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Credit Bureaus & Rating Agencies

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Credit Information Service, Bureaus, and Rating Agencies

Industry Rating Market Weight

Investment Thesis

We recommend a **Market Weight** rating for the credit bureaus and rating agencies Industry. The Credit and Information Services industry is one that thrives in favorable economic conditions. Despite concerns about a potential economic downturn dampening business activities for Credit Rating Agencies (CRAs) in 2023, the industry is gearing up for a busy 2024. The anticipation is particularly strong as market players expect two-to-three rate cuts to set the stage for improved activity and growth within the Credit Rating Industry.

Drivers of Thesis

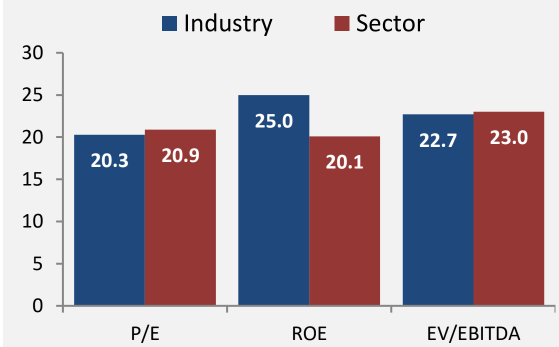
- The US economy remains resilient, fostering a climate of heightened consumer spending, amid a backdrop of declining inflation.
- Reignition of Debt issuance and Initial Public Offers (IPOs) in the wake of strong equity market activities and lower interest rate expectation
- Highly concentrated industry with the top 3 firms accounting for 50% of market share.
- Continuous strategic acquisitions by market leaders, ensuring the tightly concentrated industry maintains a high profitability margin and growth trend.

Risks to Thesis

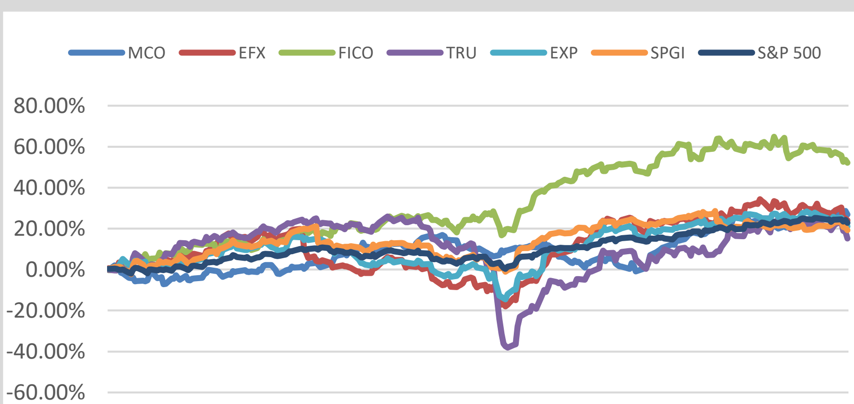
- The resurgence of optimism surrounding debt and IPO activities may be dampened in a sustained higher-for-longer interest rate environment.
- The credit rating industry operates within a stringent regulatory framework, indicating that any alterations in regulations have the potential to significantly reshape the business landscape.
- Financial institutions and government agencies can develop their analytical method to calculate credit worthiness of debtors and (or) debt instruments.

Industry Statistics (FactSet)

Market Cap	(In $ Millions)
Moody's	$68,855
Equifax	$30,684
Fair Isaac	$29,216
TransUnion	$14,289
Experian	37,579
S&P Global Inc	133,800
P/E Ratio	
Moody's	33.7
Equifax	30.0
Fair Isaac	44.7
TransUnion	18.7
Experian	25.6
S&P Global Inc	28.6
EV/EBITDA	
Moody's	29.6
Equifax	22.8
Fair Isaac	35.5
TransUnion	15.6
Experian	14.9
S&P Global Inc	27.8



12 Month Performance



Industry Description

The Credit Bureaus and Rating Agencies industry is highly concentrated with the top 4 firms accounting for over 65% of the industry's market share. The industry is largely segmented into Individual and Retail credit rating services, and Corporate, Sovereign, and Institutional credit rating services. Whilst credit bureau companies offer services related to consumer credit information, credit rating agencies focus on businesses, governments, securities, and financial markets. The industry service offering is very pivotal to capital markets, especially as it relates to the issuance of debt securities.

INDUSTRY ANALYSIS

The credit and information services industry provides information, ratings and outlook on the credit worthiness of companies, individuals, securities, financial institutions and sovereign issues. Whilst credit bureau companies offer services related to consumer credit information, credit rating agencies focus on businesses, governments, securities and financial markets.

