McGraw Hill Financial
2nd Quarter 2014 Earnings Conference Call
Prepared Remarks
July 29, 2014

Chip Merritt
Vice President, Investor Relations
McGraw Hill Financial

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

Thanks, Chip, and good morning, and welcome to the call.

We are pleased to report another strong quarter of revenue and earnings growth. Revenue growth was led by Standard & Poor's Ratings Services and J.D. Power, each with double-digit growth. Platts, S&P Capital IQ, and S&P Dow Jones Indices all contributed high single-digit revenue growth. During the first quarter of the year, Platts and S&P Dow Jones Indices delivered double-digit revenue growth, driving the overall MHFI results in that quarter. All of this speaks to the strength of the businesses we have in our portfolio.

For this quarter, adjusted diluted EPS increased 15% to $1.06. As you can see, based on this strong year-to-date performance, and our outlook for the remainder of the year, the Company is raising its diluted adjusted EPS guidance by $0.05 to a range of $3.80 to $3.90. Year-to-date, the Company reported free cash flow of $392 million and returned $525 million in dividends and share repurchases. This continues to demonstrate our commitment to returning capital to shareholders.

If we look at the financial performance in more detail:

- Revenue increased 8% year-on-year and 9% from organic growth;
- Adjusted operating profit increased 9%; and
- We achieved a 40 basis-point improvement in the operating margin.

And what was most impressive about these results is that despite facing the most difficult earnings comparison of the year, second quarter diluted adjusted EPS increased 15%.

Our global footprint continues to expand as international revenue growth of 10% continued to outpace domestic growth of 6%. In this chart, you can see that three of our business units delivered double-digit international revenue growth. Note that excluding the impact from the sale of Aviation Week, Commercial Markets delivered double-digit international growth as well.

Now I would like to highlight that during the quarter we announced a couple of key management changes. First of all, I would like to thank Ken Vittor, who's here in the room with us, for his 33 years of dedicated service to the Company. Ken's leadership and sound advice have been instrumental in guiding the Company. Most of you will remember Ken for his clear explanations of complex legal issues on these quarterly earnings conference calls. Thank you, Ken!

And we wish you all the best in your retirement and we are pleased that you will be supporting us until the end of the year when you officially retire. Ken's replacement will be Lucy Fato, who starts next week. Lucy has extensive legal experience, serving most recently as Deputy General Counsel for a premier global professional services firm and before that, she was a partner in the capital markets group at a global law firm.

The other management change has been at S&P Capital IQ. Lou Eccleston is moving on to pursue other opportunities. Lou has made significant contributions to the business since joining the Company in 2009 and I want to thank Lou and wish him every success in the future. A search is underway for Lou's replacement. In the interim, Imogen Dillon Hatcher has been named acting President of S&P Capital IQ. Imogen is a seasoned executive with a breadth of experience in the industry. Previously, she was Chief Commercial Officer with responsibility for leading S&P Capital IQ's global sales. I have been working closely with Imogen and feel great about her capability to lead the business during the transition. And we are fully committed to S&P Capital IQ, which over the past four years has become one of the fastest-growing providers of multi-asset-class and real-time data.

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 11%;
- Operating profit increased 15%; and
- The operating margin increased 160 basis points to 46.3%.

Revenue growth was primarily the result of strong market demand for Standard & Poor's ratings associated with increased debt issuance and bank loan ratings.

Expenses increased primarily due to legal expenses. With the Department of Justice case entering the discovery phase and the State Attorneys General cases remanded back to the state courts, our expenses to defend these cases rose during the quarter. In addition, compensation expense increased due to targeted headcount additions and increased incentive compensation.

Despite these cost increases, Standard & Poor's Ratings Services delivered solid margin expansion. You'll see, moving to this next slide, that non-transaction growth in the quarter, which in aggregate grew 8%, was driven primarily by increased annual fees as we continue to expand our client coverage and Rating Evaluation Service revenue.

