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Rocket Cos., Inc. (RKT)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Rocket Companies, Inc. Second Quarter 2023 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll be a question-and-answer session. [Operator Instructions]

Thank you. Sharon Ng, Vice President, 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 2023. With us this afternoon, our Rocket Companies' Director and Interim CEO Bill Emerson; our President and COO, Bob Walters; and our Chief Financial Officer, Brian Brown.

Earlier today, we issued our second quarter 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 Bill, let me quickly go over our disclaimers. On today's call, we provide you with information regarding our second quarter 2023 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 mentioned today. We encourage

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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 Bill Emerson to get us started. Bill?

William Emerson

Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

Thanks, Sharon. Good afternoon, and welcome to the Rocket Companies earnings call for the second quarter of 2023. At Rocket, we are dedicated to serving our clients through innovation and we're focused on delivering the best experience to them on every step of their homeownership journey.

On behalf of the board, I'm excited to announce the appointment of Varun Krishna as Rocket Companies' new CEO. Varun, who is currently the Executive Vice President and General Manager of Intuit's Consumer Group working on products like TurboTax and TurboTax Live, brings a wealth of fintech leadership experience that will be instrumental in driving Rocket's future success. I look forward to working with Varun in the months ahead to ensure a smooth transition.

Before we go any further, I'd like to pause and take a moment to thank our team members for their passion and commitment that drives our achievements. It hasn't been an easy time in our industry and we have made crucial but difficult decisions to better align resources with the needs of our business and today's mortgage market. As part of our ongoing companywide focus on efficiency we recently implemented a voluntary career transition program in July, along with other prioritization and cost reduction measures. Brian will share more details on that in a bit.

Now turning to our Q2 results. We reported strong results in the second quarter. Adjusted revenue came in at $1 billion, above the high point of our guidance range, reflecting continued momentum over the past three quarters. We also achieved positive adjusted EBITDA of $18 million and GAAP net income of $139 million and GAAP diluted EPS of $0.05, reflecting both our strong execution and ongoing focus on operating an efficient company.

We're also very pleased to see our purchase market share grow on both a year-over-year and quarter-over-quarter basis. Our focus on servicing clients through innovation in this challenging market is working.

Now I'd like to share some thoughts on the current market. We remain encouraged by the fact that consumer demand for homes continues to be robust and we are seeing a healthy purchase pipeline. People just want to buy home. That said, at the macro level the inventory and affordability challenges consumers experienced in the first quarter persists. According to the National Association of Realtors, May 2023 home inventory is roughly one-quarter that May of 2007. Let that sink in for a second.

While there are no quick fixes to low inventory and affordability issues in the industry, we see these market challenges as an opportunity to offer innovative solutions to help our clients during this time. For example, our BUY+ and ONE+ initiatives, which we'll talk more about in a few minutes, help increase access to homeownership and address home affordability challenges. These unique products, along with our focus on delivering a great

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client experience have driven the growth we've seen in purchase approval letters, which are up nearly 20% in the second quarter of 2023 compared to the first quarter, far outpacing historical trends.

We believe the increases we're seeing in this important metric are the result of the investments we've made in the purchase experience for both our clients and real estate agents that work with them. In the fourth months since launch, our BUY+ initiative has resonated strongly with first-time homebuyers, home sellers and real estate agents. This unique Rocket exclusive collaboration between Rocket Mortgage, the largest retail mortgage company in the United States; and Rocket Homes, our 50-state home search platform and real estate agent referral network has far surpassed our initial expectations on lead generation.

With BUY+ purchase clients can save thousands of dollars in upfront costs if they work with a Rocket Homes Partner Real Estate Agent and obtain financing with Rocket Mortgage. The homeowner can further increase their savings by buying, selling and financing through Rocket. Real estate agents are excited about working with Rocket and with high intent clients and these initiatives have proven that out as we've seen agent referrals continue to trend higher.

In May, we also introduced ONE+, a new 1% down home loan program that aims to increase access to homeownership for millions of low-to-moderate-income Americans. ONE+ is available to homebuyers purchasing single-family homes – including manufactured homes – whose income is equal to or less than 80% of their area median income. Helping clients with financial wellness and homebuying readiness is just as important as providing an excellent experience for those who are ready to purchase now. This is why we laid the groundwork for our client engagement program in 2022, which includes Rocket Money, Rocket Rewards, Rocket Visa Signature Card in their homebuying plan.

