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Rocket Cos., Inc. (RKT)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. My name is Jay, and I will be your conference operator today. At this time, I would like to welcome everyone to the Rocket Companies, Inc. First Quarter 2024 Earnings 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]

I would now like to turn the conference over to Sharon Ng, Head of Investor Relations. You may begin.

Sharon Ng

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

Good afternoon, everyone, and thank you for joining us for Rocket Companies' earnings conference call covering the first quarter of 2024. With us this afternoon are Rocket Companies' CEO, Varun Krishna, and our CFO, Brian Brown. Earlier today, we issued our first 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 Varun, let me quickly go over our disclaimers. On today's call, we provide you with information regarding our first quarter performance as well as our financial outlook. This conference call includes forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from the expectations and the assumptions we mention today.

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

Thank you, Sharon. Good afternoon, everyone, and thank you for joining the Rocket Companies earnings call for the first quarter of 2024. This is my third earnings call since joining the company in September. As I reflect on the last eight months, I am filled with gratitude to be part of a company with a clear and noble mission of helping everyone home. Never has this mission been more important, more relevant than it is right now. I am so proud of what our team has achieved together in this short time and it's evident we're only at the beginning of our journey.

As an organization, we are driven to execute and win and our determination is absolute. We're playing both the short and the long game, gaining momentum and achieving success, while strategically planning and executing for the long-term, and this has already led to some impressive results for Rocket.

Let's start with our Q1 business results where our Rocket blasted off, as we entered the New Year. I'll start by sharing just a few of the highlights that I'm especially proud of from the first quarter. We reported \$0.04 of adjusted diluted EPS and delivered adjusted revenue of \$1.163 billion in the first quarter, once again, far exceeding the high end of our guidance range. In addition, we returned to double-digit adjusted EBITDA margin.

Alongside these solid results, we also continued to capture market share. In Q1, both purchase and refinance market share expanded, showing double-digit percentage growth on a year-over-year basis. Our analysis shows that we took that market share from large industry players and big banks, in particular. Market share growth while maintaining healthy gain on sale margins is our North Star metric and it's a yardstick that objectively measures our performance compared to the rest of the industry, independent of the inevitable ebbs and flows in the market.

While we cannot control market movements, we can direct our efforts to delivering world-class service for our clients and focus on growing our share. We are currently the number two player in purchase, excluding correspondent lending. And we won't stop there as we continue our upward march. With our strategy and capabilities, we believe we can and will continue to grow market share in both purchase and refinance, and drive consolidation in this fragmented winner-takes-all market.

I'd like to drill deeper into a few areas of our business that outperformed in Q1. Our home equity loan product has continued to expand significantly as we've seen volume grow more than 3.5 times from Q1 of 2023 to Q1 this year. Since our launch, just under two years ago, Rocket is now among the top players across the entire home equity loan market. This achievement underscores the strength of our capital markets infrastructure and our team's ability to introduce and quickly scale innovative products that resonate with our clients.

Home equity loans are particularly relevant in today's market, as they present a great option for clients looking to tap into their home equity, whether to fund remodeling projects, consolidate debt, or pay for a life event without affecting a favorable rate on their primary mortgage. Home equity loans close seven days faster than our traditional refinance transactions, and importantly, they provide us with a springboard to consolidate a client's first and second lien mortgages when interest rates decline in the future.

Servicing is a key part of our business that enables us to play offense and defense at the same time. We acquired four MSR portfolios in March and April at a weighted average coupon well above that of our existing book. Rocket's recapture rate of service loans is more than two times the industry average, which is why we see our servicing portfolio as such a strategic asset. It represents a future origination opportunity on nearly 2.5 million clients, without additional marketing costs, while paying a recurring cash flow until the next transaction. These are just a few examples of where strategic thinking and solid execution have driven tangible business results and outcomes.

Now, let's shift forward. I'd like to transition and talk about some of the trends and themes that we're seeing at the industry level. Despite recent market volatility, we are steadfast in our belief that there is tremendous opportunity ahead for Rocket. In fact, when we widen the aperture, we believe Rocket is well positioned to capitalize on the current trends shaping the industry over the long run.

Let me take just a minute to unpack three market-changing dynamics that create a perfect storm for Rocket to ride, execute and win. First, let's dive into industry capacity. Undoubtedly, the most challenging market conditions in four decades have catalyzed industry consolidation and capacity rationalization over the past couple of years. Mortgage employment has declined by 36% from its peak in April 2021, resulting in nearly 150,000 loan officers and mortgage brokers exiting the industry. The months to come are expected to put further pressure on smaller players already struggling with capacity and liquidity.

Secondly, if we look at banks, we can clearly see there has been a secular trend of banks feeding mortgage origination market share since the global financial crisis. In fact, their share has declined by nearly half from roughly 75% in 2008 to approximately 40% according to the most recently available data. Even still, banks hold top positions and comprise six of the top 20 spots in the industry rankings.

In recent years, banks have faced profitability challenges with their mortgage operations made more apparent against the backdrop of difficult market conditions. Looking ahead, Basel III capital requirements which place a higher risk weighting on mortgage capital are likely to further deter banks from expanding their home lending operations. In fact, we believe many banks are reevaluating their mortgage lending operations altogether.

