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News

MOODY'S CORPORATION SECOND QUARTER EARNINGS CONFERENCE CALL

THURSDAY, JULY 30, 2020

RAY MCDANIEL, MARK KAYE, SHIVANI KAK

Shivani Kak:

Thank you. Good morning everyone, and thanks for joining us on this teleconference to discuss Moody's second quarter 2020 results, as well as our outlook for full year 2020. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the second quarter of 2020, as well as our outlook for full year 2020. The earnings press release and a presentation to accompany this teleconference are both available on our website at ir-dot-moodys-dot-com.

Ray McDaniel, 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 mentioned during this call and GAAP.

Before we begin, 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, 2019, our quarterly report on Form 10-Q for the quarter ended March 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 Ray McDaniel.

Ray McDaniel:

Thanks, Shivani. Good morning and thank you everyone for joining today's call.

I will begin by providing a general update on the business, including Moody's second quarter 2020 financial results. Mark Kaye will then provide further details on our second quarter performance, and also comment on our revised outlook for 2020. After our prepared remarks, we will be happy to respond to your questions.

I want to start off by both acknowledging that the strength of Moody's has always been in our people and reiterating our appreciation for the hard work and dedication of our employees around the world. During this challenging time, we remain committed to our Corporate Social Responsibility efforts, as we and the rest of the world deal with both the global COVID-19 pandemic, as well as civil unrest.

Our mission, to provide trusted insights and standards that help decision makers act with confidence, has never been more relevant, and our operating results reflect that. Echoing the first quarter, Moody's strong second quarter was once again driven by robust top-line growth at Moody's Investors Service as issuers sought liquidity and opportunistic refinancing amid broadly receptive credit market conditions.

Also aligned with our long-term strategy, we continue to build toward the future as we enhance our sustainability efforts and develop new products and solutions that meet the evolving needs of our customers.

As the second quarter exceeded our expectations, we are raising and narrowing our full year 2020 adjusted diluted EPS guidance range to $8.80 to $9.20, while still expecting debt issuance to taper in the second half of the year.

Amidst the global pandemic, and with the emergence of civil unrest focused on racial equality, the safety and well-being of our employees remains Moody's top priority. We are committed to providing a safe work environment for everyone.

As such, we have been conducting awareness and training campaigns, and encouraging our employees to speak out and engage with each other on these important topics. We are also building better programs to attract, retain and advance Black talent. We pride ourselves on being an inclusive firm where diverse viewpoints lead to better decisions, and where everyone's contributions matter.

On our prior earnings call, we noted how our early adoption of technology enabled us to transition smoothly to a virtual environment. We are building on this experience by working with our employees to design our future workplace models. We believe this approach will enable us to attract and retain the best talent, not only in locations in which we have a presence, but potentially anywhere.

Moody's strives to be a constructive force in all of the communities in which we operate. We mentioned on our prior earnings call that in response to COVID-19 we made our research, insights and certain products accessible to the public at large, including our customers and policymakers. These offerings within the first half of the year translated to about $12 million dollars of in-kind contributions. In addition, we've committed $1 million dollars to promote equal justice and the advancement of the Black community, while also increasing financial support for our partners focused on empowering Black-owned businesses and enhancing diverse recruiting.

Finally, before I get into the results for the quarter, I would like to draw your attention to the recent announcement made on the enhancements to our Environmental Sustainability Program. As part of this effort, we have: committed to remaining carbon neutral; agreed to procure 100 percent renewable electricity; and set science-based targets for reducing our greenhouse gas emissions.

Through these commitments, we are proud to further Moody's purpose to bring clarity, knowledge and fairness to an interconnected world.

Moving on to second quarter 2020 results, Moody's achieved a robust 18 percent increase in total revenue, with 27 percent growth from MIS and 5 percent growth from MA.

Moody's adjusted operating income of $766 million dollars was up 28 percent from the prior-year period. Strong revenue growth combined with ongoing discipline in expense management drove 410 basis points of adjusted operating margin expansion. Adjusted diluted EPS of $2.81 was up 36 percent.

