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Rocket Cos., Inc. (RKT)

Q4 2021 Earnings Call

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CORPORATE PARTICIPANTS

Sharon Ng
Vice President-Investor Relations, Rocket Cos., Inc.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

Robert D. Walters
President & Chief Operating Officer, Rocket Cos., Inc.

OTHER PARTICIPANTS

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Richard Shane
Analyst, JPMorgan Securities LLC

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Brock Vandervliet
Analyst, UBS Securities LLC

Ryan McKeveny
Analyst, Zelman & Associates

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Rocket Companies, Incorporated Fourth Quarter 2021 Earnings Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I'd now like to turn the conference over to Sharon Ng. Please go ahead.

Sharon Ng

Vice President-Investor Relations, Rocket Cos., Inc.

Good afternoon, everyone, and thank you for joining us for Rocket Companies' earnings call covering the fourth quarter and full year of 2021. With us this afternoon are Rocket Companies' CEO, Jay Farner; our CFO, Julie Booth; and our President and COO, Bob Walter.

Before I turn things over to Jay, let me quickly go over our disclaimers. On today's call, we'll provide you with information regarding our fourth quarter and full-year 2021 performance, as well as our financial outlook.

This conference call includes forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from the expectations and the assumptions we mention today. We encourage you to consider the risk factors contained in our SEC filings for a detailed discussion of these risks

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and uncertainties. We undertake no obligation to update these statements as a result of new information, or further events, except as required by law.

This call is being broadcast online and is accessible on our Investor Relations website. A recording of the call will be available later today. Our commentary today will also include non-GAAP financial measures. Reconciliations between GAAP and non-GAAP metrics for our reported results can also be found on our earnings release issued earlier today, as well as in our filings with the SEC.

And with that, I'll turn things over to Jay Farner to get us started. Jay?

Jay Farner

Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

Thank you, Sharon. Good afternoon and welcome to the Rocket Companies' earnings call for the fourth quarter and full year of 2021. On today's call, I'll recap our achievements from the past year, including our success driving growth in purchase loans and cash-out refinance, continuing to build on the strength of the Rocket platform through the addition of Truebill, and I'll cover the best-in-class capital returns we have provided our shareholders since our IPO in August of 2020.

Last year was an incredibly successful year for Rocket Companies as we continued to break records. In 2021, Rocket Mortgage reached a company best of $351 billion of originations, which represented a nearly 10% increase from the previous record of $320 billion set in 2020. On a full-year basis, Rocket generated $12.4 billion of adjusted revenue, $6.2 billion of adjusted EBITDA, and $4.5 billion of adjusted net income.

It's worth taking a step back to look at what we've accomplished over the last two years. Comparing closed loan volume and adjusted revenue in 2021, it was more than double our 2019 levels. Our adjusted EBITDA and adjusted net income more than tripled in that same period. Also we have organically grown our service client base by more than 40% since 2019, which today generates recurring cash revenue at an annual run rate exceeding $1.4 billion.

The company has grown and strengthened, all while generating profitability at scale, returning substantial capital to our shareholders. In the last two years, we have earned a cumulative adjusted net income of more than $12 billion. With today's announcement of our second $2 billion special dividend and the more than $300 million of stock repurchases, we've now returned $4.5 billion of capital to shareholders since our IPO in August of 2020. That represents roughly 20% of our market value based on today's trading price.

We're also investing to grow our platform with strategic acquisitions like Truebill. This continued investment in our platform strengthens our core offerings to our consumers who know, like and trust our brand, driving increased lifetime value.

Looking at our guidance of $52 billion to $57 billion of closed loan volume in the first quarter of 2022, you see, we project to nearly triple our 2018 quarterly run rate of $20 billion, growing significantly faster than other market participants over the last three years.

Our first quarter guidance reflects the impact of the Omicron outbreak, which disrupted our business and required us to again send team members home for their safety. Our 36-year history has taught us that our centralized model is a significant advantage in rising rate environments. The ability to train and coach in real time is critical to our success. I'm happy to report that as of February 14, we have returned to the office and we're already seeing the benefits in the last few weeks.

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As rates rapidly increase, our strategy has always been to protect our margin and our profitability. During time periods like this, many lenders will significantly reduce their margin in an effort to sustain production. We have found that this is not a sound strategy for profitability, sustainability, and maintaining a disciplined approach towards supporting our business long-term.

I'm certain that this question will come up again in the Q&A, and we're excited to talk about our strategy to address rising interest rates and continue to grow our business. In fact, we have grown our mortgage business substantially since the last market cycle by doing the right things; delivering the best client experience in the market; investing in a flexible, scalable, multichannel platform that's always ready to quickly capture opportunity; and we've also driven significant mortgage volume growth from less-rate sensitive products, including purchase and cash-out refinance. If we look at the last week since we brought our team members back to the office, our non-rate (sic) [less-rate] sensitive products make up nearly 90% of our mortgage production.

Last May, we announced our plans to become the number one retail purchase lender, excluding correspondent, in the nation by 2023. I'm happy to report that 2021 represented the largest purchase mortgage volume in our company's history, and we are seeing continued momentum here in the early part of 2022. We are well on our way to reaching our stated goal.

