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Rocket Cos., Inc. (RKT)

Q4 2023 Earnings Call

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CORPORATE PARTICIPANTS

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

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

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

OTHER PARTICIPANTS

Kevin J. Barker
Analyst, Piper Sandler & Co.

Jeffrey Adelson
Analyst, Morgan Stanley & Co. LLC

Christian M. DeGrasse
Analyst, Goldman Sachs & Co. LLC

Kyle Joseph
Analyst, Jefferies LLC

Donald Fandetti
Analyst, Wells Fargo Securities LLC

Ryan McKeveny
Analyst, Zelman & Associates

Doug Harter
Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the Rocket Companies' Fourth Quarter and Full Year 2023 Earnings Conference Call. 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 2023. With us this afternoon are Rocket Companies' CEO, Varun Krishna, and our CFO, 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 Varun, let me quickly go over our disclaimers. On today's call, we provide you with information regarding our fourth quarter and full year 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 mention today.

We encourage you to consider the risk factors contained in our SEC filings for a detailed discussion of these risks and uncertainties. We undertake no obligation to update these statements as a result of new information or further

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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 reported results can 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 Varun Krishna to get us started. Varun?

Varun Krishna

Chief Executive Officer & Director, Rocket Cos., Inc.

Thanks, Sharon. Good afternoon, everyone, and thank you for joining the Rocket Companies earnings call for the fourth quarter and full year 2023. Reflecting back on the last year, today, I'll talk about how our consistent execution drove exceptional results for the quarter and the year, especially given the backdrop of the market.

I am so eager to share with you how we are positioning Rocket to operate with greater clarity, focus and velocity and how we will achieve growth and profitability at scale through our AI-fueled homeownership strategy.

I'd like to begin on more of a personal note. It's hard to believe it's been nearly six months since I joined Rocket Companies, and time certainly flies when you're on a rocket ship. I continue to be inspired by our team members, whose talent, energy and grit are the lifeblood of our company. I am so confident about our future and the collective impact we will make as a team. And the best part is that our journey is just beginning.

We delivered strong fourth quarter and full year results against the backdrop of extreme market challenges as the industry faced persistent constraints in affordability and inventory. In Q4, we reported adjusted revenue of $885 million, representing an increase of 30% when compared to Q4 of 2022 and the second consecutive quarter that we've accelerated top line growth on a year-over-year basis.

Now, adjusted revenue in the quarter was $85 million above the top end of our guidance range. We reported positive adjusted EBITDA for the third quarter in a row, despite some of the most difficult industry conditions in three decades.

Now in 2023, we delivered $3.8 billion in adjusted revenue. And I'm proud to share that we grew market share in both purchase and refinance annually. Purchase market share grew by 14%, and refinance market share grew by 10%, from 2022 to 2023.

It's worth emphasizing, that we delivered positive adjusted EBITDA for the year, which is largely a function of two factors. One, a strong top line and two, our commitment to operational efficiency.

And as you'll hear Brian discuss in more detail shortly, we made significant reductions to our cost base over the past two years. And we took difficult, yet necessary actions to right-size the company. This has helped us prioritize and focus on what we do best and what matters most.

Now, as we look back at our 2023 results, there are a lot of great accomplishments to be proud of, but we are even more excited about the opportunities that lie ahead. We repositioned our organization in 2023. And we entered 2024 reinvigorated with momentum, clarity and a lean competitive edge. We are poised to deliver revenue growth, market share growth and further operational efficiency.

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Now, I'd like to take a moment to recap what the leadership team and I have been focused on recently, and how it will position us for success in the future.

Now, embracing transformation is an essential part of any big journey. Now, a few months ago, I collaborated closely with our leadership team to write the next chapter of Rocket's story together. We looked inward. We spent thousands of hours engaging in a rigorous process of research, interviews, analysis, introspection and debate. We dove deep to review the state of our business, our competitive strengths, and we identified our gaps as well as our opportunities. The outcome of this effort was a clear strategy to enable AI-fueled homeownership and a comprehensive blueprint that brings clarity and focus to our entire organization.

By leveraging AI, we will transform an industry that is ripe for innovation, establishing Rocket as the premier choice for clients and partners, including local real estate agents, mortgage brokers and financial institutions.

With a clear north star, we bend to bold steps to simplify our organizational structure and we aligned our resources to our strategic priorities. We recently reviewed our full list of priorities and significantly narrowed the focus, reducing it by more than 80%. This allowed us to reallocate resources to areas where we wanted to double down, while simultaneously streamlining our operational execution. Our goal is to focus intently on the things that matter the most to our clients and to do them better and faster than anyone else.

I am personally committed to maintaining transparency regarding our progress, the cornerstone of which is providing visibility into how we are tracking against our goals and delivering on our commitments, which is what we internally refer to as having a high say/do ratio.

