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Rocket Cos., Inc. (RKT)

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is David, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Rocket Companies, Inc. Fourth Quarter and Full Year 2022 Earnings Call. Today's conference is being recorded. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Sharon Ng, Head 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 fourth quarter and full year of 2022. With us this afternoon are Rocket Companies' CEO, Jay Farner; our current Director and future Interim CEO, Bill Emerson; our President and COO, Bob Walters; and our Chief Financial Officer, Brian Brown.

Earlier today, we issued our fourth quarter and full year earnings release which is available on our website at rocketcompanies.com under Investor Info. Also available on our website is an investor presentation.

Before I turn things over to Jay, let me quickly go over our disclaimers. On today's call, we provide you with information regarding our fourth quarter and full year 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 assumptions we mentioned 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. This call is being broadcast online and is accessible on our Investor Relations website. A recording of the call will be posted 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

Chief Executive Officer, Rocket Cos., Inc.

Thanks, Sharon. Good afternoon, and welcome to the Rocket Companies earnings call for the fourth quarter and full year of 2022. Today, we're going to recap last year's achievements and highlight how we continue to innovate to enhance the Rocket client experience. We'll also discuss how we have put key pieces of our client engagement program in place with the goal of lifting conversion and lowering our cost to acquire clients. And ultimately expanding our purchase market share and extending client lifetime value.

But first, I want to take a moment to talk about the leadership transition we announced a few weeks ago. As you know, on June 1st, I will be retiring from my role as CEO. The last 27 years of Rocket and in particular, the last six as CEO have been among the most rewarding experiences of my life. We've accomplished so much together as a team and I've made many lifelong friends.

With all the excellent work accomplished in 2022 and into 2023, I believe now is the right time to step aside so I can spend more time with my family while the company continues on its journey executing on these transformational strategies. I have to thank Dan Gilbert specifically. His mentorship and friendship for nearly three decades is something I'll always appreciate.

One thing is for certain, I have tremendous confidence in this team's ability to continue to execute the company's strategy. We have the brightest minds in the business and the depth and breadth of our leadership team has set the bar for the industry. My confidence also stems from the fact that Bill Emerson is taking the reins as Interim CEO upon my departure. Many of you know Bill as he served as the CEO of Rocket Mortgage for 15 years. We remain close and he's continued to lend his advice and his counsel. He has a true passion for Rocket Companies, and we will work closely together to ensure a seamless transition.

Bill, would you like to share any thoughts?

William Emerson

Incoming Interim Chief Executive Officer, Rocket Cos., Inc.

Thanks, Jay. It's great to be here with everybody today. As Jay noted, I've been with Rocket for three decades, including as Chief Executive Officer of Rocket Mortgage from 2002 to 2017. I remain engaged in the business since that time through my position as Vice Chairman of Rocket Holdings which is the majority shareholder of Rocket Companies.

I'm excited to roll up my sleeves and dig in with Jay and the rest of the company's phenomenal leadership team to build on our strong foundation and continue executing at a high level while the Board conducts a search for a permanent successor.

On a personal note, Jay has been a great colleague and friend and I want to take a moment to thank him for his tremendous impact on this organization. His vision for Rocket's future has created a pathway for success and positioned Rocket very well.

With that, I'll hand it back to Jay.

Jay Farner

Chief Executive Officer, Rocket Cos., Inc.

Thanks, Bill. Now, turning to our results. 2022 was a challenging year for the housing and mortgage industry and one defined by rapid change. Over the past 12 months, eight increases in the Fed funds rate, intended to rein in high inflation, led to a sharp rise in mortgage rates. The 30-year fixed rate mortgage spiked from roughly 3% in January to more than 7% by the end of October. This represents the largest and steepest rise in roughly four decades.

With the volatility and increased cost of financing, demand for rate and term refinance transactions shrunk significantly. While housing affordability and consumer concerns about a looming recession weighed heavily on the home purchase market. Despite this backdrop, we continue to invest in innovative technology and programs to serve our clients better and to capture the immense opportunity.

The mortgage industry is fragmented. The direct-to-consumer channel, Rocket's bread and butter from the beginning, represents the vast majority of the mortgage market. Our company has a long track record of disrupting mortgage refinance in this space and growing market share, and we believe we are well-positioned to do the same in the home purchase market with products, and ecosystem and client engagement programs that we've put in place.

We believe we can grow our purchase share by delivering an engaging and differentiated client experience with the additional programs we've launched over the last 12 months, particularly to the millennial and first-time homebuyers who drive the industry.

In fact, we've launched several significant achievements in 2022. We successfully integrated Rocket Money into the Rocket family and launched Rocket Rewards, our innovative loyalty program. We unified our business under one Rocket brand and delivered a seamless Rocket Accounts single sign-on experience to our clients. And we will soon be expanding our credit card program to include a rewards card tied to homeownership.

We also brought to market a broad suite of purchase-focused mortgage products designed to give our clients the confidence to transact in a tough environment. Inflation Buster, which reduces the homebuyers monthly mortgage payment by one percentage point in the first year of their loan and addresses today's home affordability challenges, has resonated very strongly with our clients. We then paired Inflation Buster with our Rate Drop Advantage program which covers many of the costs to refinance in the years ahead if rates fall. I'm also proud of our initiatives to expand access to homeownership to underserved communities.