Additionally, the fourth quarter was our best ever for cash-out refinance volume, as we leveraged our vast data lake, our client insights, and of course our highly trained Rocket Cloud Force to help our clients take advantage of rising home values. Home equity continues to be at record levels with $25 trillion of equity available to homeowners.

Along with the strong growth in the mortgage segment, we made significant strides last year growing our platforms to help Americans with life's most complex moments. We've expanded beyond our core mortgage business to enable an end-to-end seamless home-buying ecosystem with Amrock, our title and settlement services company, which hit 1.1 million closings in 2021 and is the largest of its kind in the country. At Rocket Homes, we saw strong growth with the company facilitating more than 30,000 transactions, representing over $8 billion in transaction value. And at Rocket Auto, we more than doubled our GMV in 2021.

The talented team of Truebill also joined our family in the fourth quarter. Truebill is a strong addition to our platform as it brings millions of existing clients who have affinity for the brand and are actively working to improve their finances in anticipation of future large purchases like home or auto. Truebill's offerings expand our relationship with our clients by managing subscriptions, improving credit scores and tracking spending, all of which strengthens clients' financial health and enables Rocket to nurture clients in between large, less frequent purchases.

Truebill is one of the fastest growing fintech businesses in America, and was recently named the number one consumer tech company by the news publication The Information. Truebill's growth has been impressive. The company's premium membership base increased by more than 115% in 2021 and has continued to outperform after our acquisition. This is all before we've even begun introducing and incubating the millions of clients in the Rocket ecosystem to Truebill.

Rocket and Truebill are aligned in one mission to remove friction from life's complex moments, and the relationship has come together quickly. In fact, our combined teams are currently working together to create a single sign-on solution that will bring the entire Rocket ecosystem together through one unified login. We expect this new experience to launch in the next 30 to 45 days.

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Another strategic part of our platform that enables us to maintain ongoing relationships is Mortgage servicing. With our 2.6 million service clients, our servicing book has grown substantially, providing a natural hedge to our origination business. We are now the fifth largest servicer in the country with servicing rights representing a $5.4 billion asset as of year-end, while maintaining an industry-best retention rate of 91%. Consider this, our business has created recurring cash flows of more than $1.4 billion annualized through servicing, plus an additional $100 million through the rapidly growing Truebill business, all supporting an incredibly capital-light business.

Heading into 2022, we see tremendous opportunity. With robust purchase and cash-out refinance demand, we view the challenging market conditions like the rising rate environment as an opportunity to shine. This is the time when we see our investments in our platform truly pay off. We don't believe any other company has invested in technology, in brand, in people, in partnerships like we have. The partnerships we have with companies like Salesforce, E*TRADE, Charles Schwab, State Farm, and many others are built on a proprietary platform that cannot be easily replicated by other lenders or other fintech companies.

To ensure consumers are aware of our unique position in the market, we recently aired a number one-rated Super Bowl commercial, our second straight year of achieving this honor. The ad touted the benefits of leveraging the combined experience of Rocket Homes and Rocket Mortgage to find and finance a home. This thought garnered billions of media impressions and is currently being reinforced through our brand and direct response advertising campaigns.

This marketing is essential in reminding consumers that in a housing market that has remained highly competitive and inventory-constrained, we provide the insight and the tools that help our clients into the closing table faster. These include our industry-leading home search platforms and programs like Overnight Underwrite and Rocket Pro Insight, and consumers are taking notice. In January of 2022, verified approval letters were up 50% compared to 2021, representing the most pre-approvals we've had at the start of a year in our company's history.

Finally, 2021 also marked our first full year as a public company. We have shown a track record of generating profitability at scale and returning significant capital to our shareholders. Cumulatively, we have returned $4.5 billion to shareholders since our IPO, putting Rocket in the top 10% of all S&P 500 companies and companies that have listed since 2020 ranked by capital return.

Our team members are excited to continue executing on our strategy and to capture the enormous opportunity in front of us. We've already seen our industry begin to consolidate and we are well-positioned to gain share and offer more value to our clients across the entire Rocket ecosystem.

With that, I'll turn things over to Julie to go deeper into the numbers. Julie?

Julie Booth

Chief Financial Officer & Treasurer, Rocket Cos., Inc.

Thank you, Jay, and good afternoon, everyone. Rocket delivered outstanding results in 2021, as we continued to drive growth in our less rate-sensitive products, build out our platform through continued organic investment as well as through the recent acquisition of Truebill, and returned substantial levels of capital to our shareholders.

As Jay mentioned, 2021 was a record year for us as we delivered $351 billion in closed loan volume, 10% above the prior record set in 2020. This growth in volume was driven by our best year ever in purchase, along with record levels of cash out-refinance volume. We saw purchase growth across both the direct-to-consumer and

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partner network channels, with particularly strong growth year-over-year from our partner network, which includes both TPO and premier enterprise partners.

While industry estimates of the total market size are still preliminary, it is clear that Rocket Mortgage gained meaningful market share in 2021, continuing our long-term trend of share growth. Based on the MBA's most recent estimate, Rocket increased its place in the market by 100 basis points to now account for nearly 9% market share for the full-year 2021.

Our gains in 2021 are particularly impressive considering the mix of refinance transactions declined as a percent on the total market during 2021. We increased our share of both purchase and refi transactions, demonstrating the flexibility of our centralized platform.

