McGraw Hill Financial
1st Quarter 2015 Earnings Conference Call
Prepared Remarks
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Vice President, Investor Relations
McGraw Hill Financial

Good morning. Thank you for joining us for McGraw Hill Financial's first quarter 2015 earnings call. Presenting on this morning's call are Doug Peterson, President and CEO, and Jack Callahan, 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 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-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.

I'm pleased to report that we are off to a good start for 2015. Let me begin by reviewing some of the highlights from the quarter:

- The Company reported strong revenue growth of 6% despite a negative impact from foreign exchange rates that reduced the growth rate by 2%;
- Every business unit delivered growth in both revenue and adjusted operating profit;
- Revenue growth, combined with progress on our productivity initiatives, led to a 380 basis-point improvement in our adjusted operating profit margin;
- We resumed our share repurchase program with 1.1 million shares repurchased in the quarter;
- We made changes to our compensation programs aligning them more closely with investor interests by eliminating employee stock option grants and instead utilizing restrictive stock grants and deferred cash;
- Our legal team continued to resolve legacy litigation matters, including receiving a dismissal of the Corte dei Conti matter in Italy. You will recall that this was the potential 234 billion euro claim from an Italian prosecutor that we referred to on our 4th quarter 2013 earnings call;
- And finally, Ashu Suyash was named as the Managing Director/CEO of CRISIL effective June. Ashu brings a strong professional track record in the financial services sector and proven leadership skills. We look forward to having her join CRISIL.

As we look to 2015, we are encouraged by the economic landscape before us. The U.S. economy continues to strengthen, albeit in fits and starts. The labor market is showing solid momentum and we expect continued job creation, coupled with lower oil prices, to enable consumer spending to fuel additional GDP growth. In Europe, we expect GDP to expand 1.1 percent due to lower oil prices, quantitative easing, and the strong U.S. dollar. And finally, we expect Asia Pacific investment and borrowing activity to remain sound.

Caution is warranted, however, for a number of reasons:

- The U.S. dollar is strong;
- Interest rates are volatile with negative rates appearing in Europe and markets in the U.S. are on a "rate-increase watch";
- Geo-political concerns continue in Greece and Ukraine;
- And emerging markets credit conditions could weaken due to lower commodity prices, sharp declines in currency value, and the strong dollar.

Overall, we expect global GDP to grow 3.5% this year, a positive environment overall for our businesses.

Now, let's turn to our first quarter results:

- Revenue increased 6%;
- Adjusted operating profit increased 18%;
- Adjusted operating margin increased 380 basis points; and
- Adjusted diluted EPS increased 25%.

Despite the challenge of a strong U.S. dollar, the Company delivered healthy revenue growth with 10% domestic growth and 1% international growth. Jack will discuss the impact to the Company from foreign exchange in his remarks.

Adjusted segment costs were well contained in the quarter due to tight cost control and progress on our productivity initiatives.

All of our business units delivered revenue growth and increased adjusted operating profit. Only S&P Dow Jones Indices did not report improved margins, and that was due to a difficult comparison with a one-time revenue increase recorded in the year ago quarter.

Standard & Poor's Ratings Services

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

In the first quarter:

- Revenue increased 6%;
- Adjusted operating profit grew 19%; and
- The adjusted operating margin increased 480 basis points to 47%.

While revenue was negatively impacted by foreign exchange, it had a negligible impact on operating profit. S&P Rating Services continues to make progress in improving margins. Reduced headcount from recent restructurings was the primary contributor to this quarter's improvement. Partially offsetting this progress were costs associated with efforts related to Dodd Frank implementation and other regulatory requirements.

Moving on to the next slide, transaction revenue increased from 43% to 48% of total revenue. Non-transaction revenue decreased due to the strong U.S. dollar and a decline in entity credit ratings revenue, and slower client acquisition than in Q1 2014.

Transaction revenue grew, resulting from increased corporate public debt finance issuance, offset somewhat by weakness in bank loans.

The leveraged loan market experienced a 51% decline in new issue volume versus the first quarter of 2014. One of the causes of the decline in bank loans is the decrease in leveraged buyouts. LBO-related activity was the lowest since 2009, with market participants discouraged by the regulatory environment.

