04-Aug-2022

Rocket Cos., Inc. (RKT)

Q2 2022 Earnings Call

Copyright © 2001-2022 FactSet CallStreet, LLC

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.

OTHER PARTICIPANTS

Ryan M. Nash
Analyst, Goldman Sachs & Co. LLC

Mihir Bhatia
Analyst, BofA Securities, Inc.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Blake Netter
Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Joseph, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Rocket Companies' Second Quarter 2022 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be question-and-answer session. [Operator Instructions] Thank you.

Sharon Ng, Vice President of Investor Relations, you may begin your conference.

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 second quarter of 2022. With us this afternoon are Rocket Companies' CEO, Jay Farner; our CFO, Julie Booth; and our President and COO, Bob Walters. Before I turn things over to Jay, let me quickly go over our disclaimers.

On today's call, we will provide you with information regarding our second quarter 2022 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 and uncertainties. We undertake no obligation to update these statements as a result of new information or further events, except as required by law.

Copyright © 2001-2022 FactSet CallStreet, LLC

This call is being broadcast online and is accessible on our IR 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 in 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 second quarter of 2022. On today's call, I'll share how Rocket is leading during this time of rapid change in the mortgage market and how we're investing in Rocket's future. I'll discuss the transformation of our Rocket services and engagement platform and strengthening of our offerings in both purchase and cash-out refinance mortgage products.

The mortgage industry has shifted rapidly and is facing challenging times. Volatility in interest rates and declining consumer sentiment have contributed to overall uncertainty about the economy. In this time of flux, we have taken proactive steps to optimize our core mortgage operations by improving lead capture and allocation, launching new products, signing new partnerships and aligning our resources internally.

Our senior most leaders, seasoned industry veterans, who have navigated numerous cycles in their 26 years here at Rocket, are as close to the business as they've ever been. We are adapting our mortgage operations to the current market environment, and we remain focused on managing the business with discipline. Julie will walk through our cost management efforts in more detail a bit later.

This is an energizing time for us. Our ability to constantly innovate to serve our clients better through our platform, particularly during these challenging times, will further differentiate us from our competition and will allow us to capture market share over the long term. Once again, we are revolutionizing the Rocket platform, setting the foundation for our next stage of growth through the use of centralized data across all Rocket businesses, which creates additional touch points to drive revenue.

We've always taken a long-term view of our businesses. Through every cycle in our 37-year history, we've adapted, invested and emerged stronger. Our track record has proven that investment into our own business is always the best one that we can make. In fact, we have more than 2,000 team members, including technology, product strategy, data and marketing functions working to expand our client engagement platform. And consequently, the Rocket flywheel is poised to spin faster than ever as we enter 2023.

We recently unified the entire Rocket ecosystem by launching single sign-on across each of our businesses. In July, we unified more of our businesses under the Rocket umbrella with Truebill, soon to be operated as Rocket Money, and Edison Financial, our Canadian digital mortgage brokerage, transitioning to Rocket Mortgage Canada. These two rebranding initiatives leverage our continued investments in the trusted Rocket brand and draw our businesses closer together.

With the Rocket Money rebrand, client service by Rocket Mortgage will enjoy a free Rocket Money premium membership, providing access to unlimited budget management tools, our network dashboard, subscription cancellation, concierge service, full credit reporting and more. We've been very pleased with our acquisition of Truebill, now known as Rocket Money, and the business is quickly becoming the core of the Rocket engagement platform.

Copyright © 2001-2022 FactSet CallStreet, LLC

Rocket Money has continued to grow rapidly with paying premium members surpassing 2 million in July 2022, more than doubling year-over-year. To put this in perspective, it took Rocket Mortgage nearly 30 years to originate 2 million mortgages. And it was only a few years ago that our servicing book surpassed 2 million clients, making the growth of Rocket Money even more impressive. Rocket Money has launched its credit card in beta, offering unique features like smart pay that help members take control of their credit. The early response is very positive.

As I mentioned, Rocket Money provides valuable insights and helps keep clients actively engaged in our ecosystem. For consumers managing their financial lives, especially during times of high inflation, the services Rocket Money provides become even more valuable to its members. The company's members link their financial and credit accounts, providing insight into our clients' lives, which our industry-leading marketing engine can then leverage to help craft bespoke experiences, delivering the right offer to the right client at the right time.

Rocket Homes, our home search platform and real estate agent referral network, grew overall real estate transactions by 25% from Q2 of 2021 to Q2 of 2022, which is even more impressive considering the overall housing industry decline over that same period. Rocket Homes also notched two record months in the quarter for closed units. The web traffic grew by nearly 60% over that same time period, reaching nearly 3 million unique visitors per month.

Rocket Solar continued its national expansion in June and is now available in 42 metropolitan areas covering a meaningful portion of the US population, including Arizona, Florida and South Carolina. In addition, as of this week, we are proud to highlight another example of our flywheel in action, as Rocket Solar is now working directly with Rocket Loans to provide solar financing options to our clients.

This partnership is made possible by the incredibly flexible AI-powered loan decisioning engine and product-agnostic platform developed by Rocket Loans over the last few quarters. This is just one of the many examples of our investment in technology continuing to pay off for our company. We look forward to continually growing our solar footprint and expanding the use of the Rocket Loans lending engine through the remainder of 2022 and beyond.