Solutions such as Home Buying Plan, our guided digital experience that keeps our clients on track as they prepare for purchase, and Rocket Rewards, our loyalty program, which gives our clients tangible value for staying engaged with Rocket are crucial, particularly as clients in today's environment are confronted with a much longer homebuying cycle compared to historical periods. And as we have shared previously, our client engagement program can meaningfully change our business model, broadening Rocket's acquisition channels, lowering client acquisition costs and lifting conversion through the data insights we get.

Rocket Visa Signature Cardholders began accruing Rocket Rewards points in the second quarter on purchases. Rocket Rewards also expanded the activities eligible for banking points to home search, including adding a home to a favorites list and saving a home search alert on Rocket Homes. We are already observing a meaningfully higher conversion rate from lead to close among mortgage clients through our Rewards members compared to those who are not. As we expand the activities for clients to accrue points across the Rocket ecosystem, we believe we have an opportunity to gain valuable insights, personalize our offering and further lift our conversion.

We're further encouraged by this progress when we consider the large and growing number of Rocket Accounts. As of June 30, the number of Rocket Accounts grew to 29.3 million, an increase of nearly 2 million from the prior quarter, with Rocket Money continuing to lead the way. Rocket Account gives us valuable signals of homebuying readiness and intent and we believe Rocket Account holders are more open to transacting with Rocket, now and in the future.

Finally, I'd like to acknowledge a recent achievement that is a symbol of our enduring commitment to the client experience. This last week, Rocket Mortgage was named #1 in the nation in J.D. Power's 2023 study for client satisfaction in mortgage servicing, the 9th year Rocket Mortgage has earned the accolade. Rocket is among a shortlist of companies with a comprehensive homebuying ecosystem who can offer a breadth of products and

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services from financial wellness, personal loans and home search to first-lien mortgages, home equity loans, servicing and title and closing.

In the two months since I've been back at the company, one thing is abundantly clear. Rocket has a tremendous opportunity in the large and fragmented mortgage market and we're changing the game. We're upending the traditional mortgage business model by diversifying client acquisition channels, lowering client acquisition costs and engaging our clients throughout their lifetime, thereby lifting conversion from lead to close. We are dedicated to growing the business by significantly elevating the client experience through our comprehensive ecosystem.

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

Brian Nicholas Brown

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

Thank you, Bill, and good afternoon, everyone. On today's call, I'll cover our financial results for the second quarter and our outlook for the third quarter. I will also discuss our innovative offerings and how we help our clients in this challenging market, and I'll provide an update on our ongoing efficiency efforts.

In the second quarter, we were profitable on an adjusted EBITDA and GAAP net income basis. And once again, we exceeded the top end of our guidance range. We are pleased to see that our purchase focus initiatives are working. Rocket gained purchase market share in the quarter, both year-over-year and quarter-over-quarter. Our client-first approach and the efforts we have taken to run a leaner business are paying off. Rocket reported strong second quarter results, reflecting sequential growth in volume, revenue and profitability.

In Q2, we generated adjusted revenue just north of $1 billion, surpassing the high end of our guidance range. Adjusted revenue is now up in consecutive quarters since Q4 of last year, with Q2 up 14% from Q1 and up 47% from Q4.

Turning to profitability. We have made significant strides over the last year to improve our profitability profile, even in what has been a historically depressed market. In the second quarter, we returned to positive adjusted EBITDA. Q2 adjusted EBITDA of $18 million improved considerably relative to losses of $79 million and $204 million in Q1 and Q4, respectively. We reported GAAP diluted EPS of $0.05 and an adjusted diluted EPS loss of $0.02 per share. We're encouraged by the improving trend in our results, and we're excited to be back in a position of growth and profitability. We have been diligent in prioritizing our resources, focusing on operational efficiency and trimming our cost structure.

Our efforts to streamline our costs have been ongoing and span across expense categories, including a recently executed voluntary career transition plan in addition to other third-party related cost reduction efforts.

