MOODY'S CORPORATION FIRST QUARTER 2024 EARNINGS CONFERENCE CALL

TUESDAY, FEBRUARY 13, 2024

ROB FAUBER, NOÉMIE HEULAND, SHIVANI KAK

SHIVANI KAK

Thank you. 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 first quarter 2024 as well as our revised outlook for select metrics for full year 2024. The earnings press release and the 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 reconciliations 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 & Analysis section and the Risk Factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2023, 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'll now turn the call over to Rob.

ROB FAUBER

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

Before I touch on a few key takeaways from our first quarter results, I want to start by saying, how excited I am to be joined today by Noémie Heuland who officially joined Moody's on April 1. And as I mentioned on our last earnings call, Noémie brings almost 25 years of global financial and accounting leadership experience at some very large public companies with a real depth of experience in technology and software-as-a-service. And we're really fortunate to have her as our Chief Financial Officer, and I look forward to all of you getting to know her in the coming weeks and months.

With that, let me turn to our first quarter results. We delivered an impressive 21% revenue growth, capitalizing on a strong issuance environment and continued demand for our leading risk assessment solutions. We delivered strong top-line performance and margin expansion in both businesses, and that translated into Adjusted Diluted EPS of $3.37 for the quarter.

Now, starting with MIS, obviously a great quarter. And over the last several years, you all have heard me talk about the investments that we've been making in analytical talent and technology enablement to ensure that we are the agency of choice for investors and issuers and in turn position us to capitalize on more robust issuance periods. And in the first quarter, we did exactly that, and we showed the tremendous operating leverage in our business with the second highest quarterly revenue on record, up 35% year-over-year, and an Adjusted Operating Margin of 64.6%.

Meanwhile, MA reported another quarter of 10% ARR growth, growing across all lines of business including double-digit ARR growth in both Decision Solutions and Data and Information.

And, during the quarter, we executed on our strategic investment roadmap across platforming, product innovation and Gen AI enablement. And this quarter highlights the unique strength of our business model. We're tracking to our medium-term EPS target of low double-digit growth while we are funding this investment program that will drive future growth, all while we expect to return over $1.6 billion to stockholders this year through share repurchases and dividends. That is the power of the Moody's compounding machine. We're also updating a few of our guidance metrics, and Noémie will give some details on that a little bit later in the call.

We've got our eye on the ball. We're looking ahead and we are focused on our mission to be the leading source of insights on exponential risk.

With that, let's dive in a little bit more on the financial performance of our businesses this quarter and our latest expectations for the full year.

As I've said before, MIS really is one of the world's great business franchises. It's widely recognized as best in the industry with strong global coverage in cross-border and domestic debt markets and it has a growing range of offerings to support growth areas like private credit and transition finance. And maintaining that leadership position really is critical in order to capitalize on the resurgence and opportunistic issuance that we experienced during the first quarter, and that's what played out during the quarter.

MIS delivered, as I said, growth of 35% in the quarter including 57% growth in transactional revenue, and a key driver of this growth in the quarter was the leveraged finance markets. It's a real strength for MIS where revenue was up 144% versus the prior-year quarter. That's quite a growth number.

As I explained a few quarters ago, we established a dedicated private credit team in MIS and that's starting to pay dividends as we're better-positioned to service the continued growth of the private credit markets, as well as a wave of deals refinancing from the private credit market into public markets. And while it's early, we're encouraged by interest in our transition finance offerings and that includes our Second Party Opinions and our new Net Zero Assessment and we already have several major issuers like Électricité de France that have published our Net Zero Assessment.

And with discipline around expenses, MIS delivered an Adjusted Operating Margin of almost 65%, again, demonstrating the tremendous operating leverage in this business.

Now while the first quarter issuance was very robust, it is still early in the year, and there are some uncertainties. So we're a bit cautious in regards to changes to our full year outlook at this point in the year.

