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MOODY'S CORPORATION FOURTH QUARTER AND FULL YEAR 2023 EARNINGS CONFERENCE CALL

TUESDAY, FEBRUARY 13, 2024

ROB FAUBER, SHIVANI KAK

Shivani Kak:

Good morning and thank you for joining us today. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the fourth quarter and full year of 2023, as well as our outlook for full year 2024. 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.

I will now turn the call over to Rob.

Rob Fauber:

Thanks Shivani. Good morning and thanks everybody for joining today's call. I'm going to start with some highlights from 2023 and then discuss our expectations for 2024. After my prepared remarks, Steve Tulenko, President of Moody's Analytics and Mike West, President of Moody's Investors Service, will be joining me along with Caroline Sullivan, our Interim CFO, for the Q&A portion of the call.

Before we get into it, I have some very exciting news. As you may have seen, this morning we announced the appointment of Noémie Heuland as our new Chief Financial Officer, she's reporting directly to me. Noémie brings a wealth of knowledge to Moody's after nearly 25 years in senior roles at global public companies, including most recently as CFO of Dayforce, formerly Ceridian, and over a decade with global enterprise application software provider SAP, during which it transitioned to a global software-as-a-service business model.

As CFO, she is going to lead Moody's global finance organization, which includes accounting and controllership, financial planning and analysis, financial systems, investor relations, strategic sourcing and procurement, and tax and treasury.

Her firsthand experience in scaling high-growth, category-leading public software companies, along with her extensive global experience, make her the ideal CFO for Moody's as we invest in and grow our subscription-based analytics businesses and continue to expand our ratings business around the world.

It is an exciting time for Moody's, and I look forward to Noémie jumping in beginning April 1st. Of course, she will be a regular fixture on this call moving forward.

Before we get into the results, I also want to thank Caroline Sullivan who is here with me for her immense contributions and support over the last few months as Moody's Interim CFO. Caroline will remain as our Chief Accounting Officer and Corporate Controller.

Moving on to our results, 2023 was a defining year for us here at Moody's. We delivered 8 percent revenue growth, grew adjusted diluted EPS by 16 percent and we were an early mover in Gen AI adoption and innovation, launching our first-ever Gen AI enabled product in December. The energy and excitement across the organization was palpable throughout the year as we launched new products, entered into strategic partnerships with some of the world's leading tech companies, and increased the gap in our Chartis RiskTech100® No. 1 ranking. And as we grew, we also increased our margin by over 100 basis points for the year – all while investing across the firm in technology, products and people.

Amidst a pretty challenging operating environment for our financial services customers, MA delivered ARR growth of 10 percent with retention rates in the mid-nineties. Looking at the three reporting lines of business in MA: Decision Solutions, Data and Information, and Research & Insights, delivered ARR growth of 11 percent, 10 percent, and 7 percent, respectively. As we have upped the pace of product development to meet the strong market demand for tools to better manage risk and to digitize and transform workflows, for 2024 we expect MA revenue to grow at approximately 10 percent with ARR growth in the low-double-digit percent range.

MIS, meanwhile, delivered 19 percent growth in the quarter and 6 percent for the full year. Corporate Finance, Financial Institutions and Public, Project and Infrastructure Finance all achieved double digit revenue growth compared to 2022 on gradually improving market conditions. I used the phrase 'fragile' when describing the markets back on our 3rd quarter earnings call, and this turned out to be true for the 4th quarter, where, despite a very active November, December issuance was more muted than we had expected. We've seen a very constructive start to the year and consequently, our revenue expectations for 2024 are in the high-single to low-double-digit percent range for MIS. I'll touch on this a bit more on the call as well as some asset class-specific issuance guidance.

Looking out over 2024 and beyond, we're really excited about the great momentum in the business and the tremendous growth potential that we've got in front of us. To capitalize on these opportunities, we're accelerating and increasing the level of organic investment this year in three critical areas. Gen AI, new product development and platforming and technology. This is a deliberate investment program to fully capture the power of AI across our business, expand the reach and connectedness of MA's solutions and accelerate the technology enablement of the ratings agency – all to deliver on our ambitious medium-term targets.

Our capital allocation priorities remain unchanged. First, invest in our business whenever we see great opportunities, and we are in fact doing that. Second, return capital to stockholders, and this year we expect to nearly double the amount of capital we return to our stockholders through dividends and share repurchases.

