On an organic constant currency basis, MA revenue increased 8 percent.

Moody's adjusted operating income rose 12 percent to $861 million dollars and the adjusted operating margin expanded 200 basis points to 55.4 percent. Adjusted diluted EPS was $3.22, up 15 percent.

On the last earnings call, I highlighted that issuance volumes reached their highest level in over a decade. This quarter, as anticipated, investment grade activity declined as many issuers had already substantially fulfilled their funding needs in recent quarters.

Although overall issuance declined by 16 percent, as you can see on the chart, second quarter issuance was still well above the historical ten-year average as shown in the blue line.

While the growth in leveraged loans outpaced high yield bonds, the demand that we saw earlier this year from both asset classes persisted, albeit slower sequentially.

We also saw increased momentum in the CLO market, driven by opportunistic refinancing as spreads remained tight.

We frequently comment on our revenue relative to issuance levels, which relates to issuance mix. In the second quarter transactional MIS revenue grew 3 percent, while MIS rated issuance declined 16 percent.

This chart provides an illustration of our second quarter issuance and revenue mix by asset class. For example, the dark green bubble on the bottom left corner represents investment grade issuance - and you can see that issuance was down 68 percent in the second quarter versus the prior year. However, leveraged loans, which has a greater proportion of issuers on per-issuance or pay-as-you-go commercial programs, represented by the dark blue bubble on the far right, saw issuance up over 200 percent which significantly contributed to this quarter's favorable issuance mix.

Similar to last quarter, favorable market conditions led issuers to access the debt markets for a variety of reasons.

Credit spreads tightened as default rates trended lower, keeping the overall cost of debt low and allowing issuers to opportunistically refinance existing debt.

And, as economies started to recover and equity markets continued their strong run, we saw an acceleration of M&A as companies used a combination of cash balances and debt financing to acquire growth and position businesses for the post-pandemic economy.

We expect this constructive environment to persist, providing issuers further opportunities to tap the markets. That said, we forecast activity for the remainder of 2021 to moderate from the historical highs we saw in the first half of this year.

Mark will go into further detail on our issuance guidance by asset class later in the call.

Now, let's turn to MA.

MA's growing recurring revenue base and strong retention rates demonstrate the market demand for our products. Our emphasis on renewable sales has increased the proportion of recurring revenue by 4 percentage points in the trailing-twelve-month period, to 92 percent. We continue to see significant opportunities in KYC and financial crime compliance solutions, as well as Insurance and Asset Management, both of which contributed to recurring revenue growth along with research and data feeds. We briefly discussed these businesses on the first quarter 2021 earnings call, and I want to further spotlight these two high-growth areas.

I will start by highlighting a few key trends in the KYC market. First, as I've mentioned before, the pandemic has accelerated digital transformation in KYC and customer onboarding. Second, regulators are requiring organizations to know more about their customers and suppliers than ever before. And finally, financial crime continues to become more sophisticated which requires advanced detection and monitoring capabilities.

Our industry-leading product offerings and solutions leverage information on hundreds of millions of entities and ownership structures, as well as detailed profiles on over 13 million politically exposed individuals. Using AI, we combine our world class data sets to map and analyze adverse media, together generating insights and identifying risks at a scale, speed and precision that is difficult for others to match, and creating a compelling solution that is unique to Moody's and enables our customers to make better, and faster, decisions to combat financial crime.

Similar to our KYC and financial crime compliance products, our expanding offerings for insurers and asset managers are contributing to revenue growth for MA and are a core part of our integrated risk assessment strategy.

We initially entered this customer segment by providing market-leading regulatory compliance software, and we then moved into actuarial models to support global life insurers enabled by our acquisition of GGY. We further

expanded our capabilities to include ALM & balance sheet solutions, portfolio analytics, and tools to help address new accounting standards, such as IFRS17 and CECL. Now, the data, analytics, and domain expertise from across our business enables us to provide insurers and asset managers with more comprehensive solutions to manage a wider set of risks.

As the industry continues to evolve, our holistic approach allows us to build on our existing position in the insurance space, while at the same time provide a broader range of increasingly important analytics and insights, such as climate risk scenarios. Together this has contributed to our ability to deliver 20% organic revenue growth over the trailing twelve months in this segment, and we are excited about the opportunity ahead to serve new and growing risk assessment use cases for insurers and asset managers, leveraging our vast datasets and analytic capabilities.