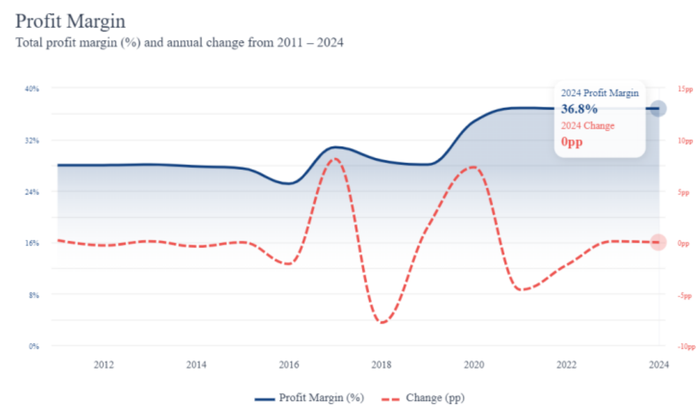
Industry players experienced unprecedented volatility from downstream markets during 2022, especially due to lagging effects of COVID – 19 on the US economy and the aftermath of the conflict in western Europe. Inflation struck the domestic economy, leaving the Fed with a challenging job of stabilizing prices in a world of supply chain disruptions and geopolitical disparity. The Federal Reserve Bank hiked rated to a record level 5.25% - 5.5%, about 500bps since March 2022, to combat sticky prices and bring inflation back to target levels of 2%. The fight against inflation lasted till the later part of 2023 when the Fed ended the rate hike regime and successfully averted the much-anticipated US recession. The decision to pause rate hikes sprinkled hopes of a possible cut in the near to medium term, since inflation is not as high as it was in 2022. This spelt optimism for the credit rating sub-industry and an end to the draught in capital market activities.

The industry is divided into two operational areas – credit bureau and credit rating agencies. The credit bureaus focus on consumer credit information and individual credit reporting whilst the credit rating agencies conduct comprehensive assessment of risks attached to debt issuances by corporations, governments, and special purpose entities. The industry benefits largely from high recurring revenue from data and analytics and low capital investments.

The credit rating industry saw a 4.0% increase in revenue for the fiscal year 2023, despite subdued capital market activities. However, optimistic consensus estimates project a turnaround in 2024, with an anticipated revenue growth of 6.1%. This positive outlook is premised on market expectations of a resurgence in capital market activities, fueled by the anticipated decline in interest rates.

Source: IBIS World

The downside risk to the outlook remains the uncertainty and worsening geopolitical tensions around the globe. In this case, inflation returns to 2022 levels forcing the Fed to either raise rates further or hold at current levels for longer.



Source: IBIS World

Profit margin for credit bureaus and rating agencies has remained unchanged at 36.8% since 2022. Inflationary pressures and dwindling demand amidst rising interest rates dampened margins for operators in this industry.

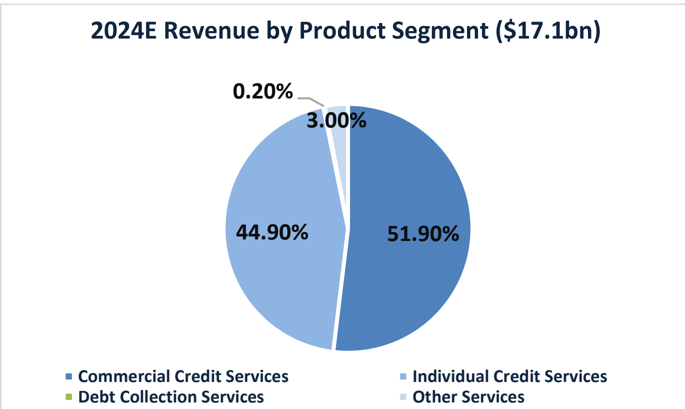
In the light of recent economic data and developments, we do not see any big change in the business environment of credit rating agencies, especially because markets are now considering the potential of “zero” cuts unlike the previous expectation of a 75bps cut. IBIS world projected profit margin to remain 36.8% in 2024. We align with this projection given prevalent economic woes and legacy geopolitical conflicts.

Product & Service Segmentation

The credit bureaus and rating agencies operates within four service areas:

- Commercial Credit Rating and Reporting
- Individual Credit Rating and Reporting
- Debt Collection and Risk Management
- Other Product and Services

The largest portion of the industry revenue comes from commercial credit rating and individual credit rating segments.



Source: IBIS World

Commercial credit reports and rating services comprise the largest revenue share since institutions that seek to lend money to businesses use rating reports frequently to make strategic decisions. IBIS world projects the commercial credit rating and reporting segments to dominate industry revenue in 2024, given the strong demand from downstream banking and continuous issuance of government large-scale project backed securities.

Retailers, landlords and credit card companies use individual credit card reports to assess consumers' financial reliability. This enables these businesses to offer individuals good credit discounts, apartments, and great credit cards. These companies often use credit bureaus to access this information. Recently, there has been widespread access to credit across the US economy and as such increased demand for individual credit rating and reporting services. This segment is projected to contribute the second largest portion of the industry revenue in 2024, given increasing credit utilization of an average household.

Debt collection services involves the discounted buyout of debt at a negotiated price that businesses cannot collect, saving time and money. This debt acquisition grants collection firms any rights to money collected on a debt portfolio. In recent times, Debt collection agencies have focused on purchasing larger debt, influencing debt load reductions, while increasing debt recovery rates. It is noteworthy that this segment has contracted significantly since the US government legislation during COVID against creditors taking legal action to recover their debt. We expect revenue contribution from this segment to expand further, given the resumption of student loan repayment and resurgence of debt market activities.

Other services make up a very small share of revenue, including credit rating services, resale of merchandise and investigation services. Demand for these services isn't particularly high, so their revenue share is expected to remain relatively steady in 2024.