As we continue to focus on our future, we're also keeping our sights firmly set on maximizing the opportunities before us. Homeowners are sitting on a record $28 trillion of home equity. The cash-out refinance opportunity remains very healthy. We see our clients using cash-out refinance to consolidate debt or remodel their existing home.

We've also launched a home equity loan product just a few days ago that will provide even more optionality to clients who may not want to refinance their first mortgage due to favorable terms, but they still want to tap into the equity currently available in their home. To illustrate an example of the power of our platform, we were able to develop and go to market with our new home equity product in just under 60 days by leveraging our flexible technology platform and internal resources.

With client insights from Rocket Money, we can offer our home equity loan and other products to come to the right clients at the right times. This client pool represents tremendous future opportunity once they're part of our ecosystem. They may roll their first and second mortgage together when the market is once again right for refinancing or take advantage of other Rocket offerings down the road.

The purchase market was more muted than we expected in the second quarter, with home buying activity impacted by affordability, inventory and consumer confidence. We are prepared and ready to help our clients

Copyright © 2001-2022 FactSet CallStreet, LLC

during these uncertain times and when the macro environment improves. This is exactly why our engagement platform is so crucial. It allows us to keep our clients engaged and active with our brand until the moment they're ready to transact, eliminating the need to market broadly, thus reducing our cost to acquire clients.

Over the past few weeks, our capital markets and marketing teams collaborated to launch new products to address our clients' immediate concerns over rate uncertainty. We have placed renewed emphasis on our RateShield program, which gives our purchase clients confidence in a rising rate environment by locking in rates for 90 days while they search for a new home.

We also launched our Rate Drop Advantage at the end of July, which provides homebuyers with a onetime credit on typical closing costs to refinance their mortgage if rates drop within three years of their purchase, something made possible and profitable by our efficient origination process.

We are also very happy to share that we signed two significant premier enterprise relationships. We've entered into a new agreement with global financial leader, Santander, to originate mortgages for the bank. You may remember, earlier this year, Santander exited the US mortgage market in light of challenging conditions.

We also signed a new partnership with Q2, a banking platform leader, who provides digital banking applications to over 500 financial institutions. We'll work with Q2 to embed the digital Rocket Mortgage experience directly into the online banking apps used by their clients. Through the Q2 banking platform partnership, Rocket Mortgage will enable the financial institutions to offer mortgages without the need to manage their own mortgage operations. Consumers will enjoy a comprehensive seamless experience through one app to apply for mortgage, make mortgage payments, deposit checks and build their savings. We're having initial conversations with banks and credit unions now and expect to make this technology available to them in the fall.

These challenging markets have spurred financial institutions to scale down or exit the mortgage business, creating a compelling case to partner with the industry leader, Rocket. More and more financial institutions are seeking out Rocket to help offer mortgage products and, in particular, purchase mortgage products to their clients without having to make the investment to originate on their own and compete with our strong brand. This is a tailwind for our enterprise partnerships channel and presents an opportunity unique to Rocket to grow our client base and market share.

As we look forward, we will invest through the cycle and further prove Rocket's track record of execution. Rocket is incredibly well positioned to seize the opportunities in the financial services space, the mortgage market and beyond by continuing to build on our platform and comprehensive end-to-end home buying and financial services ecosystem. We're excited to continue to move forward in fulfilling our mission to be the best at creating certainty in the life's most complex moments so that our clients can live their dreams.

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

Julie Booth

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

Thank you, Jay. And good afternoon, everyone. As we navigate through these challenging and rapidly changing market conditions, Rocket remains focused on serving our clients, executing on our vision and investing in the key areas of our business. I will be sharing some detail on our cost management program as well as the actions we're taking to drive short-term results, while continuing to invest in our long-term growth.

Copyright © 2001-2022 FactSet CallStreet, LLC

Year-to-date, we have seen a seismic shift to a smaller mortgage market. The average weekly 30-year fixed rate mortgage jumped from 3.2% at the beginning of the year to nearly 6% at the end of June, the steepest and fastest rise in over 50 years. The rise in rates had a significant impact on rate and term refinance demand.

More recently, purchase demand has also been affected as consumer sentiment has declined at a rapid pace, the levels not seen in more than a decade, and looming apprehension over the economy has driven fears of a potential recession. Consequently, consumer behavior has changed significantly, and in particular, potential homebuyers are staying on the sidelines.

In Q2, Rocket Companies generated $1.1 billion of adjusted revenue. We delivered GAAP net income of $60 million, resulting in GAAP EPS of $0.02 per diluted share. On an adjusted basis, we reported a loss of $0.03 per adjusted share.

In the second quarter, gain on sale margin continued to show strength, coming in at 292 basis points, which was above the high end of our guided range and largely consistent with recent quarters. As a reminder, Q1 gain on sale margin was 286 basis points after excluding the 15 basis point lift from the onetime benefits associated with the rapid move in bond markets in Q1.

We generated closed loan volume of $34.5 billion and net rate lock of $29.4 billion, both coming in around the low end of our guided range. Both net rate lock and closed loan volume were lower than anticipated, largely due to muted demand in purchase, attributable to declining consumer sentiment and recession fears.

