

News

MOODY'S CORPORATION THIRD QUARTER 2023 EARNINGS CONFERENCE CALL

WEDNESDAY, OCTOBER 25, 2023

ROB FAUBER, SHIVANI KAK

Shivani Kak:

Good morning and thank you for joining us today. I'm Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the third 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.moody.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 towards 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 Caroline Sullivan, Moody's Interim Chief Financial Officer, to answer your questions.

I will now turn the call over to Rob.

Rob Fauber:

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

I'm excited to share our strong financial results, as well as some key business highlights. And that's going to include some notable innovations and investments, progress on our GenAI strategy, and a spotlight on our fastest-growing business in MA, that is our Know Your Customer business or KYC as we commonly refer to it.

And before I get started, I just want to say how proud I am that Moody's has again finished number one in the Chartis RiskTech100. That is the most comprehensive global ranking of risk and compliance technology providers, and it is a great recognition of the breadth and depth of our solutions based on market research and customer feedback. I also want to take a moment to recognize the incredible resilience and dedication of our people, and I have really appreciated how our people have come together recently to support each other and to continue to deliver for our customers.

As you all will have seen from this morning's earnings release, we reported a 15 percent overall revenue growth with strong top-line performance and improved adjusted operating margins from each of our businesses, and that contributed to a 31 percent increase in adjusted diluted EPS in the third quarter.

MA revenue grew 13 percent, while achieving its fourth consecutive quarter of 10 percent ARR growth, and MA's growth continues to be led by our KYC business. We now have over \$300 million of annualized recurring revenue or ARR, and that's growing at 18 percent. MA also produced an adjusted operating margin of 33.6 percent.

MIS grew 18 percent in the quarter, as the leveraged finance issuance markets continue to improve from last year's subdued levels, I would call it. MIS revenue is now expected to grow in the mid-to-high-single-digit percentage range for the full year, and that acknowledges the current uncertainties in the capital markets.

Last week, we published our annual refinancing wall study, and that showed a 21 percent increase in the total U.S. non-financial corporate debt coming due over the next five years. As I've mentioned on prior calls, these refi walls are a very important component of our long-term growth algorithm, and that remains firmly intact.

And as those of you who attended our Innovation Open House last month would have heard, we are moving quickly to integrate our broad data and analytic capabilities across our product suite and to leverage the power of GenAI to develop new and cutting-edge solutions to empower both our customers and our employees.

The pace of innovation is clearly accelerating across our businesses. We are investing, we are launching new products, entering into strategic partnerships. All of that will enable us to continue delivering market-leading growth.

If I look just at the third quarter, we announced some really interesting things, and I want to take you through a few of those. I'm going to start with ratings. We have talked about on prior calls about how deepening our participation in developing capital markets and in particular domestic issuance markets is important to that long-term growth algorithm that I just mentioned. That includes Latin America, where Moody's Local has grown its customer count by more than 20 percent this year.

The Asia Pacific region also has some exciting opportunities, which is why in September, we further extended our domestic ratings business with the opening of VIS Rating in Vietnam, and that is a small but fast-growing domestic bond market.

I often also talk about how the relevance and importance of our voice in the markets is a really critical part of what makes MIS the Agency of Choice for both issuers and investors. And last month, we published really a groundbreaking cross-industry report on cyber risks and practices, and it leveraged our relationship with BitSight. We had nearly 2,000 companies that provided data and inputs, and we are able to highlight the more than \$20 trillion of rated debt that is at high risk from cyber threats. That is, I think, a really great example of the importance of a multidimensional view of risk, in this case, understanding how cyber risks are impacting credit risks.

Moving to MA, we are launching our first GenAI-enabled product. We call it Research Assistant, and we have already previewed it with over 150 customers.

Our strategy is to commercialize the launch as we head into the year-end renewal cycle.

Initially, our thinking is that the Research Assistant will be sold as an add-on to our flagship product, which is CreditView. Leveraging the power of an LLM with Moody's trusted proprietary content allows customers to generate rich credit insights in just seconds and with capabilities in multiple languages.

We also expanded our coverage in CreditView to now include 12,000 new unrated names, and that allows us to better serve the private credit market.

Customers who purchase that module are going to have a seamless integrated experience that includes financials, ownership structures, credit scores, sector research, interactive scorecards and peer analysis. And I think that is a great example of content integration to serve new customers and new use cases.

We are also constantly investing in our data estate. That includes Orbis, which is one of the world's largest databases on companies. We've expanded our partnership with BitSight by integrating their cyber data and scores for about 250,000 entities into Orbis, and that enables our customers to better understand cyber risk.

We also have several exciting product launches across Decision Solutions.

In Banking, we launched a new module in CreditLens that will integrate a bank's own loan level data with Moody's content. This portfolio module provides a dynamic view of a bank's loan portfolio by monitoring and measuring performance and providing early warning signals.