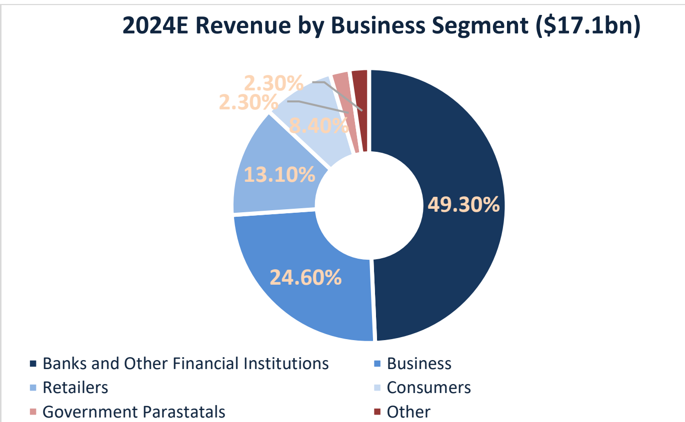
Major Market Segmentation

The Credit Information Service Industry is segmented broadly into Financial Institutions, Businesses, Retailers, Consumers, Government parastatals and other markets.

Financial Institutions and Banks hold a significant portion of the market share within the industry, primarily serving savers, borrowers, and investors, including households, businesses, and government entities. This sector encompasses various institutions like banks, credit unions, and mortgage brokers. Credit reports play a vital role in assessing creditworthiness for businesses and individuals, aiding financial institutions in managing risks. The surge in the stock market post-pandemic has empowered financial institutions with additional funds, leading to an expansion in their revenue share. A loose credit market and a robust housing sector have fueled consumer growth.

Consumers accessing credit bureaus for credit reports have seen a notable increase in revenue share, driven by expanded credit access and low interest rates. The thriving housing market has further propelled this growth.

On the contrary, the retail segment has witnessed a decline as it relates to contribution to the industry revenue, attributed to the growing presence of e-commerce. Retailers, like consumers, rely on credit bureaus to assess customer creditworthiness. However, the shift towards online shopping has resulted in fewer customers visiting physical stores, reducing demand for credit services in this segment.



Source: IBIS World

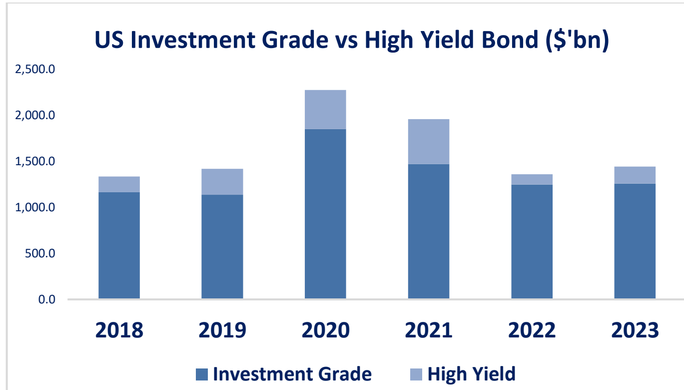
Various businesses, including manufacturers, wholesalers, and service providers, utilize credit bureaus and rating agencies to make lending decisions. Real estate developers and landlords also rely on credit reports to evaluate tenants. However, faltering corporate profits during the pandemic have led to a decrease in demand for these services from businesses.

Other markets, such as hospitals, government agencies, and non-profits, form a smaller share of revenue. These entities engage less in lending activities, resulting in limited demand for rating agencies' services. Reduced government spending and demand for healthcare and social assistance post-pandemic have further contributed to a decline in revenue from these segments.

Drivers of the Industry

Corporate Debt Issuances

The volume and value of debt issuance are key drivers of growth in the credit rating and reporting industry. Investment grade and high yield issuances slowed significantly from their peak in 2020. In 2020, businesses took advantage of near 0% interest rates to issue debt securities.



Source: SIMFA

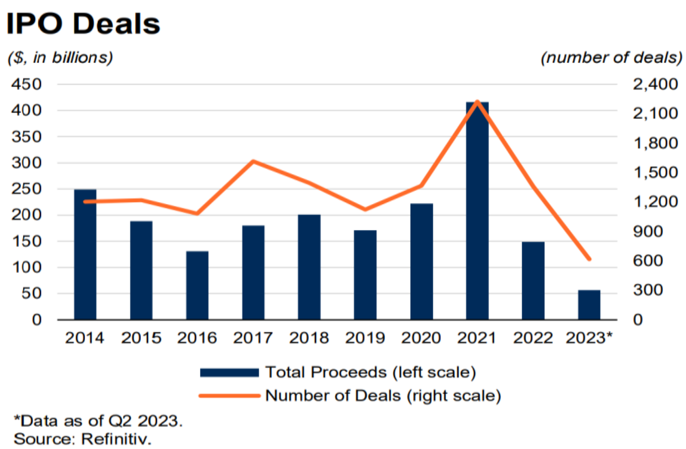
The total value of investment grade and high yield corporate issuances dropped from $2.27trn in 2020 to $1.35trn in 2022. This decline is partly attributed to increasing interest rates driven by record high inflation. Issuances remained low in 2022 and extended into 2023 as businesses had already accumulated sufficient debt during the period of low interest rates in 2020 or staying on the sidelines due to high interest rates.

In 2023, there was a modest uptick in the volume and value of investment grade and high yield bond issuances. Some market participants began to adjust to the possibility of interest rates staying higher-for-longer.

In 2024, corporate issuers started the year strongly with $454mn in new issues in both investment grade and high yield categories in the first two months alone. It is anticipated that there will be a notable improvement in the volume and value of issuances in the debt capital market by the end of 2024.