Turning to fourth quarter results, Rocket Companies generated $2.4 billion of adjusted revenue in Q4, a 33% increase from Q4 2019. We had $883 million of adjusted EBITDA in the quarter, up 19% from Q4 2019, representing a 36% adjusted EBITDA margin. We delivered adjusted net income of $637 million, exceeding Q4 of 2019 by 23%.

For the fourth quarter, we generated closed loan volume of $75.9 billion, which was in line with our expectations and exceeded Q4 2019 levels by 49%. Our all-in gain-on-sale margins came in at 280 basis points in Q4, in line with expectations.

Our net rate lock volume for the fourth quarter was $68.4 billion, coming in slightly below our expectations. The variance relative to our expectations was largely due to unforeseen disruptions from the COVID-19 Omicron variant, which impacted client engagement, our workforce, and our broker partners. Rate lock volume is more impacted than closed volume as the timing of rate lock occurs prior to the closing of a loan.

We continue to maintain a superior net client retention rate, and as of December 31, 2021, this metric stood at 91%. These high levels of retention, in addition to the new clients we continue to drive to our platform every quarter, has substantially increased the size and value of our servicing portfolio over the past year. As of December 31, 2021, we now have 2.6 million clients with $552 billion in unpaid principal balance, increases of 25% and 35% respectively as compared to December 31, 2020.

The servicing book provides a natural hedge to our originations, as its value increases when interest rates rise. As of December 31, 2021, our MSR portfolio represented a $5.4 billion asset on our balance sheet, up 88% from December 31, 2020. If we were to close the books today, the value of our MSR asset would be in excess of $6 billion due to the increase in interest rates since year-end.

Recurring cash revenue from our servicing book hit an annualized run rate of over $1.4 billion during the fourth quarter. As a reminder, the balance sheet value of our MSR asset only includes the discounted cash flows associated to servicing strip, as the GAAP accounting rules do not allow us to include the retention value of future origination revenue. When considering that we have consistently maintained a net client retention rate north of 90%, we believe the GAAP accounting rules understate the true intrinsic value of our MSR assets.

Looking ahead to Q1, despite a rise in mortgage rates at the beginning of 2022, we continue to see a robust mortgage market by historical standards. The median US home value has increased 25% over the last two years, equating directly to larger loan sizes. In addition, demand from homebuyers remained strong, demonstrated by the record levels of verified approval letters we are providing at Rocket Mortgage, up 50% year-over-year in January.

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And, lastly, today American homeowners are sitting on record levels of home equity. As Jay mentioned, third-party sources estimate total American home equity at $25 trillion. For the first quarter, we currently expect closed loan volume in the range of $52 billion to $57 billion and rate lock volume between $50 billion and $57 billion. We expect first quarter gain-on-sale margin to be in the range of 280 to 310 basis points.

Regarding operating expenses, we expect Q1's expenses to be in line with Q4 levels, excluding onetime items that occurred in Q4. Our GAAP expenses in the fourth quarter included a onetime extinguishment of debt expense of $87 million and a $19 million true-up to the tax liability under our tax receivable agreement. Excluding these items, our Q4 expenses were $1.63 billion.

We expect this to be a good run rate for Q1 expenses. This takes into account reductions in production-related expenses, offset by seasonally higher expenses in Q1 for marketing and compensation-related expenses. Q1 2022 will also reflect full quarter consolidation of Truebill for the first time. Excluding the addition of Truebill, we expect our Q1 expenses to be down over $100 million year-over-year compared to Q1 of 2021.

The acquisition of Truebill contributes incremental annualized recurring revenue of more than $100 million on top of the $1.4 billion of annualized cash revenue generated by our servicing portfolio. Truebill's growth has been impressive. And as we work together to unlock the synergies across our platform, we see even more opportunities to grow.

Turning to our balance sheet, liquidity and capital allocation, we exited 2021 with $2.1 billion of cash on the balance sheet and an additional $3.5 million of corporate cash used to self-fund loan originations for a total available cash in self-funding of $5.6 billion. Total liquidity stood at $9.1 billion as of December 31, including available cash plus undrawn lines of credit and undrawn MSR lines.

Our $5.6 billion of available cash in self-funding, combined with $5.4 billion of mortgage servicing rights, represents a total of $11 billion of asset value on our balance sheet as of December 31. This equates to $5.58 per share.

The earnings power of Rocket Companies over the last few years has been remarkable. In strong markets, the scale of our profitability rivals the best fintech companies in the world. To put this in perspective, our adjusted net income of $12.8 billion over the last two years combined was larger than PayPal's and nearly as large as Mastercard's.

We have demonstrated discipline allocating the capital generated by our business. Inclusive of last year's special dividend of $1.11 per share, the special dividend of $1.01 per share announced today and the more than $300 million of share repurchases that we have made since our IPO, we have distributed a total of $4.5 billion to all classes of shareholders since we went public less than two years ago. This ranks Rocket among the best-in-class for capital return.

As Jay stated earlier, relative to our current market capitalization, Rocket ranks in the top 10% of all S&P 500 companies and companies that have listed since 2020. We have also deployed capital to grow our platform with the acquisition of Truebill for $1.3 billion in December. We will continue to deploy our capital in a strategic and disciplined manner to generate long-term shareholder value.

