McGRAW HILL FINANCIAL

McGraw Hill Financial
3rd Quarter 2014 Earnings Conference Call
Prepared Remarks
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Chip Merritt
Vice President, Investor Relations
McGraw Hill Financial

Good morning. Thank you for joining us for McGraw Hill Financial's third quarter 2014 earnings call. Presenting on this morning's call are Doug Peterson, our President and CEO, and Jack Callahan, our Chief Financial Officer.

This morning we issued a news release with our results. I trust you have all had a chance to review the release. If you need a copy of the release and financial schedules, they can be downloaded at www.mhfi.com.

In today's earnings release and during the conference call we're providing adjusted financial information. This information is provided to enable investors to make meaningful comparisons of the Corporation's operating performance between periods and to view the Corporation's business from the same perspective as management's. The earnings release contains exhibits that reconcile the difference between the non-GAAP measures and the comparable financial measures, calculated in accordance with U.S. GAAP.

Before we begin, I need to provide certain cautionary remarks about forward-looking statements. Except for historical information, the matters discussed on today's call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including projections, estimates, and descriptions of future events. Any such statements are based on management's current expectations and current economic conditions and are subject to risks and uncertainties that may cause actual results to differ materially from results anticipated in these forward-looking statements. In this regard, we direct listeners to the cautionary statements contained in our Form 10-K, 10-Q, and other periodic reports filed with the U.S. Securities and Exchange Commission.

I would also like to call your attention to a recent European regulation. Any investor who has, or expects to obtain, ownership of 5% or more of McGraw Hill Financial should give me a call to better understand the impact of this legislation on the investor, and potentially the Company.

We're aware that we do have some media representatives with us on the call. However, this call is intended for investors and we would ask that questions from the media be directed to Jason Feuchtwanger in our New York office at (212) 512-3151 subsequent to this call.

At this time, I'd like to turn the call over to Doug Peterson.

Douglas L. Peterson
President and CEO
McGraw Hill Financial

Thank you, Chip. Good morning everyone and welcome to the call.

The Company delivered a terrific quarter with 10% revenue and 32% adjusted EPS growth. And more broadly, in creating McGraw Hill Financial, we have made sweeping changes to the Company. In the third quarter of 2014, we continued to take actions designed to position our Company for innovation and profitable growth.

Before reviewing our financial performance, I'd like to highlight three matters included in our press release:

- First, during the third quarter, we announced the sale of McGraw Hill Construction to Symphony Technology Group for $320 million. This sale positions us as a more growth oriented and profitable company.
- Second, we took a number of restructuring actions in the quarter, which impacted almost 400 employees. We remain committed to our growth and performance objectives we outlined at Investor Day including productivity goals.
- Third, Standard & Poor's Ratings Services is in active discussions to resolve matters pending before the Securities and Exchange Commission, including with respect to the previously disclosed "Wells Notice" received in July, as well as related investigations by the Attorneys General of New York and Massachusetts. Although definitive settlements have not been reached, a charge of $60 million related to these matters was recorded in the third quarter. Because we remain in active discussions with these parties, I am unable to provide additional information regarding these matters at this time. Separately, I am pleased to report that the SEC recently notified us that it has completed its investigation of the Delphinus matter, this was the subject of a Wells Notice issued in September 2011. The SEC indicated that no enforcement action will be taken with respect to this matter.

Now, let's turn to our results, we are pleased to report excellent operating performance in the third quarter. Revenue, margins, and profitability, on an adjusted basis, all improved versus the third quarter of last year.

Leading the revenue growth during the quarter were Standard & Poor's Ratings Services and S&P Dow Jones Indices—each delivering double-digit growth. S&P Capital IQ and Commodities & Commercial reported single-digit revenue growth and record adjusted operating profit. Adjusted diluted EPS increased 32% to $1.02.

If we look at performance in the third quarter on a consolidated basis:

- Revenue increased 10% year-on-year;
- Adjusted operating profit increased 24%; and
- We achieved a 420 basis-point improvement in the adjusted operating margin.

All very impressive accomplishments.