I've also talked a number of times about the importance of innovating and integrating our data and analytics across our product suite.

For example, this quarter we launched an industry first ESG Score Predictor. This offering combines Moody's ESG scoring methodology with company-specific data and predictive analytics to produce ESG scores for over 140 million small and medium-sized enterprises. These scores allow our customers to screen ESG risks on public and private companies to monitor portfolio and supply chain risk and are a great example of integrating our SME and ESG capabilities to address a key market need, which is ESG assessment to support sustainable supply chains.

Staying on ESG for a moment, there has been a proliferation of climate-related financial disclosures over the past few years. We recently partnered with the TCFD, to provide insight on the quality of climate disclosures leveraging our natural language processing and machine learning tools.

In MIS, we expanded our proprietary ESG credit impact score coverage to companies in a broader range of industries, as well as to U.S. states and cities. We believe this is a unique offering that will allow investors to understand more clearly the impact of E, S, and G on any issuer's creditworthiness, and enhances our credit ratings relevance and thought leadership.

In MA, as a leading provider of KYC data and analytics, our customers are increasingly needing to comply with regulations relating to modern slavery and human trafficking within their supply chain. Working with various stakeholders, we added new, AI-enabled features to help our customers screen and track

previously-undetected instances of human trafficking and modern slavery risk across their supplier base, providing an opportunity to further broaden our KYC customer base beyond financial institutions.

I am frequently asked how we are differentiating ourselves in the ESG space, so I thought I would take a minute to provide a few customer case studies that illustrate how we are combining our capabilities to meet the risk assessment needs of different customer types.

In the Americas, we worked with a leading global commercial real estate firm to embed physical climate risk analysis into their global funds and client portfolios. The detail and rigor of our climate scores - and data on individual properties - allowed them to analyze thousands of properties in a more sophisticated and efficient way.

In EMEA, a large government agency requested our expertise on their green bond financing framework. Through our second party opinion, we assessed that the proposed framework not only aligned with their climate and environmental agenda, but also with the 2021 Green Bond Principles. Since 2012, we have provided hundreds of second party opinions across 30 countries, with over 60 second party opinions provided just in the first half of this year.

On to APAC, a large regional bank, also an existing MA customer, selected Moody's to create a robust framework to quantify the ESG and climate risk of customers' portfolios, leveraging our ESG assessments, ESG and climate insights and data, and our ESG Score Predictor that we launched this past quarter. They also requested in-house training on how to integrate ESG and sustainability into their risk management practices, so it is a great example of commercializing ESG and climate across our risk assessment offerings and customer base.

Before I turn it over to Mark, I want to highlight a few examples of industry recognition Moody's has received through the first half of this year. These matter because they are independent third party validation about the strength of our offerings across the firm.

MIS was named best credit rating agency in multiple areas in the GlobalCapital Bond Awards, and the best global credit rating agency by Institutional Investor. MIS was also ranked the number one securitization rating agency of the year in the GlobalCapital European awards.

As I noted, within MA, we are investing in our products to help our customers make better decisions on a wider range of risks. Industry participants recognized the pace of our innovation, awarding MA's Credit Sentiment Score the best AI-based solution in the 2021 AI Breakthrough Awards. I am also pleased that we ranked number two on Chartis' Storm Top 50, demonstrating our position at the forefront of digital transformation in our sector. Moody's ESG Solutions also won the Climate Risk Solution of the Year in Environmental Finance's Sustainable Investment Awards.

I am also enormously proud that Moody's was named a Top 50 Company for diversity by DiversityInc. Together, these recognitions underscore our commitments to customer delivery, innovation, sustainability, and diversity, equity and inclusion, all of which are critical to our sustained success.

Finally, I'm thrilled that Moody's joined the Fortune 500 earlier this quarter. This milestone is a testament to the dedication our employees have shown to our customers and to one another. On behalf of the executive team, I would like to thank all of our employees for their ongoing efforts which contribute to these great recognitions.