We have incredible talent here at Rocket and we will continue to build the team that drives our success. We've realigned our organization with key leaders stepping into expanded roles. We also welcomed new talent to propel us forward. In January, Alex Rampell joined our Board. Alex is a partner at Andreessen Horowitz and is one of the world's leading experts in AI and FinTech. In addition, Jonathan Mildenhall, the former CMO at Airbnb, whom Forbes has listed as one of the 10 most influential CMOs in the world, recently joined our leadership team as the first-ever Chief Marketing Officer for Rocket Companies. We're investing in world-class talent here at Rocket and we're playing to win.

Now, our entire company is united behind a common vision and strategy, and we are executing at full speed. Earlier this month at Little Caesars Arena, right here in Detroit, we held our first all-company meeting since our IPO. More than 14,000 team members attended and the energy and the level of engagement were simply off the charts.

The main focus of our all-company meeting was heavily geared towards artificial intelligence and the opportunity it presents for Rocket. With AI, we are rewriting the rules of the game and structurally and fundamentally changing how this industry operates.

Our mortgage origination has long been associated with inefficient up and down hiring cycles. Because of that, scaled profitability has been notoriously difficult to achieve in the mortgage industry, because that volatility and cyclicality have made it challenging to adequately plan ahead and invest for the future. The industry has traditionally staffed up rapidly to handle higher volume in up-markets, only to reduce staff in respond to down-markets. So, those who don't manage capacity or liquidity effectively may be acquired or exit the industry altogether. And in 2023 alone, we saw this. We saw the industry with 62 M&A transactions, exits and bankruptcies, and recent data shows that capacity is down nearly 35% from the peak.

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We believe AI will shape the future of the home buying industry and Rocket leading the way. Technology is the answer to better client experiences and capacity management in our industry. We aim to redefine the home buying experience through AI and deliver market share growth, scaled revenue growth and profitability. I will share with you that automation and AI are being aggressively deployed across Rocket, helping us to deliver better client experiences at scale across the entire home-buying process.

Now, I'm going to share three examples of how AI is driving impact today across mortgage banking, underwriting and servicing. Purchasing a home can be an overwhelming process, which is why at Rocket, we excel in blending personalized service with cutting-edge technology. Now, AI lets computers do what they do best, while allowing our team members to focus on what they do best, fostering relationships and connecting with our clients. So if you take, for example, our mortgage bankers, these team members play a crucial role, because they guide clients through the entire mortgage journey.

In Q4, we piloted an AI virtual assistant with 325 mortgage bankers for outbound client calls. Now previously, these bankers juggled notetaking, selling out applications, remembering regulatory requirements, all the while talking to our clients. What the AI assistant does is it seamlessly and accurately automatically transcribes, summarizes and populate hundreds of crucial application fields, hands-free in real time. So our bankers are more productive than they've ever been and they can now focus on what they do best with AI handling the rest.

Now, the initial response from this pilot has been overwhelmingly positive, and we're already seeing signs of dramatically faster turn times. We're excited to roll this technology out to our broader banking force to deliver a better client experience through the millions of calls that we make in a given year.

Now, switching gears in underwriting. Automation and AI are helping to deliver higher accuracy and operational efficiency at scale. An underwriting decision typically requires the gathering and verification of thousands of data fields, which are drawn from disparate resources and formats to populate key categories of income, assets, collateral, property and the credit profile. Now, income verification is one of the critical inputs to an underwriting decision and also a very complex process that takes regulatory requirement, documentation, accuracy, employment types and unstandardized data format into consideration.

So in December, nearly two-thirds of income verification were automated without an underwriter needing to intervene. This provided a fivefold improvement compared to just 15 months prior here at Rocket. So, thus far, our automated income verification has posted zero audit findings, which is also highly impactful as income verification issues are amongst the top reasons behind GSE repurchase request.

I'm also excited to share that we've recently rolled out this great income verification technology to our mortgage broker partners, further enriching the offerings we provide to help them thrive. Now imagine applying these advances in automation at scale across all underwriting categories as we continue to take market share and grow.

Now in 2021, a record year for mortgage origination, when we processed 4 times the number of applications that we did in 2023, we demonstrated that our technology could scale up even when the industry was constrained by capacity.

Today, we're in an even better position to drive operating leverage through automation and AI. We've made significant advances in automating income verification and then we're tackling asset verification next.

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Now, AI is also enhancing our client interactions at scale across devices, whether our clients are reaching us by phone, by computer or by mobile app. So take servicing, for example, in 2023, we facilitated 3.1 million client interactions with payment and escrow questions topping the list. Our servicing calls and chats are increasingly powered by AI, providing clients with smart, conversational self-service experiences 24 hours a day, seven days a week. Approximately 70% of our servicing calls and chats are fully self-serve without the need of team member assistance with interactions only escalating to team members where the human touch is required.