If we turn to issuance, the recent trends in U.S. and European issuance have benefited our businesses. First quarter issuance in the U.S. was quite strong across all sectors. Investment-grade increased 24%. In the U.S., the improvement in corporate issuance was largely due to a 45% increase in industrials issuance as financial services only increased 2%. Large debt-financed M&A transactions also contributed to the lift in issuance. In addition, a continued thirst for yield has enabled corporate issuers across the rating spectrum to tap the capital markets, extending maturities at beneficial pricing and terms.

High-yield increased 39%. Public finance was up 61% over an unusually weak first quarter in 2014. Sequentially, public issuance was flat, albeit at an elevated level as local governments continue to refinance maturing debt. Structured finance issuance, while up 21% vs 1Q 2014, is consistent with levels seen throughout most of 2014. Of particular note was strength in ABS as auto securitization levels remain robust.

In Europe, while there was a strong sequential recovery, year-over-year issuance comparisons were mostly negative. There is an increasing universe of government debt trading with a negative yield or a fixed rate of return barely above zero. This is due to the European Central Bank's aggressive stimulus policies. This has resulted in yield-hungry European bond investors buying "reverse" Yankee bonds as a growing number of U.S. companies turned to the other side of the Atlantic for their financing needs. By the way, reverse Yankee bonds are counted as U.S. issuance and revenue.

Further in Europe, investment-grade decreased 9% and high-yield declined 5%. Structured issuance was one of the bright spots, however, increasing 23% thanks to ABS and a surge in United Kingdom RMBS.

Note that from a revenue perspective, bond activity was not as positive as issuance might suggest as the growth in the number of issues did not keep pace with the growth in the par value of issuance as deal sizes increased in most asset classes.

There is a perception among some investors that corporate debt is unusually high and issuance likely unsustainable. Periodically we have provided data that suggest otherwise, including that generated in our annual analysis of debt maturity.

This chart illustrates data from Standard & Poor's Ratings Services' annual global debt maturity studies. Each study shows the upcoming five years of debt maturities. Over the course of a year there was no change to the total debt maturing. Both last year's study and the most recent study depict total debt maturities for the following five years totaling $8.9 trillion. These data help provide confidence that corporate issuance will continue in the coming years.

S&P Capital IQ

Now, let me turn to S&P Capital IQ. Revenue grew 6%, segment operating profit grew 18%, and the operating margin increased 200 basis points to 19.5%. This is the fifth consecutive quarter of year-over-year margin expansion. Revenue growth was consistent both in the U.S. and outside the U.S.

Two particular highlights during the quarter were:

- The continued low-teens growth of S&P Capital IQ Desktop users and
- The product retention rates across the segment that reached 92%.

S&P Capital IQ is known foremost for the breadth and consistency of its data. To enhance our data even further, we established a partnership with Klooks, a recognized source of Brazilian corporate financial information, to offer financial data on more than 10,000 unlisted private companies in Brazil.

Let me add a bit more color on revenue growth in the three business lines of S&P Capital IQ:

- S&P Capital IQ Desktop & Enterprise Solutions revenue increased 10%, principally as a result of a low-teens increase in Desktop revenue.
- S&P Credit Solutions revenue increased 6% due primarily to single-digit growth in RatingsXpress®.
- In the smallest category, S&P Capital IQ Markets Intelligence revenue decreased 12% overall. While Global Markets Intelligence continued to deliver double-digit growth, declines in Equity Research Services and the shutdown of FMR Europe more than offset those gains.

S&P Dow Jones Indices

Turning to S&P Dow Jones Indices, this business delivered a 5% increase in revenue due to derivative, mutual fund, and data license revenue which all increased. Operating profit increased 4%. This quarterly comparison was impacted by a one-time revenue increase of approximately $12 million associated with refined revenue recognition for certain ETF products in the year-ago quarter.

While the comparison was difficult, the results were still solid — with an operating profit margin of 66.6%.

Highlights during the quarter included an aggressive expansion of our fixed income business and the establishment of a strategic index agreement with NZX Limited in New Zealand.

If we turn to the key business drivers, the ETF industry experienced record first quarter inflows of $97 billion; however, much of this was directed to non-U.S. ETFs where our position is not as strong as the U.S. In the long run, this is still positive. We believe that once investors place funds into passive investments, these funds tend to stay in passive investments and then they shift between various ETFs based on asset allocation models and decisions.

ETF assets under management (AUM) associated with our indices increased 22% to $810 billion versus the end of 1Q 2014, with approximately three quarters of this growth coming from inflows. While year-over-year growth was meaningful, this AUM decreased sequentially from $832 billion at the end of 2014 as ETF flows moved to products offering European and non-U.S. exposure.