In November, we introduced a conventional loan option for Americans who are interested in purchasing or refinancing a manufactured home. We also unveiled a special-purpose credit program that offers credits for first-time homebuyers to use toward their mortgage costs available in specific census tracts in Atlanta, Baltimore, Chicago, Detroit, Memphis, and Philadelphia.

With home equity levels at record highs, we're helping existing homeowners achieve their financial goals with cash out refinance options as well as our closed-end second home equity loan product for those who are looking to tap the current equity available in their house without sacrificing the favorable interest rate on their first mortgage.

Turning to the fourth quarter. We grew the number of Rocket Accounts to 25.4 million as of December 31st. Rocket Accounts, a key North Star metric, represents clients who have taken the action to create an account with us and with whom we may have the visibility on creditworthiness, spending behavior, finances, and home-buying intent, and more. We believe that these clients are more likely to engage and that we can craft bespoke experiences for them, delivering the right offer to the right client at the right time.

Rocket Money drove a significant amount of growth in Rocket Accounts and had its biggest month of premium member growth in its 8-year operating history in January. In addition, on January 2nd, Rocket Money took the top spot for daily downloads in the iOS App Store finance category and also reached top 10 in the overall iOS App Store.

In a few short months since our launch of Rocket Rewards in October, we are seeing strong client adoption and engagement. Rocket Rewards has enrolled more than 1 million clients and approximately $600,000 in point value have been redeemed, helping clients lower closing costs. This proprietary loyalty program gives our clients points for taking certain actions such as downloading a 1098 tax form, completing learning activities, and submitting mortgage applications, ultimately, helping to drive engagement across the Rocket ecosystem.

While it's early, we are particularly encouraged to see that the lead-to-close conversion rate for Rocket Rewards clients is more than double that of clients who did not use Rocket Rewards in our control population. We are expanding our rewards program based on this success, and we're excited to announce that just last month, we introduced Rocket Rewards to our 2.5 million servicing clients.

Last quarter, we also launched our Home Buying Plan to a select group of clients and broader rollout is currently underway. Home Buying Plan is a guided digital experience that helps our clients prepare for homeownership and stay informed throughout their home-buying journey. Clients can set home-buying milestones, engage with personalized financial tools, and credit-building resources. They can search for their dream home, and receive advice on how to stay on track to be more confident homebuyers.

Home Buying Plan enables us to engage with clients, providing them with help and guidance as they prepare for the next transaction. We will be launching even more Rocket-exclusive initiatives to make the client purchase experience smoother and easier leading into the spring-buying season.

In aggregate, all of these client engagement programs help us elevate the Rocket client experience and keep our clients engaged until they're ready to purchase their dream home or refinance with Rocket.

As I said before, we are uniquely positioned to help our clients through every step of the homeownership journey. From a financial planning and education process well before they apply for a mortgage, to searching for and the financing of their new home as well as title and closing. It's all within the Rocket ecosystem.

Let me take a moment to illustrate the Rocket Client Experience with this example. Our client might begin their relationship with Rocket by using Rocket Money's financial planning tools and creating a Rocket account. We identify their desire to become a homeowner and introduce the digital Rocket dashboard with Home Buying Plan. The client can bank loyalty points by joining the Rocket Rewards program, consuming content on the purchase process as well as obtaining a verified approval letter. This is just the beginning. Rocket Homes tools put the power of home search into our clients' hands, making personalized recommendations on properties that meet their targeted neighborhoods, price range, and amenities.

Additionally, local Rocket Homes real estate agents are available to provide personalized services when needed. Utilizing data we already have through the Rocket Account, we can streamline the mortgage application process and help the client purchase and close on their first home. With our industry-leading servicing and 90-plus percent retention rates, we can recapture the client through a refinance transaction when rates drop.

With the full suite of Rocket products and our commitment to client service, we hope to nurture and retain the client over the course of their journey as homeowners until they're ready for their next transaction. We believe we have an excellent opportunity to deliver a more personalized experience to each of our 25.4 million Rocket Accounts.

Through our client engagement programs, we believe we can lift conversion, lower our cost to acquire clients and extend client lifetime value. Over time, we believe this will translate into substantial and sustainable market share growth, particularly in purchase and growth in revenue and profitability.

In 2020 and 2021, we demonstrated the ability to scale our business and deliver best-in-class client service during the refinance heavy market. As we enter 2023, with key pieces of our client engagement program now in place, we can tap our sizable and growing Rocket Accounts base to succeed in a purchase heavy market. Our assets are unmatched in the industry. Our robust capitalization, our fortress balance sheet and our platform and ecosystem just to name a few.

Most importantly, I'm grateful to our leadership team and our team members' dedication to always putting our clients first. We are executing on our strategy, and we remain focused on fulfilling our mission to be the best at creating certainty in life's most complex moments so that our clients can live their dreams.

With that, I'll turn it over to Brian.

Brian Nicholas Brown

Chief Financial Officer, Rocket Cos., Inc.

Thank you, Jay, and good afternoon, everyone. On today's call, I'll cover our financial results for the fourth quarter and full year 2022. I'll talk about the actions we're taking to improve the cost structure and the investments we're making in our platform. I'll conclude by sharing our outlook for the first quarter of 2023 and discuss what we're seeing in the current environment.

As you heard from Jay, the mortgage industry faced an extremely difficult environment in 2022. Rapidly rising interest rates, declining consumer confidence and challenging affordability impacted demand for purchase and refinance mortgage products throughout the year.