We've seen a continued trend of lower call volume in servicing as our AI-powered digital experiences become the preferred choice for our clients. And we're not just handling interactions, we're actually turning them into actionable insights. With AI's assistance, we're transcribing and tagging these servicing interactions, organizing this invaluable data to construct unified client profile in a centralized repository. From this repository, we train models to gain deeper insights and analytics. Our next objective is to expand this initiative to other areas of the business, which ensures that AI continues to drive enhanced client experiences and operational efficiency across the board.

With these examples, the consistent themes that I hope to convey are first, to harness the power of our data and artificial intelligence; second, to simplify and automate; and to third, unlock team member productivity and deliver better client experiences through speed, certainty and value.

The efficiency gains when deployed at full scale will be an absolute game changer for our organization as we will be able to serve many more clients without adding to our fixed cost structure. So really just scratching the surface here. There's so much more impact that generative AI can bring, and we're incredibly well-positioned to capitalize on the opportunity and lead the industry.

I am so honored to be a part of this next chapter in Rocket story. Looking ahead to the coming year, I'm confident in our team, our capabilities and our mindset. We look forward to sharing our progress with you on future earnings calls and during our first Investor Day later this year, when our senior leaders will present on how we're executing our strategic priorities to enable AI-fueled homeownership.

And with that, I will turn it over to Brian.

Brian Brown

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

Thank you, Varun, and good afternoon, everyone. On today's call, I'll cover our strong financial results for the fourth quarter and the full year 2023. I'll share how our AI-fueled homeownership strategy positions us for success this year and into the future. I'll conclude by sharing our outlook for the first quarter of 2024.

In 2023, Rocket again made significant strides in market share growth, gaining share on a year-over-year basis in both purchase and refinance. More specifically, we grew purchase market share by 14% and refinance market share by 10% from 2022 to 2023. I am incredibly proud of what we accomplished in the face of an extremely challenging mortgage market. It's a testament to our grit and tenacity.

In my 10 years at Rocket, I have never been more excited about what's to come. Through the ups and downs of mortgage cycles, we have continued to invest in our data and technology foundation. And now with AI, Rocket will change this industry.

As Varun shared, we are unlocking capacity at scale through higher team member productivity and delivering a better client experience. We have made material progress in increasing scale and capacity in 2023, and we

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expect those gains to accelerate into 2024. Said differently, we believe we can keep our fixed costs relatively flat, while originating significantly higher volumes.

Turning to the full year results. We delivered $79 billion in closed loan volume and $3.8 billion in adjusted revenue in 2023. After cutting roughly a quarter of our cost base in 2022, we further reduced expenses in 2023 by nearly 20%. We are operating with greater clarity, and we're laser-focused on prioritizing the most important work that will deliver the highest impact.

In 2023, we took action to pivot or sunset projects that were not meeting our expectations, such as Rocket Auto and Rocket Solar. More recently, after conducting a review of our entire portfolio of projects, we cut the list by more than 80%, which helped reduce cost, but more importantly, it freed up resources to work on the core business.

Despite the persistent macro challenges in 2023, for the full year, we delivered $67 million in adjusted EBITDA. We reported an adjusted diluted loss of $0.07 per share and a GAAP diluted loss of $0.15 per share.

Now, let's dive into our strong fourth quarter results. We generated adjusted revenue of $885 million, well above the high-end of our guidance range. The $885 million of adjusted revenue represents a 30% increase from the fourth quarter of 2022 and marks the second consecutive quarter of year-over-year growth.

Our performance in the quarter was primarily driven by stronger-than-anticipated purchase and refinance volume and gain on sale margin as we continue to see capacity come out of the industry. We delivered these achievements in what was one of the worst quarters for mortgage originations in recent history. Gain on sale margin for the quarter was 268 basis points, up nearly 25% from 217 basis points in the fourth quarter of last year.

Net rate lock volume for the quarter was $16 billion. We generated $55 million of adjusted EBITDA, a year-over-year improvement of more than $250 million from Q4 2022 and this marks the third quarter in a row that we've reported positive adjusted EBITDA.

Adjusted EPS for the quarter was breakeven. On our last earnings call, we committed to a further reduction in total expenses in the fourth quarter of $50 million to $100 million. Excluding the $51 million onetime charge in the third quarter, and we came in at the top end of the range, reducing total expenses by approximately $100 million in the fourth quarter compared to the third quarter.