For our year-to-date figures:

- Revenue increased 8% year-on-year and 9% organically;
- Adjusted operating profit increased 14%; and
- The adjusted operating margin improved 200 basis points.

Our year-to-date growth in revenue, adjusted operating margins, and diluted adjusted EPS are all consistent with our 2014 guidance. The Company has converted high single-digit revenue growth into double-digit diluted adjusted EPS growth.

And year-to-date, the Company has delivered free cash flow of $737 million.

Our global footprint continues to expand as international revenue growth of 12% outpaced domestic growth of 8%. In this chart, you can see that most of our business units delivered double-digit international revenue growth.

Standard & Poor's Ratings Services

Now, let me turn to the individual businesses. And I'll start with Standard & Poor's Ratings Services.

During the quarter:

- Revenue increased 12%;
- Adjusted operating profit jumped 24%; and
- The adjusted operating margin increased 430 basis points to 44.0% in what has been a seasonally weak quarter.

Revenue growth was primarily the result of strong market demand for ratings associated with bond issuance, bank loans, and new entities.

Adjusted expenses increased almost entirely from additional legal expenses.

In an effort to improve streamline operations, Standard &Poor's Ratings initiated a voluntary severance program during the quarter. This program accounts for much of the restructuring charge in the business unit.

Standard & Poor's Ratings delivered exceptional margin expansion during the quarter. In this seasonally slow quarter for issuance, the adjusted operating margin increased 430 basis points.

We are always interested in making investments to augment our portfolio of leading brands. On October 1, we acquired BRC Ratings Services. BRC has 16 years of experience as a leading provider of credit ratings based in Bogota. BRC provides approximately 300 ratings in Colombia covering corporate bonds, counterparty risk, securitizations, and public sector entities. This is a welcome addition to our ratings capabilities.

You'll see, moving to this next slide, that non-transaction growth in the quarter, which in aggregate grew 7%, was driven primarily by annual fees and growth at CRISIL. Annual fees increased as we continue to expand our client coverage. In addition, they increased from a recent focus on better realization from frequent issuer programs.

CRISIL delivered 13% growth primarily driven by Irevna which increased revenue almost 20%. Irevna provides global research and analytics services.

Transaction revenue was up 18% due to strong growth in Financial Services' bond ratings as banks continue to rebuild capital structures to meet regulatory requirements. While many of these large customers have signed up for frequent issuer programs, issuance that exceeds certain stipulated thresholds results in excess issuance fees. These excess issuance fees are recorded as transaction revenue and contributed to growth during the quarter.

Also driving transaction revenue growth was a 19% increase in bank loan ratings revenue. This is a continuation of a trend that we have seen for several quarters now.

As you see in these graphs, total issuance decreased in the U.S. by 2% while it increased in Europe by 9%. Excluding the $49 billion bond issuance by Verizon in the third quarter of 2013, issuance in the U.S. actually grew.

In the U.S., structured finance issuance increased 37%. This was primarily the result of collateralized loan obligations (or CLOs) with year-to-date 2014 issuance surpassing the previous annual issuance record. In addition, CMBS had its strongest quarter of issuance since 2007.

In Europe, corporate issuance grew 10% driven by increased investment-grade issuance, particularly in financial services. High-yield decreased 21%, following a record second quarter. Structured finance grew 8% driven by ABS which increased 89% primarily as a result of increased auto issuance.

Before leaving the topic of Standard & Poor's Ratings, I want to provide a couple of regulatory and legal updates. First, in late August, the SEC published final rules under Dodd-Frank relating to NRSROs. Standard & Poor's Ratings is undertaking a comprehensive review of the new rules and related adopting release, which are over 700 pages long. As with all regulations applicable to our businesses, we will continue to take the steps we believe are necessary to be in compliance within the required time frames.

Second, Standard & Poor's Ratings continues to work through a number of legal and regulatory matters, including the matters I referred to earlier that resulted in a $60 million charge in the third quarter. Starting with this quarter's Form10-Q, which will be on file later today, we will provide a comprehensive update of material pending matters and developments in each of our quarterly filings. I would direct you to those filings for more information.