Which brings me to our EPS guidance. We're anticipating adjusted diluted EPS to be in the range of $10.25 to $11.00 for 2024. This incorporates a little wider range at the beginning of the year to capture some of the uncertainty around issuance, and we would expect this to narrow during the course of the year. Of note, as you compare 2024 EPS guidance to 2023, you might remember, we had some outsized tax benefits in the first half of last year that resulted in a 2023 effective tax rate of 16.9 percent. For 2024, we're expecting the rate to be in the range of 22 to 24 percent. And if you look through the 2023 benefit, at the midpoint of our 2024 range, our 2024 adjusted EPS represents 24 percent growth rate since 2022, which is in line with the low-double-digit percentage growth we've targeted over the medium term.

Looking at 2023, I want to take a moment to touch on a few data points that highlight what a powerful franchise we have and also put our 2023 accomplishments into perspective amidst what was a very challenging operating environment for many of our customers last year. Despite relatively modest MIS-rated issuance growth of about 5 percent, we generated approximately $450 million dollars in incremental revenue growth across our entire company. Today, we have a base of recurring revenue of over $4 billion dollars while our more transactional-oriented revenue model, across a $74 trillion universe of rated debt, gives us upside as debt velocity improves. Together, this underpins our confidence in accelerating our revenue growth to the high-single to low-double-digit percent range in 2024.

Over the years, we have built a customer base that is almost like no other company, with 97 percent of the Fortune 100 and 87 percent of the Forbes 1,000 being a Moody's customer today. The world's leading companies turn to us, they trust our market-leading solutions and that gives us a tremendous base to sell into.

This shows up in the many external accolades and awards that we've received. We had over 150 last year alone. I want to give a special shout out to our MIS team as we were awarded Best Credit Rating Agency for the twelfth year in a row by Institutional Investor. That is great stuff.

We all understand our market leading position in ratings, but we have also built a market leading position with our MA business. For the second year in a row, we were ranked No. 1 in the Chartis RiskTech100®, supported by category wins in strategy, banking, insurance and a number of solutions categories ranging from climate risk to credit risk to financial crime data and a number more. And understanding the critical importance of attracting and retaining the best talent in this environment– we continue to lean in to our culture to make this the kind of place where the brightest minds want to build their careers and help our customers address some of the world's great challenges.

To sustain our growth, you frequently hear about the investments that we make in our solutions to help our customers make better, more informed decisions about risk. We achieved a number of important milestones in 2023, too many to get into on this call, but I am going to focus on just a few of the highlights. In Ratings, we continued to expand the markets we serve through Moody's Local. We also developed dedicated teams in digital finance and private credit so that we are at the forefront of opportunities in the global debt markets. In private credit specifically, we are coordinating across our ratings franchise so that we have the engagement, the methodologies, and the analytical and commercial resources to be the Agency of Choice for players in this market, ranging from BDCs to alternative asset managers to insurance companies and debt funds.

To further address the private credit opportunity we added more than 12,000 unrated entities to our CreditView research service in November. That triples the breadth of our coverage and provides a new runway for growth for our research business.

Another growth opportunity in our Research & Insights business is our Research Assistant product. That's the first Gen AI-enabled product that we launched commercially on December 1st. It's the first of a number of Gen AI-enabled tools that we're developing and we're excited about the initial customer feedback and early traction with this product. I am sure we will touch on this more in the Q&A.

We also continued to enhance and expand our massive company database in important ways to create valuable early warning signals for our customers and address the increasing demand for third party risk management. There were 3 elements to this in 2023. First was integrating predictive analytic tools and credit scores on over 450 million companies in Orbis. Second was expanding our coverage of over 1 million AI-curated and scored news stories a day that are available on companies in Orbis. And third, leveraging our investment in BitSight, over the course of 2023, we integrated over 6 million cyber scores into Orbis and that number continues to grow.

Across Decision Solutions, we developed new solutions and integrated more datasets to expand the utility of our offerings. In KYC, our new entity verification tool combines real time registry content with our Orbis data to help customers identify risky shell companies and minimize the potential for fraud or sanctions risk. With the launch of our most recent Sanctions360 tool, we're the only one in the market who can look through multiple, complex layers of corporate hierarchies and ownership structures to identify potential sanctions breaches.

In Banking, we integrated climate analytics into a broad range of workflow solutions from loan origination, to portfolio management to stress testing. And in Insurance, in just a year, we more than doubled the number of customers using our cloud-based Intelligent Risk Platform. This versatile, cloud-based risk analytics platform enables customers to analyze hundreds of millions of commercial and residential locations and it's not just being used by insurers. We're attracting a diverse set of customers who have a tangible and growing need for our more sophisticated climate data and analytics. I am proud to report that at the end of January, we signed one of the world's largest banks as a new customer of our climate and catastrophe modeling solutions to support the in-depth climate analysis for required regulatory disclosures and stress testing.

Underpinning all this is our ongoing foundational investments in the business. These investments will enhance our ability to integrate our data estate across all our customer use cases more efficiently and more effectively.

