Moody's

News

MOODY'S CORPORATION FOURTH QUARTER AND FULL YEAR 2020 EARNINGS CONFERENCE CALL

FRIDAY, FEBRUARY 12, 2021

ROBERT FAUBER, MARK KAYE, SHIVANI KAK

Shivani Kak:

Thank you. Good morning, and thank you for joining us to discuss Moody's fourth quarter 2020 results, and our outlook for full year 2021. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the fourth quarter of 2020, as well as our outlook for full year 2021. The earnings press release and a presentation to accompany this teleconference are both available on our website at ir-dot-moodys-dot-com.

Rob Fauber, 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 referenced during this call and 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, 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 Rob Fauber. I will now turn the call over to Rob Fauber.

Rob Fauber:

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

I will begin by summarizing Moody's full year 2020 financial results and then provide an update on our strategic direction. Following my commentary, Mark Kaye will provide further details on our fourth quarter 2020 results, as well as our outlook for 2021. After our prepared remarks, we will be happy to respond to your questions.

First, on behalf of the entire Moody's management team, I'd like to extend my appreciation to our employees for their steadfast dedication and resilience. Your remarkable adaptability and commitment to providing our customers with world-class service and supporting each other is key to our continued success, and we are proud of your accomplishments. Thank you.

Our employees helped Moody's achieve record financial results in 2020, with revenue growth of 11 percent and an increase in adjusted diluted EPS of 22 percent. Against a backdrop of heightened credit market activity, Moody's Investors Service generated $3.3 billion dollars in revenue, up 15 percent from the prior year. Moody's Analytics also performed well, with revenue totaling $2.1 billion dollars, up 6 percent, demonstrating the strong value of our products and solutions during these unprecedented times.

For 2021, we project Moody's revenue to increase in the mid-single-digit percent range, driven by our expectation that strong growth from MA and a favorable issuance mix for MIS will offset an expected decline in global debt activity. Moody's 2021 adjusted diluted EPS is forecast to be in the range of $10.30 to $10.70.

In 2021 and beyond, we'll continue to deliver solutions to meet our customers' evolving needs by integrating and leveraging our data and analytic capabilities, and investing in innovation. In addition, recent acquisitions, combined with organic investments, position us well for the future and reinforce our long-term growth opportunity.

Finally, we continue to emphasize our role as responsible stewards of our stockholders' capital. While investing in the business remains our top priority, we will seek to return approximately $2 billion dollars to our stockholders this year in the form of dividends and share repurchases.

Turning to full-year results, Moody's revenue grew an impressive 11 percent with record revenues from both MIS and MA that increased 15 percent and 6 percent, respectively. On an organic constant currency basis, MA revenue increased 8 percent.

Moody's adjusted operating income rose 16 percent to $2.7 billion dollars and the adjusted operating margin expanded 230 basis points to 49.7 percent. Adjusted diluted EPS was $10.15, up 22 percent.

Together, we achieved many milestones in 2020. For the first time, revenue at MIS and MA surpassed $3 billion dollars and $2 billion dollars, respectively, with MIS having rated more than $5.5 trillion dollars in global issuance.

We also made significant progress in delivering for our stakeholders. During 2020, we made an $11 million dollar contribution to the Moody's Foundation to support its work to empower people with the financial knowledge, resources and confidence they need to create a better future and to reach their potential – for themselves, their communities and the environment. The events of the past year have also underscored the importance of a strong commitment to diversity and inclusion, both internally and externally. This past year, we launched a number of initiatives to further support diversity and inclusion both across our company as well as within the communities we operate, including $2 million dollars in commitments to support equal justice and educational opportunities.

On the environmental front, we furthered our sustainability leadership by enhancing our disclosures and establishing clear commitments to environmental sustainability. As a result, Moody's was recognized by CDP with an 'A' score for addressing climate change.

And in 2020, amidst the pandemic, we continued to invest in our business and position the company for ongoing growth. In addition to a range of product launches, we also acquired or invested in companies that complement and enhance our products and solutions and expand our market reach.

And in September, we restructured our ESG assets under a single unit. This aligns our efforts across the firm, strengthens our thought leadership in the ESG space, and better positions us to meet the needs of the market.

