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MOODY'S CORPORATION FIRST QUARTER 2023 EARNINGS CONFERENCE CALL

TUESDAY, APRIL 25, 2023

ROB FAUBER, SHIVANI KAK

Shivani Kak:

Thank you. Good afternoon, and thank you for joining us today. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the first quarter of 2023, as well as our revised outlook for select metrics for full year 2023. The earnings press release and a presentation to accompany this teleconference are both available on our website at ir.moodys.com.

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 U.S. 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, 2022, 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.

Rob Fauber, Moody's President, and Chief Executive Officer, will provide an overview of our results, key business highlights and outlook, after which he'll be joined by Mark Kaye, Moody's Chief Financial Officer, to answer your questions. I will now turn the call over to Rob.

Rob Fauber:

Thanks, Shivani. Good afternoon and thanks to everybody for joining today's call.

As we typically do, I am going to touch on a few takeaways from our first quarter results and provide some insights into what is supporting our growth outlook. This quarter, I'm also going to drill down a little bit on our Decision Solutions line of business in MA, as that is a very important growth area for us, and then Mark and I will be happy to take your questions.

While the first quarter experienced market turbulence from the stress in the U.S. banking sector – and as is frequently the case – this heightened market uncertainty drove some strong demand for both our insights and our risk assessment offerings, and we saw some very strong upticks in usage this quarter.

We're also continuing to unlock the potential of MA and its great assets and businesses and those include: one of the world's premier credit and economics research businesses; a data & information business that includes the one of the world's largest database on companies; and our award-winning Decision Solutions businesses serving KYC, banking, and insurance workflows.

Together, MA delivered 10 percent ARR growth as we continue to enhance and extend our mission-critical data, analytics, and workflow solutions.

While MIS revenue declined 11 percent from a pretty robust first quarter of 2022, as we talked about on prior earnings calls, the anticipated rate of revenue decline did indeed moderate from what we experienced in the third and fourth quarters of last year, as MIS really capitalized on strong investment grade issuance in the first quarter.

Improvement in issuance activity, combined with our decisive expense actions that we took last quarter, together enabled us to deliver more operating leverage as reflected by the meaningful increase in MIS's operating (sic) [adjusted operating] margin to almost 57 percent. Notably, the adjusted operating margin for the first quarter is up approximately 500 bps over the margin for full year 2022.

At the same time, we are maintaining financial flexibility while funding strategic investments in things like product development, sales and go-to-market initiatives, modern cloud-based workflow platforms, data interoperability and accessibility, and AI innovation all to position us for the future.

Now, let me move to some of the results.

There are a few key things I want to highlight amongst the performance numbers you see on the screen. First, MA revenue grew 6 percent, or 9 percent on a constant currency basis. ARR grew 10 percent and we had solid growth across the board in Data & Information, Research & Insights and Decision Solutions, and I'll touch on that in a little bit more detail in a few minutes.

As I mentioned just a couple of minutes ago, MIS revenue was down versus a challenging Q1 2022 comparable before issuance volumes decelerated through the balance of last year. Corporate Finance accounted for most of the decline this quarter, particularly in bank loans, and that was followed by Structured Finance as we saw some deals delayed amidst the market volatility in the quarter.

Despite overall revenues down 3 percent in the quarter, our overall adjusted operating margin was 44.6 percent, and that was up approximately 200 bps versus our full year 2022 margin, again reflecting the benefit of those cost efficiency initiatives. And adjusted diluted earnings per share was $2.99, and that includes $0.75 of aggregate benefits from the resolution of several outstanding tax matters.

I mentioned earlier the upticks in usage that we experienced across several products in the first quarter.

On the screen you can get a sense for that. During the recent stress in the banking sector, traffic to our flagship website, moodys.com, was up approximately 20 percent from the prior year period. That is important for a few reasons. First, as you have heard me say before, we have the most experienced analytical teams in the industry and that is why we have been recognized as the Best Credit Rating Agency by Institutional Investor Magazine, 11 years in a row.

That experience allows us to be the industry thought leader, which is even more important in times of stress and uncertainty like we experienced in the first quarter. That thought leadership also drives increased demand for our insights, for our research, and for access to our analysts. And together that all supports our value proposition – and our growth opportunity – for both ratings and research.

Demand for our solutions during times of stress and uncertainty goes beyond ratings and research and you can see it across a range of MA offerings. During the peak period of banking stress last month, usage of our cloud-based Asset and Liability Management solution, which enables banks to model and manage their maturity, interest rate and liquidity risk, rose nearly 50 percent. As we are witnessing unprecedented deposit flows moving across banks, the use of our Screening and Risk Monitoring KYC solutions grew by almost 30 percent.