We are integrating RMS' physical and transition risk models with our proprietary ESG and climate data into a range of Banking solutions, and that is empowering our customers to make better, more informed decisions around lending, portfolio management, stress testing and regulatory reporting. These are some of the original synergies that we envisioned with the RMS acquisition. It's great to see this in practice.

And speaking of RMS, I was in Europe last month at a major Insurance industry gathering with CEOs and Chief Risk Officers, and I came away very excited about what we are doing with the industry. Together with BitSight, we recently launched the Moody's RMS Cyber Industry Steering Group with two major market players,

Munich Re and Gallagher. We are also partnering with Lloyd's of London to develop a carbon emissions accounting platform for their ecosystem.

In addition to these recent product launches and initiatives, we are continuing to leverage GenAI across our organization. As you heard at our Innovation Open House last month, our colleagues are taking a really active and hands-on approach in innovating and driving change. In fact, over 70 percent of our people have used our in-house CoPilot tool and that includes for coding, preparing a report, or improving an internal process. This adoption is also reinforcing our early-mover advantage as we are now benefiting from an internal feedback loop and that's allowing us to share learnings from our own GenAI journey with our customers.

And speaking of customers, we have been engaging extensively with customers around our GenAI strategy, including the relevance of our curated and proprietary data and research and our approach to data integrity and security.

In particular, since July, we've demoed our Research Assistant with a number of our customers, and nearly every one of these customers believes that this product will have meaningful benefits for both their productivity and their insight.

We're also revving up the work that we've been doing as part of our partnership with Microsoft and leveraging their secure Azure OpenAI service. We are building new functionality and content sets and entitlement capabilities into Research Assistant.

We're also continuing to expand the ways that we leverage Microsoft Teams to collaborate internally. And importantly, we are seeking to expand our joint go-to-market opportunities, broadening the appeal of this partnership to new customers and market segments. That includes creating Teams plugins that will be available to Microsoft's 300 million monthly users and infusing Moody's content into their Dynamics and Power platforms to enable CRM and workflow integrations.

We're also continuing to explore migrating our content sets to Microsoft Fabric to enable entitlement and delivery of content and insights to our shared customers. Taken together, we are very energized by the progress we've made and we're excited about the opportunities that lie ahead. In addition to Microsoft, we're working closely with other leading cloud and software players, leveraging our respective strengths to deliver new and innovative GenAI solutions.

Partnerships can take many forms. It can include joint product development, joint go-to-market activities, or direct commercial opportunities. To help maximize this

opportunity, we've developed a strategy and a framework and a team for third-party partnerships.

I think a good example of this is the work we announced earlier this week with Google. Through this partnership, Moody's and Google Cloud are going to explore creating LLMs and AI applications specifically to help financial professionals perform faster and deeper analysis of financial reports and disclosures and other materials. So we are certainly excited to be at the cutting-edge of GenAI innovation with some leading partners.

In recent quarters, we've been spotlighting one of the three cloud-based SaaS businesses within Decision Solutions, and so I want to cap off that series, with KYC. Unlike Banking and Insurance, which are obviously industry specific, KYC is relevant to all of our customer base. I've said before, a really important objective for many of our customers is to have a better understanding of who they are doing business with, whether it's making a loan, underwriting an insurance policy, onboarding a customer, or monitoring a supplier.

Over the years, we have tried to be very thoughtful about how we have added to our capabilities to build a business that is generating over \$300 million in ARR and growing at 18 percent.

Two significant acquisitions that some of you ask about from time to time and that's BvD and RDC. They're really foundational elements of our KYC solutions, and they have both outperformed their original acquisition targets.

There are several thematic drivers behind the growth of the KYC business. Specifically, I would call out the digitization and automation of what are very manual and expensive in-house compliance processes, the growth in online transactions and payments, and also the need for greater breadth and precision amidst new and increasing regulations.

All of this combines with the need for better analytics and insights, not just about customers, but more broadly who companies are doing business with.

By combining our proprietary data on companies and people with analytics and through a modern cloud-based SaaS platform we are delivering solutions for our customers in compelling ways.

These solutions use traditional AI. You've heard us talk about that on this call before that includes machine learning, natural language processing, and

integrating data on over 470 million public and private companies with more than 1.7 billion ownership links, profiles on over 20 million Politically Exposed People, and sanctions, and adverse media. And recently, based on customer feedback, we've also added in ESG scores and credit scores.

We offer access to our KYC tools and content in several different ways. That includes via data feeds or APIs into customers' in-house systems. Or full end-to-end workflow with proprietary and third-party data that supports customer acquisition and onboarding, screening, monitoring, and third-party risk management processes. This front-end workflow software is what we acquired when we bought PassFort back in 2021. That moved us from being just a data provider to being a full-service provider in this space. That combination is increasingly being recognized across the industry, including the recent Chartis awards as the only vendor that's identified as a market leader for both data and workflow.