I will now provide an update on the credit markets in the second quarter. The pandemic has had a significant negative impact on the global economy, resulting in widespread unemployment, negative global GDP estimates, and other recessionary conditions as countries shut down their economies in order to contain the spread of the virus. This morning's reported second quarter U.S. GDP contraction of nearly 33 percent is a stark reminder of this. To mitigate the economic impact, governments have undertaken unprecedented global monetary easing efforts and fiscal actions which have thus far enabled supportive fundamentals and robust activity in the credit and equity markets. Most recently we've observed the E.U. proposal to raise debt to fund a 750 billion euro stimulus plan to aid its member nations hardest hit by the pandemic, the U.S. Federal Reserve has extended its emergency support facilities to the end of the year, and the U.S. government is in discussions to extend fiscal stimulus measures.

As the credit markets continued to 'read through' severe economic stresses and governments quickly took actions to mitigate them, the dichotomy with the 'real economy' remained. Investment grade issuers responded to economic uncertainty by shoring up their balance sheets with record-levels of bond issuance. Additionally, after being inactive for most of March, high yield bond issuance surged as spreads tightened. The leveraged loan market re-opened, but has been slower to recover.

Looking towards the second half of the year, we expect issuance to moderate as many companies and institutions have completed their balance sheet and liquidity strengthening initiatives, and governments may see less of a need to intervene in support of their economies.

As I just noted, given uncertain economic conditions, companies looked to bolster their balance sheets in the first half of the year while capital markets were receptive. As you can see from the chart, working capital and debt refinancing became more prominent drivers of issuance, whereas M&A has historically been a more often cited use of funds. This rush to liquidity also helped explain the dichotomy between the performance of the economy and capital markets as many issuers took advantage of low rates to create fortress-like balance sheets to help see them through this period of uncertainty and stress.

I'd like to further highlight second quarter issuance, specifically within the corporate finance sector. As you can see, second quarter corporate investment grade issuance was up significantly, together with solid high yield supply, but bank loans continued to lag. This mix caused the rate of corporate finance issuance growth to outpace transactional revenue growth due to larger, more frequent issuers coming to market. Despite this headwind, issuance growth was beneficial to our operating results and MIS exhibited significant top-line growth, which Mark will discuss further.

COVID-19 has had wide-reaching impact on nearly every sector of our global economy. In the second quarter, the default rate rose, and, as Mark will touch upon later, our guidance assumes it will continue to do so through the end of the year. During these turbulent times, the quality and consistency of ratings becomes even more important. Therefore, investors look for transparent methodologies that follow a measured, thoughtful and systematic approach. Moody's processes ensure that we are consistent and rigorous in delivering our rating opinions and research. Our starting point is to assess and rank the impact an event, such as COVID-19, has on various sectors. This then flows through to the underlying issuers, as shown on the chart on the bottom left, which lists the most impacted sectors and the percentage of issuers downgraded within each of those sectors. It is important to note that ratings quality remains MIS's top priority and we continually strive for exceptional ratings performance. As you can see from the graph on the bottom right corner, Moody's ratings have performed very well on an ordinal ranking basis with the lower rated debt exhibiting higher default rates for the trailing twelve months, as of the end of June 2020. Through Moody's long history of ratings quality, investors have come to expect our ratings to look through the credit cycle so that in uncertain times like these, investors can compare ratings not just by issuer, but also over time.

Turning to MA, I want to update you on how the business continues to adapt to the current environment. Last quarter, we discussed how COVID-19 could impact our customer renewals and new sales activity. We are encouraged by the observed trends in both of these categories as they are proving to be better than expected. MA's retention rates remain strong at 94 percent, demonstrating the relevance of our products during times of stress, while sales grew despite the lack of in-person meetings, providing us with momentum as restrictions begin to ease outside of the U.S.

Looking toward the sales pipeline for the second half of 2020, we are more optimistic than in our prior outlook as compliance and accounting products have provided better than expected growth opportunities despite current headwinds.

Throughout this challenging time, we've remained focused on our customers' rapidly evolving needs for integrated and holistic risk solutions. This slide highlights some of our second quarter innovations and enhancements that increased the collective value of our offerings. I will focus on the recent additions and improvements to our ESG & Climate product suite, as well as the new Pulse tool.