S&P Capital IQ

Now let me move on to S&P Capital IQ which delivered top-line growth of 6% this quarter. Excluding the lost revenue from ongoing portfolio rationalization of several small products, organic growth was approximately 7%. The largest contributors to this growth were S&P Capital IQ Desktop and RatingsXpress® which both delivered double-digit growth.

Top-line growth in S&P Capital IQ is particularly impressive in light of the ongoing revenue and employment declines across the financial services industry. This revenue growth has enabled the business to report record adjusted operating profit and the highest adjusted operating margin since the second quarter of 2012.

Let me add a bit more color on revenue growth in the three business lines:

- S&P Capital IQ Desktop & Enterprise Solutions revenue increased 8%, principally driven by a 13% increase in Desktop revenue.
- S&P Credit Solutions revenue increased 6%. This was driven by an 11% increase in RatingsXpress®.
- S&P Capital IQ Markets Intelligence revenue decreased 3%. While Leveraged Commentary & Data and Global Markets Intelligence continued to deliver double-digit-growth, declines due to the shutdown of FMR Europe more than offset those gains.

S&P Dow Jones Indices
Now let me turn to S&P Dow Jones Indices.

This business delivered a 15% increase in revenue with an 18% increase in adjusted operating profit. Revenue growth was achieved across all businesses: ETF AUM, mutual fund AUM, derivatives, and data subscriptions. Adjusted expenses increased 10% year-over-year due primarily to headcount additions.

If we turn to the key business drivers, ETF AUM associated with our indices increased 25% to a record $733 billion from the end of the third quarter 2013. Importantly, 10% of this growth was the result of new inflows.

Derivative trading volumes picked up in the quarter with daily volumes based on S&P Dow Jones Indices increasing 7%. The trading volumes of two key products, SPX and VIX, increased 10% and 12%, respectively.

S&P Dow Jones Indices continues to expand its product offerings and partner relationships around the world. During the quarter, the business announced an agreement with Bolsa Mexicana de Valores (BMV) for index licensing, distribution, and management of BMV Indices. This includes their flagship index, IPC (Índice de Precios y Cotizaciones), the broadest indicator of the BMV's overall performance.

S&P Dow Jones Indices also announced an agreement with Bolsa de Valores de Lima (BVL) for index licensing, distribution, and management of BVL Indices. All BVL indices will be co-branded "S&P" including a new version of the flagship IGBVL index and a new blue chip index soon to be launched.

Interest in passive investing through index-based investment products is just beginning to take shape in Latin America. With more ETF assets based on our indices than any other index provider in the world, S&P Dow Jones Indices is in a unique position to help facilitate the growth of index-based investing in Mexico and Peru by offering a deeper and more prolific lineup of benchmarks. By aligning with these premier exchanges, international and domestic investors will have new tools to measure and potentially access investment opportunities in Latin America.

Lastly, S&P Dow Jones Indices, in conjunction with Research Affiliates, a global leader in innovative indexing and asset allocation strategies, launched the Dow Jones RAFI Commodity Index. There has been a lot a talk about alternative-beta indices lately. This is another example of an alternative beta index offering from S&P Dow Jones Indices. The Dow Jones RAFI Commodity Index offers a factor-based approach that uses certain criteria to under and overweight commodities, but with typical indexing merits like liquidity, governance, and transparency.

Commodities & Commercial Markets
Now let me turn to Commodities & Commercial Markets.

With the sale of McGraw Hill Construction expected to close in the fourth quarter of 2014, we moved McGraw Hill Construction to discontinued operations, thus restating our financials for 2014 and 2013 to reflect this.

On a continuing operations basis, revenue grew 7% in the quarter and adjusted operating profit increased approximately 9%. Importantly, the segment's adjusted operating margin has been materially enhanced. The divestiture of Aviation Week and McGraw Hill Construction, coupled with the elimination of the Commodities & Commercial management layer, has improved adjusted margins by approximately 400 basis points.

If you go back and look at last year's third quarter results, you will see that this business unit reported adjusted operating margins of 32.3% versus 36.7% this quarter.