Lastly, the landmark National Association of REALTORS settlement has the potential to upend the home buying and selling realtor commission model that has remained unchanged for nearly 100 years. The traditional home buying and selling experience is fragmented, inefficient, costly and ripe for disruption. This settlement has the opportunity to change the home value equation and to pave the way for a better experience for both buyers and sellers of homes.

Rocket's strategy capitalizes on these three seismic shifts. We have a fortress balance sheet that gives us the flexibility to not only survive, but to thrive through the inevitable ups and downs of the market. While others are buying for survival, we are strategically investing in top-tier talent, cutting-edge technology and the enhancement of our brand to build a durable and growing business for the long term.

Our comprehensive suite of integrated end-to-end services squarely addresses every aspect of the home buying opportunity from every side of the equation. We are poised to lead and revolutionize how homes are bought, sold and financed.

As I shared earlier, at Rocket, our mission is to help everyone home. This is our grand challenge. We stand for every aspect of the homeownership journey from buying, selling and listing homes to purchase, refinance and

servicing. That is what help everyone home mean. We aim to transform the homeownership experience end to end, and our market opportunity is the entirety of the homeownership category.

The foundation that underpins this mission is a strategy that we call AI-fueled homeownership. That means we are committed to delivering industry-leading experiences powered by AI benefiting our clients, mortgage brokers, real estate agents, financial institution partners and our team members alike. In a short amount of time, Rocket has already positioned itself as the industry leader in AI, continually pioneering client experiences that are unmatched by others.

Let me just share a handful of recent examples of how our innovation is accelerating. Our Rocket Homes team recently launched Explore Spaces visual search, the first of its kind in the industry. This innovation enables users to discover their next dream home by displaying photos based on features that are important to them such as kitchens with marble countertops or backyards with lush lawns. This is made possible by leveraging computer vision AI for image recognition and processing. This technology enables listing images to be quickly identified and text descriptions to be automatically generated, removing the need for manually tagging or writing content from scratch.

And since launch, we've seen some very compelling early stats. Users who engage with the Explore Spaces experience spend almost twice as long on the site per visit, and they returned 6 times more often. As part of the Explore Spaces experience, Rocket Homes also launched auditory search, which makes home search inclusive and accessible for the nearly 10% of the US population that experiences visual impairment. AI automatically generates detailed captions for each photo that can actually be read aloud through AI-powered voice transcription.

Continuing our incredible pace of innovation, just last week, we launched a new pilot that uses voice-based generative AI to allow clients to update their verified approval letter simply by using their voice. Typically, when a client needs to modify their approval letter to make an offer on a house, a need that has only increased in today's dynamic and competitive home buying environment, they have to call their mortgage banker who then makes modifications. Our bankers and underwriters handle those adjustment requests nearly 300,000 times a year. This is an incredibly manual process, which can take hours or days and not only takes our bankers away from prospecting for new business, but it is prone to errors and delays.

In an industry first, our clients can use natural language to easily make modifications over the phone in just minutes. And the realtors are kept up to date through automated notifications 24 hours a day, seven days a week. This new feature is great for clients because the speed gives them an extra edge to make winning offers in their dream home. Every second counts in a competitive market. It's great for realtors to be kept in the loop and great for our bankers who can use time previously spent on this administrative task to work with more clients.

This is just one of many industry-first client-facing features in our pipeline that leverage AI to deliver great experiences, no matter the modality, whether through chat, phone, our website or our mobile app. There are many use cases for AI, but the most significant and immediately impactful application at our company is supercharging our team members. AI eliminates the drudgery of burdensome, time-consuming manual tasks so that our team members can spend more time on making human connections and producing higher value work. Ultimately, with AI, we are driving operational efficiency, speed, accuracy and personalization at massive scale.

Rocket Logic, our proprietary patented AI technology platform and where the majority of our engineering resources are directed, powers both our client-facing interactions and back-end processing. Rocket Logic continues to add new capabilities and expand full automation of mundane tasks, bringing up team member

capacity to serve many more clients and drive growth. Rocket Logic utilizes collaborative intelligence to help our team members complete work more seamlessly.

Here are just a few recent additions to our Rocket Logic platform. Rocket Logic Assistant, which seamlessly and accurately follows the conversation with a client in real-time, populates hundreds of crucial application fields hands-free. We believe we have the best mortgage bankers in the business, and now we're providing them with the tools to be even more productive. As a result, they're able to devote their time and full attention to where it matters most, our clients.

Rocket Logic Docs, our intelligent document processing platform automates document upload, classification, loan association and field extraction, enabling fast and accurate processing at scale like never before. Rocket Logic Docs automatically identifies nearly 70% of the more than 1.5 million documents we receive monthly, resulting in a savings of more than 5,000 hours of manual work for our underwriters in February 2024 alone.

Of the 4.3 million data points extracted from documents, including W-2s and bank statements in February, nearly 90% were automatically processed, saving an additional 4,000 hours of manual work for our team members. And we're continuously building upon and adding new capabilities to Rocket Logic. Just last month, we announced Rocket Logic – Synopsis, a new feature used by our client-facing team members across mortgage banking, EPO, mortgage operations and servicing.

Each year, our teams participate in 65 million calls with our clients, and Synopsis works behind the scenes, transcribing and tagging client interactions, logging client preferences for communication method, time to be contacted, all purpose, sentiments and more. The key to AI is continuous training of models with recursive feedback loops and data. We are organizing this invaluable data to construct unified client profiles in a centralized repository.

