McGraw Hill Financial
4th Quarter 2013 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 fourth quarter 2013 earnings call. Presenting on this morning's call are Doug Peterson, President and CEO, and Jack Callahan, Chief Financial Officer. Also joining us is Ken Vittor, our General Counsel.

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 in the teleconference 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 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-Ks, 10-Qs, and other periodic reports filed with the U.S. Securities and Exchange Commission.

I would also like to call your attention to a new 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.

McGRAW HILL FINANCIAL

Douglas L. Peterson
President and CEO
McGraw Hill Financial

Thanks, Chip and good morning everyone. I would like to begin this call this morning by summarizing the highlights of what was a truly momentous year for the Company.

- We completed the sale of McGraw-Hill Education in March, probably the most significant change to the portfolio that we could have made. In addition, we sold Aviation Week in August as we continued to prune the portfolio of publishing assets.
- We launched McGraw Hill Financial with a new name and a new ticker symbol to signify the extraordinary changes taking place at the Company.
- We increased our investment in CRISIL to roughly 68%. CRISIL has proven to be a well-run growth company and this was an excellent use of non-U.S. cash.
- We achieved record revenue from continuing operations and record adjusted diluted EPS for the year highlighting what a tremendous portfolio of assets this Company possesses.
- Standard & Poor's Ratings Services, S&P Dow Jones Indices, and S&P Capital IQ all delivered very strong revenue growth.
- The Company continued its strong commitment to returning cash to shareholders with $1.3 billion in dividends and share repurchases.
- After exhausting the previous share repurchase authorization, the Company announced a new 50 million share repurchase authorization.
- As you know, Terry McGraw retired as President and CEO after having led this Company, and served its shareholders, so commendably for the past 15 years. Terry, what a tremendous achievement.

As you can see from this slide, earlier this year we completed the Growth and Value Plan that was announced in 2011. We believe this Plan proved to be a considerable success. After shedding over $2 billion of revenue, predominantly from the sale of McGraw-Hill Education, we are a vastly more profitable company with considerably higher adjusted operating margins and lower capital expenditure needs. More importantly, we unlocked value for our shareholders who have enjoyed a total shareholder return of 140% over the last two years.

Now let's turn to our financial performance during the quarter and for the full year 2013:
- Revenue increased 10% for the year,
- Adjusted operating profit increased 16%, resulting in a 180 basis point improvement in margin, and
- Adjusted diluted EPS increased 21%.

Fourth quarter revenue tied second quarter revenue as the highest of the year. However, revenue only increased 2% versus the strong fourth quarter of 2012. Impacting the profitability of the quarter was a $26 million non-cash impairment charge in S&P Dow Jones Indices and a full-year adjusted tax rate that was lower than anticipated. Jack will elaborate on these and all of our financials momentarily.

Standard & Poor's Ratings Services
With that, let me turn to the individual business segments and I'll start with Standard & Poor's Ratings Services.

The fourth quarter in 2013, while down versus a very strong fourth quarter of 2012, was the second best of 2013. The operating profit decline in the fourth quarter was due to both lower revenue as well as a 4% increase in costs.

For the entire year:

- Revenue increased 12%;
- Adjusted operating profit increased 15%; and
- The adjusted operating margin increased 120 basis points to 43.7%. That's the second year in a row the margin has improved by more than 100 basis points.

Non-transaction growth both in the fourth quarter and for the full year was driven by increased entity credit rating activity, particularly in Europe. In fact, during the fourth quarter we added more than 60 new clients in EMEA (Europe, Middle East, Africa). In addition, fourth quarter non-transaction revenue increased due to strength in CRISIL's Coalition and Irevna analytical businesses.

While fourth quarter transaction revenue increased sequentially, it decreased from the fourth quarter of 2012 due to a decline in U.S. corporate issuance, particularly high-yield issuance. For the full year, 2013 transaction revenue benefited from both healthy issuance and a 42% increase in bank loan ratings.

With an 8% increase in international revenue, fourth quarter international revenue reached 50% of total revenue. This is the highest international percentage since the fourth quarter of 2008 and is an encouraging sign as the European economy continues to recover.

