S&P Global

S&P Global
First Quarter Earnings Conference Call
Prepared Remarks
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Chip Merritt
Vice President, Investor Relations
S&P Global

Good morning and thank you for joining us for S&P Global's earnings call. Presenting on this morning's call are Doug Peterson, President and CEO, and Ewout Steenbergen, Executive Vice President and Chief Financial Officer. This morning we issued a news release with our first quarter 2017 results. If you need a copy of the release and financial schedules, they can be downloaded at investor.spglobal.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 make 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 European regulation. Any investor who has, or expects to obtain, ownership of 5% or more of S&P Global 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 at (212) 438-1247.

At this time I would like to turn the call over to Doug Peterson.

Douglas L. Peterson
President and CEO
S&P Global

Good morning. Thank you, Chip. Welcome everyone to the call.

With a surge of bond issuance, healthy stock markets, recovering commodity markets, and improving global GDP we're off to a great start in 2017.

Let me begin with the first quarter highlights:

- We attained strong organic revenue growth in every segment;
- Ratings results were truly outstanding and were the highlight of the first quarter;
- We continued to improve margins and delivered 630 basis points of margin improvement and adjusted diluted EPS growth of 35%;
- We generated $306 million in free cash flow in what is typically our weakest cash quarter due to payment of annual incentives;
- We returned $307 million to shareholders through share repurchases and dividends;
- And, we increased our adjusted diluted EPS guidance to a range of $6.00 to $6.20.

Looking more closely at the financial results:

- The Company reported 8% revenue growth and on an organic basis, grew 18%.
- We frequently talk about the pull through of revenue to adjusted operating profit being quite high. It is rather striking this quarter that the adjusted operating profit exceeded revenue growth. This can be primarily attributed to the Market and Commodities segment where divestitures drove revenue declines of $68 million yet adjusted operating profit only declined $7 million.
- The Company achieved a 630 basis-point improvement in adjusted operating profit margin due to the sale of lower margin businesses, strong organic revenue growth, and productivity initiatives.
- Forex had an $8 million unfavorable impact on revenue, with a $6 million unfavorable impact on adjusted operating profit. Ratings realized the majority of the impact.
- The progress we are making to build a cohesive set of high value assets is paying off. We were able to turn 18% organic revenue growth into 35% adjusted EPS growth through a combination of productivity improvements, share repurchases and the inherent scalable nature of our businesses.

In a moment Ewout is going to discuss the results of each of our businesses in more detail. What I would like to do is provide a bit more color on some of the current and future drivers of our businesses.

And let me start with credit conditions. While GDP is the fundamental long-term driver of issuance, spreads can influence timing. This was clearly evident in the first quarter. High-yield spreads contracted 400 basis points over the past year marking an attractive entry point for issuers. And during this same time frame, investment-grade spreads contracted 74 basis points.

We saw strong bank loan activity in the first quarter partially as a result of the rate and spread environment. Bank loan rating revenue has become an important part of our Rating business over the past few years. This chart depicts the growth. First quarter 2017 bank loan rating revenue was particularly strong, increasing over 140% versus the first quarter of 2016. Bank loan ratings are primarily issued on leveraged loans typically rated BB+ or lower.

Both the volume of leveraged loans and the percent of leveraged loans rated by S&P have increased over the past few years. Leveraged loan growth has been supported by strong investor demand with record inflows into retail loan funds and a recovery in the issuance of CLOs since the financial crisis.

In the first quarter, leveraged loan volumes were very strong driven by tight spreads driving borrowers to refinance their outstanding loans. We estimate that 47% of the global volume in the first quarter was for refinancing. In addition, the percentage of leveraged loans rated by S&P surpassed 93% in the U.S. and 78% in Europe.

While many of you track issuance, we always try to point out where issuance takes place, which type of issuance, and the size of the issuance deals make a big difference in the revenue we realize. This was abundantly clear in the first quarter. Global issuance in the first quarter, excluding sovereign debt, increased 4%. Yet high-yield debt increased over $100 billion or 172%. Because very few high-yield issuers are part of our frequent issuer programs this provided a tremendous amount of incremental revenue to the Ratings business.

Geographically, issuance in the United States increased 23%, with:

- Investment-grade increasing 15%;
- High-yield soaring 115%;
- Public finance decreasing 11%; and
- Structured finance increasing 57% due primarily to strength in CLOs, ABS, and RMBS.