Regarding our expenses, we continue to execute a disciplined and prudent approach to cost management. We communicated on our last earnings call that we would undertake significant cost reduction measures during the second quarter. At that time, we forecasted a roughly $200 million reduction in total expenses from Q1 to Q2. However, as we closely monitored the challenging macro environment during the quarter, we made a concerted effort to accelerate expense reductions.

We took additional cost savings measures beyond the career transition plan, including, but not limited to, marketing, production and other vendor-related costs, which resulted in a reduction in cost of $300 million as compared to the first quarter. Our total expenses in the second quarter were $1.3 billion, down from $1.6 billion in the first quarter, including a partial quarter of savings from our career transition program, which will result in a cost reduction of approximately $50 million on a four-quarter run rate basis.

Looking ahead to Q3, we expect our core mortgage business to continue to face headwinds. For the third quarter, we expect closed loan volume in the range of $23 billion to $28 billion, and net rate lock volume between $23 billion and $30 billion. We expect third quarter gain on sale margin to be in the range of 250 to 280 basis points.

Our guidance assumes that concerns of recession and subdued consumer sentiment will persist throughout the third quarter. As always, our forward-looking guidance is based on our current outlook and visibility into the third quarter.

For Q3, we anticipate a further reduction in total expenses of between $50 million and $150 million from Q2, driven by production and marketing-related expenses and the full quarter savings associated with the career transition plans put into effect in Q2. We will continue to be diligent about managing our costs, balancing the current macro environment as well as our long-term objectives.

Copyright © 2001-2022 FactSet CallStreet, LLC

Today's environment accentuates how important it is for us to continue to invest in the Rocket engagement services platforms. The Rocket engagement platform increases the number of clients that we interact with, improves conversion and lowers our client acquisition costs. Together with the services platform, this enables us to capture market share and grow profitably.

Turning to servicing. As we've talked about on prior earnings calls, our servicing book is a strategic asset for Rocket. As of June 30, our servicing portfolio included 2.5 million clients with $538 billion in unpaid principal balance. At the end of Q2, the value of our mortgage servicing rights was $6.7 billion, including newly created MSRs and the mark-to-market adjustments. This reflects an increase of $1.3 billion year-to-date, including a $1.1 billion mark-to-market adjustment due to changes in assumptions.

While the mark-to-market change in the MSR portfolio value is excluded from our adjusted net income metrics, it's worth noting that the positive market adjustment on the portfolio is countercyclical in a rising rate environment. As a reminder, the mark-to-market increase in value of the servicing portfolio is a result of the assumption that, with higher interest rates, prepayment speed slow, which extends servicing cash flows, and therefore, our recurring cash generation from this asset will be greater.

We also drive a considerable amount of annualized recurring revenue from servicing our clients' mortgages. During the second quarter, annualized recurring cash revenue from our servicing book was over $1.4 billion. When considering the cash flows from our servicing portfolio and Rocket Money, formerly known as Truebill, we generated over $1.5 billion of annualized recurring cash revenue as of June 30.

As we have shared with you before, the first priority within our capital allocation waterfall is reinvesting in our business even during challenging times, and that's exactly what we're doing today. Jay mentioned in his remarks that our investments over the years have enhanced our ability to emerge stronger from challenging environment.

In 2004, we invested in our core operations process, making it vastly more scalable and efficient, which allowed us to grow production by 70% and double our market share in the next three years. In 2008 and 2009, during the financial crisis, we began investing in our brands and held some excess operations capacity, which allowed us to triple our market share over the next few years.

Through our continued brand investment, Rocket has become the number one most differentiated brand in mortgage. We have made continuous investments in technology over time, building our next-generation fintech lending platform, the foundation for Rocket Mortgage, which we launched in 2015.

In 2018, as interest rates began to rise, we continued to focus our energy on investing in technology and growing our TPO business. These investments in technology allowed us to more than quadruple our mortgage origination volume from 2018 to 2021, and today, our TPO business is the second largest in the space.

These examples demonstrate how our continued investment in the business throughout the cycle gives us a competitive advantage, and the time to make that investment is upon us once again.

We will also maintain a well-capitalized balance sheet with substantial liquidity capable of navigating different market conditions. Our strong balance sheet is one of our many competitive moats. We exited the second quarter with $915 million of cash on the balance sheet and an additional $3.1 billion of corporate cash used to self-fund loan originations for total available cash and self-funding of $4 billion.

Copyright © 2001-2022 FactSet CallStreet, LLC

Total liquidity stood at $7.3 billion as of June 30, including available cash plus undrawn lines of credit and our undrawn MSR line. Since June 30, our total liquidity has increased, as subsequent to the quarter end, we put in place a new $1 billion MSR facility. On a pro forma basis, including this new MSR facility, our total liquidity as of June 30 would have been $8.3 billion.

Our $4 billion of available cash in self-funding, combined with $6.7 billion of mortgage servicing rights, represents a total of $10.7 billion of asset value on our balance sheet as of June 30. This equates to $5.42 per share.

Despite broader industry headwinds and a challenging market, we remain focused on serving our clients and taking care of our team members, and we are committed to investing in the expansion of our engagement services platforms to position Rocket well to deliver short-term results and drive long-term growth. We will continue to deploy our capital in a strategic and disciplined manner to generate long-term shareholder value.

