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News

MOODY'S CORPORATION FIRST QUARTER 2021 EARNINGS CONFERENCE CALL

WEDNESDAY, APRIL 28, 2021

ROBERT FAUBER, MARK KAYE, SHIVANI KAK

Shivani Kak:

Thank you. Good morning, and thank you for joining us to discuss Moody's first quarter 2021 results and our revised outlook for full year 2021. I am Shivani Kak, Head of Investor Relations. This morning, Moody's released its results for the first quarter of 2021, 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, 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.

Rob Fauber:

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

I'm going to begin by providing a general update on the business, including Moody's first quarter 2021 financial results. Following my commentary, Mark Kaye will provide further details on our first quarter 2021 performance, as well as our revised 2021 outlook. After our prepared remarks, we will be happy to take your questions.

Moody's achieved significant financial results in the first quarter of 2021, with revenue growth of 24 percent and an increase in adjusted diluted EPS of 49 percent, supported by strong performance from both Moody's Investors Service and Moody's Analytics.

Improving economic fundamentals and increased M&A activity drove robust issuance in the first quarter, particularly in the leveraged loan and high yield bond markets. MIS generated over $1 billion dollars in revenue, up 30 percent over the prior-year period.

MA's best-in-class subscription-based products and solutions drove revenue growth of 14 percent in the quarter.

Amidst this growth, we are reinvesting back into our business by introducing new offerings and integrating our recent acquisitions.

As a result of our strong performance in the quarter, we have updated our full-year 2021 guidance and now project Moody's revenue to increase in the high-single-digit percent range. Additionally, we have raised and narrowed our adjusted diluted EPS guidance to be in the range of $11.00 to $11.30.

Turning to first quarter results, this is the first time that MIS's revenue has exceeded $1 billion dollars in a single quarter, while MA delivered its 53rd consecutive quarter of growth.

Moody's adjusted operating income rose 41 percent to $914 million dollars and the adjusted operating margin expanded 680 basis points to 57.1 percent. Adjusted diluted EPS was $4.06, up 49 percent.

We couldn't have accomplished these great results without the hard work and dedication of our employees across the world. So, on behalf of the entire management team, I'd like to express our appreciation and say, thank you. I would also like to acknowledge the continued challenges faced by many of our employees across the globe due to ongoing pandemic conditions, especially our colleagues in India.

Turning back to the first quarter, issuance volumes reached their highest level in over a decade. While all sectors were active, leveraged finance was the busiest of all the asset classes with leveraged loans and high yield bond issuance increasing by 94 percent and 85 percent, respectively. Typically, it is unusual for both leveraged loans and high yield bonds to experience this amount of growth in the same quarter, as issuers tend to favor one type of debt over the other depending on their outlook. But attractive refinancing opportunities, as well as improving M&A activity, supported both fixed and floating rate issuance this quarter.

Additionally, the CLO market rebounded from a quiet 2020, as issuers refinanced their existing securitizations to take advantage of tighter spreads.

The strength in leveraged finance issuance in the first quarter stemmed primarily from an improving outlook for corporate defaults.

In January, the global speculative-grade default rate was expected to end the year at just under 5 percent. By early April, this outlook had improved to approximately 3 to 4 percent due to a more positive economic backdrop.

These lower default expectations led to tighter credit spreads, keeping the overall cost of borrowing low despite an increase in benchmark rates. This created an attractive environment for opportunistic refinancing and M&A driven issuance.

We are often asked what informs our longer-term views of issuance. We have shown a version of the graph on this slide before – in fact, I showed it at our 2018 investor day – and, as you can see, the data shows that historically GDP is one of the best predictive indicators of issuance over the longer term. While this relationship may not hold in any one year, there is a clear correlation that issuance tracks GDP growth over time, and we expect this to remain true going forward. This makes intuitive sense, as healthy economies promote business growth and capital investment, and provide a positive backdrop for our business over the medium term.

Focusing on 2021, we still expect overall issuance to decline, albeit modestly, from 2020's pandemic-related surge, and it will still be above the prior 5-year average. Investment grade issuance, which grew the most in 2020, is expected to face the toughest comparable. However, with GDP expanding, segments of the debt markets most sensitive to improvements in the economy -- like leveraged loans and structured finance -- are expected to show corresponding strength. Mark will provide further details on our issuance forecast by asset class later in the call.

Now - moving to MA, we are driving robust organic growth across multiple products and solutions.

Credit research and data feeds delivered low-double-digit growth, driven by continued demand for ratings data feeds coupled with strong retention rates.

KYC and compliance is growing in-line with our mid-20 percent expectations, led by our compliance catalyst and supply chain solutions.

And, we are continuing to grow in Insurance and Asset Management. In addition to our IFRS 17 offerings, we are expanding our footprint with the buy-side, benefitting from the enhanced solution suite obtained as part of our RiskFirst acquisition in 2019.

