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Rocket Cos., Inc. (RKT)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by, and welcome to the Rocket Companies Second Quarter 2024 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.

I'd now like to turn the call 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 call covering the second quarter of 2024. With us this afternoon are Rocket Companies' CEO, Varun Krishna; and our CFO, Brian Brown.

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

Before I turn things over to Varun, let me quickly go over our disclaimers. On today's call, we provide you with information regarding our second 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.

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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.

Thanks, Sharon. Good afternoon, everyone, and welcome to the Rocket Companies' Q2 2024 earnings call. As I reflect, it is hard to believe that it's been almost a year since I joined Rocket and what an exhilarating journey it has been. This rocket is fueled by the passion of our team members who are the driving force behind everything that we do. They are led and inspired by an unrivaled leadership team, each bringing decades of experience and knowledge, ranging from fintech and mortgage, capital markets and AI, and marketing, product, operations, sales, and so much more. Together, we're blazing new trails, pioneering experiences that will redefine how consumers experience the homeownership journey now and into the future.

Our mission is to Help Everyone Home. That means we are obsessed with making homeownership easier and more accessible for everyone. It's not just a business goal. It's our higher calling. We consider ourselves the most optimistic company in America because, every day, we make 30-year bets on people who make 30-year bets on themselves.

The need for hope and optimism has never been greater in our country. We're navigating through challenging times, and unpredictability is the new normal. Despite some signs of gradual recovery in home listings and sales, affordability remains at historic lows due to persistently high mortgage rates and rising home prices. This past spring, the industry experienced a weak home-buying activity with purchase applications dropping to their lowest levels in over three decades. Macro uncertainty and affordability issues are keeping potential buyers on the sidelines, while consolidation continues with smaller players being acquired or exiting the market. Mortgage employment has decreased by 36% from its peak.

Yet, in the face of these challenges, optimism remains our mantra and higher calling. While others are faltering or retreating, we're mobilizing our immense resources, capabilities and talent to innovate and serve our clients like never before. It is our moment to show our unshakable resilience, growth from strength, and redefine our leadership role in the homeownership category as the most optimistic company in America.

On that backdrop, let's go a little deeper on the second quarter when we demonstrated growth despite industry challenges. Most importantly, we achieved profitable market share growth, our north star metric, and expanded purchase share year-over-year through numerous optimizations in our processes, teams, marketing, and technology capabilities.

This quarter, we delivered strong financial results, generating $1.228 billion in Adjusted Revenue, above the high end of our guidance range and grew year-over-year for the fourth straight quarter. We expanded Adjusted EBITDA margins quarter-over-quarter and year-over-year through both top line growth and our continued focus on operational efficiency. We reported $0.06 of Adjusted earnings per diluted share for the quarter.

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Solid execution is the lifeblood of our business, and our AI-powered initiatives stand at the forefront. I'd like to spend just a few minutes highlighting four key achievements this quarter: our AI-powered live chat for clients, Rocket Logic Assistant for banking, growth in home equity loans, and automation in servicing.

I'll start with our AI-powered live chat experience. We have expanded this interface throughout the client journey from early inquiries using tools like the mortgage calculator to live help with applications and servicing questions on escrow and payments. Chat is an absolute game changer for us. Our live chat interface is so much more than just a communication tool. It's a strategic advantage that enhances engagement with deep personalization, drives efficiency, and ultimately improves outcomes for our clients and business at scale. Chat is the asynchronous communication mode of choice in today's fast-paced world, favored by both older and newer generations. 80% of our clients prefer chat. They love the instant responses and 24/7 availability that allow them to manage their mortgage based on their individual preferences and needs.

The beauty of chat lies in its scalability and versatility. It seamlessly complements our traditional phone interactions. We're not just responding faster with chat. We're providing an experience that is more personalized and tailored. We can quickly gauge client intent and direct them to the best solutions, whether they need immediate answers or deeper discussions with the right expert team member. And by leveraging generative AI, we can deliver great client experiences at scale by handling more interactions and keeping more clients engaged with better automation.

The result of AI-powered chat is a resounding win-win-win: happier clients, satisfied team members and clear business value. Recent data shows that clients using chat had conversion rates three times higher compared to those who didn't leverage chat. Building on these successes, we are expanding chat across more client journey touch points, including purchase, which we launched two weeks ago.

The next example is the rollout of Rocket Logic Assistant to our entire banking force, helping our clients navigate the home-buying journey. This AI-powered personal assistant transcribes client calls and automatically completes mortgage applications in real time, supercharging our bankers' productivity. Gone are the days of manual note-taking with hands on keyboard or pen and paper, which would fatigue our bankers and leave gaps in client conversations. Now, the Rocket Logic Assistant seamlessly generates over 300,000 detailed transcripts every week from outbound calls. It supports over 100 data points on mortgage applications, saving our bankers from inputting tens of millions of data fields each week. This enhances efficiency, allows us to closely monitor calls and extracts valuable client insights, while also creating recursive models and feedback loops to continuously improve our bankers' performance and more effectively train each new generation of the best bankers in the country.