To put the demand headwinds in perspective, the MBA's mortgage application index dropped nearly 70% in 2022, the largest intra-year drop in the history of the dataset going back to 1990. At the same time, demand was falling the mortgage industry faced excess capacity. We've seen players across the industry struggle to adjust to the volatile environment, facing liquidity issues, retrenching or exiting the industry altogether. Against this backdrop, Rocket Companies continued to invest and innovate. We also took significant action to adapt to the changing market.

From Q4 2021 to Q4 2022, we reduced our expenses by $3 billion or 40% on an annualized basis while protecting our platform investments and focusing on client lifetime value in a purchase heavy mortgage market. For the full year 2022, Rocket delivered positive GAAP net income and adjusted EBITDA.

As always, we're focused on driving operational efficiency and financial profitability while investing to position the company for sustainable long-term growth.

Diving a bit further into the full year results, we delivered $133 billion in closed loan volume and $4.6 billion in adjusted revenue in 2022. Our GAAP net income for the year was $700 million or $0.28 per share. We recorded $59 million in adjusted EBITDA. On an adjusted net income basis, we reported a loss of $137 million or $0.07 per share. Our GAAP results include the $1.2 billion mark-to-market appreciation of our mortgage servicing right asset during 2022, which is countercyclical in a rising rate environment.

Moving on to fourth quarter results. Despite challenging market conditions, Rocket's fourth quarter adjusted revenue came in at $683 million, which was above the midpoint of our guided range. As we shared last quarter, we believe the switch to revenue guidance provides the best representation of Rocket's businesses and most closely aligns with how we manage the company.

In the fourth quarter, we generated closed loan volume of $19 billion, net rate locks of $15 billion, and our gain on sale margin was 217 basis points. Inflation Buster, our promotional purchase product running through the fall and winter resonated strongly with our clients and demand for the product exceeded expectations. This higher-than-expected demand for Inflation Buster negatively impacted gain on sale margins in the fourth quarter. It's worth noting that since the start of the first quarter through today, we have seen gain on sale margins improve by more than 20 basis points compared to fourth quarter levels, primarily due to a shift in promotional products.

As a reminder, these levels are what we have observed year-to-date and may not provide forward-looking indication into the quarter. On an adjusted net income basis, we reported a loss of $197 million or $0.10 per share.

Turning to expenses. We continue to execute a disciplined and prudent approach to cost management. On our last earnings call, we committed to a further reduction in total expenses from the third quarter to the fourth quarter of $50 million to $100 million, and we far exceeded that estimate, reducing expenses by $202 million during the quarter.

As we shared with you on the previous call, we have taken significant action to reduce our overall cost structure and the fourth quarter was no different. In fact, if we look at the fourth quarter of 2022 compared to the fourth quarter of 2021, on an annualized basis, we have reduced our expense base by almost $3 billion or more than 40% of total costs. While monitoring our expenses closely, we're also focused on making the right investments in our platform to grow purchase market share and extend client lifetime value.

As Jay mentioned, we had several significant accomplishments in 2022 as we put foundational pieces of our client engagement program in place. We believe we have an excellent opportunity to deliver more personalized experiences to the high-value clients within our 25.4 million Rocket Accounts.

Rocket Money is a critical piece of our platform strategy. Growth has accelerated at Rocket Money since our initial acquisition of Truebill in December 2021 and rebranding last year. In fact, January 2023 was the best month ever for Rocket Money premium member growth.

As I mentioned last quarter, Rocket Money provides us with a distinct competitive advantage by acquiring clients for less than $100 per client. In contrast, the mortgage industry acquires a closed client for thousands of dollars. We see tremendous opportunity to lower our client acquisition costs by acquiring clients through Rocket Money. Clients acquired through Rocket Money are focused on their finances and tend to be much earlier in their homeownership journey. We are also encouraged to see early signs of success from Rocket Rewards, which, as Jay highlighted, includes enrollment that has surpassed 1 million clients in the first few months, client point redemptions in excess of $600,000 and very promising early lead to close conversion improvements.

Our goal is to engage with a large and growing base of clients, particularly potential homebuyers at a lower cost of acquisition with better conversion levels, using our industry leading net retention rates to drive higher client lifetime value; ultimately, positioning us to succeed in a purchase driven mortgage market.

Overall, we believe the ability to provide these clients with a fully integrated experience early in their homeownership journey and throughout their lifetime as homeowners will be a game changer in our industry.

Turning to our balance sheet. Rocket's financial strength is a major strategic advantage for us. We ended the fourth quarter with $3.3 billion of available cash and $6.9 billion of mortgage servicing rights. Together, these assets represent a total of $10.2 billion of value on our balance sheet. Our $3.3 billion of available cash consists of $722 million of cash on the balance sheet and an additional $2.6 billion of corporate cash used to self-fund loan originations. Total liquidity stood at approximately $8.1 billion as of December 31st, including available cash plus undrawn lines of credit and our undrawn MSR lines.

As of December 31, our mortgage servicing portfolio included 2.5 million clients with $535 billion in unpaid principal. We also drive considerable recurring revenue from mortgage servicing. During the fourth quarter, we generated $371 million of cash revenue from our servicing book, which represents approximately $1.5 billion on an annualized basis. Net client retention remained over 90% in the fourth quarter, well-above the industry average.