Our innovative products were also a key driver of our success in the period. Our home equity loan product continued to resonate with clients, as we saw volume more than triple in the fourth quarter compared to the first quarter. This product offers a solution for clients who may want to tap into their home's equity without impacting the lower rate on their first lien mortgage. It also provides us with a great opportunity for a refinance transaction, because when rates move lower, we will have the opportunity to consolidate the client's first and second lien mortgages.

Home equity loans, ONE+ and BUY+ are unique products that have resonated strongly with both existing and new clients. Notably, the vast majority of our clients who came to us through these products were new clients, who did not already have a loan with us. These innovative solutions helped us attract new clients into the Rocket ecosystem, where they can experience our award-winning service for the first time and many times thereafter, throughout their lives as homeowners.

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From a capital perspective, Rocket's strong balance sheet and substantial liquidity continued to serve as a major competitive advantage. Our financial strength provides us with flexibility and optionality that most of our competitors simply do not have. We ended the fourth quarter with $3.6 billion of available cash and $6.4 billion of mortgage servicing rights. Together, these assets represent a total of approximately $10 billion of value on our balance sheet.

Our $3.6 billion of available cash consists of $1.1 billion of cash on the balance sheet and an additional $2.5 billion of corporate cash used to self-fund loan originations. Total liquidity stood at approximately $9 billion as of December 31, including available cash, plus undrawn lines of credit, plus our undrawn MSR lines.

Our servicing portfolio is a key strategic asset and one where we have delivered award-winning service to our clients. J.D. Power has recognized Rocket Mortgage as being the best servicer in 9 of the last 10 years. We've notched these repeated wins by delivering amazing service. We meet our clients where they are, augmenting the human touch with technology to provide confidence and peace of mind.

As Varun mentioned, AI is driving impact across our organization, including servicing, where we are enabling better client experiences through AI-powered interactions and insights. As of December 31, our mortgage servicing portfolio included nearly 2.5 million loans with $509 billion in unpaid principal balance. Our net client retention rate in the fourth quarter was 97%, which continues to be multiples higher than the industry average. Retention rate serves as a key metric engaging client satisfaction and is one of the primary indicators of client lifetime value.

We also drive significant recurring revenue from mortgage servicing. During the fourth quarter, we generated $348 million of cash revenue from our servicing book, which represents approximately $1.4 billion on an annualized basis. Our industry-leading recapture rates resulting in significant client lifetime value allows us to be opportunistic with MSR acquisitions, and this will continue to be a focus of ours during 2024.

Turning to our outlook for the first quarter of 2024, we expect adjusted revenue to be in the range of $925 million to $1.075 billion, the midpoint of which would represent a 13% increase quarter-over-quarter. This sequential improvement demonstrates notable strength, as the industry's typical seasonality calls for a double-digit decline in origination volume from the fourth quarter to the first quarter.

On a like-for-like basis, the midpoint of our Q1 outlook implies year-over-year growth of 13.4%, building on the trend of year-over-year revenue growth we've achieved in each of the past two quarters.

Regarding operating expenses, we expect Q1 to be slightly lower compared to the same period last year, due to savings realized from our operational efficiency efforts implemented in 2023. These savings will be partially offset by reinvestments in performance marketing, leveraged by Rocket Mortgage and a seasonal Rocket Money campaign.

As always, our forward-looking guidance is based on our current outlook and visibility. We are entering 2024 with momentum, and we are poised for growth. We are optimistic about market conditions improving from 2023. Industry forecasters expect the size of the mortgage origination market to grow by north of 30% in 2024. But regardless of what the market does, we expect to continue growing market share through our AI-fueled homeownership strategy and by driving scalable revenue growth and profitability.

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As I mentioned earlier, I have never been more excited about Rocket's future and what we can accomplish. The opportunity is tremendous, and we are poised to continue taking share, and be the leader in the homeownership category.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Kevin Barker from Piper Sandler. Your line is open.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Great. Thanks for taking my questions. I just wanted to follow up on the outlook. It seems like you're implying that you're going to take market share in the first quarter. Do you assume that that's going to continue throughout 2024 and accelerate revenue growth in 2024 above the 30% growth that's implied from industry originations? And what I mean by that is, are you taking market share and then subsequently, the revenue growth will come with it? Thanks.

Operator: Please stand by. We are experiencing some technical difficulties, one moment.

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Okay. Can you guys hear me okay?

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Yeah. I hear you.

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Okay. Sorry about that, Kevin. Let me just repeat. Thank you for your question. We ended 2023 strong. We're entering 2024 with momentum, and that's reflected in both our results and our guide. And we look at many factors when we think about the outlook for the year. We look at the forecast. We look at the CPI. We look at the 10-year treasury. We look at the Fed forward curve. We look at our own data. And most of the industry, we predict a 33% larger market, $2 trillion versus $1.5 trillion. We expect rates to drop in the second half of the year. And these are all tailwinds for Rocket. And so we're investing in growth, and we're playing to win.