From this repository, we train models to gain deeper insights and analytics to personalize all future interactions with our clients. The ultimate objective is to deliver industry-best client experience that translates into better conversion rates and higher client lifetime value and to just get continuously better and better at it.

Rocket Logic's automation has already reduced the number of times a team member interacts with a loan by nearly 25% year-over-year. This, in turn, has shaved several days off the time it takes Rocket's clients to close on a home purchase, reducing turn times by 25% from August 2022 to February 2024. These efficiencies are key in helping Rocket close loans nearly 2.5 times faster than the industry average.

Great companies succeed with exceptional execution. At Rocket, we are driving better and faster execution across the board, and it's only going to continue and get even better from here. We are excited to share more examples of how AI is being deployed and the value it brings to our core businesses. We've recently solidified our roadmap and established objectives and key results to support our AI-driven homeownership strategy, and prioritized key strategic objectives.

Consequently, we're operating with a heightened sense of focus and accountability. Through this process, we've also streamlined how we interact internally and significantly reduced the number of meetings we conduct, while sharpening the focus of those that we do have. As a result, I'm excited that our engineers are spending less time in meetings and roughly 30% more time coding and creating great experiences for our clients.

In fact, just last month, I attended our HackWeek event, and I was just blown away. It was an amazing experience that highlighted our incredibly talented technology team members working rapidly to build that next game-

changing innovation. From this HackWeek, dozens of the best ideas have gone from ideation to production in a matter of weeks.

In closing, we are laser-focused on our mission to help everyone home, and we are executing with velocity. We believe we're in the perfect position to take advantage of the opportunities presented by multiple once-in-a-generation tailwind and we are poised to transform the home buying category, building upon our established refinance and servicing business and also continuing to grow and take share in purchase. All of this is underpinned by AI, which enables us to accelerate our pace of execution and grow our market share, revenue and profitability at scale.

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

Brian Nicholas 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 first quarter of 2024, including achieving another quarter of profitable market share growth. I'll share some insights on the tangible value we are seeing from leveraging AI to drive efficiency, velocity and accuracy across our business, and I'll close with our perspectives on the current market environment and outlook for the second quarter.

But before I get started, on a personal note, I'm approaching my 10-year anniversary with Rocket, and I have never been more excited about the course we are charting ahead. As Varun mentioned, we have the strategy and resources necessary to capitalize on a once-in-a-generation tailwind in this huge fragmented home buying space. We are executing with speed, and we are incredibly well positioned to be the leader in home ownership.

Over the past few months, we have realigned the entire company around our strategy of AI-fueled home ownership. The energy and engagement from our team members have been electric. And I'm confident we are going to accomplish great things together as we execute on our mission to help everyone home.

Turning to the first quarter, we once again achieved strong results. We gained market share, accelerated revenue growth and achieved our highest profitability in two years. We delivered these results against a backdrop of higher for longer interest rates in a mortgage market that remains well below historical levels. Our exceptional performance is a testament to the hard work and focused execution of our team members.

Diving further into Q1 results, we generated \$22.4 billion in net rate lock volume and \$20.2 billion in closed loan volume. Once again, we have made significant strides in both refinance and purchase market share, delivering meaningful growth on both fronts during the period. Our differentiated solutions like our home equity loan product, attracting new refinance clients who want to access the equity in their home while preserving an already low rate on their existing mortgage.

And then from a purchase perspective, Rocket's integrated end-to-end ecosystem across real estate and mortgage makes for unbeatable offerings like our BUY+ program, which is directly geared towards addressing the historic affordability challenges that today's buyers face. Like home equity loans, the majority of BUY+ clients are new to Rocket, and helped drive our purchase market share gains over the past year, while continuing to organically grow our servicing portfolio.

Looking at industry forecasts and other more real-time data sources, the total industry volume was roughly flat on a year-over-year basis in the first quarter. By comparison, our first quarter loan volume was up 19% on a year-over-year basis.

Turning to revenue, we generated adjusted revenue of \$1.163 billion in the first quarter, well above the high end of our guidance range. This represents a 32% increase from the first quarter of 2023 and marks the third consecutive quarter of accelerating growth year-over-year.

Gain on sale margin for the first quarter was 311 basis points, which compares favorably to the 268 basis points in Q4 and 239 basis points in the first quarter of 2023. This upward trend in gain on sale margins over the past year has been driven in part by capacity continuing to come out of the system. I'll elaborate further on gain on sale margins in a moment.

In addition to posting strong top line growth, we also meaningfully increased profitability. Adjusted EBITDA was \$174 million, an improvement of more than \$250 million from the first quarter of last year. Adjusted diluted EPS came in at \$0.04 per share in the first quarter.

While we are pleased to return to double-digit adjusted EBITDA margin in the first quarter, this is only a glimmer of Rocket's true earnings potential. The past few years have been a tale of peaks and valleys in the market, and we have done the difficult but necessary work to right-size the company and respond to market realities. More importantly, though, with our robust financial profile, we have continued to invest heavily in crucial areas such as talent and technology to seize the future market opportunities.