Looking at the trends we're seeing in the first quarter, consumers remain concerned about a potential recession and rates continue to be volatile and sensitive to economic indicators. Despite this, for the first quarter, we expect adjusted revenue to be in the range of $700 million to $850 million, driven by an increase in production and improved margins compared to the fourth quarter.

Regarding operating expenses, we expect Q1 to be relatively consistent with Q4 with a slight increase on an absolute basis, primarily as a result of seasonal items such payroll taxes and 401(k) resetting and higher variable expenses associated with increased production in revenue. It is worth noting that the expense total for Q1 2023 is expected to be roughly 30% less than the Q1 2022 figure.

Looking ahead, we will continue to be diligent in managing expenses as we continue to monitor the macro environment with an eye towards profitability. As always, our forward-looking guidance is based on our current outlook and visibility. Despite a challenging environment in 2022, we are proud of what we achieved as an organization and advanced our ability to serve our clients better in 2023 with key pieces of our platform in place to gain share in the purchase market and extend client lifetime value.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first from Kevin Barker with Piper Sandler. Your line is open.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Thanks for taking my questions. I just wanted to follow up on – you obviously have been impacted by the refi market and rates and everything associated with it has been really, really tough across the industry as well.

What are you doing that is going to really accelerate the diversification of revenue, particularly in the next 6 to 12 months, given we've seen gain on sale and mortgage volumes come under quite a bit of pressure, just given the rate environment?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Thanks, Kevin. It's Jay. Certainly, that's something that we think about each and every day, and we have been thinking about it, especially the last 12 months. And I think, I'll point back to a lot of our prepared remarks, we have been focused on strengthening our ability to cut through what is a very challenging marketing and acquisition model in mortgage.

So, you might say, well, diversify even more into other products. But, actually, what we're seeing right now is, because so many others are coming out of the space. We can go through Wells Fargo, JPMorgan Chase, USAA, Blend, Compass, Mr. Cooper, Flagstar, mortgage company and bank after bank has pulled back from the mortgage space. So there is an opportunity to actually grow market share in the mortgage space and purchase in particular, but you've got to bring down the cost to acquire the client, you've got to increase conversion rate.

And so, as we went through the prepared remarks, the work with our Home Buying Plan, the work with the Inflation Buster, I think I referenced that there are other very unique products that will be launched here shortly. The launch or the mention I made of a credit card that will help homeowners, in particular with rewards, the strong growth of our rewards program, over 1 million clients already signed up, early tests showing that we're doubling the conversion rate there.

All of that will allow us to grow market share in the purchase category, as others come away. And when we prioritize where our tech resources, our sales resources, and our marketing resources should be, we feel very strongly that grabbing that purchase market share is our best place to focus because, as we know, with a 90% retention rate, as rates move around, tick up, tick down, people take cash out, we'll recapture that client again and maximize lifetime value.

So it doesn't mean we're not focused on Rocket Loans, doing great stuff with Rocket Loans when it comes to personal loans, solar financing, auto financing, but we see a very big opportunity right now as the mortgage market seems even more fragmented than it's been in the past, to lean in and grab that market share.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah, it seems like quite a bit of opportunity, just given the headwinds across the industry. Do you feel – some of the things that you're putting in place obviously take time to develop, as you start to build out and deploy into your customer base and others. But do you feel like there's an opportunity to accelerate some of that diversification via M&A or some other type of strategic initiative?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Well, as you mentioned, I think some of the things do take time, and that's why we have prioritized the work to be so focused. And I'm so proud of the team and how much they've rolled out in the last six months, and that was the decision. Do you go into other non-mortgage products or do we redirect our tech resources into these areas that can help accelerate mortgage?

And that's the decision that we've made. So that will reduce the timeframe for us, in particular, but you're right, purchase, we could be doing a lot of great work right now with purchase clients at the top of the funnel building rewards. And it may take four, five, six months for those clients to actually work their way through the funnel to buy a home. But we can see that progress. We can track that progress. And the more they bank those rewards, the more that we know they are going to be a client that will close with us.

And so, I think as we get into the spring, we'll probably be able to provide even more visibility as we watch clients kind of work their way through that funnel. And M&A, we're very – we're very active there. We're always looking, but we always want to make sure we're making the right investments that provide a unique opportunity to grow market share, not just kind of buy something that we already have, quite honestly, under our own umbrella.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah. Thank you, Jay, and I wish you best of luck in retirement. Thank you.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Thanks. Thanks so much.

Operator: Next, we'll go to James Faucette with Morgan Stanley. Your line is open.

Blake Netter
Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is Blake Netter on the line for James. Thanks for taking my questions. So, one thing we were interested in drilling down into is how do you size the benefits of some of the investments you've been making to the platform to drive client engagement such as Rocket Money and Rocket Rewards? So far, are you seeing any tangible improvements in customer retention and new customer acquisition rates?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Yes, I think we touched on before some of the improvements we've made to Rocket Money, in particular, I think Brian mentioned this, our cost to acquire a client has now dropped to $100, far different than where most people sit to acquire a mortgage client. And so, tying that client into the Home Buying Plan, the Rewards plan will help bring them through the funnel.

We touched on the fact that, here in January, Rocket Money was rated the number one app in the iOS system, something they've been focused on achieving for quite some time. But it's the heavy focus on making that product special, making it great, that allowed us to achieve that. It actually got top 10 overall for app downloads in January. So, we're seeing the top of the funnel widen.