High-yield European corporates drove the outsized international growth for both the fourth quarter and 2013. During the quarter, U.S. corporate and public issuance were down 18% and 19%, respectively, driven by the government shutdown, interest rate volatility, and economic uncertainty.

Recall that issuance in the fourth quarter of 2012 was particularly strong with a rush to market due to the looming fiscal cliff and upcoming presidential elections. Conversely, in the fourth quarter of 2013, October issuance was significantly impacted by the government shutdown and the debt ceiling crisis.

Structured issuance in the U.S. was flat with strength in commercial mortgage-backed securities which increased 35%, offset by weakness in residential mortgage-backed securities which decreased 43%, and CDOs (collateralized debt obligations), predominately collateralized loan obligations, which decreased 15%.

During the quarter, European corporate issuance was flat with weak investment-grade issuance offset by very strong high yield, which increased by 71%.

Improved economic conditions drove a structured issuance increase of 25% due primarily to strength in asset-backed securities and covered bonds. European high-yield issuance is benefiting from an improved European economic environment, investors' appetite for yield, and an increase in the number of companies turning to the capital markets for the first time.

As for 2014, Standard & Poor's Ratings Services published its expectations for corporate new issuance to grow modestly in 2014 at a rate between flat and 6% higher.

Now, let me update you on our litigation matters:

- 3 additional cases were dismissed in the quarter, bringing the total to 36 cases dismissed outright.
- 1 case was withdrawn since we last reported earnings. There are now 11 cases that have been voluntarily withdrawn and 13 dismissals by lower courts that have been affirmed by higher courts. That leaves us with a few dozen non-government cases that remain outstanding.
- In the Department of Justice case, we are in discovery and the next hearing is scheduled for March 11th.
- In the consolidated states cases, we are awaiting a ruling on the States' motion to remand the cases back to the states.
- One new constant proportion debt obligation case has been filed in the Netherlands and a notification had been received of a potential claim from an Italian prosecutor at the Corte dei Conti, since the Company's third quarter earnings call. In the Italian matter, the prosecutor's potential claim of 234 billion euros would allege, in essence, that by downgrading Italy's sovereign rating, S&P *"interfered in the institutional independence of Italy as a sovereign state which caused serious damage to its economic credibility and international creditworthiness."* If any such claim were to be made in the future, we believe it would be frivolous and without merit.

S&P Dow Jones Indices

S&P Dow Jones Indices delivered the largest revenue growth of any segment during the quarter, delivering 18% growth. This growth was primarily driven by increased licensing fees from ETF customers based on AUM (assets under management) and from exchanges based on increased derivative trading volume.

During the quarter, adjusted operating profit decreased due to a $26 million non-cash impairment charge associated with an intangible asset acquired through the formation of our S&P Dow Jones Indices joint venture. Notwithstanding this non-cash charge, costs in the quarter were up primarily due to increased royalty payments, marketing, and incentives.

By the way, S&P Dow Jones Indices' recent marketing campaign was focused on increasing brand awareness, which in turn supports our customers. Over 10,000 viewers watched over 2,750 hours of our advertising campaign videos.

For the full year, organic revenue increased 12% and adjusted operating profit increased 19%, despite the non-cash charge. In each quarter of 2013, we established a new record of AUM in exchange-traded funds linked to S&P Dow Jones Indices. Year-end AUM increased 43% to $668 billion from the end of 2012. Importantly, roughly one third of the AUM increase was the result of new inflows into these passively-managed ETFs.

We continue to listen to the marketplace and create innovative new indices. During the quarter, 14 new ETFs based upon our indices were launched, providing opportunities for future growth from these new products. Fourth quarter licensing revenue from derivative trading increased. This was primarily due to SPX and VIX trading volumes, which increased 11% and 19%, respectively.

At the end of the quarter, the Company made the final payment to acquire the intellectual property for the S&P GSCI, eliminating future royalty payments. The S&P GSCI is the first major investable commodity index. The index includes the most liquid commodity futures and provides diversification with low correlations to other asset classes.

S&P Capital IQ

With that, let me now move on to S&P Capital IQ.

In the fourth quarter, this business delivered quarterly revenue with top-line growth of 4%.

- Excluding the lost revenue from ongoing portfolio rationalization of several small products, organic growth was approximately 5%.
- Adjusted operating profit increased for the second straight quarter, although the margin was down slightly.