As I've shared before, we invest with discipline and track our progress closely. We are constantly evaluating and making capital allocation and prioritization decisions and we take action to pivot or sunset projects that are not meeting our expectations. For example, most recently, we pivoted from investing in a sales platform for Solar to only offering solar financing through the Rocket Loans platform. We also recently wound down Rocket Auto operations.

As a result of these actions, we anticipate cost savings in the range of $150 million to $200 million on an annualized basis, with a full quarter of cost savings set to begin in the fourth quarter. In addition, we expect to incur a onetime charge of approximately $50 million to $60 million related to the voluntary career transition program, primarily in the third quarter.

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Looking at current market conditions, we continue to see healthy client purchase demand. People want to buy homes. That said, inventory and affordability challenges are resulting in a much longer homebuying process than we've seen historically. For example, one of the things we monitor internally is the amount of time between when a client shows intent to transact and when they actually find and purchase a home, a measure that we refer to as approval letter to application. This metric has been steadily increasing since February of this year and has recently hit a record high. This is not surprising when you consider that in May inventory was at its lowest level in two decades according to the National Association of Realtors.

We're helping our clients stay on track while navigating the longer homebuying life cycle in an inventory-constrained market with products like our Home Buying Plan, which provides a guided digital experience to help prepare for home purchase. For those even earlier in their journey, Rocket Money helps clients improve their credit score, budget and reach their savings goals. We're giving our clients tangible benefits to stay with Rocket throughout the process with program such as Rocket Rewards, our loyalty program, whereby clients can grow rewards through engagement across the Rocket ecosystem.

We're addressing affordability concerns and expanding accessibility to homeownership through recent initiatives such as BUY+. With BUY+ purchase clients can save thousands of dollars in upfront costs if they work with a Rocket Homes Partner Real Estate Agent and obtain financing with Rocket Mortgage. This is something that only Rocket can at offer scale through our integrated real estate and mortgage experience. In addition, because of our ability to capture the economics from both the real estate side and the mortgage side of the transaction, Rocket is uniquely positioned to provide consumers with meaningful savings on their closing costs.

With this increased engagement, we're gathering valuable signals and insights, enabling us to personalize our offerings across financial wellness, home search, personal loan, first-lien mortgages, home equity loans and more, regardless of where the client is in their homebuying journey, or when they are ready to transact.

Our scale and unique approach to client acquisition, engagement and lead conversion continues to distinguish us from other mortgage lenders, particularly in this challenging fragmented market.

From a capital allocation perspective, we have always prioritized maintaining a well-capitalized balance sheet with substantial liquidity capable of navigating different market cycles, while remaining opportunistic. Rocket's financial strength continues to be an important strategic advantage for us, especially in today's market.

We closed the second quarter with $3.8 billion of available cash and $6.4 billion of mortgage servicing rights. Together, these assets represent a total of $10.2 billion of value on our balance sheet. Our $3.8 billion of available cash consists of $883 million of cash on the balance sheet and an additional $2.9 billion of corporate cash used to self-fund loan originations.

Total liquidity stood at approximately $8.6 billion as of June 30 and including available cash plus undrawn lines of credit and our undrawn MSR lines. As of June 30, our mortgage servicing portfolio included more than 2.4 million loans serviced with approximately $500 billion in unpaid principal balance. Q2 unpaid principal balance was lower compared to Q1 due to the sale of MSRs in the quarter.

We also drive considerable recurring revenue from mortgage servicing. During the second quarter, we generated $343 million of cash revenue from our servicing book which represents approximately $1.4 billion on an annualized basis. Net client retention remained over 90% in the second quarter, well above the industry average.

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Moving on to our outlook for the third quarter. We expect adjusted revenue to be in the range of $850 million to $1 billion. This guidance takes into account current market conditions, including challenges presented by the historically low housing inventory levels. We expect Q3 expenses to be roughly flat compared to Q2, excluding the $50 million to $60 million in onetime charges. As we have consistently demonstrated over the last 18 months, we are committed to operating an efficient business with continued focus on profitability.

As always, our forward-looking guidance is based on our current outlook and visibility. Despite the continued uncertainty at the macro level, we are very well positioned in the current environment. We remain focused on serving our clients and investing with the discipline to drive long-term growth and shareholder value.