And then we're starting to see the more kind of middle of that funnel, we referenced the Rewards program or the early test we've now done show a doubling of conversion. And as I mentioned before, there will be additional programs we're rolling out here in the spring and probably in the next call, we'll be able to share more information around how we're seeing those conversion rates increase.

All of that will allow us to rethink the cost to acquire a client, in particular, a purchase client. And I think one other exciting thing that we're watching is the pairing up of our Rocket Homes preferred agents with our Rocket Mortgage program and how that's assisting in conversion rate increase, and we'll probably be touching on that more here in the future as well.

Blake Netter
Analyst, Morgan Stanley & Co. LLC Q

Okay, great. And just a quick follow-up from me. How much success have you guys had in adding new partners to the TPO network, given some of the competitive pricing dynamics we've seen in the wholesale space and some of the irrational pricing behavior we've seen from competitors?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc. A

Yes, that's a very interesting space. As you know, Mike Fawaz and the team have done a wonderful job, really proud of his work the last few months. It's resonating with brokers and it's a very fluid space. We track how many partners are coming in. We track how many partners are leaving others. And as you really articulated, those brokers are very price-sensitive. And so, you'll watch kind of partners move from partner-to-partner. We've talked about this. Bob Walters, the President or the CEO of the mortgage business has talked about this a lot. That's the superpower of a mortgage broker, the ability to pick and choose who they work with to give themselves an advantage. And as you know, we stand firmly behind providing that superpower. So we're onboarding new TPO partners all the time, and we think that's the right way to approach that market.

Blake Netter
Analyst, Morgan Stanley & Co. LLC Q

Great. Thanks.

Operator: Next, we'll go to Ryan Nash with Goldman Sachs. Your line is now open.

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

Hey, good evening, everyone. Maybe to start off Jay or Brian, so I would say despite outstanding expense performance, it seems the business is still losing a few hundred million a quarter. And Brian based on the revenue guide and the color you provided on expenses, it sounds like that's likely to continue. So maybe if you could just talk about the strategy in place to return to profitability, when do you foresee this happening?

And Jay, maybe just talk a little bit about how you think about the trade-off on continuing to lose money and continuing to make investments in the business versus further rationalization in terms of improving the profitability of the company? And I have a follow-up.

Jay Farner

Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. Look, I think the team has done an incredible job this year of reducing expenses. It's easy to sit on these calls and talk about expense reduction. The real work is the hundreds and hundreds of leaders inside the organization that have to go through that process. And when Brian talks about taking billions and billions of expenses out, we've accomplished that in nine months. And so my hat's off to him and to the entire team in achieving that.

I think if we go back, at least the 27 years I've been here, and especially when I took over as CMO and CEO, our focus was the direct-to-consumer channel. And our focus was doing something different that no one had done before, being excellent in every category from marketing to outreach to conversion, our banker force being the best of the best, and that worked. And we scaled refinance, in particular, to levels that no one has ever seen.

When you hear us talking about the rewards program and the home buying program and the Rocket dashboard and the servicing and the Rocket Money and Rocket Homes, and these are a lot of moving parts, far more complicated than refinance. Absolutely.

On one side, it's taking us longer to achieve it because it's far more complicated. On the other side, the barrier to entry for anyone else to do this type of work, I don't see it happening and that work, it's those inches. It's the one-tenth of the conversion rate increase over here and one-twentieth of a conversion increase over there, but they all add up to allow us to have the same success in purchase direct-to-consumer that we had in refinance.

And so yes, we've invested some money these last six, seven months in particular, to achieve that. But I have all the confidence that that will result in our ability to scale, purchase the same way that we've scaled refinance and will lead to a very profitable and successful organization. So that's where our focus is, and we're just – we're taking the same scientific approach that we took to refinance, and we're applying it now to purchase more complicated, taking longer. But I think it's a proven thing that can work and Brian, I mean, jump in.

Brian Nicholas Brown

Chief Financial Officer, Rocket Cos., Inc.

A

Yeah. Thanks, Ryan. I think to Jay's point, profitability is a priority. And you can see it in the expense numbers. But we're not here to sacrifice long-term results. As you know, you've been with us a long time. We've been a private company long before we were a public company, and we're not interested in sacrificing to hit a short-term number. 40% of the expenses came out last year. If you need any more proof that we're focused on it, we more than doubled what we said we'd do in the fourth quarter, we accelerated some of our expense items. So it's definitely something the management team is focused on. But as we sit here in the first quarter with the guide that you mentioned, and we're on the forefront of the home buying season, we feel really good what we've done in terms of the cost structure.

Ryan M. Nash

Analyst, Goldman Sachs & Co. LLC

Q

Got it. I appreciate the color. And then, maybe, just as a follow-up, I think you mentioned in the prepared remarks that you expect volumes are improving in the first quarter. Maybe just talk about what is driving that. And then, more broadly, can you maybe just talk about – Jay, you've touched on purchase a couple of different ways.

Can you maybe just talk about the actual strategies in place that you think are going to inevitably drive purchase volume? And how do you think about some of these newer products, whether it's Inflation Buster, home equity and some of the others that – when do we start to see these things having a meaningful impact on the volumes of – in the actual mortgage business? Thanks.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. Well, it's an interesting market that we're in, and you've watched a lot of folks trying a variety of things, especially in the second half of 2022. When I think about the purchase market, and I've touched on this a few times already, I think, I think about the entire funnel.