At the same time, when you think about the market share itself, the second part of your question, there are still multiple tailwinds as well. You have a lot of market consolidation with M&As and exits and bankruptcies. You have banks that are ceding market share and leaning back. You have Basel III, which is on the horizon. You also have industry capacity coming out. So when you put all these things together, I mean, we do expect to accelerate growth. It's a bit of a survival of the fittest dynamic with winners taking most. We grew share double-digits in both

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purchase and refi, and we feel very good about our position in terms of our assets and our endurance, so we're confident on building on those gains.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Okay. And then just to follow up on some of your comments around AI. Obviously, you're embracing this wave that's happening within fintech and AI in general. Could you just maybe give us a little bit more depth or a little more color around why the AI that you've developed or how far you've developed it, that is better than some of the biggest industry competitors, given we've seen several other companies also look to embrace AI. Maybe not at the scale, but maybe you can delve into why Rocket is different or at least well ahead of the rest of the industry? Thanks.

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah, absolutely. Look, I'd start by just saying that that we believe that AI is going to be absolutely transformative to this industry and to fintech and tech in general. And we've made quite a bit of progress, but we're just still scratching the surface. And we're in the earliest of innings, but our progress is only going to accelerate with generative AI. It's a major area of investment across the board.

The biggest thing that I would say is AI is something that you have to have a right to win and the right to win means you have to have the assets, you have to have capabilities, you have to have data, you have to have these ingredients to create the right recipe. So because of those ingredients that we have at scale, it's why we expect to be a benefactor.

And I shared a couple of examples earlier on this call, three in particular, but you're going to expect – you can expect to see us continue to show you more and more and more examples of how we're going to be differentiated, whether it's the 50 million call logs that we process every year, the thousands of attributes that we have on clients, how we use chat, how we use transcription, the 3.1 million clients that we engage with in servicing, document automation, appraisal review, hiring.

So kind of across the board, we think we have a durable advantage, because we have many of the ingredients that it takes to build one of the AI companies of the future. And so those are just some examples, and you can expect to see many more as we continue to make progress on this journey, but it is a major strategic imperative, and we're investing across the board.

Kevin J. Barker
Analyst, Piper Sandler & Co.

Q

Thank you, Varun.

Operator: Your next question comes from the line of James Faucette from Morgan Stanley. Your line is open.

Jeffrey Adelson
Analyst, Morgan Stanley & Co. LLC

Q

Yes. Hi, this is Jeff Adelson on for James. Thanks for taking our questions. I guess maybe I wanted to ask about some of the more recent focus from regulators on the non-bank oversight world. Yellen's making some comments about better oversight of non-bank mortgage lenders in the future and FSOC put out this framework for monitoring risk for non-banks. I'm just curious if you could share your thoughts on how you're thinking about this.

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Have you been interacting with the regulators on this front yet? And maybe what could we be expecting to come here over the next year or two on this front?

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

A

Yes, Jeff, I'll take that one. Thanks for the question. Listen, I'll start by saying, of course, we're aware of the comments, and we're staying close. But I'll also add, it's never a good idea to speculate too much on these matters. We have a really active presence in D.C., and we're watching it closely.

But I guess if you think about it, from our perspective, we have an extremely strong balance sheet or a really strong capital profile and a ton of liquidity, I would say, one of the strongest in the industry, if not the strongest.

The way we look at it, we actually stand up pretty well to even some of the banking capital requirements. So it's something we'll pay close attention to. But in a lot of cases, new regulation like this could actually increase our competitive advantage and sometimes even increase the moat around this business.

Jeffrey Adelson
Analyst, Morgan Stanley & Co. LLC

Q

Understood. And just to maybe circle back on some of the comments around AI, generative AI. Lots of examples here, it sounds like initiatives you're kind of rolling through here. But do you have any early views at this point to maybe what kind of uplift to financial metrics look like as a result of these initiatives, whether it be profitability, EBITDA margin, EPS growth?

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. Thank you for sharing. I mean look, I think fundamentally, the simple answer is we expect this to be a transformative implication across the board, whether it's helping us be more efficient and productive, driving top line growth as well as bottom line growth. But it's a very natural technology to fit with every aspect of the homeownership journey, everything from home search to lead generation, to underwriting, to servicing, appraisals.

And so the great thing about this is we feel like the sky is the limit. And so we have made it a strategic imperative to apply this at the top level at every aspect of the company. And so you can expect to see those gains be transformatively impacting every aspect of how we do business.

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

A

Yeah, Jeff, I would just say completely agree with what Varun said. And to be clear, going back to some of our prepared remarks, we did about $79 billion of mortgage production last year. And right now today, we believe that we could put through the system a significantly higher amount of mortgage volume.