In Europe, issuance increased 3% with:

- Investment-grade declining 1%;
- High-yield rocketing 181%; and
- Structured finance decreasing 21% with weakness in covered bonds, and RMBS.

In Asia, issuance decreased 18%. However; the vast majority of Asian issuance is made up of local China debt that we don't rate.

Ratings published its latest issuance forecast. For 2017, we expect an overall decrease in global issuance of 1%. This compares to the forecast of a 3% increase that we issued about 3 months ago. The most significant change was in International Public Finance which had been forecast to increase 5% and is now forecast to decrease 40%. It now appears that the 2016 issuance in International Public Finance was an aberration and that issuance will revert to historical norms. Importantly, this is not a category that generates much revenue for our Ratings business.

When you look at the chart, you can see that the categories that are most impactful to our revenue—namely nonfinancials, financial services, structured, and U.S. public finance—are collectively forecast to increase in 2017.

Turning to S&P Dow Jones Indices, in February we celebrated the 60th anniversary of the S&P 500. We often talk about the importance of benchmarks and the time it takes to build one. None is more iconic than the S&P 500. Originally known as the Standard "500", it was introduced at a luncheon for the press on Feb. 27, 1957, at the Lawyers Club in New York, with a turnout of 35 top financial writers. The initial 500 included 425 industrials, 25 railroads, and 50 utilities that were deemed most representative of the overall market. These 500 stocks accounted for 90% of total U.S. market value. The "500" was groundbreaking not only for its breadth, but also because it could be calculated and

distributed on an hourly basis. Today the S&P 500 is the world's most followed stock market index being calculated continuously.

S&P Dow Jones Indices continued to build its business and several examples are listed on this slide. I am only going to touch on the first item. The S&P Green Bond Select Index was created for market participants seeking to monitor developments in the critical areas of green finance. This pioneering index maintains stringent standards in order to include only those bonds whose proceeds are used to finance environmentally friendly projects.

Platts is also actively expanding its business opportunities and two examples are listed here.

- We believe the U.S. Gulf Coast is poised to become a key anchor for liquefied natural gas (LNG) prices and our customers require that the new flexible supply from the U.S. is underpinned by both price transparency and the means to hedge. In a response to the growing U.S. LNG exports, ICE will launch LNG derivative contracts. These will be cash-settled against the Platts LNG Gulf Coast Marker price assessment and use Platts-derived forward curves for daily settlements.
- The first OTC swap contract for Black Sea wheat traded with Platts Black Sea Wheat price assessment as the settlement price. This transaction is a significant step towards the emergence of a new regional futures market for Black Sea wheat. The Black Sea region is a major global wheat trading hub. But in spite of its size, this major trading hub has not had a dedicated derivatives market reflecting its own supply and demand dynamics.

Turning to Market Intelligence, I thought it would be instructive to provide a breakdown of the business by customer type. With investor concerns about the impact that the continued movement of assets from active to passive could have on Market Intelligence revenue, you can see that Investment Management makes up only about 25% of our customers' annualized contract value. In addition, our move to more enterprise-wide contracts should result in less customer volatility.

As we look to the remainder of 2017, geopolitical risk and central bank actions may create volatility in the second half.
There are a number of positive trends that we have identified including:

- Expectations for slightly stronger GDP growth in the U.S.;
- European GDP looking promising;
- ECB continuance of its quantitative easing program;
- Strong global equity markets so far in 2017; and
- A steady shift from active to passive investing;

There is cause for caution; however, with a number of risks, including:

- Potential for U.S. Federal Reserve to initiate more frequent interest rate increases and begin unwinding its balance sheet;
- Formal Brexit negotiations and upcoming elections in Europe; and
- Continued devaluation of most currencies against the U.S. dollar.

Finally, I want to share with you some significant changes planned for our Board of Directors. Sir Win Bischoff and Hilda Ochoa-Brillembourg, two long standing directors who have provided wise counsel and oversight over many years, are retiring. In the meantime, four new directors have been added in the past six months who bring a wealth of business acumen and experience to our board.

With that, let me turn the call over to Ewout.

Ewout Steenbergen
Executive Vice President and CFO
S&P Global

Thank you, Doug, and good morning to everyone on the call. This morning, I would like to discuss the first quarter results and then provide updated guidance for 2017.