Before we turn the call over to the operator, I wanted to make you aware that our inaugural ESG report for 2021 can be found on the Social Impact tab on our IR website. This first ESG report highlights Rocket's For-More-Than-Profit philosophy and approach and the positive impact Rocket has made on our community and our environment.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Ryan Nash. Your line is open.

Ryan M. Nash
Analyst, Goldman Sachs & Co. LLC

Q

Hey, good afternoon, everyone.

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

A

Hey, Ryan.

Ryan M. Nash
Analyst, Goldman Sachs & Co. LLC

Q

Jay, maybe to kick it off, I know in your opening remarks, you mentioned that you're going to continue to execute on a prudent cost management approach. I think you even said another $50 million to $150 million of cost reduction next quarter. Can you maybe just talk a little bit more about what's driving some of the cost declines? And if we're going to be in a mortgage market sub-$2 trillion, I guess, how much more cost leverage is there beyond what you've identified, and where do you think you can maybe take the run rate to in this kind of environment?

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

A

Yeah. I'll have Julie make some comments on how we think about the cost moving past Q3. But, I think, just to frame up how we think about this, we've got our core mortgage business, right? And so, although I look across all

Copyright © 2001-2022 FactSet CallStreet, LLC

of RKT, I think about the operations, underwriting, core mortgage technology, and how that is functioning on different mortgage volumes, and we strive to have that as a profitable part of our business.

We then have our platform. And we talked a lot about that in my prepared remarks, because if you think about a mortgage market, whether it's $1.7 trillion, $1.8 trillion, $2 trillion, no one's sure, but you've got to find a way to bring down the cost to acquire. And what you're watching right now in the industry is there's still too much capacity and people are fighting very hard for every particular loan that may be out there.

And so, to strategically win in the long run, we've got to make sure that our engagement rates with our clients are up. Our lead flow is still very, very strong, but not every client is ready to transact right now. In particular, we referenced this, the purchase market has slowed a bit because people are concerned about the increase in their monthly payment. So, how do we stay engaged with that client? How do we increase conversion of those leads, over time, driving down our cost to acquire and increasing the lifetime value of the client?

We've done a lot of work on the services side of our platform, so offering homes, offering auto, offering solar, which is growing rapidly. But the acquisition of Truebill, now Rocket Money, that's our engagement side of the platform, with the budgeting, with the managing of assets in the balance sheet, with the managing of credit, with the subscription canceling. And we will – as we move forward into the second half of this year, we'll make further announcements about how we're going to engage with that client base daily, weekly, monthly. Those efforts, and now nearly 2,000 or over 2,000 people are focused on that here. And that's the strategic advantage Julie referenced.

Every so often, we've got to put a lot of effort into something outside of core mortgage to grow the overall platform and grow mortgage. And so, back to your question, that's what you're watching us do right now. We're taking those resources, those salaries and we're accelerating that engagement component of our platform so, as we get into 2023, and what we expect to still be a fairly challenging mortgage market, that lead flow that we're generating will be staying in our ecosystem, staying in contact with us, and we will drive down the cost to acquire, thereby allowing us to actually spend more on marketing and drive more mortgage volume and take market share.

So, we can continue to work on expense reduction, and again, Julie will touch on that, but really, the focus is taking the assets that we have, our team members and accelerating our ability to drive revenue growth. And that's what you're seeing us do in Q2, that's what you're seeing us do in Q3. And the expense reduction is coming more from the career transition plan that we did. Our team is doing an amazing job of working through all of our vendors and contract costs. And we're just getting smarter about that. But we've got to keep putting money into the tech, the product strategy, the data science, because that's how we're going to grow market share in a more challenging mortgage market in 2023.

Julie, I'll let you add comments.

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

A

Sure. I'll make a few comments on expenses here, just to add to that. So, looking at the second quarter here, we've reduced expenses by $300 million over the first quarter and exceeded our target of $200 million by $100 million. So, we've really taken a lot of moves to reduce our cost into the quarter here. And as we look ahead into the third quarter, we have opportunity of about another $100 million. So, if you add all that up, $400 million, that's an annual run rate of $1.6 billion of savings. So, significant cost reduction has already taken place.

Copyright © 2001-2022 FactSet CallStreet, LLC

As we look ahead, there's more opportunity, we do believe, as Jay mentioned, on the vendor cost side of things. Some of these things take a little bit longer to work into as our contracts mature, as we look at how these are going to be coming for renegotiation. We will still see some of these cost savings happening going forward as well. So, there's opportunity there. Natural attrition we believe there will be some of that, that will continue throughout the year and we will be smart about how we spend our marketing dollars as well.

Ryan M. Nash
Analyst, Goldman Sachs & Co. LLC

Q

Got it. That was very helpful color and context regarding the entire platform and how do you think about it. So, maybe if I could just squeeze in one follow-up, Julie or Jay. So, rates have obviously come in a bit, and I'm just wondering, do you think this at all helps the trajectory of volumes, particularly on the refinance side? And do you think 3Q represents the trough for volumes just based on the market conditions? And if so or not, what do you see as the drivers of originations from here if market sentiment doesn't improve, as, Jay, you highlighted, you expect 2023 to be challenging, too? What do you see as the drivers of originations as we look forward, given the uncertainty in the economic backdrop?