Transaction revenue increased 14%, driven by several factors:
- First, as investors search for yield in a low interest-rate environment, their demand for high-yield debt has enabled more corporations to access the debt markets.
- Second, financial services firms have actively issued debt, driven primarily by new regulatory requirements.
- And third, bank loan ratings revenue increased 19% as banks seek to issue new loans that are more liquid.

As you see in these graphs, total issuance increased in the U.S. by 15% and in Europe by 37%. In the U.S., I would like to highlight the strength in structured finance issuance which is primarily a result of collateralized loan obligations (or called CLOs) and asset backed securities (ABS). CLO quarterly issuance was the highest since 2007 as banks moved loans off of their balance sheets. ABS included the largest quarterly issuance of auto debt since 2008 and credit card debt issuance was almost double the second quarter of 2013.

In Europe, I would like to highlight the 44% increase in Corporate issuance, and as part of that, the record high-yield issuance which increased 109%. This is the second quarterly record in a row. And these issuance levels are a direct result of bank deleveraging.

One of the questions that has been frequently asked is, "Why is U.S. corporate debt issuance so robust when so many corporations have substantial cash on hand?" In April, in a Standard & Poor's report entitled "2014 Cash Update: Cheap Debt Fuels Record Cash Growth", this topic was discussed. Essentially, what S&P proposes is as U.S. companies become more global, they have been generating an increasingly higher portion of their cash flow from overseas. This is subject to taxes as high as 35% upon repatriation. And this is a topic being discussed actively in the press. While many cash uses are domestic in nature, such as share repurchases and dividends, cash flow is increasingly generated overseas, leaving companies with domestic cash deficits even as overseas cash piles up. The S&P study proposes that companies are issuing debt as a form of "synthetic cash repatriation."

Moving to the next slide, here we depict a number of European corporate bond issuers by year since 1989. Take a look at the increase of issuers in 2013 as European banks deleveraged and more companies accessed the corporate bond market. Also noteworthy is the growing number of high-yield issuers over the past six years in Europe. More recently, investors' appetite for high yields in this low interest rate environment has helped fuel an increase of over 100% in high-yield issuance in the second quarter, along with the traditional bank constraints and disintermediation.

Now, let me update you on developments on the litigation front.

Our case statistics remain unchanged from the first quarter. That leaves us with a couple dozen non-government cases that remain outstanding.

- During the quarter, IKB Deutsche Industriebank AG filed a suit related to the Rhinebridge Structured Investment Vehicle. You may recall that in an earlier case related to the Rhinebridge SIV, IKB was a co-defendant as the manager of the SIV. We have filed a motion to dismiss this lawsuit.
- In the CalPERS case, the California appellate court affirmed the denial of our motion to strike the complaint under anti-SLAPP law. We are seeking review by the California Supreme Court.
- In the Department of Justice case, discovery is underway and we are working through our first wave of documents provided by the government while continuing to seek further discovery from the government and third parties. A hearing will be held later today in California in the DOJ case to address outstanding discovery issues.

As I'm sure you're all aware, the Company received a "Wells Notice" last week relating to S&P's ratings of certain commercial mortgage-backed securities in 2011. We've issued a press release about it, we're cooperating with the SEC with respect to this matter, and there is little more we can add on this subject today.

S&P Capital IQ

Now let me move on to S&P Capital IQ which delivered top-line growth of 7% this quarter. Excluding the lost revenue from ongoing portfolio rationalization of several small products, organic growth was approximately 8%. The largest contributors to this growth were S&P Capital IQ Desktop and RatingsXpress®.

Adjusted operating profit increased year-over-year for the fourth straight quarter and the margin increased modestly. Lastly, rollouts continued on a wave of new desktop capabilities which I'll discuss in a moment.