Turning to MIS, credit market activity reached record levels in 2020, especially for non-financial corporate issuance, which grew over 16 percent from its previous high in 2017, and was 34 percent above its prior five-year average. Both investment grade and speculative grade debt benefited from a favorable environment, as issuers fortified their balance sheets and opportunistically refinanced debt. However, leveraged loan volumes remained modest for most of the year, despite an uptick in M&A activity in the fourth quarter.

Mark will provide details on MIS's 2021 issuance expectations when he discusses our guidance.

Pivoting to MA, we continue to see significant growth in recurring revenue, which now comprises over 90 percent of its total. This has been driven by our strategic focus on building our subscription-based business, with mission-critical products and services embedded into customer workflows that support strong customer retention rates.

As a result, MA's margin has grown 480 basis points over the past three years. This expansion is inclusive of the organic and inorganic investments we have made in the business.

Before I turn it over to Mark, I thought I would provide some thoughts about the opportunity in front of us. To do that, I think it is helpful to reflect on our journey as a company over the last 15 years, in which we have expanded our capabilities in order to meet the evolving needs of our customers.

In 2007, we formed Moody's Analytics, which was our first step in broadening beyond the rating agency through the development of our software and analytics businesses.

From 2017 through 2020, we built out some very substantial data and analytics capabilities, starting with the acquisition of Bureau van Dijk, one of the world's largest company databases, and we complemented that by adding depth across people, properties, ESG and climate, to name a few.

This strategy has positioned us well to serve a wide range of risk assessment markets, where we can integrate data and analytics and deliver insights, enabled by technology.

Looking forward, organizations face a complex, inter-linked world of risks and stakeholders. Covid has accelerated the digitization of manual processes across the financial sector and highlighted the importance of resilience and scenario planning. Organizations are managing a variety of risks that were not on their radar screens years ago, ranging from ESG, to climate, to cyber to financial crime. They are seeking a more holistic, 360 degree view of risk -- of who they are connecting to and who they are doing business with.

To do this, companies are increasingly incorporating alternative datasets into their core risk processes and are looking for insights amidst the proliferation of data.

There are a variety of stakeholders influencing companies to better identify and manage these risks including regulators, customers and employees. There are significant financial and reputational impacts for not managing these risks effectively. With this as a backdrop, customers are looking for trusted partners who have the scale, rigor, and capabilities to help them make better decisions about a wider range of risks.

As CEO, I am focused on three key areas to meet these market needs and realize the full potential we have as an integrated risk assessment business.

First, sharpening our understanding of how our customers' needs are evolving and delivering solutions that can draw on the breadth and depth of our capabilities.

Second, investing with intent to grow and scale, deepening and extending our presence in expanding risk assessment markets, as we have done successfully with KYC.

Third, collaborating, modernizing and innovating with a focus on technology interoperability and data access that allows us to maximize our data, analytic and technology capabilities on behalf of our customers.

And of course, this is all underpinned by supporting and developing our people so that we have the skills and engagement needed to drive the business forward.

For the last year, we have referred to Moody's as an integrated risk assessment business. Today, we serve a wide range of risk assessment use cases and end-markets collectively worth north of $35 billion dollars. Our largest risk assessment business is the rating agency, which serves fixed income issuers and investors. And, as Moody's has evolved, we now help customers with everything from customer onboarding, to commercial lending, to sustainable investing and a number of other areas, as you can see around this circle.

What has been a winning formula for us over the years has been combining our data, analytics and insights with our deep domain expertise and technology enablement to provide solutions for customers to identify, measure and manage risk.

We are not just a data company or a software company, but a company that has a unique combination of strengths and assets, as well as a deeply trusted brand. We continue to invest in our people and these datasets and analytics capabilities, as they are increasingly important across a growing number of risk assessment use cases and markets. This is what we mean by an integrated risk assessment business.

Earlier this week, we announced our intention to acquire Cortera. We are excited about the valuable assets they will add to the Moody's portfolio, including a world class database on private companies in North America, and one of the most comprehensive databases of commercial credit information featuring data and analytics on over 36 million companies.

We plan to integrate Cortera's data into our offerings to better serve several markets, including commercial lending, customer onboarding and supply chain management. And, by combining the data from Cortera with Moody's proprietary analytics, we look forward to helping our shared customer base make better decisions about their business relationships.

Cortera builds on several acquisitions we have made over the past few years, beginning with the Bureau van Dijk business in 2017, and followed, more recently, by RDC and Acquire Media in 2020. Together, they form a comprehensive suite of reference and entity data and AI technology to serve a range of use cases including, among others, KYC and compliance.