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

A

Yeah. I think that we're in a moment where you've got to transform your business and how you're thinking about it. The current environment that we're in is causing, like I said, a lot of kind of scrambling and scraping and so forth. More capacity has to come out. We're very fortunate in our ability to continue to invest. And I touched on this, it's not investing in – although we have a little excess capacity, that excess capacity for us is staying around, because as we implement all of these things, we're working on with our engagement platform for the rest of this year, and that drives market share gain, we'll need that capacity as we move into 2023 as we grow our market share again. So, it wouldn't make a lot of sense for us to go through a significant capacity reduction only to turn around and to hire again four or five months later. But I don't see a lot of people in the mortgage space making the millions and millions and millions of dollars of monthly investment that we're making in an engagement platform like that. I don't see folks signing up partners like Santander like we are.

And so, I think we're going to see the rest of the industry contract as we continue to move forward. And without something that allows you to bring a client onto your platform and continue to work with them, maybe it's a second mortgage product that we just released, another thing that – again, without our tech platform, there's no way we could go on from not having that to doing all the programming and creating the docs and launching it in less than 60 days. Our capital markets team is working on additional products that we'll launch as we get into the second half of this year to help our client base. So, we're going to leverage all of that tech, but those type of things that will allow us to grow our market share. If you don't have those things, I think it's going to be a challenge for you to grow market share as we finish up this year and roll into 2023.

Ryan M. Nash
Analyst, Goldman Sachs & Co. LLC

Q

Thanks for the color.

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

A

All right. Great. Thank you.

Copyright © 2001-2022 FactSet CallStreet, LLC

Operator: Your next question comes from the line of Kevin Barker. Your line is open.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Great. Thanks for all the color on the operating efficiencies. Just a follow-up question on some of what Ryan has already asked. You had $1.3 billion of expenses. Was there an additional $61 million in there from the changes in movement of employees embedded in that $1.3 billion? And then, where could we expect a lot of the expenses to come out within – going into the third quarter? Is a lot of it in G&A and marketing expense, or is it other items that can really drive some of the efficiencies that you laid out?

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

A

Yeah. We've got continued thoughts around marketing, although, as you probably know, from a performance marketing perspective, we're very thoughtful about making sure that we don't cut anything that is profitable for us there. And again, as we start getting more and more signal around how that marketing will work, not only in the short run, but the long run, it allows for us to continue to spend marketing there. We'll continue to see attrition, as Julie talked about, we're being really thoughtful about that. If there's attrition in places that are critical for us from a technology perspective to keep building out the platform, then we can – we will backfill, but in other places, we won't. And so, you'll continue to see those salaries drop. There's additional work with the vendors and contracts that we've got, as Julie referenced before. Even once you go through and identify areas where you need to make adjustments, either renegotiating and/or waiting for contracts to season can take a bit of time. It's not something you can work through in a matter of a month or a quarter.

So, all of that work continues forward, and will continue to move forward. And we're pretty diligent about it. We've got a great team here in our procurement group and they're working every single day to be smart. But I just want to reiterate, smart but also making sure that we have all the proper resources to do what we've always done in years past, which is to grow market share. And so, as we think about the expenses and we think about the revenue, we'll continue to work on the expenses, but our main focus is driving up that revenue by increasing in the conversion rates and bringing down the cost to acquire our clients. And that's what I referenced in my remarks.

Our senior leader team, we're dedicating many, many hours a week reviewing line-by-line, where all of our resources are at, the work that is being done. I've not seen – I'm not going to say that this is more intense than ever before, but we are at equal intensity than we've ever been in the 27 years I've been at the organization in terms of being all over these projects. And I'm watching a team of people that are highly energized because they see the work that we're doing that no one else is doing that will really differentiate this company moving forward to be far broader than just a mortgage lender.

So, Julie, I don't know if you have anything I've missed there?

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

A

The only thing I'll add to that, Kevin, you asked a question about the $61 million in career transition expenses, you're correct, that $1.3 billion does include $61 million of expenses in connection with that career transition program. We had a couple of nonrecurring items this quarter. There was a $24 million item as well related to just tax adjustments that we made. So, expenses would have been $1.276 billion in the second quarter had it not been for those couple of adjustments.

Copyright © 2001-2022 FactSet CallStreet, LLC

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Okay. Great. And then, your leverage is very low, you have a lot of cash. You mentioned over $8 billion access to liquidity today on a pro forma basis. Is there anything you could do to potentially accelerate your revenue diversification efforts besides what you've already built within Rocket Homes or Rocket Auto, perhaps maybe look at M&A opportunities to potentially diversify or offset some of the revenue headwinds you see on the mortgage side?

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

A

Yeah. I think that's a great question, and we've got our team out constantly looking at those opportunities. If you think about the waterfall approach, you've got the bottom services layer that actually generates the true revenue; Mortgage, Homes, Auto. Solar is growing rapidly. I know I kind of touched on it just briefly, but all the tech work that we did in Rocket Loans to really build an AI-driven loan-agnostic technology platform. So, whether it's a solar loan today or an auto refinance loan for example tomorrow, that tech allows us to do that very quickly. So, that's the revenue component of that.