Before we turn the call over to the operator, I'd like to share with you that our 2022 ESG report can be found on the Social Impact tab of our Investor Relations website. Our second 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're ready to turn it back over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] First question is from Kevin Barker with Piper Sandler. Your line is open. Kevin Barker with Piper Sandler, your line is open.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah. Sorry. Thank you for taking my questions. I appreciate you having me on. First off, I'd like to thank – congratulate Bob Walters on his retirement. Also like to dig into what happened with the CEO search process and try to understand any color you can provide on the background on the search process and one of the reasons why Varun was chosen to become the next CEO starting in September.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Sure, Kevin. Thanks for the question. This is Bill. And thanks for acknowledging Bob. So, obviously, we went through an extensive search, as that process started back in February as soon as we announced that I was the Interim CEO because we were diligent about wanting to make sure that we can find someone. We employed a national search firm. And if you – as you can imagine, with a job like this, we've got quite a bit of response and a number of great candidates that we have the opportunity as a board of vet. And in going through that process we were looking for somebody who had great business acumen, somebody who had consumer product skill sets, somebody who was really good with people. And as we had the chance to evaluate Varun and all of the other candidates that we looked at, he clearly rose to the top as far as someone that would be able to come in here and paint a great strategic vision for the organization. Someone who had alignment with us in the fintech space and the abilities that we have and the things that we're looking to do as it relates to expanding our business and our platform and our ecosystem. So as we went through that process, it was not surprising to see that the board was unanimous in making the decision to bring Varun onboard.

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Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Great. And thank you for that color. And then just shifting gears, you obviously put a lot of focus on attracting new originations, particularly in the origination – particularly in the purchase market. I was hoping you could provide a little more color behind some of the progress that you've made with these initiatives, particularly Rocket Rewards, the Inflation Buster and then the new programs you guys announced in May as well.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yes, sure. I'm sure Brian will have some thoughts on this as well. But you're talking about BUY+, ONE+, two programs that we rolled out here in the second quarter. Inflation Buster was last year.

And so when you think about the problems in the market today, all kinds of inventory challenges, right. I mean, we just talked about the fact that inventory levels are one-quarter of what they were in 2007, which was the last time we went through Great Recession. I mean, the inventory levels are incredibly low. People want to buy, but it's really hard. And so our BUY+ program gives people the opportunity to save money on the transaction, especially if they're working with us from a mortgage perspective, but also because of Rocket Homes, if they're able to work with both us and Rocket Homes. It's real money that they can save on the transaction.

And I think that really gave us an opportunity to drive lead flow that we hadn't seen in the second quarter and allowed us to grow our market share, not only year-over-year but quarter-over-quarter as well, which are very, very important metrics that we keep an eye on. So, we're excited about what – the way that worked. We're looking forward to that continuing as we move forward.

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

A

Yeah. The only other thing I'd add, Bill, is exactly what you said that these products are designed for this market. The two challenges are affordability and inventory. And BUY+ is a good example of an innovative product.

Just to dive a little deeper into the metrics, it's exceeded our expectations on driving traffic to our sites. Consumer engagement on the product is beating all of our internal metrics. The real challenge is just getting people into homes with the inventory levels that – that Bill just discussed.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah. It's obviously a challenging environment and a lot of these programs are relatively new. Are you able to provide just some metrics behind some of the incremental market share you've taken, particularly around the purchase market?

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

A

Yeah. The way I'd comment on that, Kevin, is I think we've talked about this before, but it's a challenge to report market share just if you use the industry forecast. And when I say the industry forecast, I mean, the MBA and Fannie, and we know that because, one, there's – it's like any other forecast, it's usually not correct, but the actuals change frequently and get updated. So this is how we look at it. We look at securitization data, which is, of course, publicly available, and you can get your hands on that. And that shows us taking purchase market share

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quarter-over-quarter and year-over-year. Now that's about 70% of the overall mortgage market, but it's a great sample size and a great indication.

We also look at other sources like Optimal Blue and CoreLogic data and that helps us get more real-time information and up to date, again, maybe not capturing the entire market. But when you look at every source and even if you do the math on Fannie and MBA, they all point in one direction, which is us taking share in the purchase market.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Great. Thank you for taking my question.