Now, let's take a look at our operating expenses. Total expenses in the first quarter were \$1.085 billion, roughly flat year-over-year, which is particularly notable when compared to the 32% increase in adjusted revenue over the same period. Thanks to the operational efficiency measures we implemented last year, we realized full quarter cost savings in Q1, which we then chose to direct towards ROI-driven performance marketing spend to drive the additional production. We also incurred higher variable costs related to higher volumes, which included industry-wide credit cost increases.

Earlier, you heard Varun talk about how AI is powering great client experiences and unlocking team member productivity. I'd like to share even more perspective on how AI is bringing tangible business value through enhanced operational efficiency, velocity and accuracy at scale. The most apparent and significant value add that I've seen is augmenting team member capacity through operational efficiency. With AI, we are unlocking significant productivity by supercharging our team members in the most critical functions.

Take our team member intensive areas such as mortgage banking, operations and servicing, which make up the majority of our total team members. Every day, team members in these areas are using AI tools to handle routine tasks, such as Rocket Logic – Synopsis to transcribe calls, Rocket Logic Assistant to populate mortgage applications and Rocket Logic Docs to classify documents and extract data fields. With AI handling this work, our team members have more time to provide tailored advice and engage in higher value conversations with our clients.

Rocket Logic is reducing manual tasks by nearly 25% year-over-year directly translating into tangible operational efficiencies. With AI, we are also serving our clients with greater velocity. Rocket Logic's automation has shaved days off of our purchase turn times, improving closing time by 25% from August 2022 to February 2024.

Turn times are an important factor, first and foremost, because the more quickly we can close a loan, the better experience we can offer clients, especially in a competitive home buying market. AI is also helping us reduce risk and strengthen compliance by driving never before seen accuracy.

For example, income verification is a critical step in the underwriting process. And income verification issues are among the top reasons behind GSE repurchase requests. AI is helping to drive significantly higher accuracy rates, which has the potential to reduce financial losses on previously originated loans repurchased from the GSEs.

Turning to our balance sheet, Rocket's strong financial position continues to be a strategic advantage. Amidst the shifting industry landscape, our financial position increasingly serves as a competitive moat, affording us the flexibility to be opportunistic when others may be fighting just to stay alive. Our financial profile allows us to continue investing in top talent as well as technology and AI capabilities to build a durable business to position our organization for growth.

Looking ahead, our robust liquidity will be an even greater advantage as new capital requirements begin to take effect in the industry. With respect to the FHFA liquidity 2.0 requirements that went into effect in late 2023 and Ginnie Mae's new risk-based capital standard, that to take effect later this year, Rocket is well in excess of both of the capital and liquidity levels. This is a regulatory requirement that many of our competitors are actively having to manage rather than being able to invest in technology and programs that will deliver long-term growth.

We ended the first quarter with \$3.5 billion of available cash and \$6.7 billion of mortgage servicing rights. Together, these assets represent a total of approximately \$10.2 billion of value on our balance sheet. Our \$3.5 billion of available cash consists of \$900 million of cash on the balance sheet and an additional \$2.6 billion of corporate cash used to self-fund loan originations. Total liquidity stood at approximately \$8.9 billion as of March 31, including available cash, undrawn lines of credit and our undrawn MSR lines.

As of March 31, our mortgage servicing portfolio included nearly 2.5 million loans with \$511 billion of unpaid principal balance. Our net client retention rate in the first quarter was 96%, which continues to be multiples higher than the industry average. Retention rate serves as a key metric engaging client satisfaction and is the primary indicator of client lifetime value.

We also drive significant recurring revenue from mortgage servicing. During the first quarter, we generated \$346 million of cash revenue from our servicing book, which represents approximately \$1.4 billion on an annualized basis.

Servicing is a strategic area of growth and we see strong synergy between our servicing portfolio and our origination business. With our industry-leading recapture rate, we take a different approach to servicing than others viewing it through the lens of client lifetime value.

In March and April, we acquired over \$8 billion of unpaid principal balance with a blended weighted average note rate above that of our current portfolio. These higher note rate MSRs enable us to capitalize on our industry-leading recapture rates and set us up for future refinance opportunities.

Turning to our outlook for the second quarter, our guidance on today's call is based on trends we've observed quarter-to-date and one month of actual performance. April is typically the lowest month of the quarter from a volume perspective and market conditions in April were challenging. The 10-year treasury yield has increased roughly 70 basis points since the start of the year in response to persistent inflation and strong macroeconomic data.

Despite some gradual improvements, home inventory levels remain well below their historical average, while higher mortgage rates further compound affordability challenges. The traditional spring purchase season is off to

a slow start. Across the industry, 2024 has turned in the worst March and April for purchase applications in the last 30 years. Despite the challenging rate and inventory environment, our Q2 guidance reflects our expectation of higher volume and positions us to take share again in the second quarter.

It's worth noting that our strong gain on sale margins in Q1 benefited from two market-driven factors that may not reoccur. One factor was a lower interest rate environment when compared to Q2. Another factor was our extremely strong execution in the securitization markets for our home equity loan product. Therefore, our expectation is that the second quarter gain on sale margins will return to levels closer to those observed in the second half of last year.

In Q2, we expect adjusted revenue to be in the range of \$1.075 billion to \$1.225 billion. In summary, we are confident that we will drive top line growth, take share and our guidance reflects exactly this. Regarding operating expenses, we expect the second quarter to be roughly flat on a year-over-year basis, as the savings from last year's operational efficiency initiatives are expected to be mostly offset by increased variable costs related to higher volumes, which includes the industry-wide credit cost increases.