With that, we're ready to turn it back to the operator for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the questions-and-answer session. [Operator Instructions] In the interest of time, please limit yourself to one question and one follow-up. [Operator Instructions] Our first question comes from Doug Harter from Credit Suisse. Please go ahead.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. Jay, since we spoke last, the markets have been quite volatile with rates and mortgage spreads moving quite a bit. Can you just talk about how – what your outlook is for the market, for the overall market size in the coming year and how you're positioning Rocket to compete in that environment?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. Thanks for the question. As I mentioned in my remarks, this is an important topic to discuss. It's hard to know market size. Of course, any event on any given day can determine, like we're noticing here today in Europe, can determine what might happen. So what we focus on are kind of our long-term playbook to ensure that we can continue to grow, like we have here for the last 36 years.

In particular why I've mentioned this in my remarks is that when you see a rapid increase in interest rates like we've experienced in the last 60 days or so, there are few different levers you can pull. For us, being a centralized business model with the brand and technology, our lever is training, our lever is skill, our lever is investing in our team members.

We had a bit of a challenge because at the same time that this increase occurred, the Omicron outbreak here in particular in Michigan and Ohio caused us to send everyone home, making it a bit more challenging for training. But we've got people back in the office now, and as I referenced before, here in last week we've seen I think about roughly 90% of all of our loan volume be less interest rate-sensitive products, cash-out refinance, rate and terms purchase.

So I bring all that up because the lever you noticed that we aren't pulling is the margin lever. And Julie can talk more about this. This is important. The way that we have always thought about operating our business is that the unit that we generate, the mortgage, if we're talking about the mortgage business, needs to be a high revenue, profitable unit.

And as you structure your business in a way where you're driving that, you do a few things. First of all, you don't teach your organization that the solution to growing market share is cutting margin. I'm seeing numbers here, our direct-to-consumer in Q4 I think was north of 400 basis points. I'm seeing people coming at like 250 basis points. You can run those numbers, but how can you invest in marketing at 250 basis points, how can you invest in technology at 250 basis points, how can you keep your best LOs at 250 basis points, how can you keep your best underwriters.

Like, although – the entire heartbeat of your organization needs to be supported through profitability. And although you may not grab market share over 30 or 45 days, you keep your organization focused on the real things that matter, the client experience, the brand, the marketing, the tech. And in the long run, that's how you grow your company. So you've noticed, we didn't go to cut margin, we're going to focus on the training. So,

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whether the – it's hard for me to project what the market in 2022 will be. Here's what I know, over the course of time, this is a huge market and if we keep investing in all of the things that we've just talked about, we will win that market share.

And the last thing I'll say is that when you look at – you can watch us, but then if you cut margin and then you look at your profitability and you don't have any, the next thing you cut is you cut your marketing. And now you don't have the lead flow. And as you don't have the lead flow, you cut your LOs because now you have nothing to give them. And that's a death spiral. And so you'll notice that we're going the opposite direction of that, continuing to invest. That's what we've done and that's why I brought up where we were a few years ago at a similar interest rate market to give a comparison of making the right investments, then you take advantage of opportunity, you grow substantially, you reset your foundation, which is what we're doing now, and you compare yourself for continued growth.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

I appreciate that. And just to follow-up, when you're talking about cash-out refi and purchase being less rate-sensitive, can you just talk about how higher rates impact that? And that is there kind of a breakpoint where the higher rates start to kind of slow down overall volumes and people's appetites?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. This is an important topic because rate is relative to the other rates that you borrow money. And so, we're fortunate that mortgage rates don't sit by themselves. They sit with other vehicles that someone might use a credit card, a personal loan, a home equity line of credit, those sorts of things. And so, with the benefit of mortgages and how they're done in this country with the benefit of tax deduction, even if we see a tick-up in interest rates, it still in most cases is the best way for our clients to achieve their goals.

And the other thing that I think is critically important here, when you're buying a home or when you're noticing that you can't find a home and saying now you're going to invest in a new kitchen or putting out an addition or whatever it might be, then the client becomes less rate-sensitive, whether they receive 4.5% under 30-year or 4.625% or 4.25%, that's not really the driver. The driver is achieving that new thing that they want, that new home or their kid's college education, or a new kitchen. And that's where skill, that's where brand, that's where confidence in our company comes through.

And so, that's why in a rising rate market like this, we have an advantage because our conversation shifts from a rate and term refinance where I'm really fixated on every 0.125% in rate to, hey, I want to get this done so I have a bedding for the baby that's on the way in eight months. And so, that's how we think about it. It's – the real conversation is about the opportunity you're creating for the client. If we just take a step back, 4.5% or so on a 30-year fixed rate, it's still incredibly low interest rates, incredibly advantageous for clients to take advantage of it.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah.

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Operator: The next question comes from James Faucette from Morgan Stanley. Please go ahead.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Thank you so much. I'm wondering, and it seems it's always a topic on your calls, so I apologize maybe in advance, but can you talk about a little bit how gain-on-sale margins are trending, what you're seeing, what your planning assumptions are for how those evolve over coming quarters and periods, especially in quite a volatile environment?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. I'll let Julie field that. Obviously, you can see our guidance here. And so we're feeling confident about where our margins have been here in Q4 and where we're headed in Q1, but Julie can give you more color.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Yeah. Let me just give you a little bit more insight. So, gain-on-sale margins during the fourth quarter did come in within our expectations at the midpoint of our guided range at 280 basis points. And just taking as a reference point, our Q2 2021 gain-on-sale margins came in at 278 basis points. Q3, excluding the impact of the removal of the adverse market fee, in the third quarter was 295 basis points.