Mutual fund AUM associated with our indices reached $1.1 trillion, an increase of 14% versus 1Q 2104.

Derivative trading licensing, generally the most volatile portion of revenue, diverged during the quarter with over-the-counter volumes increasing and exchange-traded activity decreasing.

The fallout from the LIBOR scandal has elevated the importance of both objective and independently governed indices and benchmarks. We see this as an exceptional opportunity for S&P Dow Jones Indices to build investor confidence in the fixed income markets by developing factor-based fixed income benchmarks.

During the quarter we announced an important expansion of our fixed income business. Our objective is clear — to be the premier provider of financial market indices across all asset classes, including all bond types, throughout the world.

S&P Dow Jones Indices already publishes over 500 fixed income indices globally covering municipal bonds, preferred stock, corporates bonds, credit default swaps, and senior loans amongst others. We are the third largest provider of fixed income indices for the global ETF market with approximately $30 billion of AUM linked to our indices. The flagship S&P Aggregate™ Bond Index Family will cover over 20,000 individual securities with the ultimate goal of launching thousands of maturity- and sector-based indices. The S&P U.S. Aggregate Bond Index was launched in January. It is a broad, comprehensive, market value-weighted index designed to measure the performance of the investment-grade U.S. fixed income market.

And finally, recognizing the strategic importance of exchange relationships, S&P has formed a number of unique and dynamic alliances with exchanges in various markets since 1998. The latest agreement with NZX Limited puts us at the center of a series of initiatives to facilitate greater investor access to the New Zealand market. We are committed to raising the global profile of the NZX indices with our well-recognized marketing and international commercialization capabilities.

Commodities & Commercial Markets

On to Commodities & Commercial Markets. As a reminder, McGraw Hill Construction was sold and its results moved to discontinued operations, thus our financials for 2015 and 2014 do not include these results.

Revenue grew 7% as both Platts and J.D. Power delivered high single-digit revenue growth. Segment operating profit grew 23%. Due to solid revenue growth and tight cost control, the operating margin increased 510 basis points to 38%.

During the quarter, Platts continued to grow revenue despite low commodity prices. As we have seen in recent quarters, the newer areas of metals and agriculture had the highest revenue growth rates. Global Trading Services' revenue increased primarily due to license revenue from The Steel Index derivative activity at the Singapore Exchange.

Platts added petrochemicals to its suite of forward curves in oil, natural gas, coal and power. These new forward curves include a range of aromatic petrochemicals including benzene and naphtha, and can be used as references for valuing contractual assets and liabilities, measuring profit and loss from changes in market prices, and making more informed risk management decisions.

We often talk about keeping benchmarks fresh, relevant, and delivered in a user-friendly manner. Here are a couple of examples:

- Platts recently introduced a faster method for delivering real-time global commodity prices with historical and reference data via Platts Market Data Direct. The new-and-improved version transfers Platts data straight into subscribers' proprietary systems providing need-to-know prices at the moment of publication. Customers can focus on what's most important to them.
- Another example is an update to Platts Dated Brent benchmark, one of the world's most important and widely-used price assessments. To further strengthen and enhance its long-term viability, the cargo loading period was widened enabling the benchmark to reflect an additional five to six days of supply responding to the reality that oil fields decline in supply over time.

Finally, J.D. Power delivered high single-digit revenue growth led by strong activity in the U.S. auto sector. Global Services Industries and advertising licensing revenue also contributed to growth.

During the quarter, J.D. Power launched a new product, Voice of Experience (VoX), a holistic solution enabled by an innovative technology platform designed for businesses to optimize their customer experience and drive financial results. VoX displays interactive data in an intuitive user interface, for all levels of an organization, to determine how to improve the customer experience and improve loyalty, advocacy, sales and service.

In summary, the Company is off to a good start to the year. With a focus on creating growth and driving performance, all our businesses achieved revenue and adjusted operating profit growth. This performance resulted in a consolidated 380 basis-point improvement in our adjusted operating margin and a 25% increase in adjusted diluted EPS to $1.09.

Our Company continues to be aligned around very important themes:
- Strengthening customer and stakeholder engagement;
- Accelerating our international growth;
- Sustaining our margin expansion and maintaining discipline in capital allocation; and
- Fostering a robust risk & compliance culture to manage and mitigate risk throughout the Company.

With that, 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 some color on several items related to first quarter financial performance, and then we will open it up to your questions.