You've got the top of the funnel, whether it's our Quicken Loans site, our Core Digital LowerMyBills site, our Rocket Mortgage site, other assets we're building. Then, you've got the middle layer, the engagement layer. So, as we drive traffic in, you've got to find a way to make sure that you can engage that client base. And so, when we think about M&A, you think about other services you can add to drive revenue and you think about other ways to drive top of the funnel, it's critical that we – that's why we said we've got 2,000 people accelerating the growth of the engagement layer, because that's the kind of secret sauce that unlocks our ability to bring the clients in and keep the clients in.

And that's why the growth of Truebill doubling in a year is so exciting, because it's taken us so many years to get to a place where we've got north of 2 million people now, I think almost 2.6 million in our servicing book. But to watch and be able to add millions of people a year where they're linking their bank accounts, where we have access to their credit data, their asset data that informs all those up funnel to how we're buying leads or engagement plus it goes down funnel and into how we generate revenue. That component is critical. So, that's why we really are trying to point out, the work we did in the last two quarters and the work we're going to do in the next 2 quarters, it gets us to kind of phase 1 completion of that engagement layer, which unlocks all the other M&A activity that we're doing right now.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Okay. So, in regards to M&A, you still see it as an opportunity you're still looking at...

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

A

Yes.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

...things right now, even in the...

Copyright © 2001-2022 FactSet CallStreet, LLC

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

A

Yes.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah, okay. Thank you...

Operator: Your next question comes from the line of Doug Harter. Your line is open.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. Can you just talk about the impact on rates that you're seeing on both purchase and cash-out refinance kind of as you went through the second quarter into the third?

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

A

Yeah. Certainly, I think we're all seeing the fact that it's taken many consumers out of the market right now. That was why rolling the second mortgage home equity loan was so critical for us, because it allows us to monetize lead flow today, but more importantly, it allows us to put that client into our servicing portfolio and into Rocket Money and be there to service them tomorrow. So, we've really got a waterfall approach here. The first is the cash-out refinance on the primary mortgage. The second is the second home equity loan we've now just rolled a few days ago, maybe last week, if I remember correctly.

And then, we've got our Rocket Loans loan for those that don't fit. I know we referenced the fact that our beta credit card from Truebill is in the market. So, we're really stacking a full suite of products that allow a client who is looking for a cash-out. And I think we're all watching the word comes out every week that consumer debt continues to grow. And as inflation occurs, that variable rates keep rising. So, there's more and more demand. We've just got to have a full product selection for those clients. And again, I think we're uniquely positioned to help clients across the board where others that we compete with aren't.

Now, purchase is another interesting thing, because if slight increase in interest rate is fine, certainly for all purchasers, but first-time homebuyers as well, the increase we've seen probably pulled off purchases more than

Copyright © 2001-2022 FactSet CallStreet, LLC

we had expected going from Q2 and into Q3, which is reflected in some of our guidance. Our team is working on ways to solve that for consumers to help them have an affordable payment and still purchase a home, and we'll talk more about that as we get into further – or future kind of earnings calls or press releases when we can discuss those things.

So, it is having an impact. That's why it's so critical that all these other investments that we're making, we accelerate so we can find those avenues to grow even as the mortgage market itself may shrink for a while.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

I guess, just a follow-up, Jay, on kind of what the economics look like on home equity loans, are you looking to sell those to someone else, would you put those on your balance sheet, what type of gain on sale margins might you'll be able to generate on those?

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

A

Yeah. We're in a unique position to be thoughtful about that. And as you know, we use some of our cash to do self-funding for a while, especially when there's a nice opportunity for us to gain interest income on that. In most cases, at some point in time, we do wind up securitizing or selling mortgages, whether they're first or second. And so, we'll kind of continue to keep that same philosophy there. So, that's kind of how we think about.

From an economics perspective, I think it's really important to remember, although the revenue – because these loan sizes are smaller, although the revenue is lower, the cost of process,underwrite and close we've already got capacity, number one. And number two, there's no cost to acquire. Those clients (00:40:31) are already here, we're already bringing them in after a first mortgage. And so, if the second makes more sense, we're not incurring any additional marketing costs. So, at the end of the day, the profitability on the loans still looks good, even if the loan size is closer to $100,000 versus $200,000 to $250,000. So, that's how we think about that particular product.

And then, again, as I referenced, there's other products that follow after that. Again, all of those represent revenue opportunity, client engagement with no cost to acquire.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks, Jay.

Operator: Your next question comes from the line of James Faucette.

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

A

Hi, James.

Blake Netter
Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is actually Blake Netter on the line for James. Thanks for taking my questions.

Copyright © 2001-2022 FactSet CallStreet, LLC

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

A

Sure.

Blake Netter
Analyst, Morgan Stanley & Co. LLC

Q

So, first off, in the current environment, your strong balance sheet gives you the flexibility to play offense and defense. So, looking ahead, how are you planning on leveraging this optionality to your advantage?

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

A

Well, I think we've touched a bit on it already, but we're going to continue to be prudent around our expense management. I think Julie and team did an incredible job of kind of exceeding our expectations in Q2. And as I referenced already, the group is all over the next quarters as well to ensure that we're being thoughtful there. But, as the other caller had asked, the first step is the folks that we've got on building the engagement platform and all the services I talked about, if we were to go back in time, 5 or 10 years and we didn't have all of these opportunities, you wouldn't have those 2,000-plus people working on it, right?