Issuance in the first quarter benefited from pull-forward given the favorable market environment and questions about the back end of the year in regards to upcoming U.S. elections, ongoing tensions in the Middle East, and uncertainty around U.S. inflation and central bank rate cuts. So consequently, we have not changed our full year issuance and revenue growth guidance targets. However, our updated outlook now centers on the upper end of both ranges, and there are some things that we're watching to determine if we've got some upside to our current outlook.

The global economy has certainly demonstrated resilience and that's also going to be reflected in declining high-yield default rates, which are now projected to range between 3% to 3.5% by year-end. And we see some strong investor demand for riskier assets that's kept spreads tight. Notably, we're starting to see M&A activity pick-up. Private equity funds are actively seeking exits and looking to deploy huge pools of capital. So again, there are some things that we're keeping a close eye on and I'm sure we're going to discuss that a little bit further in the Q&A.

Now, turning to Moody's Analytics. As we've seen over the years, MA continues to be a very consistent growth engine for us, achieving 65 consecutive quarters of revenue growth, and now six consecutive quarters of double-digit ARR growth. Our retention rate has held steady at 94% for the last two years and yet again, for the first quarter of 2024 and that's a real testament to the stickiness of our solutions.

As we look across our reported lines of business in MA, we can see our land and expand strategy in action. So starting with KYC, which I think you can see on the bottom far left of the webcast slide. About a quarter of our 18% ARR growth in the first quarter is from new customer acquisitions, so a lot of new logos adopting our solutions in this space.

On the other end of the spectrum, about 90% of our insurance ARR growth of 10% is from really strong execution of our cross-sell strategy across our existing customer base. Clearly, RMS is an important contributor to that and it continues to deliver against the targets that we set back in 2021. And I think a number of you will remember that at the time of the acquisition, RMS was growing at a low single-digit pace and it's moved up very nicely as we've made progress on migrating customers to our SaaS platform and really activating our cross-selling strategies. And that includes things like climate models to banks and conversely selling data and analytics and other Moody's solutions to the RMS customer base. So when we take all of this into account in 2024, the ARR for RMS including synergies is expected to grow at a low double-digit pace.

Switching gears a little bit. Last year at this time, we were just starting to mobilize around Gen AI. In fact, we hadn't even deployed our internal CoPilot or announced our partnership with Microsoft at that point. And it is interesting to look back because what a difference a year makes, and we now have a framework for our suite of Gen AI-enabled solutions that we're rolling out during 2024.

It's no longer going to be just about Research Assistant, so we've categorized our capabilities into three primary buckets that we call navigators, skills and assistants. And really each of these capabilities deliver increasing levels of value to our customers and are going to have some distinct economics.

Navigators leverage in AI-powered natural language user interface to help our customers really get the most out of our products. And I would expect that almost all of our solutions will have some form of AI navigator or chat, what you might think of as a chatbot. And these will be table stakes I think for both our offerings as well as competitor offerings, I would assume in the relatively near future.

Then we've got skills. Those are specialized Gen AI capabilities that connect to Moody's data and content and analytics. And we're designing these skills to deliver automation and provide the tools to drive productivity and insight for our customers. And that includes things like the planned release of our – what we call our QUIQMemo, which is our automated credit memo, and our QUIQAlert, which is our surveillance and early warning system.

And then we're going to have a set of assistants for a number of our major customer personas which are going to be a combination of skills and prompt engineering that are most relevant to their jobs to be done.

This go-to-market framework I think is going to address the needs of our customers as they move up the spectrum of Gen AI adoption in their daily work processes. And while it is still too early to quantify, we now have a pipeline that is coming to market in the coming weeks and months, and we expect that to help drive our value proposition and retention rates and open up opportunities to serve new users.

On that note, I am very happy to hand it over to Noémie to provide a little more color on our results.

NOÉMIE HEULAND

Thank you, Rob. Let me start by saying that in my previous role as the CFO of a public company, which was also an issuer, I've been in the building a few times over the years. But being here as Moody's CFO is both an honor and a thrill.