Thought leadership in ESG & Climate Risk remains a key strategic priority for Moody's, as its importance for our customers continues to grow and we are encouraged by the demand for these products. In the first half of this year, Vigeo Eiris completed 29 issuer paid sustainability ratings, 46 second party opinions and 9 sustainability-linked loan assessments. During the second quarter, Vigeo Eiris launched its Enhanced Second-Party Opinion Service, which enables more impactful issuer communications and provides increased transparency for investors. We are also excited to announce that through partnerships with Euronext and Solactive, we continue to build our presence serving the index space, including the creation of the new Euronext ESG80 and Solactive VE Developed Markets ESG Quality Indices, which use Vigeo Eiris' data to screen its constituents. In addition to these new ESG and Climate Risk initiatives, we are further integrating Vigeo Eiris and 427 content into multiple MA platforms, including moodys.com and REIS, which should provide additional channels for exposure and monetization.

Moving on to Pulse. This tool was launched by the Moody's Accelerator to help our customers quickly consume and digest the ever-increasing news flow. Pulse utilizes machine-learning and natural language processing to gauge sentiment around news, such as COVID-19, on a chosen company or sector, enabling investors to more quickly assess the impact of a news article on their portfolios.

We continue to invest in these types of product innovations, which allows us to provide better value and insights to our customers to help them make better decisions.

I will now turn the call over to Mark Kaye to provide further details on Moody's second quarter results and our revised outlook for 2020.

Mark Kaye:

Thank you, Ray.

In the second quarter, record investment grade activity drove MIS revenue growth of 27 percent from the prior-year period as issuers looked to ensure sufficient liquidity, in addition to opportunistically refinancing their debt portfolios amidst ongoing economic uncertainty. High yield issuance also increased in the quarter as issuers took advantage of broadly receptive credit conditions. Strong activity in the fixed rate bond markets was partially offset by weakness in bank loans as investor demand remained muted for floating-rate instruments in a 'low-for-long' rate environment. Structured finance was the only line of business that experienced an overall decline in revenue, primarily due to a decrease in asset origination.

Total MIS rated issuance growth of 53 percent exceeded total transactional revenue growth of 39 percent. As Ray noted, issuance mix was skewed toward large, frequent issuers in corporate finance and this was also the case in public, project and infrastructure finance.

MIS's adjusted operating margin expanded by 390 basis points as revenue growth significantly outpaced the increase in operating expenses.

MA's second quarter revenue growth of 5 percent, or 8 percent excluding the impact of the MAKS divestiture and acquisitions, along with FX headwinds, demonstrated resilience as customers came to Moody's in search of integrated risk solutions.

RD&A revenue grew 16 percent, or 7 percent on an organic basis, driven by strong demand for know-your-customer solutions, as well as credit research and data feeds.

In ERS, revenue grew 12 percent, or 7 percent on an organic basis, led by software sales of IFRS17 products that enable compliance with new accounting standards for banks and insurers, as well as credit assessment and loan origination solutions.

In the second quarter, the MA adjusted operating margin increased 50 basis points primarily due to top-line growth and ongoing expense discipline.

Before I turn to our full-year 2020 guidance, I will mention some of the macro assumptions that have changed since our last earnings call and which continue to shape our outlook for 2020. Notably, we have shifted the majority of our key directional markers from 'decelerate' to 'accelerate', as shown on the right-hand side of this slide.

We considered these markers in our updated base case scenario, which assumes a continuation of the nascent economic recovery into the second half of 2020 and non-linear improvement in COVID-19 cases. Our macroeconomic assumptions include: 2020 U.S. and Euro Zone GDP to decline approximately 6 percent and 9 percent, respectively; the U.S. unemployment rate to end the year at approximately 10 percent; benchmark interest rates to stay low with high yield spreads remaining in excess of 650 basis points; and the high yield default rate to rise to approximately 9 percent.

As we head in the second half of the year, we will closely monitor both the macroeconomic backdrop and credit market activity that Ray highlighted previously.

Turning to Moody's full-year 2020 guidance.

Moody's outlook for 2020 is based on assumptions regarding many geopolitical conditions and macroeconomic and capital market factors. These include, but are not limited to, the impact of the COVID-19 pandemic, the responses to the pandemic by governments, 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 markets. Our assumptions also include general economic conditions and GDP growth in the U.S. and worldwide, on the company's own operations and personnel and additional items as detailed in the earnings release. These assumptions are subject to uncertainty, and results for the year could differ materially from our current outlook.