As always, our forward-looking guidance is based on our current outlook and visibility. What should come across clearly from our remarks today is our conviction to grow purchase and transform the massive, fragmented homeownership category. Through our strategy and with our capabilities, we believe we are well positioned to navigate and thrive regardless of market conditions. With AI, we are unlocking capacity and enhancing operational efficiency, velocity and accuracy. We are just getting started, and we're fired up to execute on our mission to help everyone home.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from the line of Ryan Nash of Goldman Sachs. Your line is open.

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

Q

Hey. Good evening, guys.

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

A

Hey Ryan. How you doing?

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

Q

Good. How are you? So I wanted to dig a little bit further into the outlook across a handful of areas, originations, revenues and profitability. Maybe to just sort of dig into each of them, Brian, you gave a little bit of color on 2Q saying continued market share gains, revenues, obviously, we had the guide, and this is the first quarter I think we had net income profitability. So can you maybe just talk about how you think all of these things together will evolve into the outlook for 2024, given you guys are obviously talking about growing originations? The industry

might end up being relatively steady. How do you see all these things working together and now we're back to a sustained level of profitability?

Varun Krishna

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

A

Yeah. Ryan, thank you for the question. I'll start, and then I'll ask Brian to jump in if there's anything that you would add. And I think the first thing I would just say is it's a tough market out there. You've got rates that are kind of moving a little bit in the wrong direction. You've got MBA data that's showing that mortgage applications are lower than expected.

But when you step back from that, we firmly believe that the dynamics of the market are going to be favorable to Rocket. And that's regardless of the size of the market, whether it's a \$1.5 trillion TAM or a \$2 trillion TAM. And I want to just highlight a few indicators that reinforce my confidence in this.

I think the first one is just our focus and track record. When you look at the TAM, regardless of what it is, and you sort of throw in real estate and financial services, that's a \$5 trillion TAM. And we have proven that we have the ability to take share in any market purely as a function of our execution and persistence.

The second thing I'd highlight is just you've got so many tailwinds that are going to be benefiting Rocket that may be headwinds for industry, whether that's the rate environment that's putting pressure on smaller players, whether it's the capacity that's coming out of the industry, whether it's things like Basel III, disruptive dynamics like the recent NAR ruling that are going to create new opportunities to redefine the experience. These are all things that are tailwinds for Rocket that may be headwinds for the broader industry.

And then the third thing I highlight is just, again, strategy and execution. We have assets that uniquely span the entirety of the homeownership journey. Purchase, refinance, servicing, personal finance, we're making significant investments in technology and talent. We've narrowed our focus. And so the bottom line is fortune really favors those who are built for storms, and there's tremendous share that's up for grabs, and that reflects our sort of tenacity in going after the market and playing to win and grow our share.

Brian, is there anything you would add?

Brian Nicholas Brown

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

A

Yeah. The only thing just to build on that, Ryan, when we look – sit here today and we look at some of the industry forecasts, a few of them are triangulating around about \$1.8 trillion, that feels high from what we've seen, to Varun's point, in terms of the rate moves. But regardless of that, we've shown, because the first quarter was also a challenged market, that we can drive significant profitability through our system and take share.

So to Varun's point, it's a really good case study into us doing – executing on our strategies. And it's worth noting, too, that if rates are to stay higher for longer and let's say it's not a \$1.8 trillion market, it's something less than that, there's a view you can get to pretty easily that that actually benefits us even more given our capitalization levels, given our liquidity and some of the investments we've made over the past few years in terms of technology to increase capacity. We think that actually bodes really well for us.

Ryan M. Nash

Analyst, Goldman Sachs & Co. LLC

Q

Got it. If I can ask a follow-up sort of two-part question on margins and market share. So first, maybe just thinking about market share, Varun, you outlined capacity rationalization, banks being secular, share shutters and then you talked about the national retailer settlement. Do you think these things in and of itself are enough to drive accelerating share growth for Rocket and how do you think about it over an intermediate timeframe?

And I guess related to that, Brian, you talked about a couple of idiosyncratic factors that elevated the margin in the near term. But if I look today, margins are still below 2018, 2019 levels. And given these favorable dynamics, do you still see the opportunity for margins over an intermediate timeframe to expand back to historical levels? Thank you.

Varun Krishna

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

A

Yeah. Thank you. I mean I'll just cover a little bit on share and the NAR settlement. I think the first thing I would just say is there are three strategic levers that really come together in a durable way to enable our growth in share now and in the future. The first one is just innovation. We're betting big on AI experiences. We've simplified our funnel. We've got better personalization, more automation.

The second thing is just our internal focus. We've streamlined our execution. We've got more dedicated autonomous teams with clear goals. So we've just improved our process. The third thing is just our top of funnel. We're meeting clients where they are. We've improved performance marketing. We've got better optimizations to improve our creative, our lead flow. We've got better engagement with our servicing portfolio. We've got better search and engagement experiences to nurture relationships with Rocket Homes and Rocket Money. So the bottom line is, I mean, what you see is in our results, and you see it in the market dynamics. So we definitely see that as an accelerator. So to your question, my answer is yes.