Doug already discussed the changes in revenue, organic revenue, and adjusted operating margin for the Company. I would like to point out that the tax rate of 30.3% is below the anticipated full-year run rate of 31% due primarily to the discrete tax benefit from stock option exercises through March. In addition, our ongoing share repurchase program led to a 6.4 million decrease, or 2%, in average diluted shares outstanding. I would like to echo Doug's comments that with a 35% increase in adjusted diluted EPS, we are off to a great start to 2017.

Net of hedges, foreign exchange rates had a modest negative impact on the Company's revenue and adjusted operating profit in the first quarter. The bulk of the impact was in the Ratings segment with a $6 million unfavorable impact on revenue and an $8 million unfavorable impact on adjusted operating profit due to weakness year-over-year in the British Pound and Euro.

Now, let me turn to adjustments to earnings to help you better assess the underlying performance of the business. Pre-tax adjustments to earnings totaled to a loss of $41 million in the quarter and included:

- $15 million of acquisition and divestiture related adjustments;
- a $2 million expense associated with an increase in financial crisis legal reserves; and
- $24 million in deal-related amortization.

In the first quarter, every business segment contributed to gains in organic revenue but the gains in Ratings were particularly noteworthy. The reported revenue decline in Market and Commodities Intelligence was due to several divestitures.

The adjusted operating profit growth varied by segment with 50% at Ratings and 14% at S&P Dow Jones Indices. Once again, the impact from divestitures affected results with Market and Commodities Intelligence's adjusted operating profit declining 3% due to the sale of several businesses. Organic growth and synergies were able to make up much of this loss.

Both Ratings and Market and Commodities Intelligence delivered remarkable adjusted operating margin improvement.

Let me now turn to the individual segment's performance.

S&P Global Ratings

As Doug discussed earlier, tight spreads drove high-yield issuance and bank loan volume. And this resulted in a surge in high-yield and bank loan ratings and propelled results for the Ratings segment. Revenue increased 29% including a 1% unfavorable impact from forex.

79% of the incremental revenue flowed through to adjusted operating profits highlighting the scalable nature of the Ratings business. Adjusted operating margin increased substantially to 53.1% due to strong revenue growth, partially offset by increased headcount and incentive compensation.

Very strong transaction revenue fueled Ratings' first quarter revenue growth.

- Non-transaction revenue increased 4% from growth in surveillance fees, entity fees, intersegment royalties from Market Intelligence, and CRISIL.
- Transaction revenue increased 65% primarily from a substantial increase in high-yield bond and bank loan ratings, as well as improved contract terms.

If we look at Ratings revenue by its various markets, you can see that while all of these categories reported growth, the growth in Corporates was exceptional. And this is the category where the high-yield bonds and bank loans are recorded.

Market and Commodities Intelligence

Let me now turn to Market and Commodities Intelligence. This segment includes S&P Global Market Intelligence and S&P Global Platts.

In the first quarter, reported revenue declined 10% due to recent divestitures. Excluding these divestitures, organic revenue increased 7%. Adjusted operating profit was down due to the divestiture of several businesses. Despite these divestitures, adjusted operating profit only decreased by $7 million as organic growth and synergies were able to make up much of this loss. Adjusted operating margin improved 270 basis points primarily due to the sale of lower margin businesses, strong organic revenue growth, and SNL integration synergies.

Let me add a bit more color on the first quarter. Recent divestitures mask solid organic growth of 9%. This was due, in part, to a 9% increase in the number of SNL, S&P Capital IQ, and RatingsDirect desktop users.

One of the important milestones in the quarter was the launch of a unified S&P Capital IQ and SNL commercial organization. This is a critical step in harmonizing our product offering into cohesive enterprise commercial agreements, and ultimately one product platform. During the quarter, we also expanded our content quality reward program to include most of the Capital IQ content. Some of you may be familiar with this program as it awards $50 to those who find an error in our data.

And the final highlight of the quarter was the beginning of a strategic relationship with Kensho Technologies. If you are not familiar with Kensho, you should check them out. Kensho provides next-generation analytics, machine learning, and data visualization systems to Wall Street's premier global banks and investment institutions. We have agreed to a long-term commercial relationship which will result in product and data collaboration.