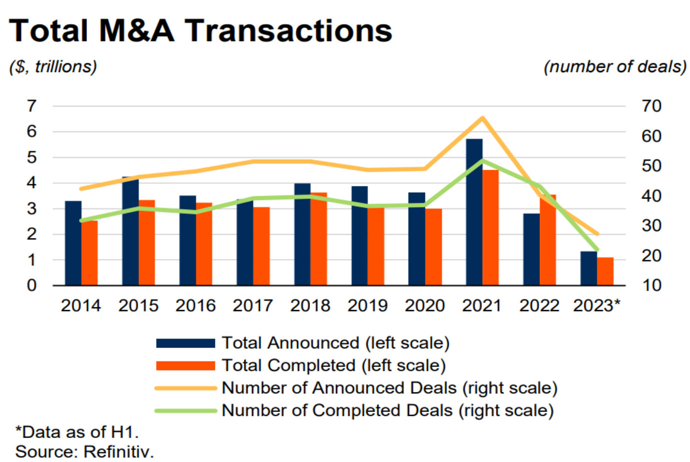
IPO Market

A vibrant Initial Public Offer (IPO) market is often indicative of positive economic sentiment and investor confidence. Credit rating agencies play a crucial role in providing independent assessments of credit risk of companies entering the public markets, improving investor confidence.



A booming IPO market translates to increased demand for credit rating services which in turn bolsters revenue for operators in this industry. IPO proceeds in 2022 printed at $148bn compared to $416bn in 2021. In 2023, number of successful IPOs fell to 154 compared to 181 IPOs in 2022 and 1035 recorded in 2021. We anticipate a resurgence of IPO activities in 2024, especially towards the second half of the year given the broad base anticipation of four-to-six rate cuts.

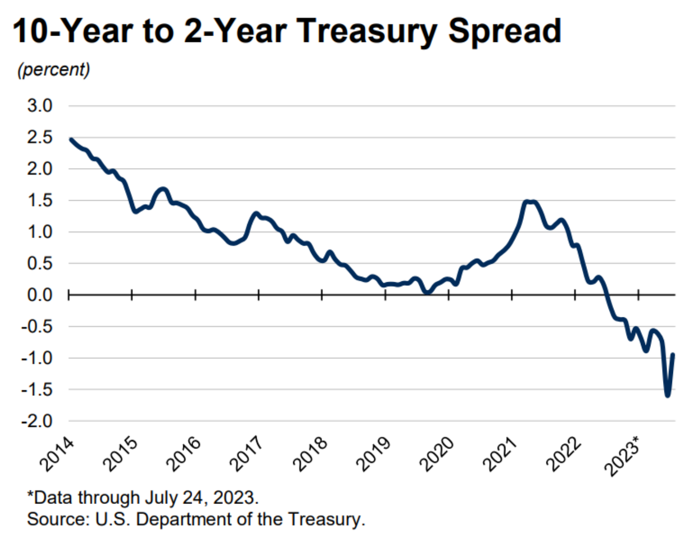
M&A Transactions



Global M&A activity in terms of announced deals touched $1.3trn in the first half of 2023, representing a 37% downward revision from same period in 2022. This was largely due to the interest rate environment and economic uncertainty fueled by geopolitical uproar across the globe. M&A fees also declined by 36% during the first half of 2023 compared to same period in 2022.

The 10-to-2-Year Treasury Spread

The spread on 10-year versus 2-year Treasury is also an indicator of investor's expectation about economic direction. A positive spread portends confidence in economic growth into the future while negative spread indicates fear of a possible decline in economic growth. The yield curve has stayed inverted since the second half of 2022 and this represents the longest inversion of the yield curve since 1980.

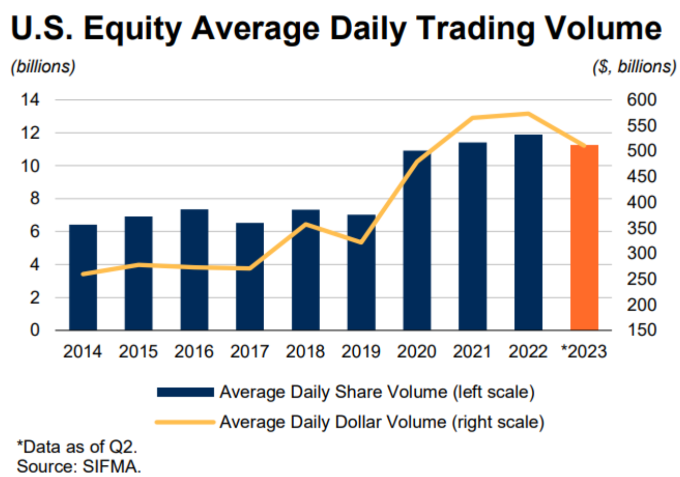


We believe the curve will gradually return to historical levels as Fed begins to pivot, particularly during the second half of 2024. In this scenario, capital market activities are expected to respond positively and in turn bolster the 2024FY revenue for credit bureaus and credit rating agencies.

Equities Market

In the Equities market, average trading volume during the first half of 2023 printed at $510.3bn compared to $665.2bn recorded the same period in 2022.

Although higher trading volume communicates increased investor activity and confidence in the market, we believe other factors like geopolitical uncertainty and Fed's hawkish stance may have contributed to the high volume recorded in 2022 and 2023.