Operator: Next question is from Ryan Nash with Goldman Sachs. Your line is open.

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

Q

Hey, good evening, guys. Maybe I'll start off looking at the current quarter's results and digging into a little bit on the third quarter guide. So, results came in just above the high end of the expectations. Can you maybe just talk about what you saw throughout the quarter on the competitive side that led to the better results?

And then when you think about the 3Q guide, maybe just talk a little bit about what's driving the sequential decline at the midpoint of the range. Obviously, there's some seasonality with the spring selling in the second quarter. But maybe just flesh out some of the moving pieces in terms of volumes and margins? And is there some conservatism similar to what we saw in the second quarter. Thanks. And I have a follow-up.

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

A

Yeah. Thanks, Ryan. I'll take the first shot. But let me start with the Q2 performance. And even just – I'll talk about the revenue beat, which is obviously exciting. But let me just take a step back and say, we're very pleased with the execution in the second quarter, profitable on an adjusted EBITDA basis, profitable on a GAAP basis. This is on a backdrop of a market that shrunk over 60%, almost overnight. So we're – this is an execution quarter from the leadership team and our team members, and we're very proud of that.

And here's the good news. The profitability was driven by an increase in revenue from the second quarter. And that makes three quarters of back-to-back increases on the revenue side, on the gain on sale margin side. And the outperformance was really simple. It was driven by purchase. We talked about some of these BUY+ metrics. They're absolutely resonating with consumers. And then we've got a little cooperation from margins as well. The margin print is very healthy. So that drove the outperformance.

And then as we think about Q3, I can tell you, we're a third of the way through the quarter as we sit here and talk to you today and the trends are very consistent, particularly on the purchase side with what we saw in Q2. So that's the good news.

The challenge comes back to the inventory levels. If you want to believe that Q3 is going to be a healthy purchase quarter, you need to believe that homes are going to sell, and you need to believe that inventory is going to come online.

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So the guide is consistent with Q2, $850 million to $1 billion. We're very confident in our execution and our internal performance, but the inventory levels do give us pause as we look into the third quarter.

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

Q

Got it. And then maybe as a follow-up, you talked about expenses being flat next quarter, but then you also talked about the $150 million to $200 million of cost saves that you bring on. Can you maybe just talk about over – how much of that is going to be in the run rate for the second quarter over – and over what timeframe you see it making it in? Does this lead to absolute expenses declining over time?

And Brian, you talked about the progress you made on revenues and improving, getting to positive adjusted EBITDA, does this cost saving initiative that you're putting in allow you to move back to sustained profitability. Thank you.

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

A

Yeah. So I want to be clear that the cost savings that we're talking about, the $150 million to $200 million, we'll really start seeing the effects of those in the fourth quarter. They're executed in the third quarter. They'll work their way through the system. There might be a small benefit in the third quarter, but sort of be a full quarter of realization in that fourth quarter, which, again, just to touch on the profitability metric, again, this is the $18 million in EBITDA and the $140 million in positive GAAP income is before any of these cost savings take effect.

But if you think about what we've done, and we said this before, but we're committed to running an efficient business and looking over the cost structure has to be a part of that. Just as a quick reminder for the group, last year we took out $3 billion of cost. Over 40% of the cost structure came out. This round was really about focusing on efficiency and focusing on prioritization. Those two things we've committed to and we know how important they are, and they can make or break a business. So, these are the results of being efficient in terms of how we think about our team structure and our organizational structure and our prioritization. So, this $150 million to $200 million range should start being a full effect in the fourth quarter. And of course, if you just pro forma that and layer that on to the Q2 profitability results, they would have been even better had these cost savings been in place.

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

Q

Appreciate all the color, Brian.

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

A

Thanks, Ryan.

Operator: The next question is from Kyle Joseph with Jefferies. Your line is open.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey, Good afternoon, and thanks for taking my questions. And just sorry to – one more on the expenses. On the $150 million to $200 million of savings, does that factor in the changes you guys made in Solar and Auto that you addressed on the call?