So we've really seen margin stability since the second quarter of 2021 and we're seeing that stability continue into Q1, as our expectations are for gain-on-sale margins to be increasing at the midpoint to between 280 and 310 basis points. So we're continuing to see strength, as Jay mentioned, especially the direct-to-consumer channels where we're seeing margins there. I've talked about historically kind of that 400 basis points range for those margins and we're still seeing very strong margins, as Jay said, better than a lot of others that you'll see out there as well. So we're really pleased with where we're seeing them go into Q1 here.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Got it. And Julie, maybe just to be clear, so the improvement that you're expecting, is that all mix-driven and is that – or is there something happening in the market that's providing some additional support? And I guess, as part of that, particularly the direct-to-consumer, can you talk a little bit about like how that – how you're doing in terms of hitting your objectives in growing share with consumers and especially as the market becomes more purchase-based?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. I'll jump in and Julie has some comments too. But going back to the first question, and there's an initial kind of competitive situation as many lenders scramble, many cut margin, and so everyone is fighting for that business. As times move on and if rates continue to kind of stay where they're at or continue to rise, and we talk about other people cutting margin, then as I described before, now they have to come out of the market. Now they reduce their marketing spend. And actually what happens is, we now have less competition. That lead that maybe two or three other big lenders we're talking to, now it's just us, or it's us and only one other lender.

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And so, that actually creates an environment where we can be even more confident in standing behind our margin. So, it's not the mix as much as it's just kind of the cycle that you go through, the initial kind of flavoring that people do, trying to do some win through price, will subside. And then, all of a sudden, you're left with a new playing field with fewer competitors out there talking to the same clients that you're talking to.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Got it. And just for Julie – yeah, sorry, Julie.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Yeah. I guess, I'll just add to that too. Certainly mix is a key to this but not a big piece of the difference here. We're also seeing strength in the partner network channel relative to where we had seen margins coming in. So I think that that also is really contributing here to the strength we're seeing.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

That's awesome. Thanks for all the color, guys.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Yes.

Operator: The next question comes from Kevin Barker from Piper Sandler. Please go ahead. Hi, Kevin, is your line on mute? The next question comes from Ryan McKeveny from Zelman & Associates. Please go ahead.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Hey. Good afternoon. Thank you. Jay, as you said, you'd get some more questions on the topic of volume and margin, but I think especially that first answer you gave hit on a lot of the aspects I was wondering. So, I will shift a little, wanted to focus on the expense side. Julie, correct me if I'm wrong, I think the commentary you gave was that the 4Q expense level was a good run rate for 1Q.

So, correct me if I'm wrong there, but I'm thinking more as we move through the year, any commentary you can provide about what we should expect from the expense side of things, given obviously the revenue side is fairly uncertain? And maybe just remind us in terms of the cost base, how much is fixed versus variable, anything that can kind of help us bridge the gap between an uncertain revenue environment relative to your expense base and ultimately profitability? Thank you.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Yes. And thanks for your question. And I'll kind of reiterate some of the things that I said in my prepared remarks. I know I said a lot there. So, first of all, let me just start by saying that we are very thoughtful about our costs, and I do want to be clear about that. So, I'll share a couple of things relative to the fourth quarter and to Q1 and reiterate some of the things I said earlier.

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So, our total Q4 expenses were $1.74 billion and this included two onetime items, one of which was $87 million associated with the early extinguishment of a portion of our outstanding bond and the other one was $19 million of expense associated with the re-evaluation of our tax receivable agreement liability. So, if you exclude those two onetime items from Q4, our total expenses would have been $1.63 billion. So, that's down $60 million from our Q3 levels.

Then as we look ahead into 2022, we do expect expenses in the first quarter to be relatively consistent with Q4, as I mentioned, excluding those onetime items. And there's a fewer moving parts impacting Q1 that are important to understand. We do expect production-related expenses to continue to come down by more than $80 million in Q1 compared to Q4. However, these costs are being partially offset in Q1 by some seasonal items, including payroll taxes and our 401(k) match costs, which both reset at the beginning of the year, and also some additional marketing expense that's going to be – that we've incurred with the Super Bowl ad that we did.

And then the other thing I'll mention relative to Q1 is that that quarter's going to now include a full quarter of Truebill expenses as we closed on that acquisition in late December. So, Truebill also typically sees higher marketing expense in the first quarter, as many consumers are looking to improve their financial health or their New Year's resolutions. And so this marketing spend, we see a little bit higher and it does drive seasonal lift in the user base and revenue growth.

As we look a little bit farther out than that at our current volume levels, we would expect expenses to decline modestly beyond Q1 as well. So, that's the trend that we're seeing.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Okay. Thank you. Very helpful.