And to Varun's point, we believe that will only accelerate in 2024 with some of our plans and future releases. But if you think about it, there's kind of a couple of key roles in the mortgage business. One is a licensed loan officer, another one is a licensed underwriter and the ultimate goal is to increase the productivity of those roles because if you increase the productivity, you increase the capacity, but you also increase the velocity.

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And if you increase the velocity, that means faster turn times and faster turn times mean better client experiences, because if you're refinancing on a rate and term refinance, you're saving money faster. If you're getting cash-out, you're getting your cash faster. If you're making a purchase offer, having faster turn times means in a very competitive market, it makes your offer stronger, because you can close faster.

And by the way, to the extent that you can get loans off your balance sheet faster, it lowers your financing costs. So we completely believe that these will translate into financial metrics and frankly speaking, they already have through some of the investments in 2023.

Jeffrey Adelson
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you for taking my questions.

Operator: Your next question comes from the line of Christian DeGrasse from Goldman Sachs. Your line is open.

Christian M. DeGrasse
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thank you. Gain on sale margin has hovered around the 2.7% levels for the past couple of quarters that's little off the lows, as you guys mentioned. So as you guys look at the competitive dynamics, the capacity coming out of mortgage, as you guys mentioned, and what could be a potential improving volume environment? How do you see margins trending from here over 2024?

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

A

Yeah, Christian, thanks for the question. So yeah, just to take a step back, I think it's important to look at what happened over 2023. To your point, there was sequential increase from Q1 to Q2 to Q3. And then as you saw here in the release, a slight dip in Q4, but that dip was completely planned because we see that in Q4. And it wasn't down as much as we typically see in Q4. And that's really important.

And then as we looked ahead into the guide in Q1, the big component of that is strong gain on sale margins. There's no doubt about it. And when I say strong, I mean building on even the high point of last year, the Q3 number of 276 basis points. So I think your question is what are we seeing and why is that happening? And one component of it is absolutely capacity coming out of the system and price competitiveness seeing a little bit of relief.

There's other components that go into gain on sale margins, too, like primary, secondary spreads but absolutely capacity is a big part of that. Varun mentioned in his prepared remarks, some of the more recent reports are 30% to 35% down. We're starting to see that come through the system now.

So look, we're not going to comment on exactly where we think gain on sale margins will be all of 2024, but I can say this is a great way to start the first quarter, being two-thirds of the way through, a great way to start the year with a lot of momentum around gain on sale margins

Christian M. DeGrasse
Analyst, Goldman Sachs & Co. LLC

Q

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Thank you. And I'd like to follow up on expenses. I understand the first quarter revenue guide just points to a nice uplift and looks to be pretty strong. It also looks like expenses are guided to be up a decent step higher quarter-over-quarter, down year-over-year. Can you maybe just help contextualize some of the moving pieces you guys mentioned a little bit further? How much of that's being driven by a pickup in volume, the seasonal marketing campaign you guys have talked about, some of these investments in AI and then maybe beyond that, strategically how you're thinking about expenses throughout the year beyond the first quarter?

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. I'll start and maybe ask Brian to chime in as well. I think the biggest thing I would share is that our primary focus is growth. And the reason for that is you have a $5 trillion home buying TAM. You have an incredibly fragmented market. You have no player with more than double-digit market share, and that's a great place for us to be disruptive and drive growth, especially with AI. So we're always looking for efficiency. We think we're in a good place. We're actually well-capitalized, as Brian shared, but we're trying to invest our dollars in innovation, and we're trying to figure out ways that we can actually achieve significantly more with the ingredients that we have.

So, part of that is where you see our increase in focus and prioritization, but we have a lot of share to take, and we want to invest our resources to win. And let me ask Brian if there's anything he would add.

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

A

Yeah. Thanks, Varun. Completely agree. And just even taking a step back on the expense front, 2023 was about doing the difficult, but necessary work to right-size the business, but it was also about narrowing our focus. We mentioned narrowing our priority list by roughly 80%. And if you think about what's left, it's really stuff about – that's a part of our core business and home ownership. And then to Varun's point, we did something we don't believe others did. We still continue to invest through the down part of the cycle. And that's important, because if you were going to start that now, it's much, much too late. And this is largely a big reason for some of this capacity gains that we've been talking about.

To answer your question more specifically, I'll talk a little bit – if you look at like Q1 of this year to Q1 of last year, there are a couple of things going on. Number one, Rocket Money had a really great first quarter of this year. That's their biggest customer acquisition month. They call it their Q5. They actually had a record quarter. So there was some performance marketing this year in Q1 that wasn't quite as substantial last year.