In 2024, we do believe anticipation of a lower interest rate may sustain higher trading volume.

The Housing Market

The Housing market is also a great gauge or driver of activities in the credit rating industry, largely due to credit rating services offered to pool of mortgages packaged and sold as investment products. Credit rating agencies conduct comprehensive assessment of institutions, lenders, developers, and financial securities within the housing market. A slow-down in both starts and existing home sales during 2022 and 2023 FY dragged on revenue of credit rating agencies.

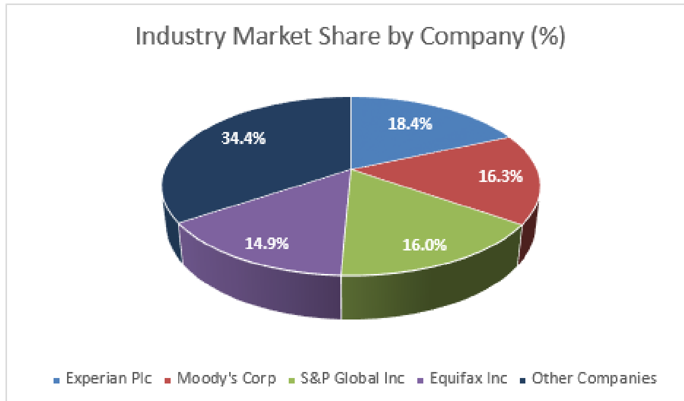
Looking ahead, we expect mortgage related activities to rebound in 2024 due to the broad anticipation of lower interest rates.

Who are the major players?

The credit rating sub-industry is a tightly regulated and concentrated space with top four firms in the industry accounting for 65.6% of the industry market share. Riding on their longstanding experience, reputation, and database, the top four firms provide quality services and thus thwart the ability of younger businesses to thrive.

Notably, the major players leverage their size and enduring reputation across markets to enjoy economies of scale whilst establishing a high barrier to entry. Specifically, companies dominating the credit rating industry are Moody's and Standard and Poor's, especially within financial services market and government debt markets.

The major players over the years strategically acquire companies in the industry to benefit from improved services or technology. We do not see any deviation from the norms except regulators shift their ruling.



Source: IBIS World

A closer examination of major industry players placed Experian Plc ahead of other rating agencies in Market share terms. The private rating agency made $2.71bn in revenue during FY 2023, albeit with a relatively low profitability margin. Moody's recorded $2.4bn in revenue with a 48.3% profit margin, while S&P Global Inc reported $2.37bn in revenue with the highest profitability margin of 59.2% in the sect.

Company	Market Share (%)	Revenue ($mm)	Profit ($mm)	Profit Margin (%)
Experian Plc	18.4	2,714.3	933.5	34.4
Moody's Corp	16.3	2,402.8	1,161.5	48.3
S&P Global Inc	16.0	2,369.7	1,403.0	59.2
Equifax Inc	14.9	2,200.0	578.7	26.3
Transunion	13.2	1,950.1	541.7	27.8
Fair Isaac Corp	3.5	512.5	145.0	28.3

Source: IBIS World

By and large, S&P Global Inc and Moody's Corporation stand tall in the industry with heavy market share, relatively competitive revenue, and a very attractive profitability margin. Experian also depicts strong market share but lower profitability and revenue growth.

Industry Trends

- **Transparency and Independence**: In recent years, regulators have consistently urged more transparency in the methods used by credit rating agencies and emphasized the need for their independence. The enactment of the Dodd-Frank Act marked a substantial change in the regulatory guidelines governing the activities of credit rating agencies. This shift aims to enhance the credibility of industry players and increase consumer trust. Additionally, notable failures in the banking sector have served as a catalyst for increased regulatory oversight of operations within the credit rating industry. Regulators now place a greater emphasis on monitoring and evaluating the methodologies, practices, and internal controls of credit rating agencies. This heightened scrutiny is designed to identify and address potential vulnerabilities and risks that could have broader implications for the financial system.

- **Technological Advancement**: Artificial intelligence (AI) and big data analytics are continuously changing how the credit rating industry operates. Given the data-centric nature of the industry, major players, particularly the leading four firms, are actively exploring ways to streamline processes and improve the accuracy of risk assessments. In the last quarter of 2023, Moody's collaborated with Google Cloud to leverage Generative AI applications, aiming to expedite data processing and enhance insights generation. Similarly, S&P Global Inc incorporated Generative AI search into its global data solutions platform, focusing on improving insights generation through natural language queries. This shift towards optimizing data and integrating AI is expected to redefine industry standards and ultimately increase demand.

- **Competitive landscape:** The credit rating industry is tightly concentrated with the two biggest contenders – Moody's and S&P Global striving hard to retain market leadership. Technological changes and dynamic consumer demand is rapidly lowering the barrier to entry and thus, increasing competition. Although, factors like decades of gathering proprietary data, market/investor preferences, industry standards and fierce regulation will be key cutting edge for major industry players. Continuous strategic acquisitions by the top firms in the industry corroborates the fierce competition and drive to deliver accurate and credible assessment of risk and creditworthiness of securities, corporations, and sovereign issues.