Next, our home equity loan origination volume reached an all-time high in Q2, more than doubling from a year ago. Home equity loans continue to resonate with our clients, as we help them unlock record levels of home equity, while still being able to keep their favorable rates on their first lien mortgages. Additionally, we enhanced the speed and efficiency of our home equity loan process through the launch of an Automated Valuation Model, or AVM. AVM represents a major upgrade, providing a cost-efficient digital alternative to traditional in-person appraisals. This innovation allows us to deliver cash from home equity loans in as little as seven days, meeting our clients' needs with unprecedented speed and accuracy.

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Finally, we've made significant strides in expanding our servicing portfolio, a strategic asset that complements our origination business. We're retaining clients for the next transaction at rates three times higher than the industry average, positioning ourselves as their lender for life and generating recurring cash flow without additional acquisition costs. Our advantage lies in providing technology-powered class-leading service to 2.6 million clients and leveraging rich data profiles to continuously understand their needs for life.

In the second quarter, we acquired five MSR portfolios, adding 67,000 new clients and approximately $21 billion in unpaid principal balance. The loans in these acquired MSRs have a blended weighted average coupon higher than our current portfolio, opening up a range of products and services for these new clients. From refinance options that capitalize on declining rates to home equity loans for those looking to leverage their home equity and new purchase loans for clients ready for their next home, we offer a comprehensive suite of solutions to meet diverse client needs across the spectrum.

We've also become more operationally efficient in this space. Traditionally, MSR trailing document audits required manually sifting through extensive documents to verify data for each loan, which could take months for a single portfolio. With our upgraded workflow automation, our capital markets team can now complete MSR audits in half the time. This enhancement allows us to onboard MSR portfolios more quickly, efficiently and accurately, which is essential as we expand our portfolio.

We've built a powerhouse technology suite for servicing that enables us to scale and deliver outstanding client service. The recent launch of MSR audit automation streamlines the first step of the loan onboarding process. Our AI-powered self-serve phone and chat tools drive efficiency and provide exceptional service to millions of clients. Additionally, Rocket Synopsis, a tool leveraging generative AI, listens to, transcribes and searches client calls, analyzing sentiment and recording client patterns and preferences.

Furthermore, features like live chat, real-time transcription and tagging are enhancing the value of our data lake and AI-powered solutions. This infrastructure supports recursive feedback loops that continuously refine and train our models. Our structured data lake aggregates and organizes information, making it readily accessible to our data scientists and technology teams. And from this repository, our models extract deep insights and analytics, enabling us to deliver exceptional client experiences and maximize team effectiveness. As we roll out new solutions and increase the usage of existing ones, we gather more data, creating an AI flywheel that accelerates velocity, enhances accuracy, personalizes interactions, and optimizes operational efficiency across our business.

Now, as a former software engineer, I'm going to keep geeking out for the next minute and talk about some of the deeper technology that powers our rocket ship. Leveraging our data and modeling tools like TensorFlow, Faster Region-Convolutional Neural Network models and EfficientNetv2L Keras models, our technology fully automates high-volume tasks such as document processing, appraisal reviews and income verification. With groundbreaking methods like this, we've already been able to bypass human intervention on nearly 10% of all appraisals in April 2024, saving 1,701 hours for collateral underwriting alone.

Hopefully, you're still with me. Let's talk about another AI concept called Retrieval-Augmented Generation, or RAG. RAG is a way to supercharge the utility of GenAI by adding your own data into the conversation. We're using this technique in our Rocket Logic platform, allowing team members to dive deep into all facets of a loan and provide in-the-moment insights and assistance. We're also able to leverage our own data and best practice documentation to assist our engineering teams and to provide an easily accessible natural language interface over our data analytics platform. This provides all of our

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teams with the context and data they need to make the best decisions for our clients where and when they need it.

We work closely with amazing partners like AWS, Anthropic, OpenAI and others to stay on a cutting edge of research and techniques to make the most out of GenAI and this will only increase going into the future.

As I conclude, I want to give a huge shout out to our amazing servicing team for winning our 10th J.D. Power Award for servicing just last week. This achievement further cements Rocket Mortgage as the most awarded company for mortgage servicing and the most awarded mortgage company overall – something we will continue to work hard to earn day-after-day and year-after-year.

In closing, I am so proud of our strong execution in the second quarter, but this is just the beginning. The four examples we discussed all share a common theme. They illustrate how AI both enhances client experiences and boosts team productivity through improved velocity, accuracy, personalization, and operational efficiency. While many companies aspire to be AI-centric, few have the right blend of talent, assets and mindset to succeed. I believe that Rocket is exceptionally well-positioned to execute on our AI-fueled homeownership strategy, and I look forward to sharing our continued progress with you each quarter.