For the full year, revenue increased 4%. As we continue to build new products and new data sets, however, operating profit decreased for the year. It is worth noting that for both the quarter and full year 2013, Desktop Solutions, Enterprise Solutions, and Ratings IP all delivered mid-single-digit revenue growth while Proprietary Research revenue declined mid-single-digits.

During the quarter we sold the first Portfolio Risk solution with a five-year contract. This product offers next generation risk and scenario analytics to traders, portfolio managers, and risk managers for pricing, hedging and capital management of multi-asset class portfolios. This is one of several new desktop analytics and capabilities scheduled for launch throughout 2014.

While there are many areas of S&P Capital IQ where we have been investing, there are other areas that we have shut down or divested. This quarter we continued to fine-tune the portfolio by shutting down Funds Management Research Europe. This was an independent, qualitative research service that provides assessments of fund manager investment processes.

As a result, we expect that both revenue and adjusted operating profit will increase in 2014. Robust equity markets, new products launches, and increased customer compliance requirements also point to improvement in 2014.

Commodities & Commercial Markets

With that, now let me turn to the Commodities & Commercial Markets segment.

- Revenue grew 2% in the quarter.
- Excluding the impact of the sale of Aviation Week, organic revenue increased 7%.
- Platts delivered double-digit revenue growth and J.D. Power delivered high-single-digit growth. This was partially offset by softness at McGraw Hill Construction.
- For the full year, revenue grew 4% with organic revenue increasing 7%.
- Adjusted operating profit increased 41%, resulting in record quarterly adjusted operating profit of $84 million.

In Commodities, Platts achieved a 10% increase in revenue for the quarter and a 13% increase for the year. Platts' revenue has doubled in the last 5 years, with 2013 revenue setting a new annual record.

During the quarter, subscriptions from Metals & Agriculture and Petrochemical products grew faster than Petroleum, driving double-digit growth. In addition, licensing revenue from petroleum derivative trading increased more than 30% as volatile oil prices increased trading activity.

In Commercial Markets, revenue decreased 6% in the fourth quarter and 4% for the year.

- Excluding the sale of Aviation Week, organic growth increased 4% in the quarter and was flat for the year.
- J.D. Power delivered a second year of strong growth in the quarter and for the full year driven by the auto business in China and license revenue from customer advertising.
- Furthermore, the decline in Construction revenue moderated compared to recent years as our new product launches gain traction and the U.S. construction industry recovers.

Summing up, 2013 was a great year:

- We completed the highly successful Growth and Value Plan and launched our new company, McGraw Hill Financial.
- We achieved records in revenue from continuing operations and adjusted diluted EPS.

Importantly, we expect to deliver an even better 2014. Today we introduce 2014 guidance of mid-single-digit revenue growth and diluted EPS of $3.75 to $3.85 per share, representing growth in the mid-teens.

During my first few months we have made a number of changes to improve our management structure and drive growth, performance, and productivity:

- We have appointed Neeraj Sahai President of Standard & Poor's Ratings Services. He brings the right skill set to lead our largest business.
- We added Larry Neal, head of Platts, and Alex Matturri, head of S&P Dow Jones Indices to our Executive Committee. Many of you already know Larry and Alex, who are excellent managers.
- In addition, Larry will be relocating to London, which is the global hub of our Platts business.
- Following these moves, Glenn Goldberg, President of Commodities & Commercial Markets, has decided to leave the Company to pursue other career opportunities. Glenn is a seasoned professional who has had great success running our Commodities & Commercial segment. We thank Glenn for all of the tremendous contributions he has made during his 23 years with the Company.
- We have also added the S&P Chief Risk Officer and Chief Economist to the Executive Committee. The entire Company will now benefit from their insights and expertise.
- In addition, we initiated a consolidation of our real estate footprint, including the decision to move our Company headquarters to 55 Water Street in New York.

Finally, on March 18th we will host an Investor Day in New York. I will provide additional detail on our strategy and each of our business leaders will provide greater insights into our growth plans.

So with that, let me turn the call over to Jack Callahan, our chief financial officer, for additional details on the fourth quarter and full year.