- **Diversification of service offering:** In recent times, credit rating agencies have been expanding their service portfolios to navigate economic downturns and adapt to challenging cycles within the rating business. Moody's, for instance, has incorporated data analytics into its credit rating operations, providing financial analysis, risk management, and valuable insights for institutional participants in the global financial market. This strategic adaptation not only bolsters the agencies' resilience but also positions them as proactive partners for financial institutions seeking robust solutions in dynamic market conditions.

PEER COMPARISON

Return Ratios Comparison:

To assess the performance of the credit rating industry, a peer comparison among key players offers valuable insights into their respective financial strengths.

Company	ROA (%)	ROE (%)
Moody's Corp.	9.5	53.0
Experian Plc	7.1	25.5
Equifax Inc	4.6	12.6
S&P Global Inc	8.5	16.9
Fair Isaac Corp	27.6	-
Transunion	2.1	(4.4)

Source: FactSet

Moody's corporation lead the sect with a 53% return on equity, while Experian and S&P global Inc trailed with 25.5% and 16.9% respectively. Elsewhere, Fair Isaac record the biggest return on asset of 27.6% with Moody's and S&P

global trailing with 9.5% and 8.5% respectively. Barring any major changes to industry norms, companies like Moody's are best positioned to continue squeezing the best return margin in the near to medium term.

Profitability Comparison:

The credit rating industry generally enjoys high profitability margin with an industry-wide average profitability margin of 28.6%.

Company	EBITDA Margin (%)	Net Margin (%)
Fair Isaac Corp	43.3	28.4
Moody's Corp	42.6	25.1
S&P Global Inc	39.8	29.0
Experian Plc	34.4	11.6
Transunion	32.0	6.8
Equifax Inc	29.3	10.4

Source: FactSet

Fair Isaac Corporation (FICO) led the pack with a 43.3% EBITDA margin and a 28.4% Net margin in 2023. Moody's Corporation and S&P Global Inc. closely trailed, with EBITDA margins of 42.6% and 39.8%, respectively. While Moody's and S&P ended the FY22 with a strong operational profitability, their Net Margins of 25.1% and 29.0% printed close to the industry average.

Experian Plc, TransUnion, and Equifax Inc. also contributed to the industry's solid average, each with distinctive EBITDA and Net Margin figures.

Experian Plc

Experian Plc operates globally as an information services company, specializing in providing data and analytical tools for credit risk management, fraud prevention, targeted marketing, and automated decision-making. Experian Plc commands approximately 21,700 employees with significant presence in the US across multiple industries, notably in Management Consulting and Credit Bureaus & Rating Agencies. It controls a noteworthy 18.4% market share in the Credit Bureaus & Rating Agencies industry, positioning itself as an incumbent due to its strong market share.

$millions	2020	2021	2022	2023
Revenue	5179	5372	6288	6619
EBITDA	1792	1842	2155	2275
EBITDA Margin	34.6%	34.3%	34.3%	34.4%
Net Income	677	803	1149	770
Net Margin	13.1%	14.9%	18.3%	11.6%

Source: FactSet

Experian However, Experian exhibits comparatively lower profit and revenue growth than some industry counterparts. The company's business is organized into four main global segments: Credit Services, Decision Analytics, Marketing Services, and Consumer Services. Experian demonstrated consistent growth in revenue and net margin, with revenue increasing from $5,179 million in 2020 to $6,619 million in 2023. The net margin saw a progressive rise from 13.1% in 2020 to 18.3% in 2022, indicating an increased demand for credit services and a surge in the number of issuances post-COVID-19. Despite these positive trends, the EBITDA margin remained relatively stable, hovering around 34% throughout the reviewed period.

S&P Global Incorporation

S&P Global, Inc. is a renowned provider of transparent and unbiased ratings, benchmarks, analytics, and data for global capital and commodity markets. The company operates across various segments, including Market Intelligence, Ratings, Commodity Insights, Mobility, Indices, and Engineering Solutions.

In Market Intelligence, S&P Global offers data and analytics with workflow solutions. The Ratings segment focuses on credit ratings, research, and analytics, furnishing investors and market participants with valuable information, ratings, and benchmarks, especially in public and private securities domain. Commodity Insights focuses on commodity and energy market information. Mobility serves the automotive value chain, and Engineering Solutions uses technology for innovation.

$millions	2020	2021	2022	2023
Revenue	7442	8297	11181	12497
EBITDA	3990	4419	4453	5197
EBITDA Margin	53.6%	53.3%	39.8%	41.6%
Net Income	2339	3024	3248	2626
Net Margin	31.4%	36.4%	29.0%	21.0%

Source: Factset

S&P Global had consistent growth in revenue from $7.4 billion in 2020 to $12.5 billion in 2023. The EBITDA also increased steadily from $3.99 billion in 2020 to $5.2 billion in 2023. However, in margin terms, EBITDA contracted moderately from 53.6% level seen in 2020 and 2021 to 41.6% in 2023. Given the positioning of S&P in the credit rating industry, we expect profitability margins to return to historical averages as credit activities and demand return.

The credit rating veteran was established in 1917 by James McGraw and John Hill with its headquarters located in New York.

Fair Isaac Corporation

Fair Isaac Corporation (FICO) is an active player in the decision management solutions space, operating primarily through the Software and Scores segments. The Software segment encompasses focuses on analytics and decision management solutions tailored for specific business needs or processes. On the other hand, the Scores segment concentrates on providing business-to-business credit scoring solutions and services, along with business-to-consumer credit scoring solutions and services. FICO also operates myFICO solutions tailored for consumers, coupled with associated professional services.