In 2020, Moody's Analytics generated approximately $525 million dollars in annual sales of these solutions and we expect them to produce high-teens growth in 2021. The KYC and Compliance use case, in particular, is generating over $200 million dollars in annual sales and is projected to grow by over 25 percent in 2021, continuing to be our fastest growing risk assessment market.

I will now turn the call over to Mark to provide further details on Moody's fourth quarter results, as well as our outlook for 2021.

Mark Kaye:

Thank you, Rob.

In the fourth quarter, Moody's total revenue increased 5 percent with MA and MIS contributing 8 percent and 2 percent of growth, respectively.

Moody's adjusted operating income of $531 million dollars was down 5 percent from the prior-year period. Solid revenue growth in the quarter was outpaced by increased operating expenses, including non-recurring items such as severance and incentive compensation. This resulted in a 410 basis point decline in the adjusted operating margin. Fourth quarter adjusted diluted EPS was $1.91, down 5 percent.

For MIS, fourth quarter 2020 revenue benefitted from favorable issuance mix across all lines of business, increasing by 2 percent, against a 3 percent aggregate decline in global MIS rated issuance.

Financial institutions was the largest contributor in the fourth quarter, growing 12 percent, double the 6 percent increase in issuance. This was driven by infrequent U.S. bank issuers taking advantage of the low rate environment.

Corporate finance revenue grew 2 percent, despite a 9 percent decline in issuance. This was primarily the result of strong contributions from both U.S. leveraged loans and speculative grade bonds as issuers continued to opportunistically refinance debt and support M&A deals.

Revenue from public, project and infrastructure finance declined 3 percent, driven by a 13 percent decrease in U.S. public finance activity as many issuers addressed refunding needs earlier in the year to avoid potential election-related volatility.

In structured finance, revenue decreased 11 percent, compared to a 31 percent decline in issuance. This was primarily due to lower CMBS activity, despite signs of improvement in CLO issuance.

In the fourth quarter, first time mandates grew 32 percent. For the full-year, we received approximately 700 new mandates.

MIS expense growth included non-recurring costs, such as severance related to business efficiency initiatives, and incentive compensation accruals associated with strong full-year performance. Consequently, expense growth outweighed revenue expansion for the quarter, resulting in an adjusted operating margin of 48.3 percent. On a full-year basis, MIS's adjusted operating margin expanded 170 basis points to 59.7 percent.

Moving to MA, fourth quarter revenue grew 8 percent, or 5 percent on an organic basis.

Continued robust demand for KYC and compliance solutions drove a 21 percent increase in RD&A revenue, or 11 percent on an organic basis. This was further supported by sustained customer retention rates in the mid-90s percentage range, and strong sales of research subscriptions and data feeds.

In ERS, low-double-digit recurring revenue growth, driven by strong demand for our insurance products, was offset by an expected decline in comparable year-over-year one-time software licensing fees and implementation services, resulting in an overall growth rate of 1 percent.

Growth in ERS's subscription products, the acquisition of RDC, as well as the divestiture of MAKS in 2019, all contributed to a 5 percentage point increase in MA's recurring revenue – now comprising 91 percent of its total, up from 86 percent in the prior-year period.

In the fourth quarter, MA's adjusted operating margin increased 280 basis points, benefitting from lower year-over-year incentive compensation accruals. For the full-year, MA's adjusted operating margin increased 160 basis points, supported by the growth in recurring revenue, as well as expense efficiency initiatives.

Turning to Moody's full-year 2021 guidance.

Moody's outlook for 2021 is based on assumptions regarding many geopolitical conditions, macroeconomic and capital market factors. These include, but are not limited to, the impact of the COVID-19 pandemic, responses by governments, regulators, 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 market. The outlook also reflects assumptions regarding general economic conditions, the company's own operations and personnel, and additional items as detailed in the earnings release.

Our full-year 2021 guidance is underpinned by the following macro assumptions: 2021 U.S. GDP will rise approximately 4 to 5 percent and Euro area GDP will increase in the range of approximately 3.5 to 4.5 percent. The U.S. unemployment rate will gradually decline to between 5 and 6 percent by year-end and benchmark interest rates will remain low, with U.S. high yield spreads falling below approximately 450 basis points. Finally, the global high yield default rate is expected to decline below 5 percent by year-end.