I want to point out that since Commodities & Commercial Markets now includes only Platts and J.D. Power, on a going forward basis, we will no longer be breaking out revenue for the two components.

Now turning to Platts in the third quarter, Platts delivered high single-digit revenue growth as strength in price assessments, market data subscriptions, and a modest benefit from the recent Eclipse acquisition were partially offset by weakness in Global Trading Services.

Global Trading Services' licensing revenue continued to be impacted by weak trading volumes. Metals & Agriculture, building on recent investments, delivered the greatest rate of revenue growth at 27%.

On September 9, IOSCO released its initial report on the implementation of its Principles for Oil Price Reporting Agencies, or PRAs, concluding that "…during the first year of implementation, the four PRAs have made good progress with regard to the PRA principles."

Platts continues to launch new products and services. This slide shows the increasing breadth of the Platts business. Platts' leadership has worked steadily over the past few years to build an Agriculture Group capable of growing beyond sugar and biofuels. Platts recently embarked on its first foray into a new agricultural sector, formally launching its inaugural publication for the grain markets.

Daily Grains features daily price assessments for FOB Black Sea Wheat, Azov Sea Wheat, Black Sea Corn, and CIF Marmara Wheat, as well as market commentary and price rationales. The new offering introduces the concept of price discovery into the Black Sea grains market and frees market participants from gathering news and prices from multiple sources.

The liberalization of Turkey's power industry was the driving force behind the July 2 launch of new price assessments for the Turkish market and a new supplement to *European Power Daily*. The new assessments and new publication, *Turkish Power Weekly*, reflect nearly two years of deep market engagement in Turkey with key market participants.

On August 15, Platts launched a weekly spot price assessment for Europe-delivered, industrial-grade wood pellets, known as I2, and a suite of U.K. wood pellet profitability spreads at different fuel efficiencies. The move was spurred by an emerging trend in Europe of fueling power plants with I2 pellets alone or in combination with coal to cut down on greenhouse-gas emissions.

Now turning to J.D. Power, the business delivered double-digit revenue growth in the third quarter driven by gains in the auto business. Auto business growth was fueled primarily by the U.S. PIN (Power Information Network) business, as well as consulting. PIN provides real-time automotive information and decision-support tools based on the collection and analysis of daily new- and used-vehicle retail transaction data from thousands of automotive franchises. Details from these transactions are evaluated to create products that focus on key measures, including price, cost, profit, finance terms, lease, and trade-in values.

Revenue from Global Services Industries, which includes financial services, insurance, telecommunications, travel, and other non-auto related customers, increased modestly in the quarter as did revenue from advertising licensing from customers' usage of the J.D. Power brand.

In summary, I am pleased with the excellent operating results we saw in the third quarter as we continue to create growth and drive performance across the Company:

- Total revenue increased 10% supported by 12% international revenue growth,
- We continued to launch new products and establish licensing agreements,
- We rationalized our portfolio with the sale of McGraw Hill Construction, and
- We initiated additional restructuring efforts.
- Financially, the Company delivered 32% adjusted diluted EPS growth and year-to-date free cash flow of $737 million.

I want to thank all of you for joining the call this morning and now I'm going to hand it over to Jack Callahan, our Chief Financial Officer.

Jack Callahan
Executive Vice President and CFO
McGraw Hill Financial

Thank you, Doug. Good morning to everyone joining us on the call.

I want to briefly add a bit more color to several items related to third quarter performance.

- First, I will discuss the impact to our financial results due to the reclassification of McGraw Hill Construction as a discontinued operation;
- Second, I will review certain adjustments to earnings that were recorded in the quarter;
- Third, I will recap key consolidated financial results in the quarter;
- Fourth, I will provide updates on the balance sheet, free cash flow, and return of capital;
- And finally, I will review our updated guidance, which is directly impacted by the elimination of McGraw Hill Construction.

The sale of McGraw Hill Construction to Symphony Technology Group is expected to close in the fourth quarter. With the sale pending, we have reclassified the business as a discontinued operation. It is important to understand the impact on our financial results from this change.