We have introduced a new disclosure here depicting Market Intelligence revenue by its three components. Risk Services delivered the strongest growth in Market Intelligence thanks to mid-teens growth of RatingsXpress and high single-digit growth of RatingsDirect. Enterprise Solutions revenue increased 7% as the demand for data feeds continues to be robust. And finally, our Desktop products grew 8% as the growth of the former SNL and S&P Capital IQ desktop products continues to roll out as one commercial offering. Finally, note that there was $38 million of revenue in the first quarter of 2016 from businesses that were divested.

Platts delivered reasonable organic revenue growth as commodity markets recover. The OPEC production cuts have been very successful in increasing oil prices. Tensions remain as higher prices have encouraged new shale investments. According to RigData, North American rig counts have doubled since the low in May of 2016.

First-quarter revenue increased 10%; however, excluding revenue from recent acquisitions, organic revenue increased 4% due to modest growth in both subscriptions and Global Trading Services.

The core subscription business delivered mid single-digit revenue growth with similar gains across all commodity groups. Global Trading Services' low single-digit revenue increase was primarily due to timing of revenue and strong trading volumes in petroleum, partially offset by weakness in metals.

Of particular importance during the quarter was the announced inclusion of Norway's Troll as the latest additional crude grade in the Brent basket beginning January 2018. The makeup of the Brent oil benchmark has evolved over time as production changes have occurred. This latest change follows the addition of Forties and Oseberg in 2002 and Ekofisk in 2007.

Here again we have a new disclosure breaking out Platts revenue by four primary markets. You can see that Petroleum and Power & Gas make up the majority of the business. The growth rates of each market are depicted on the slide. During the first quarter, Platts delivered revenue growth in all but the Metals & Agriculture market due to lower Metals revenues in Global Trading Services.

Please note that there was $11 million of revenue in the first quarter of 2017 from recent acquisitions.

S&P Dow Jones Indices

Now let's turn to S&P Dow Jones Indices.

Revenue increased 14% mostly due to a surge in ETF assets under management. Adjusted operating profit increased 14%, primarily as a result of increased revenue. Adjusted operating margin increased 20 basis points to 67.9% as revenue gains were partially offset by increased headcount in commercial and operations to support future growth.

Asset-linked fees experienced the greatest growth in the first quarter rising 26% driven by a 39% increase in average ETF AUM. Subscription revenue increased modestly due to growth in data subscriptions and exchange-traded derivative revenue declined 8%.

The trend of assets moving into passive investments was very strong in the first quarter. The exchange-traded products industry reached inflows of $189 billion—a new record for a first quarter—and it was two and a half times larger than the previous first-quarter record.

The quarter-ending ETF AUM tied to our indices totaled $1,116 billion up 35% versus the first quarter of 2016. As the chart shows, this was the result of $162 billion of inflows and $126 billion of market gains over the last 12 months. The $1,116 billion was a new record—surpassing the previous quarterly record of $1,023 billion set on December 31, 2016.

The first-quarter average AUM associated with our indices increased 39% year-over-year. This is a better proxy for revenue changes than the quarter-end figures.

Exchange-traded derivatives faced a tough comparison to the first quarter of 2016 when market volatility was much higher. Transaction revenue from exchange-traded derivatives declined due to a 10% decrease in average daily volume of products based on S&P DJI's indices, largely a result of declines at the CME equity complex.

Now, turning to our capital position, there was little change from the end of the fourth quarter. We continued to have $2.4 billion of cash, and $3.6 billion of long-term debt. $1.8 billion of this cash was held outside the United States at the end of the first quarter.

Our debt coverage, as measured by gross debt to adjusted EBITDA, was 1.3 times versus 1.4 times at the end of the fourth quarter.

Free cash flow during the quarter was $306 million. However, to get a better sense of our underlying cash generation from operations, it is important to exclude activity associated with divestitures and the after-tax impact of legal settlements. In the first quarter, there was little difference as free cash flow on that basis was $307 million.

As for return of capital, the Company returned $307 million to shareholders in the first quarter: $201 million through repurchasing 1.5 million shares and $106 million in dividends.

Now, I will review our updated 2017 guidance. Based upon a strong first quarter, and our expectations for the remainder of 2017, we have made several changes to our original 2017 guidance. This slide depicts our GAAP guidance and the changes that we have made. Please keep in mind that our guidance reflects current spot market forex rates.