And then the other piece, and you've mentioned it is a difference in performance marketing. You mentioned the growth in the client acquisition. That's simply a math equation. We're going to spend that money when we like the returns. And starting off the first quarter with momentum, we're seeing some nice returns.

Christian M. DeGrasse
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Kyle Joseph from Jefferies. Your line is open.

Kyle Joseph
Analyst, Jefferies LLC

Q

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Hey, good afternoon and thanks for taking my question. Just wanted to dig into expenses and profitability a little bit more. I just want to get a sense for how big Rocket Money has become as a percentage of marketing. Obviously, there's some seasonality to that business. And then just as we think about, obviously, there's some variability in your expenses tied to your originations. But how much does the AI initiative really impact the fixed versus kind of floating rate nature of your expense as originations hopefully ramp up?

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. Thank you for the question, Kyle. I'll just start with Rocket Money. And Rocket Money, obviously, is a part of our personal finance division, and the team has done a fantastic job. I believe they've grown almost twice the volume since the acquisition. This is an area on a personal note that I'm very passionate about, given my background.

The business has over 5 million members. They've saved our clients over $1 billion in savings. And quite frankly, it's the best personal finance app there is. We've seen impressive top line growth. I believe in December, they were the number 1 app in the App Store in the finance category, and they're on track, as Brian said, for the best quarter ever.

And as we think about AI, the thing I would say, before handing it over to Brian, is this is really about supercharging everything we do around home ownership. It's about making sure that our team members can be, orders of magnitude, more productive which is what we need when we're trying to go after a massive market and go after share. And so, this is really about allowing us to do more with the same and to allow us to basically take share and grow in a market that's incredibly fragmented and there are multiple places in which we're investing in AI across the board at every level of the organization. And so, huge strategic imperative for us. And I'll ask Brian to comment on some of the more specifics.

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

A

Yeah, Kyle. I mean just to jump in a little bit on your fixed versus variable. I want to be clear because we think we're in a really good spot on expense reductions after the past two years in those tough efforts. We focused, of course, mostly on the fixed expenses and we feel really good about that. I mean this business is a beautiful thing, as volume and revenue is growing and operating leverage continues to expand. Again, we don't know exactly what'll happen in 2024, but to Varun's earlier comments, most of the industry forecasters are predicting about a 30% to 35% increase. So, if you slap something like that on the same fixed cost base, you really like the outcome.

The beauty of this business is once you cover those fixed costs, that next loan, a huge chunk of that drops to the bottom line. We still focus on, of course, the variable side and lowering that aspect of the business.

But from a fixed cost side, we feel good about where we're at. We'll continue to monitor and watch the market and respond to conditions as any good business leader would, but as we sit today with a strong Q1 guide and a decent forecast from the market of what 2024 could look like, we feel good.

Kyle Joseph
Analyst, Jefferies LLC

Q

Great. Thanks for taking my questions.

Operator: Your next question comes from the line of Don Fandetti from Wells Fargo. Your line is open.

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Donald Fandetti
Analyst, Wells Fargo Securities LLC

Q

Yes. I guess on the capacity coming down in the industry, are you – is the trend strong enough in your view that you can sort of get back to like the 300-plus basis point gain on sale margin ultimately? And is Q1, I guess, will we see progression through the year? Is that kind of your sense where it's not just like a kind of peak in Q1 on the margin?

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

A

Thanks, Don. Yeah. It's hard to say exactly what'll happen in terms of the rest of 2024, because obviously, there's a lot of factors like interest rates and things that go into that.

But what I can say is we're sitting here two-thirds of the way through the first quarter and we're building on the high point of last year, those Q3 gain on sale margins. So, it feels good. Like we had mentioned earlier, we do believe the primary reason for that is capacity coming out of the system. We saw that through 2023 really elevated in the second half of 2023. And now we're starting to actually see it flow through in terms of pricing competitiveness. So it's hard to say exactly what will happen.

But I'll tell you what, as we sit here in the first quarter, guiding up and we sit here looking at the overall mortgage forecast and it's both coming from volume increases and gain on sale margin increases, it feels pretty good to us.

Donald Fandetti
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Ryan McKeveny from Zelman & Associates. Your line is open.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Hey. Thank you. Exciting times even with this macro, so I want to ask on Rocket Homes, always a lot of buzz around the online search portals. There's some new competitors. There's always a lot of innovation.

Can you maybe talk to us about how you feel Rocket Homes is positioned within that online ecosystem? What's your view around the differentiation of your platform and ultimately, maybe tie it to some of the long-term vision, either specific to the Rocket Homes business or even the interplay with purchase market share overtime? Thank you.

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. Thank you for the question, Ryan. I'll start by just saying that, it's critical. And one of the reasons we have this amazing aspect of our company structure and organization is that, home search is the first part of the journey.