Lastly, we are thrilled to invite you to Detroit on September 10 for Rocket's first-ever Investor Day. This is your opportunity to go behind the scenes, meet our leadership, experience our company culture and innovation firsthand, and discover what makes Rocket rock. We're also excited to showcase our beautiful city of Detroit, and I look forward to seeing all of you there.

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. Today, I'll cover our financial performance and provide an update on our investments in growth, particularly in technology and servicing. I'll close with our outlook and guidance for the third quarter.

You heard Varun share the passion behind executing our AI-powered homeownership strategy, all in service of our mission to Help Everyone Home. Our mission is so important because we bring people the pride and joy that only homeownership can offer. In pursuit of this mission, we're breaking new ground. We're transforming the homeownership experience from one traditionally filled with stress and complexity into a radically easier and simpler process for everyone.

Rocket has a unique opportunity to transform the fragmented $5 trillion homeownership market. We have all the ingredients for success: an unrivaled combination of talent, assets, capabilities and culture. We're just getting started, and I couldn't be more excited for the opportunity ahead of us.

We are not just imagining the future of homeownership, we are building it.

Now, on to the second quarter results. We delivered a strong second quarter, growing purchase market share, revenue and profitability year-over-year. Our growth was particularly impressive against the backdrop of a contracting market as industry purchase applications declined to their lowest second quarter in 30 years.

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Adjusted revenue came in at $1.228 billion, above the high end of our guidance range. This represents a 23% increase from the second quarter of 2023 and our fourth consecutive quarter of year-over-year revenue growth. Reflecting on our performance this past quarter, several wins come to mind: a double-digit lift in purchase conversions due to marketing optimization, record volume for our home equity product, and a 30% increase in our agent network attachment rates, driven by demand for BUY+.

We generated $25.1 billion in net rate lock volume, a 13% increase year-over-year. Gain on sale margin was 299 basis points or an increase of 32 basis points compared to the same period last year.

Our continued focus on driving top line growth and improvements in operational efficiency combined to make the second quarter our most profitable quarter in two years. Adjusted EBITDA increased year-over-year for the fifth straight quarter to $225 million, or a margin of 18%. We also reported Adjusted net income of $121 million and adjusted diluted EPS of $0.06.

In the first half of 2024, we generated nearly half a billion dollar more in adjusted EBITDA than the same period in 2023. While we are pleased with the progress we have made over the past year, we believe our true long-term earnings potential is much greater. We see significant room for more top line growth and higher operating leverage as our AI investments gain even more traction.

Varun took us through some examples of how AI drives velocity, accuracy, personalization and operational efficiency for our business. One of the breakthroughs that I'm particularly excited about is our AI-powered live chat, which will pave the way for further scale and operational efficiency.

AI-powered live chat is a prime example of delivering personalized and fast client experiences, while supercharging our team members at scale. Chat is the clear choice for our clients, a quick way to get personalized answers. Chat empowers our team members to support multiple clients at the same time, freeing up their capacity.

Through chat, we identify client intent upfront and guide our clients to the right resource, which can include connecting them with one of our expert mortgage bankers. With client intent and call purpose matched to the right banker, these live conversations are more personalized and engaging.

We're seeing these benefits pay off in our business. Chat helps us scale up to a better client experience, leading to higher conversion and operational efficiency. In fact, we're seeing clients who use chat convert three times better than those who don't.

There is much more potential to unleash. AI enables us to do significantly more without adding more resources, which unlocks capacity. When the market inflects, we believe AI will help us drive growth at scale, while keeping fixed costs flat.

Now, turning to our servicing portfolio, a strategic asset that's worth much more than the $7 billion on our balance sheet. Our servicing asset plays an important role in growing our mortgage origination business. Let me unpack this a little more.

Clients choose Rocket for the convenience and J.D. Power Award-winning service, experiencing how easy it is to get a mortgage with us. Once they get their mortgage, they move to our servicing platform where they continue to enjoy J.D. Power Award-winning service. So, it's no surprise that when they're ready to buy their next home, lower their mortgage rate or tap into their homes' equity, they come back to Rocket at a rate three times higher than the industry average. Our servicing and origination businesses work together, creating a powerful cycle of attracting new clients, organically creating new MSRs and keeping them for their next mortgage. This cycle creates lifelong

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clients and multiplies future origination and profitability growth.

As we've discussed before, we're actively investing to reinforce this growth cycle. In the second quarter, we acquired $21 billion of unpaid principal balance and 67,000 new service clients for $315 million. These clients are immediate candidates for a new purchase mortgage, a home equity loan or even a rate-and-term refinance.