In keeping with the theme of collaborating, modernizing and innovating that I discussed on the fourth quarter earnings call, I would like to highlight a few recent examples that speak to how we are meeting our customers' evolving needs.

Starting with ESG & Climate, we are integrating ESG across all aspects of the business. In the first quarter, we launched a tool that provides climate-adjusted credit scores for approximately 37,000 public companies. In addition, building on our partnership with Euronext, our data powered the launch of their CAC 40 ESG Index.

In MIS, our analysts are enhancing our ESG analysis with the launch of ESG scores and tools, including our proprietary ESG Credit Impact Score, which identifies the impact of ESG factors on a credit rating – and our first batch of scores now cover the entire rated sovereign universe.

On prior earnings calls, we've discussed how we are integrating AI, machine learning and natural language processing into our products to make them better and faster. One example is QUIQspread, our automated financial spreading tool now used by scores of banks around the globe. This tool has helped customers substantially reduce the time and cost spent spreading financial statements, and it has won multiple awards including Best AI Technology Initiative at the 2020 American Financial Technology Awards.

Another area where we're using innovative technology is sentiment analysis and scoring capabilities. Our customers tell us they need our help with early indicators that filter the "signal from the noise." We are delivering monitoring tools that analyze news stories to understand sentiment across thousands of media outlets, and we are seeing increased interest in this use-case across our customer base. Our acquisition of Acquire Media has further enhanced our efforts in this space, which I'll touch more on in a moment.

In addition to innovating for our customers, we are modernizing our own technology infrastructure to deliver greater operational efficiency and agility. Just last week, we were recognized with an honorable mention in the Red Hat Innovation Awards for the open source platform and agile process we implemented within MIS.

Turning to our recent acquisitions, we are making good progress integrating and leveraging the capabilities we acquired to enhance our offerings.

For example, we integrated information and screening capabilities into our KYC solutions, specifically within our flagship private company database known as ORBIS. We are giving customers curated information on individuals and companies in one place, dramatically improving their ability to make better KYC decisions and saving countless hours in the process.

As I mentioned a few moments ago, the Acquire Media acquisition has accelerated our ability to generate scores that interpret the sentiment implied in news stories. We have already integrated the content from Acquire Media into multiple products, improving our customers' ability to put facts into context, focus their monitoring efforts, and consider risks in a more holistic way.

In commercial real estate, we've combined REIS and Catylist to create Moody's CRE Solutions. We are developing new tools that bring together curated data and world class analytics to support CRE professionals with more integrated lending and investing solutions, which are on track to launch this summer.

Finally, we are pairing ZM Financial's Asset and Liability Management solutions and loan pricing tools with MA's existing CECL, capital planning and balance sheet software to help customers understand risks and opportunities across their treasury, accounting and financial planning departments.

And with that, I will now turn the call over to Mark to provide further details on Moody's first quarter results, as well as an update to our outlook for 2021.

Mark Kaye:

Thank you, Rob.

In the first quarter, MIS achieved noteworthy results as strong execution, robust credit activity and favorable issuance mix contributed to revenue growth of 30 percent, compared to a 23 percent increase in global MIS rated issuance.

Corporate Finance was the largest contributor, growing 34 percent, while issuance grew 37 percent. This was primarily driven by leveraged finance issuers both opportunistically refinancing debt and funding M&A transactions. In contrast, and in line with our expectations, investment grade activity moderated as compared to the prior-year period.

The Financial Institutions and Public, Project and Infrastructure Finance lines of business also benefitted from strong opportunistic refinancing led by infrequent issuers. Revenues in these sectors grew by approximately 30 percent year-over-year, despite issuance growth in the single-digit percent range.

In Structured Finance, revenue grew 21 percent as tighter spreads drove elevated CLO refinancing and new CMBS activity.

MIS's adjusted operating margin expanded 720 basis points to 67.7 percent. This was enabled by strong revenue growth, coupled with ongoing cost efficiency initiatives and lower bad debt reserves, partially offset by higher incentive compensation accruals.

Moving to MA, first quarter revenue grew 14 percent, or 10 percent on an organic basis.

RD&A's revenue rose 17 percent, or 12 percent organically, as KYC and compliance solutions delivered mid-20's percent organic growth, and customer retention rates remained high.

ERS's revenue growth of 5 percent, or 4 percent on an organic basis, led by a 15 percent increase in recurring revenue, driven by insurance products, as well as credit assessment and loan origination solutions. Recurring revenue growth offset the expected decline in one-time revenue as we continue our strategic shift towards more subscription-based products.

MA's adjusted operating margin expanded 360 basis points to 32.9 percent. Strong top-line growth and execution of our in-flight restructuring program enabled additional operating leverage in the quarter.

As Rob mentioned earlier in the call, Moody's adjusted diluted EPS grew by almost 50 percent to $4.06, primarily driven by our extraordinary performance in the quarter. Growth in operating income contributed approximately 94 cents to adjusted diluted EPS, with 85 cents attributed to MIS. Additionally, non-operating activities, including the resolution of uncertain tax positions, as well as the release of associated accrued interest, provided a 28 cent benefit.