Jack Callahan
Executive Vice President and CFO
McGraw Hill Financial

Thank you, Doug. And good morning to everyone joining us on the call. This morning I want to briefly discuss several items related to our 2013 performance and outlook for 2014.

- First, I want to recap key consolidated financial results in the quarter and for the full year;
- Second, I will review recent cost-reduction actions taken to streamline the organization and to reduce our real estate footprint. These actions did result in one-time costs which are identified as adjustments to earnings;
- Third, I will provide updates on the balance sheet, free cash flow, and return of capital; and
- Finally, I will provide additional color on our 2014 guidance.

In our first year as McGraw Hill Financial, we delivered very strong financial results:
- Revenue grew 10% approaching $4.9 billion, with organic revenue growing 9%, excluding the impact of six months of the Dow Jones Indices business, the sale of Aviation Week, and product closures at S&P Capital IQ.
- Adjusted segment operating profit grew 14%, driven by the strong results at Standard & Poor's Ratings Services, S&P Dow Jones Indices, and Commodities & Commercial Markets. In addition, I would note that S&P Capital IQ returned to profit growth in the last two quarters of the year.
- Adjusted unallocated expense was essentially flat for the year, and the adjusted tax rate decreased 200 basis points, 100 basis points lower than our projected adjusted tax rate of 35%. This result was primarily due to an increased proportion of income from international markets and progress on several tax planning initiatives.
- Overall, adjusted diluted EPS increased 21% to $3.33 per share, a great result for the Company.

As expected, fourth quarter comparisons were the most challenging of the year, but we were able to deliver another solid quarter of growth:
- Revenue grew 2% to $1.25 billion, matching the second quarter as the two strongest quarters of the year;
- Organic revenue grew 3%, excluding the sale of Aviation Week and product closures at S&P Capital IQ;
- Adjusted segment operating profit decreased 3%, driven primarily by the $26 million non-cash impairment charge at S&P Dow Jones Indices;
- Adjusted unallocated expense decreased 7%; and
- A lower fourth quarter tax rate is the catch up that brings our full-year adjusted effective tax rate to 34%.

Adjusted net income from continuing operations increased 9% and adjusted diluted earnings per share increased 12%. The relatively faster growth was the result of a 2% decrease in the average diluted shares outstanding to 278 million shares. The year-end basic share count was 270.4 million, down 3%. Overall, a solid quarter given the tough comparisons and a good finish to the year.

There were several one-time charges during the quarter associated with cost reduction and efficiency actions as we work to drive productivity across McGraw Hill Financial.

- We are excluding a $28 million restructuring charge primarily related to severance as we took actions to streamline Commodities & Commercial, S&P Ratings, and Capital IQ;
- There is a $36 million non-cash impairment charge related to the pending sale of a data center, driven by a strategic shift to leverage the scale and capability of world class IT partners; and
- A $13 million charge associated with several lease terminations, as we reduced our real estate footprint in several major U.S. cities, in part driven by recent divestitures and the shutdown of specific product lines at S&P Capital IQ.

Note that we did not have any Growth and Value Plan costs, largely professional and consulting fees to support separation, during the quarter as that plan was completed earlier in the year.

Lastly, as Doug mentioned, the Company has decided to exit its midtown New York City office. In order to do so, a payment of approximately $60 million was necessary as consideration for early termination of the lease which ran to 2020. There was no P&L impact for this item as it was offset by deferred gains from the previous sale of equity in the building by the Company.

We continue to maintain an exceptionally strong balance sheet. As of the end of the quarter, we had $1.6 billion of cash and short-term investments, of which about $700 million was domestic cash. We continue to have approximately $800 million of long-term debt. Going forward, this strong balance sheet positions us to continue to make investments that strengthen the business and, as appropriate, sustain our share repurchase program.

Our free cash flow during 2013 was $624 million. There were several large items that have negatively impacted results:

- As we discussed before, because of Hurricane Sandy, the IRS allowed fourth quarter estimated tax payments that are normally paid in December to be paid in February. This payment was approximately $130 million and was paid in the first quarter of 2013;
- The second item was the $77 million payment associated with the legal settlement that was also included in our first quarter 2013 results; and
- Third, as I just discussed, an approximately $60 million payment was made in the fourth quarter in consideration for the early lease termination of our midtown location.