I hope as you get a sense, there are a lot of exciting things happening here at Moody's. And, as I take a step back to consider the many opportunities for growth ahead, I'm energized by all this in front of us.

There are three things we are doing to really drive future growth, that is land new customers, expand customer relationships, and then innovate continuously to deliver more value.

I just touched on the breadth and quality of our existing customer relationships. We have a fantastic customer base, especially in financial services where we have been developing relationships for literally decades. Landing new customers, expanding relationships, and innovating with a proven track record of growth. In recent years, we've been successful in growing these relationships further, diversifying into new areas like KYC and supplier risk management. In fact, our net expansion rate in the financial services sector stands at a healthy 109 percent, a clear indication of our ability to deepen relationships and deliver value. And now, leveraging Gen AI, and our broader content sets and capabilities, expanding and deepening these relationships will continue to be a significant opportunity for us.

Building on these successes, we have a great opportunity to expand into new customer segments, supporting new use cases. While financial institutions account for about 70 percent of ARR in MA, there has been very good demand coming from newer relationships beyond the financial services segment with 14 percent new sales CAGR over the last 2 years in these sectors (and that is the corporate and government sector). Over that period, we have established significant relationships with major companies in the United States and Europe, who are leveraging our expertise for customer and supplier risk assessment.

Our ratings business also has opportunities to serve existing and new customers in what I call 'the markets of tomorrow'. We have expanded our footprint in domestic and emerging debt markets where growth is faster than it is in the more developed debt markets. The Moody's Local initiative in Latin America is a great example, where organic revenue grew 22 percent in 2023.

These 'land and expand' opportunities are supported by major secular trends that are driving demand for our offerings. We're poised to capitalize on the content unlock opportunity from Gen AI enablement and innovation, the widespread digitization and transformation programs across banks and insurers, the growing demand for third party risk management solutions, and the ongoing growth of the private credit sector. With our wide-ranging capabilities we've put together to deliver a holistic view of risk, I think we're uniquely positioned at the intersection of these trends.

I can assure you, we reflected a lot on these opportunities as we entered our annual operating plan cycle this fall.

Not dissimilar to past years, we were challenged to prioritize and balance organic investments with operational efficiency and productivity initiatives. On the efficiencies side, we expect to generate savings from resource redeployment, alternative staffing models, automation and Gen AI enablement and geolocation strategies. We are prioritizing investment spending on areas that are enabling us to deliver at our current growth rates including: SaaS-based product development, sales deployment, operational resiliency, and ratings workflows.

These initiatives are funded within our "regular" pace of operating margin expansion. As we exited the initial sprint around Gen AI innovation last year, we reflected on the opportunities ahead of us. We considered our deep customer relationships, unique data assets, and market trends, together with our growth strategy, and we proactively upped the organic investments we started in the summer of last year. We are increasing our budgeted operating expenses for 2024 by an additional $60 million dollars in three primary investment areas.

First, and this isn't particularly surprising, is Gen AI. We are increasing product-related investments across MA that will continue to build on our early mover momentum from 2023 and investments across the company in initiatives to accelerate employee adoption and improve productivity.

On the product side, we have a few really interesting things that are moving ahead fairly quickly.

CreditLens, our flagship banking origination solution, will be next to launch a Gen AI-enabled capability to generate a credit memo within seconds, leveraging the digitized information about borrowers and their credit facilities that is stored natively in our software. We will be saving loan officers and credit professionals countless hours compiling information and generating the first draft of the documents that are produced with virtually every commercial loan. We have our first beta customer already and are currently in preview with a number of other customers.

I am also very encouraged by our new Gen AI enabled Commercial Real Estate (CRE) early warning system that we believe will significantly enhance CRE portfolio monitoring capabilities for both lenders and investors. I just sat through a demo in the last week or two. The early warning system integrates a wide range of datasets, enabling the evaluation of news events in real time, running scenarios and calculations that link together market forecasts, listings and property data, tenant data, and valuation and credit models. Early feedback has been very positive, and we're already looking to extend these capabilities beyond just CRE.

From an internal perspective, we have rolled out GitHub Copilot, and other Gen AI tools, to more than 1,500 engineering professionals across the company. And as a result of our experience last year, we have specifically planned for efficiency gains in our engineering budgets in 2024. We are also rolling out our next generation of AI-enabled tools for sales teams across the company over the next several months.

The second area is product development. As part of our land and expand strategy in MA, we are building on the success and momentum of our KYC business, which has grown to over $300 million of ARR in just a few years. You have heard me mention before that Know Your Customer is probably too limiting of a term for this business as it continues to expand.