And I think for the NAR settlement, the only thing I would just say is just it's been too long where the cost of buying and selling a home is too high. And it's been too long that the transparency of the process has been opaque. And transparency and value is just what we believe and it's what we've always believed in. And there are some folks in the industry that are going to fight this tooth and nail. There's others that are going to look past it and seize the opportunity. And we definitely choose to be the latter, see the bigger picture, be on the consumer side and just leverage this to take cost out of the equation, introduce efficiency into the equation and just create more value. So we've been experimenting this space already with things like BUY+ and we're only going to continue to do so.

Brian Nicholas Brown

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

A

Ryan, I can double click on your guide question, but we've shared this before. But, of course, we take into account all the information we have really leading up to the call right here. It's worth pointing out that it's a 15% year-over-year improvement on adjusted revenue, if you take the midpoint of the range. I won't belabor the rate comments, but clearly, April has seen a different rate environment than what we saw in the first quarter.

As it relates to inventory, we are seeing modest improvement. We are seeing a little bit of an uptick in listings, but in our view, that's largely offset by some of these affordability challenges. But we want to be clear that the guide does assume volume is up in the second quarter from the first quarter, and we believe that that's really from us continuing to take share. Our purchase pipeline remains very strong. Consumer demand for home buying is also very high. It's just the affordability aspect that we have to get over.

And then to your point on gain on sale margins, we've said before that we generally expect gain on sale margins to continue to expand from last year's levels. And that is definitely proving out. There's no question about it. The 311 basis point print in Q1 is obviously extremely healthy. But that did exceed even our expectations. And that was really for two reasons, both which are positive.

But the first is the closed-end second product. The consumer demand for those closed-end seconds is very high. But what we also found in the first quarter is the investment, the private space demand to buy the product, given people that are chasing yields right now is also extremely high. So we just had better than expected secondary execution. All the secondary execution has been good, but this was especially rich.

So, to your point, that's just something I wouldn't – I can't count on for future quarters, though, I do expect the demand for the product to be rich. And then the first quarter just had a – even though rates were rising, the rate of change was a little bit less so than what we saw in April. So the first quarter had a little bit better interest rate environment. So – but nothing has changed in our view on gain on sale margins. We still – we do believe there's expansion that's happening, and that's largely because of capacity coming out.

Operator: Your next question comes from the line of Jeff Adelson of Morgan Stanley. Your line is open.

Jeffrey Adelson

Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good evening, guys. So just maybe digging to the outlook a little bit for the second quarter, is there any chance to the degree of conservatism built into the number? I mean this quarter, you beat a little bit on the outlook here and if Fannie is still out there with the 40% sequential increase, I know you're kind of commenting that you think the \$1.8 trillion is a little bit unrealistic at this point. I mean, I guess I'm just wondering, is there some opportunity for upside to that number? And then just in terms of the share gain, last year, you commented on, I think, the 14% and 10% increase in the gain, double-digit this quarter. Are you seeing share gain accelerate as you kind of go into this quarter and the rest of the year or just how do you see that evolving?

Brian Nicholas Brown

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

A

Yeah. Let me start with the outlook and just to touch on the market view again, we're not trying to pin down a number, but the problem with those \$1.8 trillion numbers is they're outdated, right? Even the published dates, if you look at where rates were when they published and you look at the forward curve, we were just in a different spot. So the other interesting thing about the \$1.8 trillion is you kind of, three or four of them get there, but they all get there in different ways.

To your point, Fannie has a big step-up, but MBA step-up is actually much less so, I think, only like 16%. But the things that we're seeing in terms of real-time data, both macro and micro would tell us that that's probably not as likely, though, we do still think it will be a healthy market. So the only way I could answer your question is we take all that into account.

This quarter is always the quarter that will tell the story of home buying as we enter this home buying season. But the data that Varun highlighted that we saw in April does give us a bit of pause, but we're still very bullish on being able to grow our volume in the second quarter, largely through taking share, which leads me to your next point.

Yeah, we are seeing an acceleration of share gains. Varun mentioned this in his prepared remarks, but the banks continue to cede share for all practical purposes, most retail or other type of online lenders are

really not doing anything in the client acquisition space. If clients are inbound to them, they'll do loans, but they're not out there marketing or spending marketing dollars. And so that bodes really well for our ability to accelerate share gains.

Jeffrey Adelson

Analyst, Morgan Stanley & Co. LLC

Q

And you guys have done a pretty good job with the home equity loan offering, it sounds like. Just wondering if you had any early thoughts on Freddie's proposed program out there in the agency side for the second lien. Do you guys view this as a growth opportunity now that you could maybe do a little bit more of that business? Do you have any view of maybe how their program price is? How should we maybe be thinking of the trade-off of maybe less cash-out refi, note averages are really high right now, so maybe there's not as much of that, but how do we think of the trade-off of that versus moving some volume to doing more of this agency second lien program?

Brian Nicholas Brown

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

A

Yeah. Let me start, and I'm sure Varun will add, too. But I think on the proposal side, we'll see where that ends up. Generally, more liquidity is better in the mortgage space. So, of course, we do support more liquidity. But I would say sort of different than others in the space, we kind of created this market. If you look at securitization data and you look at what we've done, we sort of made the closed-end second market, at least for this go through.