Operator: The next question comes from Kevin Barker from Piper Sandler. Please go ahead.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Hi. Can you hear me now?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah. Sorry about that earlier. So, Julie, you mentioned earlier that you're seeing a lot of more opportunities to grow, particularly with the Truebill acquisition. And it seems like it is exceeding your expectations. I don't want to put words in your mouth, but it sounded that way. Is there anything in particular that stands out to you where you're seeing significantly more opportunities to grow outside of your core mortgage business through the acquisition and various other ancillary businesses?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

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Well, maybe I'll jump in there. I think the Truebill business is exciting for us. As Julie said, they kind of have their fifth quarter in January they consider it because there's so many people thinking about their finances. But we've got this question a lot about Truebill and the thought process behind Truebill. And so, I think it's important to walk through.

There are really kind of three elements that we're heading forward on with Truebill. The first is having that single sign-on solution. And that may not sound like much, but without that, our Rocket clients, the millions of clients we have in our servicing portfolio, the millions of clients that we'll deal with all the way through 2022, would have to create yet another account to access Truebill. And so, having a sign-on solution where they can use the same account or transfer or use their Rocket account is incredibly important. Especially as we continue to market, we're talking to clients who may be seven, eight, nine months out from purchasing a home. Today, we may have to buy that lead again.

As we launch single sign-on, those clients can now engage with Truebill to do their budgeting. They can engage with Truebill to work on their credit core. They can engage with Truebill to save some money. And we keep getting signal as they get engage. The app has the ability for us to send push notifications to them that really we don't have today. And so, we keep those purchase clients engaged.

Same on the refinance side, and probably equally, if not more important, as we turn on single sign-on, because we've talked about it, we're talking to people today who are reaching out to us, looking to save what may or may not make sense at this moment. Again, we would probably spend marketing dollar later to bring them back into the funnel. But with Truebill, we can offer additional rates to them to start their savings plan, engage and then bring that lead back. So, that's the important component of single sign-on.

As we move past that, as Truebill continues to see success, in addition to all the Rocket marketing that we're doing, Truebill gives us another avenue to bring 1 million-plus additional premium users, and not only does it generate, I think Julie mentioned, $100 million here of revenue and growing, but it's another funnel for us then to interact with folks and eventually find solutions as we're studying their credit report and studying their bank statements to offer a refinance, to offer a new car, and those sorts of things. So it's a brand new lead gen funnel for us.

And then the third will be our servicing book. So we talked about the leads that we get, we talked about the Truebill leads that we get, but there's also this opportunity to engage our servicing platform. We have a 91% retention rate and still opportunity there to find additional ways to help our 1.6 billion and growing servicing clients. And today we have lots of tools in our Rocket Mortgage servicing platform. But as we continue forward and offer bill negotiation, subscription management, better budgeting tools, all of that will create a more robust engagement with our client base and should give us more confidence as we think about acquiring MSRs, as we think about adding MSRs. And so, all of those are significant growth opportunities powered by Truebill.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

So the follow up on that, is there any way to quantify the decrease in lead generation cost associated with having Truebill within the Rocket Companies? Or is there a way to say that a certain percentage of existing Truebill customers or future Truebill customers are going to become Rocket Mortgage customers that we can say they're going to generate X amount of revenue and then suddenly they're in the ecosystem and they become 91% attrition – retention rate I guess. So is there any way to quantify that for us?

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Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.
A

Yeah. So those – I mean, look, we're thinking about CAC or cost to acquire, and how that adjusts out over time, or LTV, which is incredibly important to us. We've given some slides in the past about examples of what LTV can look like. Those are all things that we are – here's what I can tell, those are things that our data team is on every minute of every day. Our finance team is studying goals and KPRs – KPIs are being set and we are driving towards those.

But those aren't numbers that we are disclosing at this point in time, but just know that the operation of this business focuses on all of those critical things. And you're drilling down exactly why we did this acquisition, because we have a strong belief that this has not been done in the mortgage space before. And so this is something that can really continue to add to the reducing CAC and the increase in the LTV in our client base.

Kevin J. Barker
Analyst, Piper Sandler & Co.
Q

Yeah. Thank you, Jay.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.
A

Yeah.

Operator: The next question comes from Arren Cyganovich from Citi. Please go ahead.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.
Q

Thanks. I was hoping you could address the funding and capital usage that you have recently. Issuing a decent amount of new unsecured debt which is attractive pricing, but just curious, the thought process there ahead of doing another relatively large special dividend and share repurchases and balancing those items?

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.
A

Yeah. So, if you're asking about the issuance of the bond, and that was something that was really strategic for us to be able to lower our cost of funding, so that was fairly significant for us in terms of the overall cost of funding. It was 60 basis points of lowered cost there. So, that was something that allowed us to issue some debt, and as I mentioned, refinance and pay off actually some of our debt. So, that was an opportunistic time for us to be able to build capital at a time when we executed at pricing that was really unseen before for a company like us. So we were very proud of that execution.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.
Q

And then in terms of the choice of special dividends, and I don't know, it just seems like you didn't really need the cash. You raised cash and then you're doing special dividends, but just I'm trying to understand the thought process there.

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Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Yeah. It was a time in the market when it really was advantageous for us to go to market to raise that additional capital, and we are always looking at the capital. The earnings that we've had since that time coming into the business as well gave us an opportunity.