This slide shows our updated adjusted guidance. The changes are highlighted on this slide. I am going to discuss the changes to our adjusted guidance which were as follows:

- We have increased our organic revenue growth from mid single-digit to mid-to-high single-digit growth, with contributions by every business segment;
- We have lowered our unallocated expense from a range of $145 to $150 million, down to a range of $130 to $140 million. Corporate unallocated is expected to be lower, driven by continued cost discipline;
- We have changed our operating profit margin guidance which had been for an increase of roughly 100 basis points to a range of 44.5% to 45.5%. We hope that providing the margin percentage is more clear than merely providing the change in basis points;
- We have increased diluted EPS, which excludes deal-related amortization, from a prior range of $5.90 to $6.15 to a new range of $6.00 to $6.20;
- And, free cash flow, excluding after-tax legal settlements and insurance recoveries, was $1.6 billion and now is greater than $1.6 billion.

Our guidance does not take into consideration any potential policy changes from the new U.S. administration. Overall, this guidance reflects our expectation that 2017 will be another strong year for the Company.

With that, let me turn the call back over to Chip for your questions.

To access the accompanying slides online, go to:
http://investor.spglobal.com/CustomPage/Index?KeyGenPage=1073751596&event=1073749051

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

This document 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, trends, contingencies or results, appear at various places in this report and use words like “anticipate,” “assume,” “believe,” “continue,” “estimate,” “expect,” “forecast,” “future,” “intend,” “plan,” “potential,” “predict,” “project,” “strategy,” “target” and similar terms, and future or conditional tense verbs like “could,” “may,” “might,” “should,” “will” and “would.” For example, management may use forward-looking statements when addressing topics such as: the outcome of contingencies; future actions by regulators; changes in the Company’s business strategies and methods of generating revenue; the development and performance of the Company’s services and products; the expected impact of acquisitions and dispositions; the Company’s effective tax rates; and the Company’s cost structure, dividend policy, cash flows or 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 forward-looking statements include, among other things:

- worldwide economic, financial, political and regulatory conditions, including economic conditions and regulatory changes that may result from the United Kingdom’s likely exit from the European Union;
- the rapidly evolving regulatory environment, in the United States and abroad, affecting S&P Global Ratings, S&P Global Platts, S&P Dow Jones Indices, and S&P Global Market Intelligence, including new and amended regulations and the Company’s compliance therewith;
- our ability to make acquisitions and dispositions and successfully integrate the businesses we acquire;
- the outcome of litigation, government and regulatory proceedings, investigations and inquiries;
- the health of debt and equity markets, including credit quality and spreads, the level of liquidity and future debt issuances;
- the demand and market for credit ratings in and across the sectors and geographies where the Company operates;
- concerns in the marketplace affecting the Company’s credibility or otherwise affecting market perceptions of the integrity or utility of independent credit ratings;
- the effect of competitive products and pricing, including the level of success of new product developments and global expansion;
- consolidation in the Company’s end-customer markets;
- the impact of cost-cutting pressures across the financial services industry;
- a decline in the demand for credit risk management tools by financial institutions;
- the level of merger and acquisition activity in the United States and abroad;
- the volatility of the energy marketplace;
- the health of the commodities markets;
- the impact of cost-cutting pressures and reduced trading in oil and other commodities markets;
- our ability to incentivize and retain key employees;
- the Company’s 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 or improper disclosure of confidential information or data;
- the Company’s ability to successfully recover should it experience a disaster or other business continuity problem from a hurricane, flood, earthquake, terrorist attack, pandemic, security breach, cyber-attack, power loss, telecommunications failure or other natural or man-made event;
- changes in applicable tax or accounting requirements;
- the level of the Company’s future cash flows and capital investments;
- the impact on the Company’s revenue and net income caused by fluctuations in foreign currency exchange rates; and
- the Company’s exposure to potential criminal sanctions or civil penalties if it fails to comply with foreign and U.S. laws and regulations that are applicable in the domestic and international jurisdictions in which it operates, including sanctions laws relating to countries such as Iran, Russia, Sudan and Syria, anti-corruption laws such as the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act of 2010, and local laws prohibiting corrupt payments to government officials, as well as import and export restrictions.

The factors noted above are not exhaustive. The Company and its subsidiaries operate in a dynamic business environment in which new risks emerge frequently. Accordingly, the Company cautions readers not to place undue reliance on any 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, except as required by applicable law. Further information about the Company's businesses, including information about factors that could materially affect its results of operations and financial condition, is contained in the Company's filings with the SEC, including the "Risk Factors" section in the Company's most recently filed Annual Report on Form 10-K.