Looking at the broader market, around 6 million purchase mortgages have been originated since 2022 at current rates or higher. We expect many of these buyers will be highly motivated to pursue a refinance even with a small drop in rate. In the past, consumers may have looked for a 60 to 75 basis point rate reduction to make the benefit worthwhile. Traditionally, getting a mortgage was a painful process for clients that could take up to 90 days before they start to see monthly savings. Today, at Rocket Mortgage, we're seeing clients refinance for less than a 50-basis point rate benefit, thanks to our fast and easy process, with the majority of clients closing in two weeks or less.

Consider a borrower with a $400,000 mortgage, a 40-basis point rate reduction translates to a monthly savings of nearly $150. This difference is significant, especially as households feel the pinch of inflation. That money is a week's worth of groceries for the average household.

From a capital perspective, Rocket's strong balance sheet and substantial liquidity continued to serve as a major competitive advantage and provide us with tremendous flexibility to invest for growth. We ended the second quarter with $3.2 billion of available cash and $7.2 billion of mortgage servicing rights. Together, these assets represent a total of approximately $10.4 billion of value on our balance sheet.

Our $3.2 billion of available cash consists of $1.3 billion of cash on the balance sheet and an additional $1.9 billion of corporate cash used to self- fund loan originations. As of June 30, total liquidity stood at approximately $8.6 billion, including available cash plus undrawn lines of credit. Subsequent to June 30, we renewed our three-year $1.150 billion revolving credit facility, with more than 10 major banking partners participating. This fully committed facility, which is typically reserved for investment- grade institutions and is unmatched by any of our peers, further underscores our creditworthiness and strong financial standing. Having access to a range of diverse funding sources offers us great optionality to allocate capital and be opportunistic about investing for growth, whether through the acquisition of MSRs or other strategic options.

For the third quarter of 2024, our guidance reflects trends observed to date with one month of actual performance. Although housing inventory is gradually recovering, high home prices and challenging affordability persist. An uncertain macroeconomic environment and a subdued spring home-buying season have kept potential buyers on the sidelines. We anticipate the mortgage market in Q3 will mirror the conditions of Q2. We expect Adjusted revenue to be in the range of $1.150 billion to $1.300 billion. Regarding operating expenses, we expect Q3 to be flat compared to Q2.

As always, our forward-looking guidance is based on our current outlook and visibility. We are fired up in executing with momentum to achieve our mission to Help Everyone Home. Our assets and financial strength provide us with a competitive advantage to transform the homeownership market.

I'm so excited to host everyone at our first Investor Day in Detroit on September 10. We have some fantastic immersive experiences in store that will showcase what we've launched to make homeownership easier and simpler.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator instructions] Your first question comes from the line of Mark DeVries from Deutsche Bank. Your line is open.

Mark DeVries
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thank you, and thanks for the comments on your 3Q outlook. I was hoping you could give us a little bit of additional context for kind of the overall market view and outlook in the Q3 guidance? And how might that change if we start to get Fed easing and the long end of the curve moves down some?

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

A

Mark, thank you for the question. I appreciate it. I'll start by just sharing a couple of thoughts and ask Brian to jump in. I think the first thing is just, I think the operative question is really not if the market will rebound, it's really when and how. And while we might not know exactly when, we do know that 2024 is better than 2023, and we believe that 2025 is going to be better than 2024.

And if you look at the data, whether it's Fannie or the MBA, et cetera, we roughly believe that the mortgage market is going to be around $1.7 trillion. Now, the good news is that's up 8% versus 2023. So it's still well below the average, but we're starting to see some signs of gradual improvement.

But that said, we're not seeing exactly the same upswing that you would typically associate with the spring buying season. But with that said, and when you look at homeownership overall, it's still a huge market. It's still a $5 trillion overall category, and it's an industry that's existed with basically no modernization.

So, regardless, our philosophical view is that we're determined to take share, and we have a track record of taking share in essentially any market. I do just want to share three things that give me confidence that Rocket will be accelerated uniquely within our outlook and what gives us optimism.

And I think the first one is just quite simply our focus and our track record. I mean, there's a reason why we're the number two player in purchase, excluding correspondent. And if you look at the results of our execution and hard work this quarter and consistency quarter-over-quarter, year-over-year, I think those are important proof points.

The second is just there are industry tailwinds that are just realities in which we operate that are going to be headwinds for others and tailwinds for us, whether it's the capacity that's coming out of the industry by gallons, whether it's the increased regulation of things like Basel III, whether it's just kind of the dynamic of fragmentation and consolidation and this AI paradigm shift that we're all going through, these are important dynamics that will determine winners and losers in the space. And we feel confident that they will benefit us disproportionately.

And then, the last thing I would just say, before I turn it over to Brian to talk a little more about the guide and some of the external macro, is that we have very unique assets. We have assets that would disrupt every aspect of the homeownership journey. It's not just our core businesses like home search, purchase, servicing, refinance, title, personal finance. It's the fact that these business lines are underpinned by significant data, talent, culture, scale and an iconic brand. And so when you put all of that together, it reflects a company that's looking to grow share in a large market. And so when we talk about optimism in our market outlook, this is for me what reinforces that.