Here are the three business lines within S&P Capital IQ:

- S&P Capital IQ Desktop & Enterprise Solutions revenue increased 9%, and this is principally driven by a 12% increase in Desktop revenue.
- S&P Credit Solutions revenue increased 7%. This was driven by an 11% increase in RatingsXpress®.
- And, while the S&P Capital IQ Markets Intelligence revenue only increased 1%, it was driven by double-digit growth in Leveraged Commentary & Data and Global Market Intelligence. This was largely offset ─ to get to the 1% level ─ by the shutting down of FMR Europe and declines in Equity Research Services.

We have several new products that are scheduled to launch this year. In the first quarter, we've already discussed the launch of Credit Analytics. And this quarter I want to share more about PresCenter, which launched earlier this month.

PresCenter is a productivity tool that embeds Microsoft Office® products within S&P Capital IQ Desktop to allow seamless links between data and presentations. It has customized features like "quick keys" and "autochecks" that ensure compliance with corporate design guidelines. And PresCenter streamlines pitchbook creation and ensures consistency with changes in source data. This is a product that many of you on this call will find very useful. And you can learn more at www.spcapitaliq-prescenter.com or contact your S&P Capital IQ sales rep.

S&P Dow Jones Indices

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

The business delivered an 8% increase in revenue with a 6% increase in operating profit. Revenue growth with increased licensing from ETF and mutual fund customers was partially offset by subdued derivative trading volume. ETF assets under management associated with S&P Dow Jones Indices reached a new record this last quarter.

As discussed, our marketing agreement for the UBS Commodities Indices expired in June and the contract was not renewed. While we will lose the revenue that was associated with this commercial arrangement, we expect our recent action with the S&P GSCI Index license will largely offset the impact on profits.

Year-on-year expenses increased 10% due to targeted headcount additions and the timing of marketing costs.

If we turn to the key business drivers, ETF AUM associated with our indices increased 32% to a record $719 billion from the end of the second quarter 2013. Importantly, 11% of this increase was the result of new inflows.

Frequently when equity markets rise in a low volatility environment, derivative trading volumes decline. And that was the case this quarter as derivative trading volumes decreased. Two key products, SPX and E-mini S&P 500 Futures, the trading volumes decreased 13% and 26%, respectively.

S&P Dow Jones Indices continues to expand its product offerings and partner relationships around the world. During the quarter the business introduced the Dow Jones Commodity Index which will serve as a complement to the S&P GSCI®. In speaking with market participants, it became apparent there was a clear need for a commodity index which is highly liquid, avoids large sector weights, is transparent in its methodology, and is independently governed. The S&P Dow Jones Commodity Index meets each of these criteria and fills an important gap in the marketplace.

Witnessing interest in alternatively-weighted strategies, S&P Dow Jones Indices launched two comprehensive global factor index families: the first, S&P Low Beta indices, and the other, S&P Intrinsic Value Weighted indices. They're designed to serve as benchmarks or investable solutions.

S&P Dow Jones Indices launched the deepest and most extensive suite of African equity indices currently available to investors. New equity indices covering South Africa and Pan Africa countries were launched providing investors in Africa, as well as those outside, with a comprehensive offering of indices measuring the performance of African equity markets. And licenses for ETFs in South Africa, Nigeria, and 11 ETNs in Sub-Saharan Africa have already been launched.

Our clients continue to launch ETFs in other emerging markets based on the indices as well. This includes:

- The listing of an ETF which tracks the S&P 500 on the Brazilian stock exchange.
- An ETF based on the S&P Colombia Select Index that started trading on the Bolsa de Valores de Colombia, and is the first ETF launched in the Colombian market.
- Three ETFs listed on the Korea Exchange (KRX). These track the S&P Select Sector Technology Index, the S&P Select Sector Industrial Index, and the S&P Select Sector Financials Index, and they represent new exposures offered via ETFs on the KRX.

All great product innovation and international diversification from the team at S&P Dow Jones Indices.

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

- Revenue grew 1% in the quarter, but excluding the impact of the sale of Aviation Week, organic revenue actually increased 8%.
- Platts and J.D. Power both delivered organic growth in the quarter, which was partially offset by softness at McGraw Hill Construction.
- Overall operating profit was unchanged; excluding the sale of Aviation Week, however, operating profit increased approximately 6%.