As we get to know each other, I thought I'd take this opportunity to share with you my Moody's thesis that drove my decision to join. Throughout the process, everyone I met has consistently told me what an exciting time it is to join the firm. Moody's has been a trusted source of financial insights through various economic cycles and every actor in the global capital markets benefits from the value of Moody's products and services. Coming from the enterprise software ecosystem, I can tell you that this network effect, if you will, is one of the hardest competitive advantages to disrupt.

Also, in my previous CFO role, I got the chance to interact with Moody's analysts and research teams frequently. And each time, I left more impressed by the depth and rigor of their thinking. Moody's ratings is a powerful franchise with sustainable growth prospects, unparalleled reputation and an impressive industry knowledge and expertise.

Now in addition to that, Moody's built a great set of assets based on proprietary data that goes back over 100 years. The value of that historical data is unmatched, and it is my strong belief that Moody's is well-positioned to leverage Gen AI capabilities as a result, whether it's credit, KYC, climate, or many other use cases, Moody's has integrated and innovated with our customers' needs at the core. In truth, I spent the last 15-plus years talking to my peers about having the right data and analytics tools to make smart decisions in support of the business, and so I can attest to the many use cases for Moody's Analytics solution set. As you can tell, I'm really passionate about that.

Also, as you would expect of a CFO, I spent some time studying Moody's financial profile before joining. Some obvious attributes, this is a very profitable business which has delivered 13% of Adjusted Diluted EPS growth in Q1 with a high return on tangible assets and over 100% of Free Cash Flow to net income conversion expected this year. This is an outstanding set of fundamentals but they are also unique in that they provide flexibility for investing and innovating to fuel growth.

Another CFO priority is execution on a disciplined capital allocation plan. I am very impressed with our focus and results. You saw us generate savings from resource redeployment and automation, and then redirect investment spending on areas that will enable us to deliver on our medium-term targets. And we are doing that while aiming to return about 80% of Free Cash Flow to our shareholders, in the form of dividends and buybacks this fiscal year. In my experience, the operating leverage of this business and track record of long-term sustainable growth are simply remarkable.

I conclude before I get to the Q1 results and outlook that, as a CFO of a company that must abide by a large number of regulations and help its customers deal with an increased number of larger more interconnected risks I'm very proud to have joined a team that puts risk management at the center of what we do with resilient operations and a fantastic culture. I've spent some time with Rob, his leadership team, the board and many folks in finance and beyond. The culture, warmth and sharp intellect of the people at Moody's and the sense of belonging is very special. And for all these reasons, I could not think of a better place to be.

Turning to the first quarter results. As you heard from Rob, we started the year strong with reported revenue growth of 21% and Adjusted EPS growth of 13% over the first quarter last year, when, as you may recall, we saw a significant non-recurring tax benefit. Strong growth and inherent operating leverage while making selected investments in strategic areas led to an Adjusted Operating Margin expansion of 610 basis points at about 51%, which translated into a Free Cash Flow conversion to GAAP net income of over 120%. Our quarterly Free Cash Flows of close to $700 million was the highest on record.

Now let me touch on segment results. As Rob said, the issuance rebound led to MIS delivering its second highest quarter on record. We saw a strong start across all lines of business as tightening spreads and investor demand propelled opportunistic issuance. Corporate Finance grew 49%, predominantly from issuance by leveraged loan issuers and pull-forward activity. Financial institution issuance was the strongest since the financial crisis, with an elevated level of infrequent issuer activity, which then led to revenue growth of 37%.

On the margin front, the operating leverage of our ratings business coupled with our initiatives to drive operating efficiencies has allowed us to capture the significant rebound in issuance and flow the upside through the bottom line with a 780-basis points expansion of Adjusted Operating Margin year-on-year.

Turning to Moody's Analytics, first quarter revenue was up 8%. Growth was driven by strong demand in our Data and Information line of business with revenue growing 13% year on year, and continued demand for our KYC and compliance solutions with revenue growing 24%.