And with that, I will now turn the call over to Mark to provide further details on Moody's second quarter results, as well as an update to our outlook for 2021.

Mark Kaye:

Thank you, Rob.

In the second quarter, MIS revenue increased 4 percent, supported by a 3 percent rise in transaction revenue, while global MIS rated issuance declined 16 percent.

As a result of favorable mix, corporate finance revenue declined 4 percent, versus a 26 percent decrease in issuance. This was attributable to a surge in leveraged finance activity as U.S. and EMEA issuers opportunistically refinanced existing debt and funded M&A transactions. Investment grade supply contracted compared to the prior-year period, which had seen significant liquidity driven financing caused by uncertainty over the unfolding pandemic.

Financial institutions revenue rose 6 percent, above the 1 percent increase in issuance. This was due to infrequent EMEA bank issuers who sought to take advantage of the ongoing attractive rate environment.

Revenue from public, project and infrastructure finance declined 2 percent, compared to a 45 percent decrease in issuance, as increased non-U.S. project and infrastructure activity was offset by a reduction in U.S. infrastructure supply.

Structured finance revenue increased 73 percent, supported by an over 200 percent growth in issuance. This was due to approximately 200 CLO deals this quarter, our highest on record, predominantly attributable to refinancing activity. In addition, CMBS formation further bolstered overall results.

MIS's adjusted operating margin expanded 230 basis points to 66.3 percent. This was enabled by strong revenue growth, coupled with operating efficiency initiatives and lower legal accruals, partially offset by higher reserves for 2021 incentive compensation.

Moving to MA, second quarter revenue rose 15 percent, or 13 percent on an organic basis.

In RD&A, revenue increased 19 percent, or 16 percent on an organic basis. This was due to robust demand for KYC and compliance solutions, as well as strong customer retention rates and double-digit trailing-twelve-months sales growth in research and data feeds.

For ERS, recurring revenue rose 16 percent, driving overall ERS growth of 5 percent, or 3 percent organically. This reflected the demand for our insurance and asset management offerings, tools supporting upcoming accounting standards implementations, such as IFRS17, as well as our SaaS based credit assessment and origination solutions.

Additionally, ERS's recurring revenue comprised 88 percent of second quarter revenue, up 8 percentage points from the prior-year period.

MA's adjusted operating margin expanded 310 basis points to 31.8 percent. This reflected the benefits of our recently completed restructuring program, which led to the realization of incremental operating leverage in the quarter.

Turning to Moody's full-year 2021 guidance.

Moody's outlook for 2021 is based on assumptions regarding many geopolitical conditions, macroeconomic and capital market factors. These include, but are not limited to, the impact of the COVID-19 pandemic, responses by governments, regulators, businesses and individuals, as well as the effects on interest rates,

foreign currency exchange rates, capital markets' liquidity and activity in different sectors of the debt market. The outlook also reflects assumptions regarding general economic conditions, the company's own operations and personnel, as well as additional items detailed in the earnings release.

Our full-year 2021 guidance is underpinned by the following macro assumptions: a rise in the 2021 U.S. and Euro area GDP to a range of 6 to 7 percent and 4 to 5 percent, respectively. Benchmark interest rates will remain low, with U.S. high yield spreads remaining below approximately 500 basis points. The U.S. unemployment rate will decline to under 5 percent by year-end and the global high yield default rate will fall below 2 percent by year-end.

Our guidance also assumes foreign currency translation at end-of-quarter exchange rates. Specifically, our forecast for the balance of 2021 reflects U.S. exchange rates for the British pound of $1.38 and $1.19 for the euro. These assumptions are subject to uncertainty, and results for the year could differ materially from our current outlook.

Following our better than anticipated second quarter results, we are raising our full-year 2021 guidance across several metrics. We now forecast Moody's revenue to grow in the low-double-digit percent range. We maintain our expectation for expenses to increase in the mid-single-digit percent range as we balance reinvesting the benefits from our cost efficiency programs against the opportunity for future growth-oriented investments. Given our improved revenue outlook and expense stability, we now project Moody's adjusted operating margin to be approximately 51 percent.

We raised the diluted and adjusted diluted EPS guidance ranges to $10.95 to $11.25, and $11.55 to $11.85, respectively.