Our guidance assumes foreign currency translation at end-of-quarter exchange rates. Specifically, our forecast for the remainder of 2020 reflects U.S. exchange rates for the British pound of $1.24 and for the Euro of $1.12.

We have raised our full-year 2020 guidance for most key metrics as compared to the prior forecast, and now anticipate that Moody's revenue will increase in the low-single-digit percent range. Our upward revenue revision outpaces that of our operating expenses, which we now expect to be approximately flat year-over-year. The resulting improvement in operating leverage supports our upwardly revised adjusted operating margin guidance from a range of 46 to 48 percent to 48 to 49 percent.

We are reaffirming both the net interest expense and full-year effective tax rate guidance ranges of $180 to $200 million dollars and 19.5 to 21.5 percent, respectively. We have increased and narrowed the diluted EPS forecast to now be in the range of $8.15 to $8.55, and the adjusted diluted EPS forecast to now be in the range of $8.80 to $9.20. Free cash flow is now expected to be between $1.5 and $1.7 billion dollars. The guidance assumes an anticipated restructuring program in the second half of 2020 around the rationalization and exit of certain real estate leases estimated to result in total pre-tax charges of approximately $25 to $35 million dollars and estimated annualized savings of $5 to $6 million dollars. For a full list of our guidance, please refer to Table 12 of our earnings release.

For MIS, we anticipate full-year revenue to increase in the low-single-digit percent range and for rated issuance to grow in the low-double-digit percent range. MIS's forecast assumes investment grade activity for the full-year increases 50 percent, up from our prior assumption of 10 percent growth; high yield issuance increases 5 percent, up from a 20 percent decline; bank loan issuance declines 20 percent, up from a 40 percent decline; and structured issuance declines 40 percent. As Ray mentioned, after a record first half, we expect total issuance to moderate. Many issuers have fulfilled their near-term funding needs, some having come to the market multiple times. As COVID-19 has been more impactful on first time issuers than anticipated, we have reduced our new mandate forecast from 600 to 550. We also anticipate that M&A activity will remain constrained in the second half of 2020. Finally, we believe there will be a lower proportion of infrequent issuer activity, leading to a less favorable mix. The MIS adjusted operating margin is forecast to be in line with the prior year at approximately 58 percent.

We are pleased to reaffirm MA's full-year top-line growth and margin improvement guidance due to its strong recurring revenue base and renewal activity. MA's revenue guidance reflects 2 to 3 percentage points of net unfavorable impact from the MAKS divestiture and FX, partially offset by growth from acquisitions. We still expect the MA adjusted operating margin to expand over 200 basis points in 2020 to approximately 30 percent, primarily driven by the ongoing transition to scalable subscription-based products and expense discipline.

I would like to address our capital allocation approach given the current environment. Although performance in the first half of 2020 has been better than expected, there remains significant uncertainty for the remainder of the year. As such, we believe it is in the best interest of our stakeholders to continue to evaluate, at least for the time being, our share repurchase program on a quarterly and opportunistic basis.

As we consider the resumption of share repurchases in the future, we will closely monitor the COVID-19 pandemic and its effect on both our business and the broader economic environment. We will also closely review market indicators and volatility, along with the prospects for, and certainty surrounding, our free cash flow generation.

Our overarching goals remain to concurrently ensure financial flexibility, effective liquidity management, and the creation of long-term sustainable value.

Finally, our capital allocation levers remain unchanged.

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

First, Moody's remains committed to investing in our business to support key stakeholders and demonstrating sustainable stewardship. Second, especially in times of uncertainty, the relevance of our rich product and service offerings increases, which is reflected in our second quarter performance. Last, given the strong first half and early signs of economic recovery, we are pleased to be able to upwardly revise our 2020 outlook.

Ray McDaniel:

Thank you, Mark.

This concludes our prepared remarks. Joining Mark Kaye and me in a virtual format for the question and answer session is Rob Fauber, Moody's Chief Operating Officer. We would be pleased to take your questions.

"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. 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 growth 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 uncertainty as companies transition away from LIBOR and Brexit; 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 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, including provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and regulations resulting from Dodd-Frank; 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; provisions in the Dodd-Frank 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, 2019, its quarterly report on Form 10-Q for the quarter ended March 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.