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

A

Yeah. That was part of it, for sure. That's what I was alluding to on the prioritization front. There are certain things that, like Bill mentioned, BUY+, Rocket Rewards, things that are working that we'll continue to double down on and invest in. And then there's some other things such as the Solar sales arm and the Rocket Auto business, which were good things at the time and showed some success but aren't meeting our return threshold. So part of that is inclusive of winding down those businesses.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then just one quick follow-up on the – in terms of margin kind of by channel, if you could give us a sense, is 2Q kind of a good run rate at this point where you've had enough supply come out of the industry that we're kind of getting towards an equilibrium in terms of supply and demand, or just any sort of outlook by channel on your margins?

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

A

Yeah. The way I'd answer it is both channels performed well. Gain on sale margins are now up for three quarters in a row. There's no question that, that's a component of capacity coming out and competition easing. But I would go on to just say that they're still well below historical norms. So there's still room to grow there for sure. Capacity has come out of the system, competition is eased a bit, but we're not all the way through that, in our view. Some of that will depend on where mortgage volumes fall out, of course. But if you just look at the amount of mortgages being produced in the second quarter, there's still more capacity that can come out and gain on sale margins are an indication of that, still below historical norms. But yes, the sequential improvement is definitely a positive sign.

Kyle Joseph
Analyst, Jefferies LLC

Q

Very helpful. Thanks for taking my questions.

Operator: The next question is from Ryan McKeveny with Zelman & Associates. Your line is open.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Yeah. Thanks, guys. Nice job on the quarter. So you've hit on, on the purchase dynamics, which is helpful and good to see. I guess, looking forward, the midpoint of the adjusted revenue, as you referenced – was referenced previously down a bit from the 2Q results. I guess maybe help us think about the guidance in relation to the comments you made about purchase. I believe you said preapprovals were much stronger than historical in

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2Q maybe up 20%. I guess that sounded to me like that was an indication kind of a leading indicator of what's happening in 2Q that may lead into 3Q. So maybe if you could just square that dynamic with the guidance would be helpful.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. I'm happy to take that. I mean, the guidance, if you look forward to the third quarter, I mean, similar guidance for the second quarter and the third quarter typically is not going to be a purchase – as heavy a purchase season, just normally than the second quarter. So, we actually think that's a pretty good guide.

And what Brian talked about is, is the length of time it's actually taking now to make it all the way through the process. So the fact that our preapproval letters are up, it's a great indicator. And we look forward to that making its way through our pipeline in the next three to six months. But it's taking much longer for a client to be able to think about getting a home, going through the process, finding out the home, finding the mortgage, negotiating the deal, everything associated with that is just extended. So, I think that bodes well for what the third and the fourth quarter can look like. We still have to deal with the fact that the third quarter is typically and historically a little bit less robust as it comes to the purchase market.

Ryan McKeveny
Analyst, Zelman & Associates

Q

That's helpful. That makes sense. And then second question on BUY+ and SELL+. So you called out the strong consumer engagement there. I guess, can you dig in a bit on the reception from real estate agents? It seems like it's a very compelling offering not just to consumers but also to your partner agents with Rocket Homes. So, yeah, any thoughts there, just high level on the reception of agents? And is that program helping drive interest maybe more generally from real estate agents out there to partner with you either on the mortgage side or with Rocket Homes?

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. That's a great question. I mean, we believe it is. We're seeing referral numbers to Rocket Homes up significantly. So that indicates to us that realtors are interested in what we have to offer and passing that on to their client, right? At the end of the day, you know that realtors care deeply about what happens to their client and how well they can be treated through the process.

So, I mean we have been excited to see that increase. I know Rocket Homes has been happy to see it. So, it seems like to us that the real estate community is reacting positively to this particular program.

Ryan McKeveny
Analyst, Zelman & Associates

Q

That's great. Sounds good. Thank you.

Operator: The next question is from Doug Harter with Credit Suisse. Your line is open.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

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Thanks. You mentioned that the MSR – the servicing portfolio was down again I was just wondering how you're currently looking at the servicing portfolio and the split between lower coupon borrowers that have less incentive to refi and newer production, higher coupon mortgages that can see an easier path towards refinancing?