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

A

Yeah. Mark, I'll touch on the guidance piece. As usual, we include all the information, all the data leading right up to the call when thinking about where to set the guide. But we're still only a month in. So, you've got two-thirds to go. But I think there's a couple of points just worth noting. One is, you may have seen the MBA purchase application data in the month of July. The MBA said it was down 10% when you compare it to June. I mean, I'll say that that's a bit unexpected to Varun's point around what the traditional home-buying season looks like. July is usually a pretty robust month.

And then, secondly, it's just worth noting that September is traditionally the lowest month in the quarter. As kids go back to school, you usually want to have the home or be in the home by that period of time. So, September is when you start to see it trailing off. So I think when you put all that together, just the view you could get to is, Q3 is probably going to be flat to Q2 or perhaps even a little bit down. Now, of course, we saw some rate relief come through today, which is always good. But nonetheless, I still think there's a little bit of uncertainty.

I'll just touch on the gain on sale margin piece. We've said a lot that we expected gain on sale margin expansion from 2022 levels. And the 299 basis points in Q2 was really healthy. And a month into the third quarter, I feel good about those levels being relatively consistent.

So I think if I had to summarize it, you look at the guide, and it's, of course, a bit tempered because of some of the uncertainty with how the home-buying season will shake out. But to be clear, it definitely includes the confidence in our belief to take share through the quarter and beyond.

Mark DeVries
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's very helpful. Thank you.

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

Ryan McKeveny
Analyst, Zelman & Associates

Q

Hey, Varun and Brian. Nice job in the quarter. Thanks for taking the questions. Wanted to dig in a little bit on the share gains you're seeing on the purchase side of things. I guess, I'm curious if you're seeing any mix changes in the types of buyers that you're originating, whether it's first-time buyers, move-ups and kind of whether the share gains you're seeing are being driven by a certain cohort or type of buyer? And secondarily, I guess, a two-part question on the purchase side. Are the share gains apparent in both DTC and partner, or any differences in the purchase trends between those segments? Thank you.

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

A

Thank you for the question, Ryan. I would just start by saying that profitable market share growth is our defining North Star metric. That is something that strategically across the company is a top line imperative. And I would just highlight a couple of control points that we've really focused on in a durable way to achieve this metric.

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The first thing I would just highlight is innovation. Across the board, we're innovating faster than ever. We're building deeper, better experiences, and we've increased the velocity of high-impact innovation by releasing at a higher cadence. In fact, we're doing product and digital and experience releases almost weekly now.

The second thing I would just say is we have increased our focus. We have restructured the way that we execute, and we have operationalized against a new, what we call, a mission-based autonomous structure. That means that we have autonomous teams that are goal driven that are working hard to execute against clearly defined metrics.

And then, the third thing I would highlight is that we've taken, what we call, a full-funnel approach to every aspect of the business, which means that we consider every single element of funnel, whether it's how we deliberately engage with our massive servicing portfolio, improvements to performance marketing, whether that's better targeting, better creative, better channel mix optimization, tuning our front doors and then all the way through to the digital experience, making that more streamlined and then obviously, optimizing our sales and operations motion against specific workflows, whether it's purchase, refi, servicing. And this is just to name a few of the things that we've done.

Specific to purchase, one of the things I would just highlight is that we're really doubling down on our focus on purchase as a top line strategic imperative. And so you're going to start to see us innovate further and faster here, whether it's existing product innovation like BUY+ or the new AI-based verified approval letter adjustments that we're starting to see major traction because we're meeting our clients where they are through to the development of new purchase offerings that are more focused on our retain based, better segmentation of our clients, understanding our clients, whether they are first-time homebuyers, female head of household, Latino, and understanding demographics, segmentation. And then, leveraging that data to connect deeper with home search, optimizing the top of funnel for purchase.

So, lots and lots of inches across the board. But bit by bit, these inches start to stack up, and that really reflects on some of the improvements that we started to see, and we're still just scratching the surface of what is really possible. And then, I'll ask Brian to maybe comment a little bit further.

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

A

Sure. Yeah. Ryan, good to hear from you. Just two things for me. One on your channel question, where the share gains are coming from? The answer is, it's definitely both. It's definitely the direct-to-consumer and TPO.

And then just lastly on sort of the demographic attributes in terms of where these share gains are coming to. One of the things we've talked a lot about in this market is the first-time homebuyers. While they're not immune to some of the affordability challenges and down payments can be tough, they're also not trading a 3% or low or note rate for higher rates. So we've talked a lot about this, but we skew very high in terms of share, in terms of first-time homebuyers, given our digital experience and the way we interact with clients through chat. So we think that's a big piece of share gains as well.

Ryan McKeveny
Analyst, Zelman & Associates

Q

That's very helpful. Thanks, guys. Appreciate it.

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

A

Thank you.