And it's no secret that hundreds of millions of consumers use home search apps, multiple times daily, because it's the starting point of the journey. And so that part of the experience is critical to drive a disruptive experience in purchase, which is why this is such an important part of our strategy.

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And I'm very proud of the Rocket Homes team, because they continue to innovate past the bleeding edge. Two examples I will give you is the recent release that they launched with CarPlay, which allows you to have a local driving experience as you're driving around looking for homes. It's a very natural experience that is cultivated around home search. It's a way to build intent. It's the way to use location services, AI and data to really create a personalized experience that meets clients where they are.

The second thing I would share is the team isn't stopping there. We just talked about a beta that we released with the new Apple Vision Pro that changes the game when it comes to things like spatial computing and being able to tour homes, publish listings and really using the next-generation of virtual and augmented reality.

And so home search is a big, big part of our strategy, because it's kind of the beginning point of the journey of the purchase experience and if we can build intent with clients and we can build readiness with a combination of assets like Rocket Homes, Rocket Money, leveraging technology, we can bring them into the home purchase journey in a way that's more personalized, that's more streamlined and ultimately drives speed, certainty and value. So, it's a big part of our strategy. It's a big part of the top of the funnel and the team has done a good job, and we're continuing to invest.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Thanks, Varun. That's helpful. Second question, on the marketing side of things. I guess, big picture, you guys have always innovated there. You've been very prominent as a brand in this industry. I guess, anything you can share with us on how things evolve with Jonathan as CMO, what changes in terms of the focus, what remains the same? Any thoughts there?

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

A

Yeah. I mean I would start by just saying that the best is yet to come. We've hired a pretty kick-ass new CMO, and we have big, big plans for our brand. The great thing about Rocket is it already is a household brand, but we're scratching the surface on what's possible. And so we're continuing to invest. I think we have big plans for the near future and buckle up and stay tuned is what I would say.

Ryan McKeveny
Analyst, Zelman & Associates

Q

Sounds great. Thank you.

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

Doug Harter
Analyst, UBS Securities LLC

Q

Thanks. In prior quarters or I think last quarter, you purchased MSR. Can you talk about how your appetite – what your appetite is today for using that as a potential customer acquisition channel?

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

A

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Hey Doug, it's Brian. Yeah. Thanks. I'll take a shot at that. Servicing continues to be an important asset. It's a strategic asset for us. We really like the returns, of course. You're looking at double-digit returns just when you look at the cash flows alone. But as you know, when you add in the recapture rates, that's where the returns get really exciting. And just for the record, we think about the servicing asset a bit differently than some others in the space. We think we're pretty good at collecting the cash flows efficiently and a lot of that drops to the bottom line.

But more importantly, is building that lifetime relationship with the client and capturing that next mortgage transaction because we know that next mortgage transaction is worth more than almost all the actual cash flows that you're collecting combined. So we have been active in the market. We have been actively bidding. In terms of supply, there is supply out there. I wouldn't call it great supply right now. The bids are fairly aggressive. You have players out there that have publicly stated that they need to grow the servicing portfolio. So of course, you see a lot of those players show up.

In terms of us, the stuff that's interesting for us is a couple-fold. One, we like the higher note rates out there, the on-the-run production because if rates or when rates were to drop, those clients getting the money pretty fast and we'd love to take care of them and save them some money on their monthly payment. But it's also just about onboarding new clients to our servicing experience, which is J.D. Power award-winning and letting them experience Rocket, experience in taking care of them. It's a lifetime value lens. It's not just a servicing lens.

Doug Harter
Analyst, UBS Securities LLC

Q

Great. And just to follow up on that last point. I mean, I guess, what are the steps that you can do to kind of increase your ability to kind of retain that customer versus if they might have more loyalties elsewhere versus the customer that kind of chose to come in with Rocket on the initial mortgage?

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

A

Yeah. Well, it starts with a great onboarding experience. Switching services can be a difficult and painful experience, if you've ever had that happen to you. So it starts with a great onboarding experience and it starts with a great servicing platform and a great product and making sure that you're building a relationship with the client and getting in front of them at the right time without getting in front of them too often.

So that – if you think about our wheelhouse in terms of performance marketing, sharing a great experience in our brand with clients, there's no better way of doing it than when we have an excuse, at least on a monthly basis, to interact with them and show off some of the products and features that we have built into the experience.

Doug Harter
Analyst, UBS Securities LLC

Q

Thank you.

Operator: And we have reached the end of our question-and-answer period. I will now turn the call back over to CEO, Varun Krishna, for some final closing remarks.

Varun Krishna
Chief Executive Officer & Director, Rocket Cos., Inc.

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Well, thank you, everyone, for joining our call, and we look forward to seeing you next quarter and just a special invite to come to our Investor Day. Stay tuned for details.

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

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