We've also more than doubled the number of in-person customer sales meetings over the last year, and that has been supported by investments to expand the size of our sales team by almost 20 percent since the beginning of 2022 and you have heard us talk about that on these calls. Together, the increased usage and the sales engagement give us confidence in our full year low double-digit ARR growth outlook for MA.

This past quarter, MA delivered 10 percent ARR growth, which as I mentioned, was consistent and strong across all lines of business.

I'll start with Data & Information, That includes Orbis – one of the world's largest databases on companies – plus our ratings and news feeds and 300 million ESG scores – that grew ARR at around 9 percent. In addition to the very strong standalone demand for the private company data in Orbis, it's the integration of this data across MA's offerings that is helping to drive growth in other lines of business. This includes the integration of Orbis company data into our CreditLens lending solution for banks, and the integration of our ESG scores into insurance and banking underwriting and portfolio solutions.

Moving to Research & Insights, which includes our leading credit and economic research business and a growing suite of predictive analytics, also grew ARR by 9 percent this quarter. We are seeing strong and sustained demand for our economic data, research, and models particularly amidst the stress in, and around, the banking sector. This includes our new EDF-X platform, which combines our award-winning risk models with Orbis to analyze credit risk for any company in the world. We recently completed the integration of EDF-X alongside CreditView into the moodys.com gateway – which provides direct access to a growing suite of Moody's products, and enhances our customers' experience and enables further cross-selling opportunities.

Finally, Decision Solutions – which includes our businesses serving KYC, Insurance, and Banking workflows – grew ARR by 11 percent. Given this is our fastest growing segment, I want to provide just a little bit more visibility into these offerings and what is driving growth.

These are three great businesses, because they support mission-critical workflows across financial institutions, and the virtuous cycle of data network effects and the high switching costs translate into industry-leading retention rates, which are typically in the low-to-mid-90s.

We have discussed our KYC business on earnings calls before. This business supports customer onboarding, perpetual KYC monitoring, and sanctions screening on customers, suppliers and other third parties. Strong growth in this area has been driven by our ability to cover all aspects of KYC and anti-money laundering activity, bringing together our vast datasets on companies and people, plus AI-enabled risk intelligence, and cloud-based workflow orchestration, that is delivered through our new PassFort Lifecycle platform.

Moving on to Insurance, the addition of RMS has now given us a considerable business serving underwriting, risk and capital management, and regulatory reporting workflows at insurers and reinsurers. Like banks, insurance companies are moving towards greater automation and digitization, as well as the integration of more third party data and analytics to enhance their risk management processes. The RMS Intelligent Risk Platform is a cutting-edge cloud-based platform that supports a growing range of workflow and data and modeling capabilities for insurers. The latest product launched on this platform is our new Climate on Demand solution, that integrates RMS's climate and physical risk models with our extensive Orbis and commercial property datasets to provide a sophisticated on-demand financial quantification of physical risk, that enables a holistic view into a company's exposure to extreme weather events and climate change through its customers, suppliers and properties. Not only will this be useful for insurance underwriting, but we are seeing robust demand for this beyond the insurance sector including with banks, corporates, governmental entities and professional services as we expected when we announced the deal two years ago.

Third is our business serving Banking workflows, which are quite similar to those served in Insurance. They include lending, risk management incorporating credit, portfolio, and asset-liability management risk, and finance and planning which includes things like impairment accounting and regulatory capital reporting. Our most significant recent product launch in this space, and one that is contributing to our double-digit ARR growth in Banking, was CreditLens for Commercial Real Estate, which you heard me talk about on prior calls. That integrates our market forecasts and commercial property data with our SaaS lending solution, CreditLens, and it significantly extends our ability to serve the commercial real estate lending market.

Stepping back, what sets our offerings apart from many of our competitors is that is not simply software, but instead we deliver integration of our proprietary data and analytics through modern cloud-based architecture. This is further enabled by the use of sophisticated machine learning and artificial intelligence across many of our solutions, including our automated financial spreading platform and our KYC AI Review which help customers be even more effective and more efficient.

And it is that combination of data, analytics, cloud-based tech, and innovation that powered us to the #1 ranking in Chartis RiskTech100® back in November.

Let me talk briefly how this translates to a typical customer relationship, and in this case, is a top 50 regional bank in the US. As I mentioned, our workflow solutions combining data, analytics and cloud-based software, help banks throughout their value chain, interconnecting what are often siloed use cases across departments - from lending to risk management to finance and planning. It is common for us to start by serving one of those use cases and then to expand the relationship over time, as the bank looks to connect its various functions leveraging our interconnected data, models, and solutions.