I'd like to note that despite the absence of Aviation Week in our portfolio, Commodities & Commercial Markets was able to deliver identical operating profit as a year ago, which had included the results of Aviation Week.

As you can see here, Platts delivered a 9% increase in revenue for the quarter. Platts' price assessment and market data subscriptions continued to deliver double-digit revenue growth; however, Global Trading Services licensing revenue decreased due to weaker trading volumes for natural gas and petroleum. Trading volumes have been impacted primarily by the lack of price volatility, and secondarily as a result of certain banks eliminating their commodity trading operations. With fewer financial players participating in the trading of commodity derivatives, there is less liquidity for physical players.

Power & Gas, Petrochemicals and Petroleum all delivered single-digit revenue growth while Metals & Agriculture, building on recent investments, provided the greatest growth at 29%.

Platts continues to launch new valuable products and services and I'd like to highlight a few:

- The first relates to Platts' pioneering coverage for U.S. shale oil assessment for the Williston Basin. The new Platts Bakken offering, announced on April 23, captures an assessment of the value of Bakken crude oil nearest to the wellhead in the Williston Basin. That's the point where there is a choice of transportation between rail and pipeline. Some 70% of total Bakken production, at least one million barrels per day, has moved by rail thus far in 2014, but the role of pipelines will grow as several projects are coming online by 2016. In addition, pipeline capacity creates a need for price discovery at the point that allows for transportation flexibility and the largest base of Bakken supply.

- The second includes enhancements to the Minerals Value Service (MVS). It's an online platform for analytics. MVS is a Munich-based company providing an innovative and user-friendly solution to "value-in-use" pricing for iron ore. The MVS value-in-use application enables subscribers to calculate the fair price of their products faster and more accurately than ever before.

- The third was the launch of Dry Freight Wire. The location of commodities is essential to the price discovery process. Therefore shipping information is essential to our customers. Dry Freight Wire is a daily report that consolidates all of Platts' prices, news, and market commentary related to dry commodity shipping. Targeted to ship owners, charterers and trading houses, it addresses the market's growing need for an independent source of daily dry freight prices backed by a sound methodology. This expands Platts' portfolio of products dedicated to shipping.

Earlier this month, Platts announced the acquisition of Eclipse Energy Group, another acquisition that broadens our capabilities beyond oil. Founded in 2002, with offices in London, Norway, and Singapore, Eclipse Energy Group is a leader in providing market data and analysis for European natural gas, power, and LNG (liquefied natural gas) markets. This acquisition enables Platts to help market participants better understand market dynamics and drivers of price. In the same way that Bentek bolstered our U.S. natural gas business, we anticipate Eclipse Energy Group will help Platts succeed in a rapidly changing European natural gas market.

Now turning to Commercial Markets, revenue decreased 7%; however, excluding the sale of Aviation Week, organic growth increased 7% in the quarter. J.D. Power achieved double-digit revenue growth led by the auto business and licensing fees from customer usage of its brands led by business in North America and Asia Pacific.

As we announced earlier this year, we continue to explore strategic alternatives for McGraw Hill Construction. We have had conversations with a number of interested parties but cannot provide any further update at this time.

Summing all of this up, we delivered another solid quarter as we continue to create growth and drive performance across the Company.

- Total revenue increase 8% supported by 10% international revenue growth.
- We added another tuck-in acquisition with the addition of Eclipse Energy Group to bolster Platts' European natural gas capabilities.
- And, S&P Capital IQ launched PresCenter while S&P Dow Jones Indices and Platts each launched a number of new benchmarks and products.

Financially, the Company delivered 15% adjusted diluted EPS growth over the toughest quarterly comparison in 2013 and increased 2014 adjusted diluted EPS guidance by $0.05 to a range of $3.80 to $3.90. Lastly, we continue to strengthen the leadership team to better position the Company for our future.