Our guidance assumes foreign currency translation at end-of-quarter exchange rates. Specifically, our forecast for 2021 reflects U.S. exchange rates for the British pound of $1.37 and $1.22 for the euro. These assumptions are subject to uncertainty, and results for the year could differ materially from our current outlook.

In 2021, we project that Moody's revenue will increase in the mid-single-digit percent range, given our approximately flat revenue outlook for MIS and the expectation of low-double-digit growth in MA.

Operating expenses are projected to increase in the mid-single-digit percent range as savings generated from our cost efficiency programs are reinvested in key strategic initiatives. I'll provide more details on these shortly.

After expanding Moody's adjusted operating margin in 2020 by 230 basis points to 49.7 percent, we are projecting 2021's margin to remain in the range of 49 to 50 percent. We estimate net interest expense to be in the range of $190 to $210 million dollars. The full year 2021 effective tax rate is anticipated to be between 20 and 22 percent.

Diluted EPS and adjusted diluted EPS are forecast to be in the range of $9.70 to $10.10 and $10.30 to $10.70, respectively. Free cash flow is expected to be in the range of $1.9 to $2.1 billion dollars, and we plan to return approximately $1.5 billion dollars through share repurchases, subject to available cash, market conditions and other ongoing capital allocation decisions.

Additionally, today we announced an 11 percent increase in our quarterly dividend, bringing the total expected capital return to stockholders in 2021 to approximately $2 billion dollars. For a full list of our guidance, please refer to Table 12 of our earnings release.

For MIS, we estimate that revenue will be approximately flat year-over-year with global rated issuance projected to decline in the high-single-digit percent range.

We forecast that full-year investment grade and high yield activity will decline approximately 30 percent and 5 percent, respectively. In contrast, we anticipate leveraged loan issuance to grow by approximately 10 percent, supported by increased M&A activity. Structured finance issuance is expected to grow in the 15 to 20 percent range, due to increased asset formation, and loan volumes contributing to larger pipelines for new CLO creation.

In 2021, we expect 700 to 750 first time mandates, with the strongest contribution from leveraged finance activity. First time mandates contribute both to the current year's transaction revenue base and to recurring monitoring fees.

MIS's adjusted operating margin will remain stable at approximately 60 percent. Disciplined cost management is enabling ongoing investment back into the rating agency, enhancing our offerings and delivering greater value to our customers.

For MA, we project 2021 revenue to increase in the low-double-digit percent range, supported by high-single-digit constant dollar organic growth, as well as recent M&A activity and favorable movements in foreign exchange rates.

Robust customer demand for KYC and compliance solutions, including contributions from the recent Cortera, RDC and Acquire Media acquisitions support future RD&A revenue growth. This expansion is further reinforced by strong retention rates for our research and data feed products.

For ERS, we anticipate recurring revenue to continue growing at a double-digit rate. As we de-emphasize one-time sales, we expect that transaction-based revenue will decline 20 to 30 percent year-over-year.

MA's adjusted operating margin is projected to be approximately 30 percent in 2021. Our outlook assumes continued margin expansion of approximately 50 to 100 basis points, inclusive of ongoing organic and inorganic investments in the business.

Last quarter, we highlighted $80 to $100 million dollars of cost savings from our expense management initiatives that we would be reinvesting back into the business in 2021.

In addition to the KYC and compliance opportunity, our focus is on investing to meet our customers' evolving needs in ESG and commercial real estate. We are also strengthening our presence in emerging markets, including China and Latin America.

Furthermore, we continue to invest in our IT infrastructure and product development. Over the long term, these investments will reduce costs, promote interoperability and accelerate decision-making.

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

Following a record year that validated our strategic direction, we're pleased to provide a robust outlook for 2021. This is driven by high demand for our data, analytics and insights, and reaffirms our long-term growth opportunities.

Our capital allocation priorities remain unchanged, and we prioritize attractive opportunities to invest in our business before returning capital to our stockholders in the form of dividends and share repurchases.

Finally, we believe that Moody's long-term sustainability is best served by meeting the needs of all of our stakeholders. By actively supporting our employees, customers and communities, we are able to demonstrate our commitment to sustainable stewardship and create enduring value for our stockholders.

And with that, let me turn the call back over to Rob.

Rob Fauber:

Thank you, Mark.

This concludes our prepared remarks. Mark and I would be pleased to take your questions. Operator?

"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 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 Brexit and uncertainty as companies transition away from LIBOR; 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; 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; 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; 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.