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

Hey. Good morning. This is Jeff Adelson. I was curious if you could maybe just dive in a little bit on the thinking on sale dynamic this quarter and it seems like it held up a little bit better. I'm just wondering, if you're seeing some more excess capacity come out, just kind of feeding into the broader dynamic of you taking share, maybe a little bit less competition there and why you feel that should be stable from here.

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

A

Yeah. Thanks, Jeff. I can comment on that. Yeah, we've been really happy with the progress in gain on sale margins. If you were to chart it over the past two years, you've seen some pretty decent growth. We've always said, and I believe that, the number one thing, there's a number of things that can impact gain on sale margins, but is capacity and the price competitive nature of this business. So, it's absolutely contributing to that.

And we talked a lot about the consolidation and the capacity coming out of the system. But it's probably worth noting, too, that we traditionally had higher gain on sale margins, and it's also just because of great execution. We have a best-in-class capital markets team. And when you operate in all 50 states and 3,000 counties, you can create very diversified pools of loans and bondholders are willing to pay a premium for that diversification and that scale. So that always helps as well.

Jeffrey Adelson
Analyst, Morgan Stanley & Co. LLC

Q

Okay. As my follow-up, could you maybe just comment a little bit on the outlook for profitability from here? You've got two consecutive quarters of double-digit EBITDA margin. I don't think you've been there since late 2021, early 2022. Your contribution margins are holding up nicely in the different segments. Just curious if you think that can continue to expand from here or if you're a little bit more reliant on the volumes continuing to increase for that to happen? Thanks.

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

A

Yeah. Thank you. I'll just add a couple of quick thoughts toward profitability. At the end of the day, philosophically, profitability is going to be driven by a couple of key things, how well you execute, how efficient you are, and then the big swings that you choose to intentionally take.

And so, in service to that, at the end of the day, market share top line growth is our number one priority. Now, of course, we're going to run an efficient business and that's a strategic imperative as well. And there's always room to go. And we definitely think we can scale up significantly, while keeping our fixed costs roughly the same. And philosophically, the reason we believe in that is, because that's how you build a durable growth business for the long run.

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Now, I think, as you know, we made $225 million of Adjusted EBITDA in Q2. That's an 18% margin, and we believe we can grow that further. And we are leaning seriously into AI, because we believe that will increase our operating leverage significantly. And so that capacity will come from AI investments and allow us to be more productive.

And so, in summary, investing in operational efficiency, driving major innovation bets in AI, making our organization orders of magnitude more productive is how we believe we will accelerate our normalized profitability.

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

Derek Sommers
Analyst, Jefferies LLC

Q

Hey. Good evening, everyone. Now that we've had volume bounce off trough levels from seasonality and the 30-year mortgage rate seems to be cooperating a bit, can you talk a little bit about Rocket's incremental capacity for originations? Will recent investments in AI and Rocket Logic alleviate any of the typical operational bottlenecks?

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

A

Sure. Let me comment on AI, and then I'll ask Brian to just jump into some of what we're seeing in terms of capacity. And I'll just start by saying that from a resource perspective, AI is our most strategic imperative, and we are resourcing this to win. And there are real reasons that we're so vested in this because we see tangible concrete metric-driven benefits of efficiency, velocity, and most importantly, a better experience.

And so Rocket Logic continues to advance. It's now built into every part of our experience, whether it's the digital workflow through to document management, to the tools that are actually powering our team members end-to-end in terms of how they drive the client experience. As we shared earlier, we're now generating 300,000 transcripts every week. That is a massive data set, and that data is actually automating 113 fields on a mortgage application that would have to be entered manually.

As we talked about already, we've seen a multitude of benefits from the earliest days of a generative AI-powered chat experience, and we're just starting to lean in much more heavily there. And then, we're using all this data to actually refine and train our models and our workflows further. So more volume results in a better AI system that will continue to learn and improve and make us better.

So I would just say for us, this AI thing is not hype, right? Like, we see concrete tangible benefits. We see hours saved. We see faster call resolution. We see faster turn times. We see 100% accuracy on verification. And these are the earliest stages.

And then, the other thing I would add before I pass it over to Brian is, we're also investing deeply in talent, like we're not standing still. We've recently hired a CTO. We're making significant investments in data leadership and infrastructure. We've brought AI talent to our board. And we're also being very deliberate in terms of being strategic in what we build where we have strength, which is how we partner with the best in the industry, whether that's OpenAI, AWS and Anthropic to just name a few.

So, it's early days, but we're very encouraged by some of the key improvements in metrics, and so we're continuing to lean in there. Let me ask Brian to just talk a little more on capital.

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

A

Yeah. Sure, Varun, thanks, and good to hear from you, Derek. The question we get asked a lot is, like how do you think about the fixed cost structure, and we talked a lot about really keeping it flat. And I think there's two things that are worth noting there. One is like when you think about these AI investments, this is where we're deploying capital and resources. So that means we have to be really diligent and tough on the other side and looking for efficiencies and taking any slack out of the system, so that we can continue to allocate capital to these very strategic initiatives.