We increased our free cash flow forecast to be between $2.2 and $2.3 billion dollars, and we anticipate full-year share repurchases to remain at approximately $1.5 billion dollars, subject to available cash, market conditions and other ongoing capital allocation decisions.

On prior earnings calls, Rob has detailed our integrated risk assessment strategy, of which investments and acquisitions will play an important role. To that end, we are focused on M&A opportunities in our addressable markets that will advance our strategy. As always, we don't comment on specific potential acquisitions or divestitures and will not comment on any deals that we are pursuing.

We have not included the impact of any future acquisitions in our current outlook, but obviously a transaction could affect our guidance depending on the terms of any deals that we are able to reach. Under our long-held capital allocation policy, we prioritize organic and inorganic investments into the business, before returning any excess cash via share repurchases.

For a complete list of our guidance, please refer to Table 12 of our earnings release.

Within MIS, following a strong second quarter, we now project aggregate global rated issuance to grow in the low-single-digit percent range, up from our previous guidance of a low-single-digit percent decline. We would like to reiterate that our guidance, similar to last quarter, does not factor in any potential impacts from the U.S. infrastructure bill proposals.

We are raising our issuance forecast for leveraged loans to be up approximately 75 percent and for high yield bonds to be up approximately 25 percent. These are meaningful increases compared to our prior outlook of up 55 percent and approximately flat, respectively, and is the result of better than expected second quarter issuance, as well as ongoing favorable refinancing conditions and heightened M&A activity.

We expect that the increase in leveraged loan supply will continue to drive CLO creation and are therefore also improving the structured issuance outlook to be up approximately 75 percent.

Following a very active 2020, full-year investment grade supply is now forecast to decrease by approximately 40 percent, slightly lower than our previous guidance, which anticipated volumes to decline 30 percent.

After a surge of activity in the second quarter, we are increasing our guidance for new mandates to be in the range of 950 to 1,050.

While we believe favorable market conditions will persist, we forecast issuance to moderate in the second half of the year to more of a historic saw-tooth pattern as we believe many issuers will have fulfilled the majority of their funding needs earlier in the year and that liquidity driven issuance will return to pre-pandemic levels.

With our improved issuance outlook, we now estimate that MIS's revenue will increase in the high-single-digit percent range.

MIS's adjusted operating margin guidance remains at approximately 61 percent as our improved top-line outlook is partially offset by higher incentive compensation accruals and an acceleration in ESG, technology and automation investments in the second half of the year.

For MA, we are maintaining our low-double-digit revenue growth guidance, supported by high-single-digit constant dollar organic growth, given robust demand for our renewable products and stable customer retention rates, favorable movements in foreign exchange rates and tailwinds from recent acquisitions.

We are raising MA's adjusted operating margin guidance to be in the range of 30 to 31 percent as we continue to effectively manage our expense base while accelerating strategic investment back into the business.

As I previously mentioned, we are reaffirming our full-year 2021 expense guidance to increase in the mid-single-digit percent range.

Although we expect higher incentive compensation accruals associated with our improved revenue outlook, many of our cost efficiency initiatives and organic investment assumptions remain in line with our prior update. This enables us to both fund our strategic priorities and reinvest back into the business.

Finally, we want to reiterate that spending for key organic investments will be heavily weighted towards the second half of this year.

Before turning the call back over to Rob, I would like to highlight a few key takeaways.

First, we successfully executed our strategic and business objectives, delivering strong results again this quarter.

Second, several areas of MA, specifically KYC and compliance, research and data feeds, as well as insurance and asset management provided momentum for recurring revenue growth.

Third, we continued to integrate and embed our holistic E, S and G offerings within our products and solutions, enabling our stakeholders to manage an evolving set of risks.

Fourth, our culture of continuous expense discipline enables us to purposefully re-invest back into the business.

And finally, following robust first half performance and the ongoing global economic recovery, we are pleased to be able to upwardly revise our 2021 financial outlook.

And with that, let me turn the call back over to Rob.

Rob Fauber:

Thank you, Mark.

This concludes our prepared remarks. Mark and I would be pleased to take your questions. Operator?