All of the financial periods presented today exclude McGraw Hill Construction results from continuing operations. This includes the current quarter results, as well as both year-to-date and prior year results. This change reduced our reported revenue as well as our earnings per share from continuing operations. This has an impact on 2014 guidance as Construction represented approximately 10 cents of earnings per share. I will provide more detail on our updated guidance shortly.

Now let me turn to adjustments to earnings to help you better assess the underlying performance of the business. In total, pre-tax adjustments to earnings from continuing operations totaled $110 million during the quarter.

The first of these, as Doug already discussed, is a $60 million charge related to certain regulatory matters. As we stated in the earnings release, there can be no assurance that this amount will be sufficient to resolve these matters or that definitive agreements will be reached. As Doug mentioned, we are actively working with these parties to resolve these matters. You should review our Form 10-Q, which will be filed shortly, for additional information regarding legal and regulatory matters generally.

Next was a $46 million charge related to restructuring actions taken across the Company. Consistent with our efforts to achieve productivity gains, we undertook numerous actions to streamline operations. Most of the charges recorded in the quarter were related to severance. We currently expect approximately half of the savings associated with these actions will flow to the bottom line in 2015, while the balance is aimed at reallocating costs to fund longer-term growth initiatives. As Doug stated, we remain committed to pursuing the growth and performance goals we outlined earlier this year during our Investor Day.

Lastly, there was also a $4 million adjustment to S&P Dow Jones Indices for professional fees related to corporate development activities.

Now, let's turn to the third quarter income statement. Overall, these are just terrific results:

- Revenue grew 10%;
- Adjusted segment operating profit grew 20%, with all four business units contributing to this growth. Standard & Poor's Ratings and S&P Capital IQ led the way as each delivered adjusted

operating profit growth of 24%. Most notably, after cycling through a period of stepped-up investments, S&P Capital IQ delivered record adjusted quarterly operating profit;

- Adjusted unallocated expense decreased $6 million, primarily due to lower corporate costs;
- The tax rate on an adjusted basis was 33.5%, consistent with our previous guidance. Please note that on a GAAP basis, the tax rate was approximately 39%, largely due to the $60 million charge related to certain regulatory matters, which we have assumed is non-deductible.
- Adjusted net income increased 31%, and adjusted diluted earnings per share increased 32% to $1.02. The average diluted shares outstanding decreased by 3.4 million shares versus a year ago, driven by both share repurchase activity and a reduction in the number of stock options outstanding.

Now, let's turn to the balance sheet. As of the end of the third quarter, we had $1.9 billion of cash and cash equivalents, of which almost $1 billion is held outside the United States. We continue to have approximately $800 million of long-term debt. Our free cash flow during the first nine months of the year was $737 million.

Going forward, we believe our balance sheet positions us well to make investments that strengthen the portfolio, including acquisitions; maintain our long history of dividend growth; and, as appropriate, continue our share repurchase activity.

Now let me update you on our return of capital activity. During 2014, we have repurchased a total of 4.4 million shares at an average price of $79.06 for a total of $350 million. The total year-to-date return of capital in dividends and share repurchases is $607 million. We did not repurchase any shares in the third quarter. In the near term, we decided to maintain the availability of domestic cash for potential acquisitions and other considerations. Over the long term, we intend to continue repurchasing shares after taking into account the other uses of cash that I just mentioned.

Now I would like to turn to our 2014 guidance, which we are updating due to both the sale of Construction and strong third-quarter performance.

- First, we are increasing our revenue guidance from mid single-digit growth to mid- to high-single-digit growth as all of the businesses are performing well.
- Second, our previous adjusted operating profit margin guidance was an increase of at least 100 basis points. In light of the excellent progress we have made year-to-date, we are increasing this guidance to approximately 200 basis points.
- Third, we have adjusted our guidance for earnings per share from continuing operations to reflect the reclassification of McGraw Hill Construction as a discontinued operation. This removed all of their earnings from our income from continuing operations. As I mentioned earlier, from an EPS perspective, this resulted in an elimination of approximately $0.10 on a full-year basis. However, based upon the continued strength in our results, we can offset some of this elimination. Therefore, our new 2014 adjusted earnings per share guidance from continuing operations is a range of $3.78 to $3.83.
- Finally, we are slightly lowering our capital expenditure guidance to approximately $100 million.