I'll just kind of maybe reiterate how we think about capital. First of all, we think about capitalizing the business properly, investing in our platform. We did the acquisition of Truebill as well for $1.3 billion. So, another thing that we invested in. We have been acquiring mortgage servicing rights as well. During 2021, we acquired about $200 million worth of mortgage servicing rights.

So, all of that factored in then. And as we look at returning capital to shareholders, we're thinking about this all the time. And we've now returned, as I said, $4.5 billion to our shareholders since going public, so.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

And I think, look, it was the right time to do it because it was very advantageous. We did extinguish some existing debt at a higher interest rate. But when we think about the dividend, we're looking at the profitability of the company, and at least funding that in cash is fungible, but funding that with the profitability of the company.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you.

Operator: The next question comes from Richard Shane from JPM. Please go ahead.

Richard Shane
Analyst, JPMorgan Securities LLC

Q

Hey, guys. Thanks for taking my question this afternoon. In all of the chaos of getting ready for earnings and everything else happening in the world today, FHFA announced that they are reconsidering eligibility requirements for single-family seller servicers. I'm kind of curious how you look at this as a large player in that space, the advantages and disadvantages for you, and what you think it might – how it might impact the competitive landscape. Are you guys there? Can you guys hear me?

Operator: Yeah, I can hear you. Hold on. Both speakers, is your line muted?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. Sorry, guys. We were talking and we apparently weren't listening. Bob, so you can probably comment it on. But I think we just reviewed those and I think there are some capital requirements that they have increased. And I think based on the last question on the dividend, we're in great shape in terms of having enough capital.

But, Bob, I don't know if you've got additional comments?

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Robert D. Walters
President & Chief Operating Officer, Rocket Cos., Inc.

A

Well, I mean, I think nobody is in a stronger position financially from a liquidity standpoint, all the things, from a capitalization standpoint than we are. So we're totally fine with that. In fact, I think over time it becomes an advantage because you have some pretty thinly capitalized folks out there that it will become a considerable challenge for them. So we don't look to regulators for competitive advantage, but in this case, we will get it.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. The only thing that I would say also that kind of typically goes with that is that, as we think about the broader platform, we touched on this before and we've acquired MSRs. We're always strategically looking to acquire MSRs. And so, if there's fewer people out there thinking about making that acquisition, probably in the long haul it makes it even – it could be easier for us to make those acquisitions with our LTV. We're probably in a better position to do that than others.

Robert D. Walters
President & Chief Operating Officer, Rocket Cos., Inc.

A

And I think we've heard it from recent earnings calls, there are some folks that are selling servicing now to gain liquidity. And so, that creates a pretty significant opportunity for us as well.

Richard Shane
Analyst, JPMorgan Securities LLC

Q

Great. Thank you, guys.

Operator: The next question comes from Brock Vandervliet from UBS. Please go ahead.

Brock Vandervliet
Analyst, UBS Securities LLC

Q

Good afternoon and thanks for the question. Jay, I appreciated your comments earlier about marketing. Just if we could go maybe one layer deeper on that. How do you think about the return on marketing spend as we transition from, call it, a $4 trillion to a $2.5 trillion or so market? Your return on investment around those marketing dollars I would think would decline simply because the market is that much smaller. How should we think about that?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. There's probably three important components here. And again, that's why it's important to let things play out over a few months. Although initially you might see people scrambling to market, performance marketing in particular, over time as companies reduce their margin, they then typically reduce their marketing cost as well. So there could be an increased amount of competition for some period, but then actually opportunity to go in and own spaces as people back away.

So, what you have to do from a marketing budget perspective is you have to shift more of your dollars. So, as we are running performance marketing and what we consider kind of performance brand marketing, you'll see us shift increasing the performance side of the house, right? And so you'll notice there'll be more on digital. There'll be more on DR. We'll get more robust in tracking those DR responses, a little bit more surgical. So, watching it by

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state, or county, or city, or those type of things to understand how our dollar is working. And then, of course, flaring our attribution models on top to make sure that that brand spend we're doing is also supporting that.

So there's not a big change to how we think about the return on the marketing dollar. It's just – this is like a reset that gives you an opportunity to maybe find areas that six months ago, a year ago, were being – a lot of people trying to make – to buy in those areas. Now they're backing away. You can come in, you can buy. And then that's – the last thing I'll say is that is why the Truebill conversation, the value of the MSR going up, all of that matters, because you're rethinking your models based on the data coming in, the lifetime value of the client, the increase in the value of the MSR that you're acquiring, that matters. So we're always resetting the reports that we do to ensure that we're spending properly, but that's it. It's just the mathematical decisions behind the scenes and shifting more to performance.

Brock Vandervliet
Analyst, UBS Securities LLC
Q

Okay. And just as a follow-up, I think this was Julie's comment that expenses should decline modestly beyond the Q1. What's the geography of that decline? Is that – where is that coming from basically?

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.
A

Yeah. We're just giving guidance really on Q1 at this point. So, as we look ahead, we would expect that over time, as we think about our cost, there's some variable cost that adjusts immediately with production and there's some that do take a little bit more time to work into over time. So, as we think about those declining costs, that's why I say that, because some of those are going to take a bit more time.