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

A

Yes. Thanks, Doug. So our views on the MSR asset haven't changed. Of course, our superpower there are the retention rates. And that's really where we exceed anyone else in this space. The asset is a great cash flow asset and obviously brings a little bit of volatility to the balance sheet. But overall, for us, it's a lifetime value equation.

What I think you might be referring to, we did have some sales of servicing assets in the third quarter. The one I'll touch on, which is probably the more unique one for us is the sale of the excess strip. We did sell some excess strip off. If you think about our business, we take enough interest rate risk every single day by originating mortgages and servicing mortgages. So where we have an opportunity to unload a bit of that excess at a really nice exit multiple, that can make all the sense in the world for us.

We'll trade that for cash. But the most important part is we'll retain the client. And that client relationship through the primary servicing asset is obviously, again, our superpower. So that's probably what you saw come through in the third quarter. But no change in the overall strategies. We're a buyer of servicing asset every day by the loans that we originate. We do a lot of looking and if the client demographics fit our profile, and we can make an LTV argument we'll acquire that portfolio. In terms of clients or portfolios that we sell, again, it's really through that LTV lens. If there's inability to remarket to them or if there's another reason that we don't have the confidence in the recapture, those are the ones we'd look to trade.

Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Is there any way you would – can you give us a breakdown, kind of by coupon? How much of your servicing portfolio would, say, be above a 5% coupon now or 6%, just to get a sense of what – if rates came down a moderate amount, where you could start to see more refinance demand?

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

A

Yeah. The financial disclosures always include a weighted average coupon, so you'll see that when we file the Q here. But, I mean, it's not a surprise that, that we've been servicing now for a long time and 2020 and 2021 were big origination years, that's going to be a big percentage of your book, and that's going to be lower coupon.

But I think you bring up a good question because something I feel like folks do underestimate is, this year, there'll be $1.5 trillion or $1.7 trillion of mortgages produced, and all those mortgages will be at a higher coupon.

And at some point, all those mortgages will be back in the money. And people, I think, underestimate how much rates have to move to make that beneficial for the clients. So when you look at the weighted average coupon, of course, that's going to be low in the book. But we're originating mortgages every day at these prevailing rates and higher coupons that it only takes a few basis point move to be back in the money and make it beneficial for those clients.

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Douglas Harter
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you.

Operator: The next question is from James Faucette with Morgan Stanley. Your line is open.

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

Q

Thank you. That was a close one. Just a quick question on your prepared remarks, inventories of existing homes were obviously near historic lows, the statistic versus 2007 was particularly striking. And some of the lock-in effects – but it seems like new homebuilders have been filling in the gap in many markets. What are you doing to capture share in that market? I didn't know, you touched on it a little bit, but are there opportunities for Rocket to lean into the space and develop more expansive partnership with homebuilders?

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

That's actually – that's a great question. I mean we work with homebuilders on a regular basis. So, we're constantly interacting with them. But as – as again, as you know, that's a very long life cycle, right, when you start from scratch and signing a purchase agreement to building a home and the gestation period associated with that. I mean, I remember when I used to do years ago, it was about 9 months, and these days it's probably closer to 15 to 18 months. So – while we are always encouraged by a little bit of increase in the new construction, it's still relatively small in the grand scheme of life and where it's been historically. So, we're constantly working with builders on that, but that's not going to show any short-term positive impact for us from a closed loan perspective along the line.

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

A

I think that's right, Bill. And I – I mean, we've been looking at those stats very closely, James, and it's a good question. But just keep in mind, the vast majority of homes that will be sold are still existing homes. So that's still where the biggest TAM) is. And then also keep in mind, eventually, the market will be efficient. The homebuilders are doing great, and they're striking while the iron's hot, which is great for them. But existing home sales in every market still are going to be the lion's share of all home sales.

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

Q

Great perspective there. And then I wanted to ask things a little bit, I don't know, it seems a little presumptive to be asking this question, given the expense that you've already made and newly announced plans. But where are you in terms of how much more you could cut if needed and – but still maintain kind of all the things that make Rocket, Rocket. Just trying to get a sense for where the bottom may be or where it could be, if necessary?