And then, to your point on capacity, I mean, that's everything right now. We're happy with the fixed cost structure. 18% EBITDA margins in a quarter where I think we're going to look back and still say, yeah, things might be getting better, but this is still going to be a very low quarter in terms of the history of mortgages produced. So everything we're focused on right now is adding capacity to the system and doing it through efficient means and keeping the cost structure relatively similar.

Derek Sommers
Analyst, Jefferies LLC

Q

Got it. Thank you. And then just to kind of follow up on the fixed cost structure there. I'm seeing an increase of $2.7 billion of net rate lock volume and only $23 million of incremental expense. Is that a ratio that's going to hold up over time? Or any other color there would be helpful.

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

A

Yeah. I mean like we kind of look at it in two buckets, the fixed and variable side. And the beauty about this business is once you clear those fixed costs, a really healthy chunk of that top line revenue drops to the bottom line and you have a nice compounding effect. And if you think about 18% EBITDA margins in this quarter, that means we, at some point, didn't clear that fixed cost hurdle. So the cost to produce, as we've talked about, has some – you pay a commission to your loan officers, you incur some costs along the way. But in the big scheme of things, it's pretty small. So you got great leverage on your fixed cost base on the way up.

Derek Sommers
Analyst, Jefferies LLC

Q

Great. Thank you.

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

Brad Capuzzi
Analyst, Piper Sandler & Co.

Q

Good afternoon, Varun, Brian. Thank you for all the detailed commentary. You've been active acquirers of higher coupon servicing portfolios, which strategically does make sense to Rocket. Can you just give us color on these transactions and conversations? I know you mentioned a lot of demand and a little bit of supply last quarter. Have these dynamics changed in recent months? And then, what are the retention rates you assume on your MSR purchases? And how does this affect the prices paid on those purchases? Thank you.

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

A

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Yeah. Great. Thank you so much for the question. I wanted to start by talking a little bit about our strategy when it comes to servicing. And I'd start by saying that our servicing portfolio is an incredibly strategic asset because it allows us to play both offense and defense at the same time. So, our approach to servicing and origination is very unique to Rocket in the sense that servicing is actually a source of future originations. And so the two things actually work as a flywheel, where you create a cycle, where you can attract a new client, you can organically create a new MSR, and then you can actually support and build a relationship with that client as their lender for life.

So, computationally the raw MSR includes not just the servicing cash flow, but it also includes the future gain on sale from additional services and products that we can deliver to that client in an awesome way. And so when you add to that, we have very strong end market recapture capability that's 3x higher than the industry. And so for that reason, we are investing strategically. We're going to keep growing our servicing portfolio. We're going to acquire tranches strategically, and then we can provide new experiences to those clients, whether it's refinancing on falling rates, second lien loans for those who are looking to utilize equity, and then, of course, originating new purchase loans as well.

And underlying that, obviously, is our technology infrastructure and our client experience that allows us to do all of this with speed, with delight, and ultimately, value for our clients, which is what we care about at the end of the day. And it's just very exciting to me that as of June 30, we had around $535 billion of unpaid balance in servicing. And I have to just give a shout out again to our servicing team who is the best in the business, who recently won just last week their 10th J.D. Power recognition for servicing. Let me ask Brian to comment a little bit more on your question.

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

A

Yeah. Brad, I think the key part of your question, which is where is the recapture, and we talked a lot about, to Varun's point, the three times industry recapture rate. But I think, honestly, the more exciting piece is that we're starting to learn through these acquisitions that we have a really nice recaptured on the acquired books. And if you think about what that does for us in terms of the market opportunity, it allows us to pay a premium in sense of acquiring these because we're going to realize value that others in the space likely aren't going to realize. And it opens up a really exciting acquisition channel because you have your regular direct-to-consumer business, you have your TPO business, and then now you have this acquisition channel via servicing from an inorganic perspective.

So part of the hypothesis that need to be proven out was, hey, we know we do good on the clients that we originate and go through our J.D. Power winning origination experience, and we know they love our servicing, to Varun's point, with our J.D. Power winning servicing experience. But when you're acquiring clients and you start to become their servicer, they haven't gone through your origination business, and they haven't gotten to know you the same way. So there was a hypothesis that we would outperform the market there. And for a while, that's exactly what it was. But now that we've been acquiring and we have some actual historical data, it's only building our confidence in that space.

Brad Capuzzi
Analyst, Piper Sandler & Co.

Q

Thank you. And then, just on expenses, can you just give us an update on your expense management, both near term and long term into 2025? I know you mentioned relatively flat quarter-over-quarter in 3Q. But kind of how you're prioritizing investing for growth and driving operational efficiencies, both near and long term? Thanks.