If you were to walk into my office, you'd see on a whiteboard a giant funnel that I'm always kind of adjusting and rethinking. It starts with all of the marketing partnerships we've got, but also our opportunity to market directly to consumers. It works through our Rocket Homes network of agents, which is incredibly strong and getting stronger.

The reason that's happening is, because when purchases were so strong in 2021 and 2022, the beginning of 2022, most agents had enough business to kind of deal with. Now, agents are hungry for verified clients, we are the provider of those verified clients. So the dynamic between the mortgage business and agents is changing, which will, I think, benefit us greatly.

And then you'll kind of watch the different solutions we can offer to allow people to get prepared to buy. One of the complexities of a purchase lead that's different than a refinance lead is that, it's hard to help someone find a perfect house. And so, we can be there. We can be engaging with the client, but we've got to be there on that Saturday afternoon when they see that house.

And if you look back over time, usually who they're there with is their agent. And so, their agent may have a mortgage company that they like to work with. So with this network of agents that our team, Doug Seabolt, Sam Vida have been growing out and solidifying these last six months and in the rewards program.

So now our clients look and say, wait a second, I've already built $850 towards my closing fees with Rocket. I've got a verified approval. And I'm working with a preferred Rocket agent, that are sitting there on a Saturday, now the only call or text or e-mail comes directly to us, not to another mortgage company. And so, I imagine, as we get into the spring and summer, we're going to see the continued increase in conversion and all of that ties back both Rocket – in Rocket Homes' ability to market, but also Rocket Mortgage's ability to market.

And the last thing I'll say, and I can only touch on a little bit. Now imagine a credit card, where every day you're spending in doing things, and that spending allows you to build rewards to help you buy your next home. All of these factors working together really gives us a strategic advantage.

I know you want to know, hey, Jay, tell me in what month you – all I'm saying is, all these things working together, we feel very confident will allow us to apply the same marketing spend, the same creativity to drive this engagement and really grow purchase market share significantly.

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

Q

Appreciate all the color and best luck on retirement, Jay.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Thank you.

Operator: Next we'll go to Mark DeVries with Barclays. Your line is open.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Yeah. Thanks. I had a follow-up question from Ryan's line of question around expenses. Look, I mean, I'm trying to get a better sense of how you – your thinking is evolving and may continue to evolve for the environment here. I mean you clearly did even more than you guided to on expense take-outs this quarter, but it's also a very deeply cyclical business, so I appreciate not necessarily managing to getting to breakeven or profitable at what might be the trough of the cycle for fear that you cut so much that you don't participate on as much as you would like on the upside.

So, how should we think about if mortgage rates remain really high and volumes persistently muted, what else you can do? Or should we expect you to continue at this level of activity to lose money and not take out more expenses?

Brian Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Yeah, I guess, Mark, the way I think about that is revenue and the production of the business are going to be the North Star. And we try to structure the cost basis around that. But in any particular quarter, that's not necessarily what we're focused on. We're focused on setting up the business for success over the long-term.

As we think about capacity, we feel like we're in a good spot right now. We feel like we're ready for the home buying season. If that doesn't cooperate or if the macroeconomic backdrop doesn't do what we expect it to do, there are other levers that we can pull. But the way we think about it internally and the way we spend our time focused on it is we plan for multiple scenarios. And the acceleration of that expense takeout in Q4 was really because the revenue in the backdrop wasn't cooperating like we had hoped. So, we'll continue to revisit that on a quarterly and monthly basis, but the decisions we make will be for the long-term.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. And I'm going to add something to that. I think it's important, Bill sitting here to my left, but Bill and I have worked together for over a quarter of a century and for a long period of time as CEO and President of the company, and we did a nice job of kind of dividing and conquering around innovation, creativity, marketing, and execution. And so, Brian is doing a wonderful job of thinking about the expenses. But it all comes with this backdrop of we have now -- our thousands of people have been building and building these programs that are so important to us to capture purchase market share.

And you can run the numbers a few percentage point increases and we really like where the company is at. And Bill Emerson specializes in execution. We have an ISM here that innovation is rewarded, but execution is worshiped. And so, my confidence level of Bill stepping in, rallying the team and executing on these final components of what we've spent so much time investing in it's exciting. I just -- I've seen him do it for 27 years, and I just know what he's capable of. And we've laid these great kind of -- all the tracks have been laid to achieve this now.

So, I appreciate the concern around the expenses. Those are all good questions, and Brian's doing -- do a wonderful job of managing them. But I'm more excited about the opportunity for revenue growth because of the hard work that the team has been doing here. Now, it's one thing to get distracted by a very tough market; it's another thing to put your hand [technical difficulty].

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

A

Operator, we're ready for the next question

Operator: Okay. We'll take our next question from Kyle Joseph with Jefferies. Your line is now open.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey. Good afternoon and thanks for taking my questions. Just wanted to focus on margins and the outlook for 2023. Obviously, it sounds like 4Q was pressured by Inflation Buster. But as we think about kind of the supply and demand dynamics in the industry, kind of the mix shift towards purchase as well and I would guess that there's still ongoing demand for Inflation Buster, but just how you're thinking about margins in 2023 from a high-level basis maybe versus the fourth quarter of 2022 and then the full year of 2022.

Brian Nicholas Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Yeah. So margins at 2.17% in Q4, to your point, there was really two things going on. One was – it's important to note that the 10-year peaked, I think, in October. So affordability was clearly a concern. So there's no doubt that when rates are moving and whipsawing back and forth, that impacts the consumer sentiment that impacts consumer confidence. And in some cases, that's the right thing to do at that point is to get that client in the loan, in the budget that they can afford. So that impacts gain on sale margin.