Our relationship with this particular customer started back in 2019, when they began to use our models and that including the EDF model that I just talked about – as foundational capabilities to create a common language of risk in the institution. In this case, they deployed our models to support a new internal risk rating program that enabled quantitative, unbiased, and consistent internal practices for credit assessment across the bank.

Over the next two years, we deepened that relationship by providing the bank with a workflow solution that leveraged these models and combined economic data and business analytics models with our Impairment Studio software to upgrade their Current Expected Credit Loss (or you have heard us say CECL, on these calls) to upgrade those processes. In 2022, leveraging some of these same data and analytics capabilities, we broadened the relationship further to support their lending needs through a combination of our AI-enabled spreading tool and our CreditLens loan origination software that includes credit scoring. We did the same to support their forecasting and stress testing needs, bringing together another five Moody's products, and drawing on some of the data and analytics the bank was using elsewhere. This resulted in expanded licensing of several existing products but also subscriptions for new products. In just three to four years, we have grown the ARR from this relationship fivefold. And as you can see on the far right, this ARR then shows up in different MA lines of businesses, with 65 percent in Decision Solutions and 35 percent in Research & Insights, but all for the same customer for a set of lending, risk & capital management, and finance and planning use cases. And there is still further potential, and we are in active discussions with this bank about supporting their KYC needs.

This is just one of hundreds of instances of how we have expanded relationships with our banking customers in recent years and accelerated growth by offering comprehensive solutions that leverage capabilities across all three MA lines of business and more broadly, across all of Moody's.

That is our integrated risk strategy at work and that is what makes our solutions so valuable and so sticky.

Moving to MIS, Issuance was stronger in the first quarter of 2023 compared with the fourth quarter of 2022. While volatility and uncertainty constrained the structured and bank loan markets, we did see robust activity in the investment grade sector. In the first quarter, issuance represented almost 30 percent of our full year outlook, which is a pretty typical historical seasonality pattern. And as you can see, growth was higher for investment grade and lower for leveraged finance.

And as we said on our last earnings call, we would expect markets to open up with higher-quality credits before those further down the credit ratings spectrum, such as high yield and bank loan issuers, and that is in fact what we saw in the first quarter. If markets continue to improve, we would expect to see leveraged finance issuance pick up. The degree to which that happens is going to be based on a number of factors, and that includes macroeconomic risks and policy actions, market sentiment and credit spreads, and economic growth and private equity activity, among others.

Staying on MIS for a moment, over the course of the last several months, we've gotten a number of questions about MIS' growth drivers, especially over the longer term. So, Mark and I thought it would be helpful to talk about how we think about the building blocks to MIS revenue growth over the long-term. While the short-to-medium term outlook can be impacted by cyclical factors – the long-term growth "algorithm" as we like to think about it for MIS revenue we believe remains firmly intact.

First and foremost, debt issuance growth over the longer term is driven by global GDP growth, as issuers invest in and grow their businesses. We expect real global GDP growth in the 2 to 3 percent range over the long term, in line with the historical average over several decades. Second, the value proposition for ratings remains firmly intact, particularly for MIS ratings, and that supports an annual pricing opportunity consistent with the broader opportunity across all of Moody's in the 3-4 percent range.

And third, there are long-term tailwinds from the ongoing development of capital markets around the world. This includes slow and steady levels of disintermediation in developed markets like Europe, as well as higher rates of growth in smaller capital markets in developing countries.

Together, this gives a sense for what we believe is the long-term growth profile of this business, while I acknowledge over shorter time horizons, the growth rate may be above, below or within this band depending on the nature of the headwinds and tailwinds that we are showing on the bottom of the page. So, I hope that gives you a sense of how we are thinking about growth and how that may triangulate with our medium-term outlook.

As we look toward the rest of this year, we are confident in the prospects for our business, supported by strong demand for our solutions and our expertise, and a robust product development pipeline. So, we are reaffirming the majority of our guidance, with select updates to expenses as well as our diluted and adjusted diluted EPS metrics. GAAP diluted EPS and adjusted diluted EPS are now expected to be between $8.45 and $8.95 and $9.50 and $10.00, respectively.

To close, I want to acknowledge that our growth and resilience as a firm rest on the shoulders of our people across the company and I want to thank them for their continued commitment and efforts and dedication to serving our customers, to supporting each other, and to delivering for our shareholders.

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