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

A

Yeah. I think probably the only thing more I can say on that is, operational efficiency and expense management is really part of our DNA, and it's just part of running an efficient and diligent business and we'll continue to do it. We've been really tough on this stuff that isn't key, in prior calls I talked a lot about our relentless prioritization. So if things don't have the ROI that we expect and demand, we won't do them. We'll leave room for experimentation. In the things that are working, we're going to put more capital to them as anyone would expect us to do. But on one hand, we're being really tough and looking for all the operational efficiencies we can. And then, as we're freeing up some space, we're putting capital towards things like tech and AI and data, all the things that we believe will change the game here.

Brad Capuzzi
Analyst, Piper Sandler & Co.

Q

Thanks. That's it for me. I appreciate all the comments.

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

A

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. I was hoping you could talk about how you're seeing the durability of demand for home equity and kind of what you see as the limiting factors for continuing to grow that, whether that be consumer demand or investor appetite to purchase the loans?

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

A

Thank you for the question, Doug. I'll just start by saying that this is a great example of product market fit. It's the perfect product for the current market. And we've seen strong demand. The product volume has more than doubled year-over-year. That's because it's an offering that's incredibly valuable to our clients, right? They're using that money to fund a remodel. They're using it to consolidate debt. They're using it to pay for the inevitable life events that we may experience and they're able to do that without affecting their favorable rates. And that's because they have $32 trillion of equity to tap into.

And I'm incredibly proud that Rocket is now amongst the top players in the entire market. We've essentially created a market here. And by adding in the second lien, we're able to increase the weighted average coupon, which then leads to potential refinance as well.

And what I love about this is that this is just the beginning. I think we can go significantly further here because, as Brian said, it underscores the strength of our capital markets team and infrastructure, which is second to none in the business. And we're continuing to improve it. We launched an, what's called an AVM, or Automated Valuation Model, in Q2, which means clients can actually get cash in as little as seven days and they can actually close seven days faster than a traditional rate in term refi. We can consolidate their first and second lien mortgages, so when interest rates inevitably decline, they're able to unlock additional value.

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And then, I think perhaps best of all, in my opinion, is that the vast majority of clients who come to us are actually new to Rocket. So, it's a great business, it's a healthy business, and we're just continuing to improve continuously.

Operator: And we have time for one more question. That question comes from the line of Rick Shane from JPMorgan. Your line is open.

Richard Shane
Analyst, JPMorgan Securities LLC

Q

Thanks for taking my questions this morning or this afternoon. It's been a long day. The commentary on technology is fascinating, and one of the things that's always been the big opportunity for Rocket is the push into purchase. And realistically, I think there's going to be a generational shift in terms of how consumers interact with financial institutions. Are you finding that the penetration or market share for first-time homebuyers, who represent that emerging generation of buyers, is actually higher than purchase penetration for existing homebuyers or second-time homebuyers, I should say?

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

A

Thank you for the question, Rick. I'll just start by saying that purchase is a strategically elevated priority for us compared to the past. And there's a lot that you have to do to really make sure that you understand how to build a profitable, successful, growing purchase funnel.

The starting point of purchase is really understanding your client and meeting them where they are. And for that reason, we're investing significantly in segmenting our clients and really understanding that the dynamics of a first-time homebuyer are different from a second-time homebuyer. The way that we engage with our service base to understand how to help them find a new purchase loan is different. The way that we engage with home search and really nurture and build intent with our clients, the way that we create an optimized funnel end-to-end and introduce new products and services and be able to bet on AI-based experiences and leverage things like chat and generative AI are all a big part of our purchase strategy.

One of the things that I think is really important is how we think about servicing as a source of purchase origination. Another area of investment is really doubling down on our broker platform end-to-end, and that's a big part of our purchase strategy as well, and that's a very important client that we want to continue to serve.

So, I would say that across the board, we're really resurrecting an end-to-end view of how to build a profitable, successful, growing purchase business that includes segmenting our clients, building experiences that meet them where they are, investing big in technology and automation, understanding how to nurture them and their intent throughout the home-buying journey, which can often be complex and long, and by sort of achieving all of those inches is how we think we're going to grow in purchase. And then, obviously, resourcing this as a strategic priority from the top down is something that we're really, really excited about.

Richard Shane
Analyst, JPMorgan Securities LLC

Q

Got it. It makes sense. Look, I think you guys will benefit from a generational shift. I just think about how my kids interact with financial institutions versus how I do, and I think that will be transformative in terms of the purchase market.

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

A

We agree.

Richard Shane
Analyst, JPMorgan Securities LLC

Q

Yeah. Thank you, guys.

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

A

Thanks, Rick.

Operator: And that concludes our question-and-answer session. I will now turn the call back over to Varun Krishna for some closing remarks.

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

Well, thank you, everyone, for joining us today. We're really excited about Investor Day on September 10. We hope to see all of you there. And we look forward to connecting with you next quarter. Thank you again for listening to the call.

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

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