And so, that's why I referenced, we kind of think about – or I think about the business in three tranches, Mortgage kind of separate, and then you've got this investment. So, in the services and engagement platform. And that's how I think about it. It's a capital investment that we're making, because the best use of our capital is to build out this technology that maximizes our marketing, that reduces our cost to acquire, that increases our lifetime value. So, when we think about our investments, we say what's out there from an M&A perspective, what could we build internally and how do we get to this place where we grow market share in 2023? And that's where we're putting a big chunk of our capital right now is that internal investment in technology.

But we've also got Scott Elkins and our kind of acquisitions team out there looking at opportunities. We need to be thoughtful about the fact that we're not all the way through this cycle. And so, others who don't have the same ability to invest may continue to see their value drop. And if so, we'll be thoughtful about when and if we pull the trigger on those acquisitions when it's the right timing. But certainly, one very strong possibility for us to get into niche markets that we want to enter into that fits nicely into our ecosystem.

Blake Netter
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. And as a quick follow-up, given where the market is heading, how much in operating losses are you willing to endure? Would you sell some of the MSR books to reduce cash burn, or conversely, would you be willing to buy servicing portfolios of others in your – as you seek to gain market share?

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

A

Well, buying MSRs is very interesting, especially as we think about how those MSRs will interact inside of everything I've just described to get not only short-term returns, but better lifetime value. And certainly, we've demonstrated the fact that we're thoughtful, but not afraid to deploy some of our cash or have a small burn like you just talked aboutif we're deploying it in technology and product strategy, building tech, that's going to build our business, and that's where that capital is going today. But more of our focus is, how do we leverage that to grow market share in 2023, which will make us a stronger company, and that's where our mindset is here. It's not a long-term thought around burning cash. It's about investing now to see growth in 2023.

Copyright © 2001-2022 FactSet CallStreet, LLC

Blake Netter
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Thank you.

Operator: Your next question comes from the line of Mihir Bhatia. Your line is open.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Hi. Good afternoon, and thank you for taking my question. I wanted to maybe just touch on the partnerships a little bit. You announced Santander and Q2 today. Maybe just expand a little bit on those partnerships? Specifically, actually on the Q2, just is that tied to the Salesforce partnership you previously announced, or is this just another way to serve credit unions?

And just generally, maybe you to broaden out the discussion also, it seems like you're leaning in a little bit on partnerships here over the last few quarters. Maybe just talk at a high level about that decision, is it just driving more volume to the platform, what happens once the customer is on your platform, can you actually treat them as Rocket customers, or are they still customers of the partner? Thank you.

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

A

Yes. I think you've kind of touched on all the reasons why we're very interested in this. We think that partnership opportunities will accelerate because all the questions we're getting here, many folks who engage in mortgages, one of their business lines will probably decide to move out of that space as we continue forward through the end of this year and into next year, creating opportunity for us to step in and be their mortgage partner. And this is really leveraging the technology, the client experience and the brand that we've built. If someone's thinking of getting out of the space but wants to remain offering that for their clients, I think we're the obvious choice for them. And so, that we think the partnerships will continue.

Q2 is different than Salesforce, similar concept, but different technology platform that we're using. So, Salesforce gives us reach into a certain set of banks and credit unions. Now Q2 gives us reach into another set of hundreds of banks and credit unions. And so, it's an exciting moment in time. And through the end of this year, we'll be finding those first banks and credit unions and plugging them in as we enter into 2023. So, partnerships are strong. It's a – we're differentiated in that space. And so, you'll continue to see us do more and more of that as we move forward.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Thank you. And then, just if I could just follow up one. You mentioned – you talked a little bit about your strong balance sheet. I did want to ask, you've announced quite a few products, now, solar, home equity, credit card, how many of those are you funding off your balance sheet currently? And is that like the near-term goal is like just fund those off the balance sheet and as they grow then diversify out to other partners, or do you have partners for something like credit card where there's like actually an issuing partner that's more of a co-brand-type relationship?

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

A

Copyright © 2001-2022 FactSet CallStreet, LLC

Well, as we always talk about, Julie can comment, we're a capital-light business. So, if we see an opportunity to leverage the cash that we have for a short period of time to use the nice spread between the lending rate and where we're either borrowing money or using our own cash, we'll do it. But it's a small portion of the lending we do, because in the end, we're selling those loans to partners, et cetera, securitizing them. We're not going to hold them for a long period of time.

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

A

That's right, I completely agree, Jay. And as we think about these new products that we're getting into, we do look to sell those into either a whole loan market or into a securitization, if there is a market for that. Right now, there's not a great securitization market. So, we have some loan sales arrangements set up that for those products so that we – while we may finance them for a short period of time, we will be selling those and having those to be off of our balance sheet.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Okay. Thank you.

Operator: Your next question comes from the line of Mark DeVries. Your line is open.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah. Thank you. Jay, I think you mentioned several times you see the need for industry to remove capacity. Interesting in getting your thoughts on how long you think it will take for capacity to fully rationalize across the industry and kind of what the implications are for margins over the coming quarters?