During the period under review, FICO had a consistent but slow revenue growth from $1.295bn in 2020 to $1.51bn in 2023. Although EBITDA margin grew from 30% level seen in 2020 to 43% level in 2023. Net margin averaged 26% during the period under review.

$millions	2020	2021	2022	2023
Revenue	1295	1317	1377	1513
EBITDA	391	455	579	656
EBITDA Margin	30.2%	34.6%	42.0%	43.3%
Net Income	236	392	374	429
Net Margin	18.3%	29.8%	27.1%	28.4%

Source: FactSet

TransUnion

TransUnion is a provider of information and risk management solutions, offering services such as consumer reports, risk scores, analytical services, and decision-making capabilities to businesses. Its operational framework embeds several segments, namely U.S. Markets, International, Consumer Interactive, and Corporate.

Within the U.S. Markets segment, TransUnion delivers consumer reports, risk scores, analytical services, and decision-making capabilities to businesses. The International segment focuses on offering credit reports, analytics, decision-making services, and other value-added risk management services. Meanwhile, the Consumer Interactive segment provides solutions aimed at helping consumers manage their personal finances and safeguard against identity theft. The Corporate segment plays a supportive role by providing services to each operational segment, managing investments, and handling enterprise functions.

$millions	2020	2021	2022	2023
Revenue	2531	2960	3709.9	3779
EBITDA	886.7	1009.8	1186.1	1185
EBITDA Margin	35.0%	34.1%	32.0%	31.4%
Net Income	306	370	268	-164
Net Margin	12.1%	12.5%	7.2%	-4.3%

Source: FactSet

During the period under review, TransUnion saw steady growth in revenue as well as a healthy EBITDA margin. Revenue grew from $2.53bn in 2020 to $3.78bn in 2023, while EBITDA margin averaged 33% during the same period. Net margin, however, shrank significantly from 12% in 2020 to a negative 4.3% in 2023.

RECENT DEVELOPMENTS

Technological Integration

Major players in the credit rating industry are strategically embracing emerging technologies, notably artificial intelligence, and big data analytics, to optimize and enhance service quality. This industry-wide shift towards technological integration is instrumental in diversifying cyclical risks associated with economic fluctuations and the demand for credit services. Specifically, Moody's joined forces with Microsoft Azure in June 2023 to develop innovative products and services for research and risk assessment, leveraging the capabilities of Azure OpenAI Service. The partnership resulted in the creation of "Moody's CoPilot," an internal tool deployed across Moody's 14,000 global employees. This tool combines Moody's proprietary data, analytics, and research with cutting-edge large language models (LLMs) and Microsoft's top-tier generative AI technology. The goal is to drive firm-wide innovation and boost employee productivity within a secure digital sandbox. S&P Global, another significant player, introduced Generative Artificial Intelligence search on the S&P Global Marketplace in February 2024. This initiative reflects a commitment to streamlining service offerings, ultimately enriching the consumer's perspective. We expect continued adoption of artificial intelligence and technological integration to not just aid credit rating operations but also provide other avenues for credit rating agencies to generate more revenue and improve margins.

Strategic Acquisitions

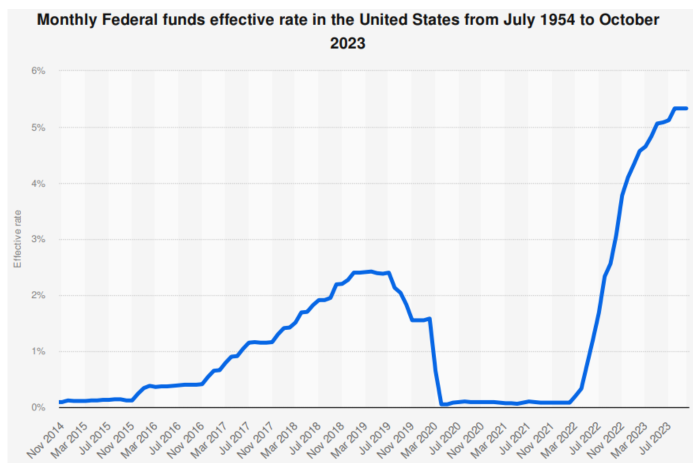
The credit rating industry is continually seeing strategic acquisitions, both on the domestic and international fronts, spearheaded by industry giants such as Moody's and S&P Global. For instance, S&P Global has marked its presence with a robust track record of 239 acquisitions since its inception, including three completed deals in 2023. Notably, several of these acquisitions, like ChartIQ and Market Scan, focus on technology and data solutions, indicating S&P Global's commitment to integrating cutting-edge innovations.

In the same vein, Moody's is actively pursuing strategic acquisitions through its subsidiaries, strategically positioning itself in the highly competitive and tightly concentrated industry. A noteworthy instance is Moody's Oliver Wyman's recent acquisition of SeaTec Consulting in February 2024. This move reflects Moody's foresight, aiming to harness SeaTec's expertise in engineering and digital domain consulting to fuel growth and enhance operational efficiency. These strategic maneuvers underscore the industry's dynamic nature, where major players continually seek to evolve, innovate, and fortify their positions through well-calculated.