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. and Euro area GDP will rise to a range of 6 to 7 percent and 3.5 to 4.5 percent, respectively. The U.S. unemployment rate will decline to between 5 and 6 percent by year-end and benchmark interest rates will remain low, with U.S. high yield spreads remaining below approximately 450 basis points. Finally, the global high yield default rate is predicted to decline to a range of 3 to 4 percent by year-end.

Our guidance assumes foreign currency translation at end-of-quarter exchange rates. Specifically, our forecast for the remainder of 2021 reflects U.S. exchange rates for the British pound of $1.38 and $1.18 for the euro. These assumptions are subject to uncertainty, and results for the year could differ materially from our current outlook.

Following our first quarter performance, we are raising our full-year 2021 guidance for most metrics as compared to the guidance provided on February 12th. We now anticipate that Moody's revenue will increase in the high-single-digit percent range. As we strategically manage our expense base, we are maintaining our expectations for cost growth in the mid-single-digit percent range. Given our improved revenue outlook and expense stability, we project Moody's adjusted operating margin to be approximately 50 percent.

Our updated net interest expense guidance is in the range of $160 to $180 million dollars and we reaffirm our effective tax rate projection of 20 to 22 percent.

We raised and narrowed our diluted and adjusted diluted EPS guidance ranges to $10.40 to $10.70, and $11.00 to $11.30, respectively. Our free cash flow forecast is now expected to be between $2.1 and $2.2 billion dollars, and we continue to anticipate full-year share repurchases of approximately $1.5 billion dollars, subject to available cash, market conditions and other ongoing capital allocation decisions.

For a complete list of our guidance, please refer to Table 12 of our earnings release.

Within MIS, we project full-year global rated issuance to decline in the low-single-digit percent range, up from our previous guidance of a high-single-digit percent decline.

Our guidance for high yield bonds and leveraged loans has been raised to approximately flat and up 55 percent, respectively, as we expect robust issuance in leveraged finance to persist into the second quarter, supported by low borrowing costs and sustained M&A activity. However, we anticipate supply to return to more normalized levels in the second half of 2021, as we believe many issuers will have fulfilled the majority of their funding needs earlier in the year.

Full-year investment grade supply is still expected to decrease by approximately 30 percent, following a very active prior calendar year.

We forecast issuance from Financial Institutions to be approximately flat. We have not factored the proposed U.S. infrastructure bill into our assumptions regarding Public, Project and Infrastructure Finance issuance, which we anticipate will decline approximately 15 percent. Depending on the contents of the final legislation, if it were to pass, it could improve our expectations for the balance of the year.

The expected increase in leveraged loan supply positively impacts new CLO creation. As a result, we predict Structured Finance issuance will increase 40 percent.

In line with the surge in leveraged finance activity in the first quarter, we are increasing our guidance for new mandates in 2021 to be in the range of 800 to 850.

We have updated MIS's revenue outlook to reflect stronger than anticipated first quarter performance. We now estimate that MIS's revenue will increase in the mid-single-digit percent range, up from our prior guidance of approximately flat.

We are also raising MIS's adjusted operating margin guidance to approximately 61 percent.

For MA revenue, we are maintaining our forecast of an increase in the low-double-digit percent range. This is due to strong demand for our subscription-based products, stable customer retention rates, favorable foreign exchange rates, and a 2 to 3 percentage point tailwind from recent acquisitions.

MA's adjusted operating margin guidance remains at approximately 30 percent as we expect underlying margin expansion to be partly tempered by an acceleration in strategic investments in 2021.

Since we are maintaining our full-year 2021 expense guidance in the mid-single-digit percent range, I would like to provide additional clarity and insight regarding our approach to expense management.

In the first quarter, operating expenses rose 7 percent over the prior-year period. Of this reported growth, approximately 4 percentage points were attributed to recent acquisitions and the unfavorable impact of movements in foreign currency exchange rates. Ongoing expense discipline continues to reinforce our operating leverage.

As noted on last quarter's earnings call, by generating upwards of $80 million in cost efficiencies this year, we are able to self-fund our strategic priorities and reinvest back into the business. The majority of these strategic investments will occur in the second half of 2021.

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

First, we successfully executed our strategic and business objectives against a backdrop of robust issuance, delivering meaningful results this quarter across both operating segments.

Second, we are acutely focused on innovation and integration of new features into our products and solutions to meet our customers' evolving needs.

Third, we are maintaining expense discipline through ongoing cost efficiency initiatives, which enable us to both reinvest in our key strategic priorities and expand our operating margins.

And finally, we are pleased to revise upward our full year 2021 outlook as we drive operating leverage and create further opportunities for growth.

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. Stockholders and investors are cautioned not to place undue reliance on these 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. 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