So we're finding the liquidity already. As I mentioned, that was a big component of the gain on sale margins over-performance, I guess, you could say, in the first quarter. So for us, we don't need to count or rely on a proposal like that. I'm not sure where that will end up. But generally, the more liquidity is better. What I'll say, though, is we've already developed a really nice program. We have a bunch of capital. We have underwriting standards that people are buying into. I'm not sure where Freddie will end up on that spectrum, but like all GSE products, they'll have pretty tight rules. So I think private capital will still be important in closed-end seconds.

Varun Krishna

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

A

The only thing I would just add is this is just a great example of how we're building products that are relevant for the current market, which is evidenced also just, by the way, with our history, I mean, whether it's BUY+, ONE+, our Inflation Buster, anticipating our clients' needs and meeting them where they are and solving a meaningful problem. I'm just very proud of our team for continuing to set the standard of being ahead of the curve.

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

Mark DeVries

Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Thank you. Notwithstanding the efforts you've already made to rightsize your expense base, was hoping to hear your updated thoughts on expense management, just given the latest backup in rates as well as any thoughts on product focus to help generate more revenue in an environment where rates remain higher for longer?

Varun Krishna

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

A

Yeah. Thank you for the question, Mark. I'll just start by saying that profitability and efficiency are two sides of the same coin, right, and they both matter significantly. Our main focus is market share and top line growth. And the way you do that smartly is you leverage your savings to invest in growth. That's going to happen through accelerated execution. That's going to happen through big swings on innovation. It's also going to happen through focus on efficiency, which is a constant strategic imperative.

The thing I'm excited about is our AI strategy is specifically designed to create and unlock operating leverage. So it will allow us to grow our capacity without increasing head count and it will allow us to actually build our company and grow durably. So we don't look at this AI investment as a head count reducer. I mean that's not how you build a growth company durably.

But the combination of being able to invest in technology and have an ongoing principle around efficiency is how we think we're going to create a durable flywheel. And, of course, continuous investment in product innovation and create new-to-the-world offerings that will be – able to create value for clients is something that represents our brand, who we are, who we've always been and who we will be.

Anything, Brian, you would add?

Brian Nicholas Brown

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

A

The only thing I would say, which is just piggybacking on what Varun said is, at this point, it's a capacity game, right? We've talked a lot about. We did \$79 billion in originations last year, and we believe we can put a significant more amount of capacity through the system. We're really starting to see these benefits come to fruition. So that's our focus right now. That capacity will be used either when rates go down and the TAM increases and/or if rates stay higher and it's more difficult and it accelerates our share gains, we think keeping that capacity, removing friction and serving more clients is, first and foremost, our focus right now.

Mark DeVries

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Great. Just one more for me. There's been a lot of talk about banks shedding share in this environment. Just wondering if there's anything you could discuss with us about ongoing conversations you may be having with banks to either white label origination offering or even a branded offering to help either take their share or help access their customer base?

Varun Krishna

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

A

Yeah. We can't comment on the specific conversations that we're having, but I would just say that, I mean, I think we see there's an opportunity to create value. And so those conversations are ongoing, and we'll share more as we make progress.

Brian Nicholas Brown

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

A

Yeah. Mark, the thing we know is the banks were trying really hard not do mortgages, and that was even before the Basel III standard. We don't know where it will end up. But we do, to Varun's point, can't comment specifically, but we think there's some interesting plays there.

Operator: Your next question comes from the line of Derek Sommers of Jefferies. Your line is open.

Derek Sommers

Analyst, Jefferies LLC

Q

Hi. Good evening, everyone. On Rocket Logic, how should we think about the improvement to the origination side of the business there? I'm imagining it would marginally widen the top of the funnel through processing client leads faster and then drive some more meaningful improvement on funnel pull-through. Feel free to correct me if I'm thinking about that the wrong way.

Varun Krishna

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

A

Yeah. No, thank you for the question, Derek. I'll just start by saying the reason that we're obsessed with AI is because it brings a number of transformative benefits to our business. And that's really grounded in the Rocket Logic platform and what it represents for the next chapter of the company. The first one is just efficiency. It allows us to serve more clients by simply just automating the mundane.

And the second one is speed and velocity, just because our clients value speed and certainty. They have to be competitive. They have to be able to operate and execute offers and things like that at speed. And then the third one is experience, just creating more personalization, more delight on what is a very emotional journey that millions of people go through when it comes to homeownership on every side of the equation.

And with Rocket Logic, we're in the earliest days of this revolution, and I firmly believe the best is yet to come. And this is our AI platform. It is our most strategic imperative and we've dramatically increased our investment as well as the velocity with which we're launching futures every week.

The platform is now extended to every part of the journey from the digital experience that clients interact with, to how we interact on the phone with mortgage banking or client services, to the way we manage documents and extractions, to income verification, to underwriting, to servicing. And we've started to see some pretty awesome benefits. We've seen hours saved. That's a metric that we track. We were up to 170,000 hours per year. We've seen improvements in resolution times. Our first call resolution has improved by 10% with the Synopsis experience that we just announced a few days ago. And then ultimately, just turn times, right, 2.5 times faster than industry.

And then last, but not least, accuracy, we've seen zero audit findings with our income verification experience. And so across the board, this platform is delivering benefit to us, both in terms of the client experience that our end clients face, but also just supercharging our team members to be able to do more with less. And so we're very excited about this platform. We think it has tremendous benefits across the board, and we're just getting started.