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. This morning, I want to briefly discuss several items related to second quarter performance. This was a relatively straightforward quarter so I don't have a great deal to add.

First, I want to recap key consolidated financial results in the quarter;
Second, I will provide updates on the balance sheet, free cash flow, and return of capital; and
Finally, I will review our updated guidance.

In the second quarter:
Revenue grew 8%, with organic revenue growing approximately one point faster. The difference resulted from of the sale of Aviation Week last year as well as the sale of Financial Communications and a small product line closure at S&P Capital IQ.

- Segment operating profit grew 10%. Excluding the impact of the sale of Aviation Week, all four businesses contributed to operating profit growth. Most notably, S&P Ratings Services led the way with operating profit growth of 15%. In addition, after cycling through a period of stepped-up investments, S&P Capital IQ has delivered adjusted profit growth in each of the last four quarters.
- Adjusted unallocated expense increased by $10 million, due almost entirely to recent asset sales. During the quarter, the Company entered into an agreement to sell the Company aircraft at a price in line with its appraised value but did incur a non-cash impairment charge associated with this transaction. In addition, the Company incurred a one-time expense associated with the sale of its data center on the Company's south campus in East Windsor, New Jersey.
- The tax rate was 33.1% in the quarter, bringing the year-to-date tax rate to 33.5%. This lower rate is the result of ongoing tax planning. For the full year, we now anticipate an effective tax rate of 33.5%, in line with year-to-date results, a 50-basis point improvement versus our previous guidance.

- Adjusted net income increased 13%, and adjusted diluted earnings per share increased 15% to $1.06. The average diluted shares outstanding decreased by 2.2 million shares versus a year ago and over 1.1 million sequentially versus the first quarter of 2014.

There were no adjustments to GAAP results this quarter.

We continue to maintain an exceptionally strong balance sheet. As of the end of the quarter, we had $1.6 billion of cash and equivalents, of which almost $1 billion is held outside the United States. We continue to have $800 million of long-term debt. Going forward, this strong balance sheet positions us to continue to make investments that strengthen the portfolio, such as Eclipse Energy Group and, as appropriate, sustain our share repurchase program.

Our free cash flow during the first half of the year was $392 million versus $145 million a year ago. The improvement was primarily due to the timing of tax payments and increased income from operations. We continue to expect free cash flow of approximately $1 billion in 2014.

Now let me update you on our return of capital activity. During the second quarter, approximately 2.2 million shares were repurchased at an average price of $79.65 per share. Year-to-date, we have repurchased a total of 4.4 million shares at an average price of $79.06. That leaves 45.6 million shares available in the current share repurchase authorization. We anticipate selectively continuing share repurchase activity, subject to market conditions. In addition, we continue to return cash to shareholders through our dividend, which totaled $163 million year-to-date.

Now I would like to turn to our 2014 guidance. We have made several changes.

- First, because of the additional expenses incurred that are associated with the sale of the corporate aircraft and the data center, we have increased our adjusted unallocated expense guidance by $10 million.
- Next, as previously mentioned, we lowered our full-year tax rate guidance from 34% to 33.5% as international growth continues to outpace domestic growth and the benefits of tax planning initiatives are realized.
- Finally, we've increased our 2014 adjusted diluted EPS guidance by 5 cents to a range of $3.80 to $3.90 based upon strong first-half results and a solid outlook for the remainder of the year. This outlook anticipates higher legal expense than we previously expected as well as benefits from ongoing productivity initiatives.

The remaining elements of our 2014 guidance remain unchanged.

In closing, we continue to focus on creating growth and driving performance. We have delivered strong first-half results and anticipate similar results in the back half, driven by many of the secular drivers of growth previously discussed. That said, market volatility could impact results as the issuance trends can be volatile.

Again, thank you for joining us today on the call and let me turn it back over to Chip.

To access the accompanying slides online, go to:
http://investor.mhfi.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=5164936

“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 Services and the economy in general;
- the regulatory environment affecting Standard & Poor’s Ratings Services 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.