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.
A

Yeah. I'm going to jump in here though, too. I think this is important. So we touch on this all the time. We've invested and we'll continue to invest in marketing and our brand. We continue to invest in technology. We've got thousands of technologists here writing software that make our systems better, make our mortgages more efficient, make our conversion rates better. We've got the most skilled operations people here in the United States of America who know how to work and process, underwrite and close loans. We've got the best mortgage banking force in this country, nearly 6,000 or so of those folks.

That's the heartbeat of our organization, right? Everything we have is due to the success of those individuals. And so we're not going to have a conference call where all of a sudden we let a group of them know they're not going to be working here any longer. That's just not how we do this. That profitability is important, but the investment in our team members is the most important thing that leads to the future growth of this organization.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.
A

Yeah. So we've seen this time and time again as we go through these cycles. We have been through the opportunity that it creates, holding a bit more of that excess capacity really does pay dividends in the end. So you may see us do that.

Brock Vandervliet
Analyst, UBS Securities LLC
Q

Got it. Understood. Thanks for the color, guys.

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Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yes.

Operator: Our next question comes from Mark DeVries from Barclays. Please go ahead.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah. Thank you. Sorry if I missed this, but could you just comment on how your efforts to gain share in the purchase market have been trending these last couple of months as refi really starts to fade?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. So, again, as we think about it, we really think in a less or non-interest rate-sensitive product, because there's $25 trillion of home equity out there, so whether someone – and with inventory levels where they're at, whether someone purchases a new home or invests in their existing home, both are huge opportunities for us.

Now we're very pleased to exceed. I think we'd set a goal for purchase and talked about exceed our 2021 purchase goal. Really proud of the team for achieving that. And so, as we talked about in the prepared remarks, we had good momentum. We continue to have good momentum in purchase. Those verified approval letters, I think the pipeline is the biggest it's ever been as we walked into January of 2022. And then the training around cash-out, the training around term change that we have implemented in the first quarter of this year, as I think I mentioned, I think we're darn near 90% of our production today is falling into that less interest rate-sensitive bucket.

So, all-in-all, going very well. And touching on another question that we had, once you make that switch, then your mortgage banking force is talking to individuals where rate is not the most important thing. Achieving the goal is the most important thing. And that allows for marketing growth, but also allows for conversion increase. And I didn't even touch on, again, the 2.5 million, 2.6 million service clients that we've got. As that value of the MSRs increases, it doesn't mean that we won't see opportunity to assist those clients as well in the retention. So, all of the levers that we – like I said earlier, different than others, but the levers that we choose to pull in a rising rate market are going very well.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Great. And then just a follow-up question on kind of the efforts to tap into the borrower equity. Does a move in mortgage rates this meaningful kind of require you to switch a little bit more from trying to market a cash-out refi to doing more like a home equity line of credit or just a second lien?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

We haven't experienced that. Again, as I said before, typically as rates rise, all rates rise. So it is just about the comparison of another way to achieve the goal versus a mortgage. And so, certainly your mortgage payment is going to be a bit higher if you're getting 4.5% on a 30-year than 3.5%. But in the grand scheme of life, and most of our clients have seen this, that's still an incredibly low interest rate, a fixed interest rate that they can count on

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over time. And so we've not – in terms of objections that you might hear, people telling us that there's a better source to achieve those goals has not been one that's been surfacing.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. That's interesting. All right. Thank you.

Operator: The next question comes from Bose George from KBW. Please go ahead.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey, everyone. Good afternoon. Actually just wanted to follow-up on the cash-out. So you guys noted 90% of the originations that are not rate sensitive. I was curious, how do you treat refis where a borrower extracts equity, but also has a rate incentive to refi, so sort of an opportunistic cash-out refi? Are there many borrowers kind of in that category?

Jay Farner
Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

A

I'm sure there are certain borrowers in that category. But, again, look, when we think about the purpose and the borrower usually or the client, as we call them, will usually tell us what it is. That may be an ancillary benefit, but the strong desire for the call or the lead or the outreach is because they're trying to achieve some sort of cash-out to get, whether it's home improvement or covering a college education or unfortunately going through a divorce or whatever the case may be. That's the driver behind it, not the additional possibility of a reduction in rate in most cases.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Great. Thanks. And then actually going back to the gain-on-sale discussion, you might have addressed this, but your guidance, does the channel mix play a role in the guidance at all or is that assuming kind of the similar channel mix to what you had this quarter?

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

The channel mix has the minimal impact on that. Really what we're seeing is improvement in the partner network margins as well. So, while there is some impact of that, holding steady on that direct-to-consumer gain-on-sale margin, as I mentioned, in that 400-basis-point range I said historically, kind of where we're at and then that improvement in partner network.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Great. Thanks.

Julie Booth
Chief Financial Officer & Treasurer, Rocket Cos., Inc.

A

Sure.

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Operator: This concludes our question-and-answer session. I'd like to turn the conference back over to Jay Farner for any closing remarks.

Jay Farner

Vice Chairman & Chief Executive Officer, Rocket Cos., Inc.

Yeah. Thanks, everybody, for the questions today. We appreciate it. And most importantly, thank you for our team members as they have done an amazing job here the last few months of dealing with all of the kind of curveballs of COVID and returning to the office and the shifting and changing in the market and the acquisition of Truebill. I mean, we just – we've got a lot of things going on and to see the entire team rally together has been – it's just incredible in the 26 years I've been here. So, most importantly, thanks to all of you. And we'll see you soon.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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