Derek Sommers

Analyst, Jefferies LLC

Q

Great. Thank you. And then just to pivot to the servicing portfolio acquisitions, can you guys share – shed any more light on those transactions? Were they coming from banks or non-banks? And is there more supply of this higher coupon product coming across your desk?

Brian Nicholas Brown

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

A

Yeah. I think let me just – that's a fair question. Thank you. Let me take one step back just to talk about how we think about the servicing asset. It's clearly a strategic asset. We really like the returns. Even if you just look at the

cash flows right now, you're generally looking at double-digit returns. And then, of course, for us, where you add in our industry-leading recapture, and that's what really starts getting exciting in the return game.

And we've always known that if a client goes through our J.D. Power winning origination experience and then we service them that we will recapture very well. But what is awesome to see is we're starting to prove to ourselves that we can also recapture well when we acquire a portfolio of servicing.

Over the past couple of years, we've been doing that. It takes some time to prove out that hypothesis because you need data and information. And obviously, since the – where rates have been, just the number of transactions might naturally be lower. But we're starting to have more and more confidence that on the acquired portfolios, our recapture rate will be very healthy as well.

So to answer your question, what that means is that gives us even more confidence to be actively bidding in the market. To your point, we still are seeing supply a bit challenged. There is a lot of demand and a little bit of supply out there. So there are competitive bids. But here's the thing, and you kind of mentioned this in your question that is exciting for us. The asset that we're very interested in and bidding on is a different asset than some of the others in the space are. Some of the servicers that have come out with some pretty robust goals around growing their servicing portfolio are actually interested in the very low WAC stuff.

For us, to your point, the higher WAC stuff is actually a bit more interesting to us. If you think about the closed-end second opportunity there, if you think about a potential cash-out opportunity there, so in the proof point being these four pools that we just bought, that strategy is really being deployed. So they're higher WAC than the current portfolio, and we really like our chances in terms of recapture. So it will be something we – I think you can expect us to continue to focus on and be active in the space.

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Operator: Your next question comes from the line of Brad Capuzzi of Piper Sandler. Your line is open.

Brad Capuzzi

Analyst, Piper Sandler & Co.

Q

Thanks for taking my question. So you highlighted in your investor presentation and obviously demonstrated in your results today, Rocket's track record of continuing to grow market share. Kind of wanted to just hone in on your ability to grow purchase market share over the long term. I know there's been a lot of investment in tech and AI, along with the addition of other products. But with the mortgage market being inherently localized specifically for the purchase market, what are the steps you guys are taking to address this issue?

Varun Krishna

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

A

I think – thank you for the question, Brad. I think the first thing I would just say is purchase is a strategic focus area for the company more than it's ever been in the past. And that comes down to how we've organized, how we've structured our teams, how we've dedicated resources and how we've just invested the time to really understand the nature of what it takes to win. That includes dedicated teams. It includes understanding the funnel. It includes also understanding the nature of just how you help clients with every aspect of the journey from searching for a home, to building relationships with the realtor and broker, to going through the process of making an offer. We have just dedicated significantly more focus toward it than ever before. That's kind of the first thing.

I think the other thing I would just say is we've integrated our ecosystem assets like never before. The role of Rocket Money has never been more important. The role of our home search experience has never been more important. The role of our servicing portfolio and building engagement with our clients where we can collect data and we can help them with their next transaction has never been more important. So this is – it's a game of inches, but the inches are everywhere when you kind of think about all of them put together and they add up.

And so when you put those inches together, you start to see that execution happen. And so there are bigger swings that we're thinking about when you think about the opportunity that AI actually affords us to take a giant leap forward. We're also obviously looking at both organic and inorganic opportunities. But we're serious about purchase, and you can expect to see us continue to invest and dedicate our focus on it until we win.

Brad Capuzzi

Analyst, Piper Sandler & Co.

Q

Thanks. And just the last question for me, I mean, obviously, Rocket is one of the leaders in technology across the mortgage market. And with your continued adoption of AI, can you just discuss how your investments and capabilities differ from industry competitors as AI, it's been a hot topic issue on recent calls from peers thus far?

Varun Krishna

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

A

Yeah. I mean I think the thing I would just say is there's a certain activation energy that's required to be successful in AI. You have to have a large number of clients that you can engage with. You have to have a lot of data that you can build models around. And then you have to have resources that you can invest to kind of train, build and sort of continue to sort of improve these experiences so that they're better. So this is one of those where it's difficult to be successful in AI if you don't have data at scale, if you don't have large engineering resources, if you don't invest in data science, algorithmic intelligence, talent.

And so I think for us, it is the strategic imperative at every layer of the company. It's where we've dedicated the vast number of our resources, and we're continuing to grow our investment both with internal and external talent. And so for us, I mean, a good example I would give is just adding Alex Rampell to our board, who is the industry leader in both fintech and AI.

That's an example of just where the level of investment that we're making, the thought leadership and just the focus is only going to be increasing. I'd also just share that we're hiring a new Chief Technology Officer that will be joining the company in days to come. And so we're serious about this. We're investing, and we're playing to win.

Operator: Thank you. That concludes the Q&A session. I will now turn the conference back over to Varun Krishna for closing remarks.

Varun Krishna

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

Well, thank you, everyone, for our great conversation today. We look forward to the next earnings call. We also invite you to our Investor Day later in the fall. We appreciate it.

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

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