With these large items behind us, combined with sustained growth anticipated this year, we anticipate approaching $1 billion of free cash flow in 2014.

Let me now update you on our return of capital activity. During the fourth quarter, approximately 1.9 million shares were repurchased, which completed the existing 50 million share authorization approved by the Board of Directors in mid-2011. For all of 2013, we have spent $989 million and repurchased 16.9 million shares at an average price of $58.52. In December, the Company announced a new 50 million share repurchase authorization approved by the Board of Directors. We do anticipate selectively continuing share repurchase activity in 2014, subject to market conditions.

In addition, the Company paid out $308 million in dividends, bringing the total return of capital in 2013 to almost $1.3 billion. Demonstrating McGraw Hill Financial's steadfast commitment to the dividend, just last week the Company announced it had increased it for the 41st consecutive year. The 7.1% increase brings the annual payout to $1.20 per share.

Now I would like to provide additional color on our 2014 guidance.

- At this point, we are targeting mid single-digit revenue growth in 2014.
- Over the longer term, we believe the Company has the potential to deliver high single-digit revenue growth. However, after delivering 13% and 10% during the last two years, we believe it is prudent to guide to mid single-digit revenue growth in 2014.
- And as a reminder, the impact of the divestiture of Aviation Week and the shutdown of several smaller product lines at S&P Capital IQ, reduces our year-on-year growth rate by approximately one point.
- We are targeting flat unallocated expense and sustained margin expansion with at least a 100 basis-point improvement in adjusted operating profit margin.
- We believe that the effective tax rate achieved in 2013 is sustainable and we are targeting a 34% tax rate again in 2014.
- On the bottom line, the adjusted diluted earnings per share guidance is $3.75 to $3.85 per share.
- From a cash perspective, we anticipate investing approximately $125 million in capital expenditures and approaching $1 billion in free cash flow.

In closing:

- For 2013, we have delivered excellent results with 10% revenue growth and 21% adjusted diluted earnings per share growth.
- We anticipate delivering continued growth in 2014 as long-term secular drivers of growth remain in place. That said, market volatility could impact results.
- Nevertheless, we anticipate mid-single-digit revenue growth, mid-teen adjusted diluted earnings per share growth, and approximately $1 billion of free cash flow.

And as a reminder, we will be hosting an Investor Day on March 18th at the New York Hilton Midtown. This will be an opportunity for investors to learn more about the Company and meet the leaders of each of our businesses. Reach out to Chip Merritt if you have not already received additional details. We hope to see you there.

To access the accompanying slides online, go to:
http://investor.mhfi.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=5082927

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995

This presentation contains forward-looking statements, including without limitation statements relating to our businesses and our prospects, new products, sales, expenses, tax rates, cash flows, and operating and capital requirements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are intended to provide management's current expectations or plans for our future operating and financial performance and are based on assumptions management believes are reasonable at the time they are made.

Forward-looking statements can be identified by the use of words such as "believe," "expect," "plan," "estimate," "project," "target," "anticipate," "intend," "may," "will," "continue" and other words of similar meaning in connection with a discussion of future operating or financial performance. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict; therefore, actual outcomes and results could differ materially from what is expected or forecasted. These risks and uncertainties include, among others:

- worldwide economic, financial, political and regulatory conditions;
- currency and foreign exchange volatility;

- the effect of competitive products and pricing;
- the level of success of new product development and global expansion;
- the level of future cash flows;
- the levels of capital investments;
- income tax rates;
- restructuring charges;
- 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 capital markets in the U.S. and abroad;
- the demand and market for debt ratings, including collateralized debt obligations, residential and commercial mortgage and asset-backed securities and related asset classes;
- the state of the credit markets and their impact on Standard & Poor's Ratings and the economy in general;
- the regulatory environment affecting Standard & Poor's Ratings and our other businesses;
- the likely outcome and impact of litigation and investigations on our operations and financial condition;
- the level of merger and acquisition activity in the U.S. and abroad;
- continued investment by the construction, automotive, and computer industries;
- the strength and performance of the domestic and international automotive markets;
- the volatility of the energy marketplace;
- and the contract value of public works, manufacturing and single-family unit construction.

We caution readers not to place undue reliance on forward-looking statements.