The remaining elements of our 2014 guidance remain unchanged.

In closing, we continue to focus on creating growth and driving performance. Strong year-to-date results across our business units, and the restructuring actions highlighted today are examples of our efforts to deliver on these goals.

We remain very much on track for a strong year of growth and performance in 2014—our first full year as McGraw Hill Financial.

To access the accompanying slides online, go to:
http://investor.mhfi.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=5171748

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995
This presentation contains "forward-looking statements," as defined in the Private Securities Litigation Reform Act of 1995. These statements, which express management's current views concerning future events or results, use words like "anticipate," "assume," "believe," "continue," "estimate," "expect," "future," "intend," "plan," "project" and similar terms, and future or conditional tense verbs like "could," "may," "might," "should," "will" and "would." For example, we may use forward-looking statements when addressing topics such as: the outcome of contingencies; future actions by regulators; changes in our business strategies and methods of generating revenue; the development and performance of our services and products; the expected impact of acquisitions and dispositions; our effective tax rates; and our cost structure, dividend policy, cash flow and liquidity.

Forward-looking statements are subject to inherent risks and uncertainties. Factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements include, among other things:

- the regulatory environment affecting Standard & Poor's Ratings Services, Platts, S&P Dow Jones Indices, S&P Capital IQ and our other businesses, including new and amended applicable regulations and our compliance therewith;
- the outcome of litigation, government and regulatory proceedings, investigations and inquiries;
- worldwide economic, financial, political and regulatory conditions;
- the health of debt and equity markets, including credit quality and spreads, the level of liquidity and future debt issuances;
- the level of interest rates and the strength of the credit and capital markets in the U.S. and abroad;
- the demand and market for debt ratings in and across the sectors and geographies where we operate;
- the effect of competitive products and pricing;
- the level of success of new product development and global expansion;
- the level of merger and acquisition activity in the U.S. and abroad;
- the volatility of the energy marketplace;
- the health of the commodities markets;
- the strength and performance of the domestic and international automotive markets;
- the level of our future cash flows;
- our ability to make acquisitions and dispositions and to integrate, and realize expected synergies, savings or benefits from, the businesses we acquire;
- our ability to maintain adequate physical, technical and administrative safeguards to protect the security of confidential information and data, and the potential of a system or network disruption that results in regulatory penalties, remedial costs and/or improper disclosure of confidential information or data;
- the level of our capital investments;
- the level of restructuring charges we incur;

- our ability to successfully recover should we experience a disaster or other business continuity problem, such as a hurricane, flood, earthquake, terrorist attack, pandemic, security breach, cyber attack, power loss, telecommunications failure or other natural or man-made disaster;
- changes in applicable tax or accounting requirements;
- the impact on our net income caused by fluctuations in foreign currency exchange issues; and
- our exposure to potential criminal sanctions or civil remedies if we fail to comply with foreign and U.S. laws and regulations that are applicable in the domestic and international jurisdictions in which we operate, including sanctions laws relating to countries such as Iran, Russia, Cuba, Sudan and Syria, anti-corruption laws such as the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act of 2010, local laws prohibiting corrupt payments to government officials, as well as import and export restrictions.

The factors above are not exhaustive. McGraw Hill Financial, Inc. and it subsidiaries operate in a dynamic business environment in which new risks may emerge frequently. Accordingly, we caution readers not to place undue reliance on the above forward-looking statements, which speak only as of the dates on which they are made. The Company undertakes no obligation to update or revise any forward-looking statement to reflect events or circumstances arising after the date on which it is made. Further information about our businesses, including information about factors that could materially affect our results of operations and financial condition, is contained in the Company's filings with the Securities and Exchange Commission, including the "Risk Factors" section in our most recently filed Annual Report on Form 10-K.