- First, I will recap key consolidated financial results and review certain adjustments to earnings that were recorded in the quarter;
- Second, I will discuss the impact of foreign exchange changes on revenue;
- Third, I will highlight balance sheet changes, free cash flow, and return of capital.

Let's start with the first quarter income statement. Overall, these were good results; especially the continuing momentum in margin improvement.

- Revenue grew 6%, despite the challenging headwinds from foreign exchange;
- Adjusted consolidated operating profit grew 16%, with all four business units contributing to this growth. Continued progress on our productivity initiatives fueled this growth. We also realized a benefit from foreign exchange, which impacted expenses from our operations outside the United States. Within the quarter, the positive benefit to expenses from forex (foreign exchange) offset the negative impact to revenue.

- Unallocated expenses decreased 3%;
- The tax rate, on an adjusted basis, was 32%. We had a one-time benefit from a prior-year item that impacted the rate. For the balance of the year, we continue to guide to an approximately 33% rate.
- Adjusted net income increased 24%, and adjusted diluted earnings per share increased 25% to $1.09. The average diluted shares outstanding decreased by almost 1 million shares versus a year ago as share repurchase activity offset the dilutive impact of shares granted for equity-related compensation.

Now let me turn to adjustments to earnings to help you better assess the underlying performance of the business. Overall the adjustments in the quarter were limited. In total, pre-tax adjustments to earnings from continuing operations resulted in a gain of $6 million during the quarter. This consisted of $35 million in settlement-related insurance recoveries, partially offset by $29 million of legal settlement charges.

Let me provide more color on the impact of foreign exchange on results. The strong dollar is having a pronounced impact on corporate America. The impact on McGraw Hill Financial is mitigated somewhat since approximately one-half of our revenue outside the U.S. is invoiced in U.S. dollars.

During the quarter, we reported a strong 10% increase in domestic revenue and a 1% increase in international revenue. On a constant currency basis, international revenue increased 6%. In total, our consolidated revenue increased 6%. On a constant currency basis, total Company revenue increased 8%. The business with the largest impact was Standard & Poor's Ratings Services, which accounted for approximately 80% of the total foreign exchange impact on revenue.

Now, let's turn to the balance sheet. As of the end of the first quarter, we had almost $1.2 billion of cash and cash equivalents, of which approximately $1 billion is held outside the United States. The decrease from the end of 2014 is primarily due to the payment of legal settlements of approximately $1.6 billion during the first quarter.

In order to meet this significant U.S. cash requirement, the Company incurred $365 million of short-term debt through commercial paper issuance and by tapping our revolving credit facility. We continue to have approximately $800 million of long-term debt.

Our free cash flow for the quarter was a negative ($1.4 billion). While the legal settlements were recorded in the income statement in the fourth quarter of 2014, almost all the cash was paid out in the first quarter of 2015. In addition, the first quarter has stepped-up cash requirements for annual incentive compensation payments.

During the first quarter, we resumed the Company's share repurchase program and bought 1.1 million shares. Share repurchase has been and remains an important component of our capital allocation program, and we will continue to selectively repurchase shares under our remaining share repurchase authorization of 44.5 million shares.

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

In closing, I would like to reiterate that our 2015 guidance remains unchanged with mid single-digit revenue growth and adjusted diluted EPS of $4.35 to $4.45. The specific elements of our guidance can be seen on this slide.

We continue to focus on creating growth and driving performance. We are off to a good start to 2015, and are encouraged by the performance of our businesses; but, we are mindful of the broader macro-economic challenges that we continue to face.

To access the accompanying slides online, go to:
http://investor.mhfi.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=5188737

"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, trends, contingencies or results, appear at various places throughout 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, 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 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 our forward-looking statements include, among other things:

- The rapidly evolving regulatory environment, in the United States and abroad, affecting Standard & Poor's Ratings Services, Platts, S&P Dow Jones Indices, S&P Capital IQ and our other businesses, including new and amended 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 credit ratings in and across the sectors and geographies where we operate;
- concerns in the marketplace affecting our credibility or otherwise affecting market perceptions of the integrity or utility of independent credit agency ratings;
- 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 effect of competitive products and pricing;
- consolidation in our end customer market;
- 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 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 impact of cost-cutting pressures and reduced trading in oil and other commodities 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;
- the level of our capital investments;
- the level of restructuring charges we incur;
- the strength and performance of the domestic and international automotive markets;
- 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