ECONOMIC OUTLOOK

Interest rate

Interest rate is a big driver of business for credit rating agencies. Throughout 2023, the Fed combatted sticky inflation by raising the policy rates by an additional 75bps to a target range of 5.00% - 5.25%.



Source: Statista

The pace of activities in the capital markets, particularly regarding debt issuances, refinancing, and Initial Public Offers, experienced a slowdown in 2023. Analysts are of the view that the Federal Reserve will adhere to a higher-for-longer policy rate, buoyed by the robust and resilient U.S. economy. Recent announcements and policy guidance from the Fed's Chair and principal officials suggest that the era of rate hikes might be behind us, with the possibility of a cut being closer than initially anticipated.

In a bullish scenario, we are factoring in the expectation of four-to-six rate cuts, predominantly in the latter half of the year. Conversely, the bear case scenario anticipates two-to-four rate cuts in 2024. For the credit rating industry, such a shift signifies a potential resurgence in activities, paving the way for a rebound in revenue and margins. These considerations underscore the industry's sensitivity to monetary policy shifts and its potential for renewed vitality based on evolving economic conditions.

Inflation

Inflation in the US jumped from 0.33% in April 2020 when the pandemic hit, to a peak of 9.06% in June of 2022. One of the legacy factors contributing to sticky prices during the period was geopolitical faction in western Europe – Russia's invasion of Ukraine. The conflict disrupted supply chain within the energy markets and led to myriad of sanctions, causing overall prices to sky.

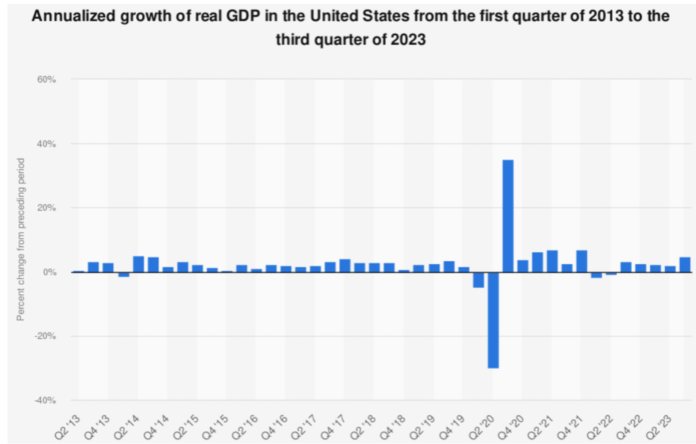
Source: Statista

Fed's effort to bring back inflation to target range of 2% yielded positive results as inflation slid from 9.06% in June of 2022 to 3% in the second half of 2023.

We believe the 2% target range will take longer to achieve, especially due to the resilience of the US economy. However, we do not anticipate any significant explosion in general prices in the near term, barring unforeseen economic situations.

GDP Growth

The credit rating industry thrives in a growing economic situation. GDP growth translates to a thriving business environment and as such, improves capital appetite of the real sector.



Source: Statista

The slowing trend of GDP growth since the third quarter of 2022 was overturned by the 4.9% growth seen in the third quarter of 2023. In line with market consensus, we expect the real sector growth to remain positive in the near term. Meanwhile, sustained growth of the real sector is a strong signal that capital market activities may gradually be returning.

CEO Confidence

CEO confidence as measured and reported by The Conference Board in collaboration with The Business Council depicted upward trajectory, especially since the second half of 2023.

Source: The Conference Board

This metric serves as an important gauge of CEO confidence, reflecting their optimism about future economic conditions. Notably, CEO confidence improved to 53 in the first quarter of 2024, compared to 46 recorded during the fourth quarter of 2023, marking the first-time optimism prevailed in the measure since Q1 of 2022.

This aligns with our expectation of businesses rebounding at least in the second half of 2024. The positive trend in CEO confidence underscores a potential shift in sentiment and bodes well for economic prospects in the coming months, and in turn the credit rating industry.

CATALYSTS AND KEYS TO MONITOR

Bull Case

Overall, interest rate dent is now behind the credit rating industry, and we believe operators are warming up for resurgence of capital market activities.

In our optimistic scenario, we see the Fed cutting rates by 75bps to 125bps in 2024, a development that will significantly impact number of debt issuances, credit refinancing, Initial public offers and government issuances. This will intensify demand for credit rating services and boost demand for companies like Moody's.

We also expect the trend of acquisition in the industry to remain on an upward trajectory, especially as major players strive to retain market leadership and keep the larger share of the industry's profitability.

Lastly, we believe technological integration into credit rating services, risk management and decision solutions across the industry will keep revenues and margin growing, barring any significant changes in the industry landscape.

Bear Case

Given the escalating geopolitical tensions globally, coupled with supply chain disruptions and an unprecedented economic shock, there is a looming possibility of a return to an era of rising prices. Should this scenario unfold, interest rates are likely to stay elevated for an extended period, impacting the overall industry outlook significantly.

The industry's optimism is heavily reliant on the Federal Reserve's ability to orchestrate a soft landing. Striking the right balance in interest rates—avoiding a recession while preventing the economy from overheating—is crucial. Failure to achieve this delicate equilibrium may cast a shadow on the industry's prospects, at least in the short term.

Another factor to closely monitor is the upcoming US election. While we don't anticipate any major surprises, the market's response during periods of political transition can be inherently unpredictable. These dynamic factors contribute to an environment where industry players must navigate carefully and stay attuned to the broader economic landscape.

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