As for Research and Insights, where revenue grew 3%, timing of revenue recognition of our on-premise software subscription and transaction revenue, even though these are a small share of the business of this segment, affected the growth rate a bit this quarter, as well as a modest, but expected, uptick in CreditView attrition from banks and asset managers. If you look at the revenue from hosted software solutions, though, the growth is trending closer to ARR growth. And overall, we expect Research and Insights ARR growth to tick up to the high single-digit range by year-end, particularly with pipeline momentum picking up around Research Assistant and unrated coverage expansion in recent months.

Speaking of ARR, MA ended the first quarter with Annualized Recurring Revenue of $3.1 billion, up 10% from the prior year. Of note, we saw a sequential acceleration of growth within two of our three lines of businesses. Decision Solutions ARR grew 12%, up from 11% in Q4 2023 and Data and Information grew 11% up from 10% supported by higher retention amongst banks and public sector customers. These two lines of business represent about 71% of total ARR, so we're really pleased to see the growth there accelerating. You heard earlier that our retention rate remains best-in-class at 94%, demonstrating the stickiness of our solutions.

As communicated in February, we're actively balancing strategic investments that we believe will drive future growth, including in our cloud platform and product roadmap with operating efficiency initiatives. That said, I'm pleased to report we delivered 29.7% Adjusted Operating Margin in Moody's Analytics segments, an increase of 80 bps year-over-year.

Let me now turn to our assumptions around issuance that underpin our fiscal year outlooks. As we said in February, our full year issuance outlook of mid-to-high single-digit growth accounted for a stronger first half of the year. Indeed, first quarter issuance was strong across all business lines but mainly from Corporate Finance and Financial Institutions driven by refinancing activities with a significant proportion of that activity being pulled forward.

That said, we are making modest revisions to select asset classes to account for what we saw in the first quarter. Specifically, we now expect FIG issuance to increase in the low single-digit percent range, up from approximately flat, driven by the elevated infrequent issuer activity in the first quarter that I mentioned earlier. And SFG to grow now in the high single-digit percent range as a combination of jumbo transactions and increased CLO refinancing activity fueled growth.

Our guidance for First Time Mandates in the range of 500 to 600 remains unchanged.

I will conclude on issuance by saying it is early in the year and although we like what we saw in the first quarter, our broader issuance outlook for full year 2024 remains largely unchanged. As such, we're maintaining our MIS revenue guidance of high single-digit to low double-digit growth for the full year.

Our updated outlook incorporates various specific macroeconomic assumptions which are detailed in our presentation. We are also adjusting our FX assumptions to reflect the appreciation of the US dollar against the euro and the British pound. We now expect the euro-to-US dollar exchange rate and the euro-to-GBP *(sic) [USD to GBP]* exchange rate to be $1.08 and $1.26 respectively for the remainder of the year.

With that background, we're making the following updates to our full year outlook. Moody's Analytics revenue is now expected to increase in the high single-digit percent range, primarily reflecting the strengthening of the U.S. dollar I just mentioned. That said, our ARR growth expectation in the low-double-digit range for fiscal year 2024 is unchanged from our prior guidance.

Of note, we are maintaining our full year operating margin outlook for Moody's Analytics in the range of 30% to 31% as there is a partial FX natural hedge on our expense pool, coupled with ongoing disciplined expense management.

For MIS, we just went through the issuance assumptions and we're maintaining our full year revenue outlook of high single-digit to low-double-digit percent range, and we demonstrated in Q1 that we can capture the increased volume of issuance in MIS and at the same time, expand our margins, which gives us confidence to raise MIS Adjusted Operating Margin to a range of 56% to 58%.

Last, we told you in February that we would narrow the EPS guidance range with increased visibility and that is precisely what we're doing. We are narrowing the Adjusted Diluted EPS range for the year to $10.40 to $11.00.

And that ends our prepared remarks. I'm happy to open the call to questions.

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