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

A

Yeah. It certainly has taken longer than we have seen in the past. I think that's a function, of course, of 2020 and 2021 and people building up reserves. And so, their ability to kind of hang on through the cycle a bit longer than usual. I don't know if I have a crystal ball to tell you when the capacity will come out, but I have a feeling we'll see that steadily happen here moving forward. There's this strategic advantage I've already touched on, whether there's excess capacity or not, for our ability to drive down the cost to acquire, which is more powerful than 10 or 15 basis points in margin in either direction.

The other important component, and I'll bring this up now, as we have multiple business lines and we think about our gain on sale margin, one of those, of course, is our TPO line, and we've got a great set of partners, we work with them very, very closely, we're going to be launching new products for them as we get into the second half of this year to strengthen their business. But we've also made it very, very clear that, moving forward, if you're not a partner of ours, we will be taking advantage of all of our data, information, our massive sales force, their incredible skill to win those partners over into our retail channel.

And so, we've launched some initiatives here in the last few months to really dial that in, strategically find each one of those clients and start bringing them aboard. So, that'll change – have an impact on margin as well as we move more towards that retail channel winning those clients. Again, protecting the third-party originators that are partners of ours, but being very clear about the fact that we're going to be full steam ahead if you're not a partner of ours winning those clients onto the Rocket platform using our retail group.

Copyright © 2001-2022 FactSet CallStreet, LLC

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Great. And just a question for Julie on the margin guidance. It looks like you're calling for a little bit of weakness Q-over-Q. Is that a reflection of – do you expect a little bit more weakness across channels, or is it more of a mixed shift to lower margin partner channel?

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

A

It is attributable to mix and that is driving that decrease in margin. We are seeing the direct-to-consumer margin holding very nicely quarter-over-quarter. And the other thing that's impacting margins is that, in July, as we have moved around a bit, we do have an MSR component of the gain on sale margin. That was a fairly significant driver of our guide down as well. And that changes quarter-to-quarter, but that was part of it, too.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Got it. And then, just one last quick one on the Santander partnership. Are they going to be offering that in their branches, or is this going to be exclusively a digital offering for them?

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

A

No, I think it's across the board how they're going to interact. So, they'll be offering that, my understanding is, to the loan officers that are in their branch system that can plug directly in and guide clients into our Rocket ecosystem.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Great. Thank you.

Operator: Your next question comes from the line of Arren Cyganovich. Your line is open.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. I was hoping you could talk a little bit more about the Rocket Solar opportunity and how are you having these loans funded? Are they being used in warehouse lines and then sold to bank partners, or is it purely capital markets? Just curious because generally solar loans are fairly large in size.

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

A

Well, yeah, a few things, and just taking a step back on Solar, there's three really important components here. Number one – and I know I point this out a lot – we are assisting the millions of clients that come to us for a mortgage. And so, it's an interesting opportunity for us because there's no cost to acquire these clients as we bring them into our Solar platform. Number two, we're engaging in the actual assistance, helping the clients plan out the solar. So, it's not just financing, we're doing the sales of that as well, and there's a nice revenue opportunity attached to that component.

Copyright © 2001-2022 FactSet CallStreet, LLC

Now the thing that we've just plugged in is the actual solar financing itself. And so, Rocket Loans will be providing that when it's appropriate, we'd like to leave lead ourselves many solar partners, including Rocket Loans, and then, of course, once the solar loan is originated, within 12 to 18 months, typically, people will roll the solar into their first mortgage. So, we'll really create – we've got lower expenses than our competition, while we create three revenue opportunities through that client as we help them save money on their utility bills, and of course, many are very excited about helping environment as well.

Now, Julie can kind of speak to what we're doing – or what Rocket Loans is doing with the solar loan itself, because we have flexibility there, too.

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

A

Yeah. Yeah. As I mentioned, when we enter into new products, we do look to get liquidity in markets for those. But we're doing in Solar right now is self-funding those at the point of origination, but it will be for a very short period of time as we do have a partner that will be buying those loans from us. We may look to get warehouse financing down the road. If we need it right now, though, we've got the capital to be able to do that while we start up this channel.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Got it. And then, just another question on the expense decline. How much of the, say, roughly $400 million over the next quarter and this past quarter is variable? Because you're – I would assume that a decent amount of that is variable just because your production levels have dropped off a decent amount.

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

A

Yes. A portion of that is certainly variable when you think about the commissions that we have, the production costs that we have associated with origination, that did come down. But a substantial portion of this is us looking at additional vendor costs that we can impact through contract renegotiation, other things that we are doing to impact those costs. So, it is a mix of both looking at marketing – marketing came down, as you saw, by about $100 million quarter-over-quarter – and other things that we're doing outside of production to impact those costs.

Operator: This concludes the Q&A session. Jay Farner, CEO, I turn the call back over to you.

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

Thank you. And thanks, everybody, for joining today. And in particular, thank you to the team members for joining. As I said here on the call, and in the correspondence I'll be sending out shortly, the opportunity that we have right now in this market to lean in, to invest and to differentiate and really transform this company, again, is like maybe the four or five times prior that Julie referenced in her remarks. And so, certainly appreciate all of your commitment to what we're doing because it's going to make all the difference in the world as we grow this company moving forward.

So, thanks to all of our team members, and thanks everybody joining. We'll see you next quarter.

Copyright © 2001-2022 FactSet CallStreet, LLC

Operator: This concludes today's conference call. You may now disconnect.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. Th is information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this i nformation do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR RE VENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.