And then the second thing which is related is the promotional product, Inflation Buster, and it's a great product for this market. On the good news, Inflation Buster performed better than we had expected which added to some of that pressure. But, as we look forward to Q2, we're seeing margins through the first, call it, two-thirds of the quarter, as we mentioned in the prepared remarks, 20 basis points – more than 20 basis points better. Some of that's due to the shift in mix, some of that's due to Inflation Buster continuing to perform well. But as Jay has talked a lot about, we launched Rewards. We're seeing clients redeem Rewards. We're seeing more diversification in purchase products. We have some things on the horizon that we're excited to talk about. And we've seen some relief from a price competitive standpoint too.

Jay mentioned all the people that have exited mortgage recently and we're starting to see that flow through and gain on sale margins. I'm not going to comment much beyond the first quarter here, but all of that is considered in the guide. And when we guided up in revenue that was largely because of an improvement in margins and an improvement in production.

Kyle Joseph
Analyst, Jefferies LLC

Q

That's helpful. Thank you. And then a follow-up, just on Rocket Money and kind of the acceleration of growth you're seeing there, would you attribute that to – is that a function of the rebranding? Or is that a function kind of more macro pressures and kind of the consumer looking to get their budget in order?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. I think there's a variety of things. I certainly think that there's a renewed focus from the consumer and thinking about their budget and Rocket Money is probably – not probably – is the best app as far as I'm concerned for consumers to use to achieve those goals.

I also think we have an incredible team over at Rocket Money. Their ability to understand where the consumer is going, add product features that really resonate with the consumer, the marketing group there, the performance marketing group is excellent, just top shelf across the board. And so that group is executing right now.

And as they start thinking about tying in their work to the Home Buying Plan where Rocket Money is attracting someone who is just starting to think about getting their finances in the right spot to buy things like cars and homes, so it dovetails perfectly into our Rocket or our Home Buying Plan, our Rewards program, credit card and down to mortgage. I mean all of these components are coming together to allow that to happen. So those are a lot of reasons for the growth over there, but all good for our business.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Thanks very much for answering my questions.

Operator: Next, we'll go to Doug Harter with Credit Suisse. Your line is open.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Given your current liquidity picture, I guess, how are you thinking about return of capital versus investment into the business?

Brian Nicholas Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Yeah. Thanks, Doug. So, no change in terms of how we think about the capital structure and returning money to shareholders. First and foremost, it's capitalizing the business. This is a great time to clearly identify the differences between us and other companies in the space in terms of the robust capitalization that we have. Reinvesting in the business is, of course, the second prong of that capital waterfall and these platform strategies like Rewards, the Home Buying Plan and the things that we've launched recently are great examples of that.

To Jay's point, we're always opportunistic on the M&A front, and that's something we'll continue to be. And then finally, after that, it will be returning capital to shareholders through either share buybacks, which, of course, we've done a lot of and then special dividends.

Douglas Harter

Analyst, Credit Suisse Securities (USA) LLC

Q

I guess, along that, how are you thinking about ways to potentially add more current coupon mortgages to the servicing book to potentially fuel future refinance opportunities?

Jay Farner

Chief Executive Officer, Rocket Cos., Inc.

A

Well, we just touched on a lot of that which is we've got to continue to grow purchase market share. I mean, that's the best way to get a current coupon, as you called it, mortgage on the book and then make sure that we capture its value later.

And as we think about returning capital, a unique thing that we've got, when we think about an overall purchase transaction, you've got the mortgage revenue, we participate at Rocket Companies in the Rocket Homes real estate revenue. If we do things right, there's an opportunity to participate in title revenue and appraisal revenue.

And so as we move forward, you'll probably see us talk about the full package which can create a better experience for the consumer, but also have greater revenue opportunities for us which is different than most of our competitors, allowing us to bring more of those purchase plans on board at a higher interest rate and then giving them the Rocket dashboard, the Rocket – a proposed credit card, a rewards program that keep them in our servicing funnel.

Our refinance retention is excellent. Our purchase retention is good. But when we talk about all these additional touch points, we can drive that retention rate up as well. So that's -- a lot of great work is being done to ensure that that happens.

Douglas Harter

Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you.

Jay Farner

Chief Executive Officer, Rocket Cos., Inc.

A

Yeah.

Operator: Next, we'll go to Arren Cyganovich with Citi. Your line is open.

Arren Cyganovich

Analyst, Citigroup Global Markets, Inc.

Q

Thanks. I was wondering if you could talk about just high level what you think about the mortgage industry outlook given the underlying dynamics are pretty challenging, folks that have very low mortgages are not likely to – they don't want to move to a larger home, they'll just stay in their home and, obviously, with the rates here, the refi market is pretty tough. What are you thinking about from an outlook perspective on the origination side?

Jay Farner

Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. I know that I have maybe tossed out the last call or two calls ago, something like a $1.8-ish trillion market. I think some of the Fannie and Freddie and others are kind of triangulating more around that number as well. Brian talked about it earlier. When we strategize, we kind of think about two or three scenarios, and ensure that we like the direction of the organization even in a more challenged scenario.