This year, we are increasing investments to develop solutions focused on the growing market demand for solutions to serve the customer and supplier risk needs. We are especially encouraged by recent wins with a number of large government and Fortune 100 customers. This year, we are going to make investments in product, technology and data, and go-to-market capabilities to be able to scale in these customer segments.

The ratings ecosystem also continues to evolve. In early January we just provided the very first rating on a tokenized bond fund. And while digital finance is still nascent, we're going to be ready to help our customers – delivering our ratings on the platforms wherever they are going to issue.

Third, is around technology platforming. We're building on the platforming work that we highlighted in our Innovation Open House event back in September. This work is critical to strengthening the interoperability of all of our data estate and improving the synergies across our solutions. By investing in our platforming and engineering capabilities, we'll accelerate our time to market, enhance the customer experience, better enable cross-sell and upsell, and deliver engineering efficiencies. The faster this work gets done, the sooner we will realize the revenue and efficiency benefits, so we have decided to hit the accelerator.

The same is true in ratings, where more tech-enabled workflow is key to quality, speed, efficiency, and compliance. We've been on a journey to modernize, digitize and automate our systems and have made some great headway, but there's still more work to be done. Optimizing our data estate and moving more of our workflow into cloud-based applications has never been more important given the promise of AI and the digitization of financial markets. So here, too, we have decided to accelerate our efforts and this will be critical in achieving our medium-term margin targets.

Now let me turn to our issuance outlook briefly.

We are expecting more constructive market conditions in 2024, and I'm sure you've all seen, it was a very busy start to the year with over $150 billion in Investment Grade issuance in January alone.

Underpinning our MIS revenue growth outlook of high-single to low-double-digits is an increase in MIS-rated issuance in the mid-to-high-single-digit percent range. For corporates, we expect that Leveraged Finance will grow faster than Investment Grade issuance, which should be favorable to revenue mix.

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Our outlook is built on the macroeconomic assumptions that are detailed on page 20 of our webcast deck, notably incorporating a soft landing here in the U.S. and rate cuts starting in second quarter of this year. I imagine we will dive deeper into both our issuance and macroeconomic assumptions in the Q&A session.

Before moving off of MIS, I wanted to highlight that early last year, we committed to reviewing our medium-term guidance for MIS revenue growth once we saw sustainable improvement in the debt markets. I'm happy to share that, following 6 percent revenue growth in 2023 and the expectation of at least high-single-digit growth in 2024, we have updated our medium-term revenue growth target for MIS to be in the mid-to-high-single-digit percent growth range.

Moving back to our 2024 annual guidance, Moody's revenue is expected to grow in the high-single to low-double-digit percent range. Moody's adjusted operating margin is projected to be in the range of 44 to 46 percent, or about 100 basis points of margin improvement at the midpoint. The Moody's revenue and adjusted operating margin guidance ranges incorporate the variability of MIS transaction-based revenue balanced against the subscription base in MA, where nearly 95 percent of revenues are recurring. In regards to MA, we are guiding to a tighter range of approximately 10 percent revenue growth and low-double-digit percent growth for ARR.

MA's adjusted operating margin is expected to be in the range of 30 to 31 percent this year, absorbing the impact of the incremental organic investments I just talked about. In the medium term, we expect MA's adjusted operating margin to be in the mid-30s percent range, and as I have discussed the path to that target is not exactly linear. For 2024, MIS's adjusted operating margin is expected to be in the range of 55.5 to 57.5 percent, a 200 basis point improvement versus 2023 at the midpoint, solidly on track towards the medium-term target of low sixties percent.

Our expenses overall are expected to grow in the mid-to-high-single-digit percent range with a couple of factors worth noting. First, we closed out our 2022-2023 Geolocation Restructuring Program at the end of 2023.

Second, we are expecting depreciation and amortization expenses of approximately $450 million in 2024, an increase of approximately 20 percent as compared to 2023. This growth is largely related to the cumulative effect of our shift towards developing exclusively SaaS-based solutions starting back in 2021, and coupled with the increased capital expenditures associated with the three primary areas of incremental organic investment that I just talked about.

We are expecting free cash flow of between $1.9 and $2.1 billion and adjusted EPS to be in the range of $10.25 to $11.00, again a 24 percent increase at the midpoint versus 2022, looking through those tax benefits that I touched on.

I'll wrap up by just saying that it was a really great year for us in 2023 and I'm expecting an even more exciting one ahead. I am energized by our strategy and we have fantastic engagement across the company. And we believe now is the time to invest in the opportunity in front of us, to fully embrace the power of AI across our business, to accelerate the buildout of our technology platform, and to bring together our content to build new solutions with unique value propositions that will accelerate growth.

And with that… I welcome Caroline, Steve and Mike to join me for Q&A.

Operator, please open the call up for questions.

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