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Listen, that's a great question. But I think at the end of the day, where we are right now and the work that we've gotten to, we feel good about where we are from a cost structure. We're going to constantly look at it. We'll be efficient in evaluating our business. But we've done a lot of work to get to the place that we are at. And we feel pretty good about what the future looks like from that perspective.

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

Q

Okay. Thank you.

Operator: Next question is from Mihir Bhatia with Bank of America. Your line is open.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Good afternoon, and thank you for taking my questions. Let me also add my congratulations to Bob on retirement. I have a two-part question. I'll just ask both parts since they are related upfront. You've talked a little bit about the cost. Appreciate the comments on the product innovation, introduction of new programs and how that's helping drive purchase volume. But I was curious if you could comment a little bit more on just where the market share gains are coming from, where you're seeing them in what channels between the partner or the direct business where that's coming from?

And also relatedly, there's been some press reports about you all hiring local officers, so talk – maybe talk a little bit about that? And just big picture, maybe as the rate backdrop has gotten more challenging and has become more of a purchase-driven origination market, how is Rocket changing? What is staying – similar to the last question, what is staying true to Rocket that grew into this juggernaut in the mortgage industry? And what has changed? How have you adapted? And what should we expect here over the next year or two? Thanks.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

That's a mouthful right there. So what I would tell you is I think we've seen growth in both channels. So it's not specific or exclusive to one or the other, and we're actually happy about the growth in both.

As it relates to your question on local loan officers, we've had remote local loan officers for a long time in our organization. We've always tried to leverage talent where the talent exists. And we probably saw more of that during COVID, right, which opened up our eyes to a little bit of the fact that some folks can work from home and do a good job in a local market, that would add value to the organization. So, our strategy going forward is the same. We're going to continue to push our Direct to Consumer business, and we've got our third-party origination channel.

I think we're – as we look at our Direct to Consumer business, there's a way to get more local and more regional with that out of a centralized location that I think is beneficial to the interactions that we would have with realtors and builders and that's something that we're constantly working on and evaluating. But I think what you're seeing as an organization that's committed to a Direct to Consumer model, the digitization of the process. I think the hiring of our new CEO indicates that in a big, big way because of his experience and where he's been. So we still look at this marketplace as a massive opportunity. It's still very fragmented, and there's still a lot to be accomplished by our organization even in a purchase heavy market.

Mihir Bhatia
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: The next question is from Don Fandetti with Wells Fargo. Your line is open.

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Donald Fandetti
Analyst, Wells Fargo Securities LLC

Q

Hi. Good evening. There have been a lot of changes to bank regulation. I didn't know if there were any potential benefits to your business even if it's around the edges.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

A

Well, I mean, I think there's – there's a lot of talk about what's going on with banks as it relates to the SVB regional bank situation that took place. And I know there's some discussions about increased capital rules and things of that nature. But at this point, that's still a proposed rulemaking state. So it's really kind of hard to determine what that's going to look like in the marketplace.

On one hand, if you see capital requirements go up, you've already started to see some regional banks that have pulled away from the warehouse lending space. And that could bode poorly for a lot of our brethren in the industry. For us, I mean we work with the largest financial institutions. So we don't see an impact there. But I think the devil's in the details, and we have to see where this – where the new regulations and the new rules come out and how that might affect things.

I mean on one hand, you could argue that by doing that, it might help the non-depository mortgage lender. On the other hand, until we really know the reality of life and what those rules are going to do, it's hard to say. It could ultimately have an impact on some of the non-depository space for folks who don't quite have the balance sheet that we have.

Donald Fandetti
Analyst, Wells Fargo Securities LLC

Q

Thank you.

Operator: That will conclude our question-and-answer session. I'll turn it over to Bill Emerson for any closing comments.

William Emerson
Vice Chairman-Rock Holdings, Inc., Interim Chief Executive Officer & Director, Rocket Cos., Inc.

So, first of all, thank you all for joining us. And I just want to make sure that I state this for the record, how much we appreciate Bob Walters, all the work he's done for this organization over the last 26 years, his leadership, I've known Bob that entire time. And while I am very happy for him in the next steps that he's going to take, he will be missed at this organization greatly. So thank you, sir. Appreciate you. And thank you all for being on listening, asking questions and until next time.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

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