We are also seeing significant growth outside of the financial sector and we are investing to enhance the relevance of our offerings in the corporate and government space. That includes our recent launch of Sanctions360 that enables customers to efficiently and effectively comply with regulatory requirements regarding their customers, counterparties, and suppliers by better understanding the implications of both sanctions and sanctions by extension. Our ability to build solutions that reach a broad set of customers is a key element of our land and expand strategy. In fact, approximately 25 percent of MA's overall new customer ARR growth in the last year came from KYC. Generating these new relationships then provides additional opportunities for us to cross-sell from other parts of MA. Likewise, our existing customer base also provides significant runway for future growth. Currently, only about 20 percent, or about 3,000 of MA's customers buy one of our KYC solutions and that represents an important cross-sell opportunity for our remaining 13,000 or so customers.

Turning to MIS. In the third quarter, issuance was consistent with normal seasonal patterns. I would say that activity was relatively subdued in July and August, and we certainly saw some stronger volumes in September. Growth was driven by leverage finance on the back of what was strongest leverage loan volume since the first quarter of 2022. And that, coupled with elevated activity from infrequent banking issuers and an improvement in project and public finance issuance versus the prior year, all of that contributed to a favorable mix.

As a result, while global issuance was up about 12 percent, MIS transactional revenue was up 31 percent versus last year. Together with 5 percent recurring revenue growth, MIS revenue grew 18 percent for the quarter.

As we head into the fourth quarter, general market sentiment remains a bit fragile. We have updated our guidance to reflect an expectation of modestly lower issuance volumes in the fourth quarter, particularly in investment grade and structured finance than we had been anticipating back in July. And the heightened geopolitical turmoil, combined with macroeconomic concerns around a higher for longer interest rate environment, continue to drive some volatility and uncertainty around yields and spreads. These conditions are likely to be particularly impactful on opportunistic investment-grade issuers. That's a reason that we're lowering the outlook for investment-grade issuance to approximately 25 percent growth for the full-year 2023.

We also continue to see the knock-on impacts of lower asset generation on the structured finance sector, so we are updating our outlook to decline by around 25 percent compared to the prior year. These two forecast updates result in an overall revision to our expectation for issuance for the year, and we now expect issuance growth to be in the low-to mid-single digit range in 2023 and MIS to grow in the mid-to high-single digit range.

While there are some headwinds to accelerating issuance growth in the near term, refunding walls continue to grow, and they are a key factor supporting medium-term issuance growth. Our annual study on refinancing, which we just recently published, captures non-financial corporate maturities in both the U.S. and EMEA. We look at the next four years as an aggregate figure and with approximately \$4.4 trillion coming due in the next four years, that's up by about 10 percent versus last year's study. You can see that in the appendix, in our supplemental materials.

I want to spotlight the U.S. in particular. Obviously, this is the largest of all the global bond markets. Looking out over five years and that's the length of the U.S. study, the aggregate forward maturity wall grew by about 21 percent compared to last year's study, and the main contributor to this is leveraged finance, which grew approximately 27 percent. So, that's certainly going to be helpful to future mix over the coming years.

Forward maturities continue to provide support for future issuance and continue to be an important part of the MIS long term growth algorithm. And overall corporate debt velocity, which is total corporate issuance as a percent of total

corporate debt outstanding, remains far below historical averages. That implies the potential for pent up issuance demand in the future.

On that note, I am going to pause here and I am happy to open the call for questions.

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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; the impact of MIS's withdrawal of its credit ratings on countries or entities within countries and of Moody's no longer conducting commercial operations in countries where political instability warrants such actions; concerns in the marketplace affecting our credibility or otherwise affecting market perceptions of the integrity or utility of independent credit agency ratings; the introduction or development of competing and/or emerging technologies and products; 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 our rating opinions, as well as any other litigation, government and regulatory proceedings, investigations and inquiries to which Moody's may be subject from time to time; provisions in 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; uncertainty regarding the future relationship between the U.S. and China; the possible loss of key employees and the impact of the global labor environment; failures or malfunctions of our operations and infrastructure; any vulnerabilities to cyber threats or other cybersecurity concerns; the timing and effectiveness of our restructuring programs, such as the 2022 - 2023 Geolocation Restructuring Program; currency and foreign exchange volatility; the outcome of any review by controlling tax authorities of Moody's global tax planning initiatives; exposure to potential criminal sanctions or civil remedies if Moody's fails to comply with foreign and U.S. laws and regulations that are applicable in the jurisdictions in which Moody's 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, such as our acquisition of RMS, or other business combinations and the ability of Moody's to successfully integrate acquired businesses; the level of future cash flows; the levels of capital investments; and a decline in the demand for 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 described in greater

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