## "Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995

Certain statements contained in this release are forward-looking statements and are based on future expectations, plans and prospects for the business and operations of Moody's Corporation (the "Company") that involve a number of risks and uncertainties. Such statements may include, among other words, "believe", "expect", "anticipate", "intend", "plan", "will", "predict", "potential", "continue", "strategy", "aspire", "target", "forecast", "project", "estimate", "should", "could", "may" and similar expressions or words and variations thereof that convey the prospective nature of events or outcomes generally indicative of forward-looking statements. Stockholders and investors are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements and other information in this release are made as of the date hereof and the Company undertakes no obligation (nor does it intend) to publicly supplement, update or revise such statements on a going-forward basis, whether as a result of subsequent developments, changed expectations or otherwise, except as required by applicable law or regulation. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company is identifying examples of factors, risks and uncertainties that could cause actual results to differ, perhaps materially, from those indicated by these forward-looking statements. Those factors, risks and uncertainties include, but are not limited to, the impact of COVID-19 on volatility in the U.S. and world financial markets, on general economic conditions and GDP in the U.S. and worldwide, and on the Company's own operations and personnel. Many other factors could cause actual results to differ from Moody's outlook, including credit market disruptions or economic slowdowns, which could affect the volume of debt and other securities issued in domestic and/or global capital markets; other matters that

could affect the volume of debt and other securities issued in domestic and/or global capital markets, including regulation, credit quality concerns, changes in interest rates and other volatility in the financial markets such as that due to Brexit and uncertainty as companies transition away from LIBOR; the level of merger and acquisition activity in the U.S. and abroad; the uncertain effectiveness and possible collateral consequences of U.S. and foreign government actions affecting credit markets, international trade and economic policy, including those related to tariffs, tax agreements and trade barriers; concerns in the marketplace affecting our credibility or otherwise affecting market perceptions of the integrity or utility of independent credit agency ratings; the introduction of competing products or technologies by other companies; pricing pressure from competitors and/or customers; the level of success of new product development and global expansion; the impact of regulation as an NRSRO, the potential for new U.S., state and local legislation and regulations; the potential for increased competition and regulation in the EU and other foreign jurisdictions; exposure to litigation related to Moody's Investors Service's rating opinions, as well as any other litigation, government and regulatory proceedings, investigations and inquiries to which the Company may be subject from time to time; U.S. legislation modifying the pleading standards and EU regulations modifying the liability standards applicable to credit rating agencies in a manner adverse to credit rating agencies; provisions of EU regulations imposing additional procedural and substantive requirements on the pricing of services and the expansion of supervisory remit to include non-EU ratings used for regulatory purposes; the possible loss of key employees; failures or malfunctions of our operations and infrastructure; any vulnerabilities to cyber threats or other cybersecurity concerns; the outcome of any review by controlling tax authorities of the Company's global tax planning initiatives; exposure to potential criminal sanctions or civil remedies if the Company fails to comply with foreign and U.S. laws and regulations that are applicable in the jurisdictions in which the Company operates, including data protection and privacy laws, sanctions laws, anti-corruption laws, and local laws prohibiting corrupt payments to government officials; the impact of mergers, acquisitions or other business combinations and the ability of the Company to successfully integrate such acquired businesses; currency and foreign exchange volatility; the level of future cash flows; the levels of capital investments; and a decline in the demand for credit risk management tools by financial institutions. These factors, risks and uncertainties as well as other risks and uncertainties that could cause Moody's actual results to differ materially from those contemplated, expressed, projected, anticipated or implied in the forward-looking statements are currently, or in the future could be, amplified by the COVID-19 outbreak, and are described in greater detail under "Risk Factors" in Part I, Item 1A of the Company's annual report on

Form 10-K for the year ended December 31, 2020 and in other filings made by the Company from time to time with the SEC or in materials incorporated herein or therein. Stockholders and investors are cautioned that the occurrence of any of these factors, risks and uncertainties may cause the Company's actual results to differ materially from those contemplated, expressed, projected, anticipated or implied in the forward-looking statements, which could have a material and adverse effect on the Company's business, results of operations and financial condition. New factors may emerge from time to time, and it is not possible for the Company to predict new factors, nor can the Company assess the potential effect of any new factors on it.