And so that's -- all the investment that we've been making this -- the end of 2022 and into this year has really been how do we capture market share in a more challenging scenario, certainly below $2 trillion in mortgages. And we're starting to see the continued reduction of originators. We're seeing the folks come out of the market. I know we touched on quite a few already. I think Wells Fargo said they were exiting correspondent. Flagstar has gotten out of retail, loanDepot, exited wholesale Amerisave exited wholesale. So, that's happening and will continue to happen because if we look at the last 25 or so minutes of this call, and we were to talk to a lot of these competitors, they don't have the strategic opportunities to grow market share the way that we do.

So, even in a more challenging 2023, which -- and Brian can chime in here, I believe we will see that. We don't anticipate any sharp rate decreases coming this year. We've set ourselves up to see growth. And then whether we see rates move around a bit in 2024, 2025, we can take an opportunity to refinance folks and increase the lifetime value.

And the only other thing I'll comment on, and teams are working on this, cash out is always surprising to me. Regardless of interest rate, mortgage in particular still is one of the best ways for people to borrow money. And so, consumer spending has remained strong. People are continuing to invest in their home. They're adding on, they're making improvements. And our team has done a great job maximizing cash out. I don't think we'll see that change in 2023, I think the cash out market will still be pretty robust.

Brian, I don't know if you have any thoughts.

Brian Nicholas Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Yeah. The only thing I'd add, I guess, two things. One is we still see great engagement from first-time homebuyers. And they're not exchanging a 3% note rate for a prevailing rate point. So, when we look at it -- and as you guys know, we are one of the best in the first-time homebuyer space.

So when we look at it, we're focused on two things, one is the consumer sentiment in the level of consumer confidence; and two is the affordability. We're not having any problems qualifying consumers for mortgages these days. That's not the issue. What is the issue is when there's volatility in rates. And it impacts refinance, of course, maybe for the obvious reasons. But when the purchase life cycle, when the time to transact can take a while with inventory levels, and your monthly payment can change based on a weekly basis in today's market, that's what puts the consumer on their heels. Higher rates that are stable, we still get great engagement from homebuyers.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

I'm glad you brought that up because that spin, as you've noticed for us, that's been where we're leaning, we certainly can help someone who needs to sell their home and buy a new one, and we've got programs coming that will even make that better. But for us, our focus through Rocket Money, in particular, is to get to the person who is the first-time homebuyer.

They've already said they want to do the transaction with Rocket. They want to do it online. They want to do it on their phone. And so, we're not battling some of those concerns about, can I afford the next house? Am I really moving up? It's a different conversation.

And to Brian's point, we just got to – we've got to be there. Dan Gilbert used to say, you've got to hang around the hoop. We've got to be present with that consumer as they go through the three to four to five months to find the right home. And all of the programs that we've built allow us to hang around the hoop, helping that client until they're ready to buy. And that's really an important -- I'm glad you brought that up, Brian. It's a very important thing to understand about us and the audience that we're reaching.

Brian Nicholas Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Give them the reason to engage with us throughout the process.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Correct. Right.

Arren Cyganovich
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Operator: And we'll take our final question from Kevin Kaczmarek with Zelman & Associates. Your line is open.

Kevin Kaczmarek
Analyst, Zelman & Associates

Q

Thanks guys. This is Kevin on for Ryan McKeveny. From an industry-wide underwriting capacity perspective, where do you estimate the industry is in removing capacity? Are we still in the early innings or perhaps has the heavy lifting been done? And if we're still early, what are your expectations regarding the timing and cadence of capacity reductions and/or company closings? For instance, could it accelerate in the near-term? And lastly, related to this, is there perhaps a longer lag to the cycle since so many companies generated outsized profitability in 2020 and 2021?

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Well, yeah, I think you did see a longer lag. Some of the work that we thought would have been done in mid to fall of 2022 dragged down and it's still happening today. There's two phases. The first phase is trying to figure out what your capacity should be as a company in mortgage in particular. But even at that, the next question is, how can you generate lead flow, you could only cut so much and then you have to have a plan to generate, to spend marketing dollar, to generate revenue, to bring out – or bring in a lead flow.

And again, that's probably why you hear us spend so much of our time talking about those plans because it can only capacity cut so much. I can't speculate on where others are. My focus is more on what are others doing to invest to allow themselves to retrench, originate again and grow market share. And if not, then I think that cutting has to keep going for them.

Brian, I don't know if you have any other thoughts.

Brian Nicholas Brown
Chief Financial Officer, Rocket Cos., Inc.

A

Yeah. I agree. I mean in some cases, from what we can see, the most profitable loan for some of these companies is no loan, and it's up to them in terms of how they want to handle that. There's only so much cutting that can happen. But taking it back to all the comments that we made, we're excited about these investments. We believe it positions us well to grow purchase in particular and the direct-to-consumer channel.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Yeah. Thanks for the question.

Kevin Kaczmarek
Analyst, Zelman & Associates

Q

Sure. Thanks for taking the question. That's all I had.

Operator: Thank you. And that concludes today's question-and-answer -- go ahead.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

A

Go ahead. Go ahead, operator. Sorry.

Operator: I'll just turn it back over to you, Jay.

Jay Farner
Chief Executive Officer, Rocket Cos., Inc.

All right. Well, I just want to thank everybody for joining us. Appreciate Bill being here. Glad to see him getting engaged, like I mentioned before, very excited to watch him help us execute on all of these great things that the team members have been working on. Appreciate everybody's hard work to get us to this point, and we've got to keep going and growing in 2023. Talk to you soon.

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