2007 MCO Strategic Plan Overview

Ray McDaniel

July 2007

Moody's Corporation
Agenda

- Financial Summary
- Market Environment
- "Critical few" Strategic Priorities & Supporting Strategies
- Significant Issues in H1 2007
- Linkages Between Current Issues and Longer-Term Strategic Priorities?
## 2007 P&L Summary: H1 and Projected FY

<table>
<thead>
<tr>
<th></th>
<th>2006 1H Actual</th>
<th>2007 1H Actual</th>
<th>Growth %</th>
<th>2006 FY Actual</th>
<th>2007 FY Fcst</th>
<th>Growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ratings and Research (a)</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Ratings Revenue</td>
<td>$762</td>
<td>$1,003</td>
<td>31.5%</td>
<td>$1,640</td>
<td>$1,881</td>
<td>14.7%</td>
</tr>
<tr>
<td>Research Revenue</td>
<td>122</td>
<td>153</td>
<td>25.3%</td>
<td>255</td>
<td>316</td>
<td>24.3%</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$884</td>
<td>$1,156</td>
<td>30.7%</td>
<td>$1,894</td>
<td>$2,198</td>
<td>16.0%</td>
</tr>
<tr>
<td>Expenses (a)</td>
<td>363</td>
<td>498</td>
<td>37.1%</td>
<td>812</td>
<td>990</td>
<td>22.0%</td>
</tr>
<tr>
<td>Operating Income</td>
<td>521</td>
<td>658</td>
<td>26.2%</td>
<td>1,082</td>
<td>1,207</td>
<td>11.5%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>58.9%</td>
<td>56.9%</td>
<td></td>
<td>57.1%</td>
<td>54.9%</td>
<td></td>
</tr>
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**Moody's KMV**

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<tbody>
<tr>
<td>Revenue</td>
<td>67</td>
<td>74</td>
<td>9.4%</td>
<td>143</td>
<td>158</td>
<td>10.9%</td>
</tr>
<tr>
<td>Operating Income</td>
<td>6</td>
<td>11</td>
<td>71.4%</td>
<td>17</td>
<td>27</td>
<td>64.5%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>9.4%</td>
<td>14.7%</td>
<td></td>
<td>11.6%</td>
<td>17.2%</td>
<td></td>
</tr>
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**Total Moody's**

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</tr>
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<tbody>
<tr>
<td>Revenue</td>
<td>952</td>
<td>1,229</td>
<td>29.2%</td>
<td>2,037</td>
<td>2,356</td>
<td>15.7%</td>
</tr>
<tr>
<td>Operating Income</td>
<td>527</td>
<td>668</td>
<td>26.7%</td>
<td>1,099</td>
<td>1,235</td>
<td>12.3%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>55.4%</td>
<td>54.4%</td>
<td></td>
<td>53.9%</td>
<td>52.4%</td>
<td></td>
</tr>
<tr>
<td>Interest Expense, net</td>
<td>4</td>
<td>(17)</td>
<td></td>
<td>1</td>
<td>(37)</td>
<td></td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>316</td>
<td>385</td>
<td>21.9%</td>
<td>658</td>
<td>710</td>
<td>8.0%</td>
</tr>
</tbody>
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<th>Growth %</th>
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<tbody>
<tr>
<td>Diluted EPS - Pro forma (a)</td>
<td>$1.07</td>
<td>$1.37</td>
<td>28.0%</td>
<td>$2.25</td>
<td>$2.57</td>
<td>14.2%</td>
</tr>
<tr>
<td>Diluted EPS - As Reported (b)</td>
<td>$1.07</td>
<td>$1.56</td>
<td>45.8%</td>
<td>$2.58</td>
<td>$2.76</td>
<td>7.0%</td>
</tr>
</tbody>
</table>

(a) Excludes gain on sale of HQ in 2006; legacy tax provisions in 2006 and 2007

(b) Includes gain on sale of HQ in 2006; legacy tax provisions in 2006 and 2007
Market Environment

Secular growth will continue, but more slowly. Cyclical conditions mixed, but credit cycle has peaked and market sentiment pessimistic...

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<th>-’s</th>
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<tbody>
<tr>
<td>• Fed probably won’t tolerate an extended &quot;seizing up&quot; of capital markets</td>
<td>• Ultimate credit (&amp; ratings) performance for RMBS won’t be clear for 12-18 months</td>
</tr>
<tr>
<td>• Housing market has been slow to undermine broader economic performance</td>
<td>• Contagion risk from sub-prime still uncertain – stabilized credit conditions for housing still 12+ months off</td>
</tr>
<tr>
<td>• Corp spreads still reasonable by historical measures &amp; default rates at historical lows – 1.4% default rate in June 07</td>
<td>• Credit stabilization may not cure aversion to illiquid instruments – esp. for mark-to-market investors</td>
</tr>
<tr>
<td>• Corporate debt protection compares favorably with 1998 (post-LTCM)</td>
<td>• Last major credit crunch followed Enron by &gt;1 yr</td>
</tr>
<tr>
<td>• Similar number of upgrades/downgrades of US high-yield companies</td>
<td>• Widening of yield spreads – but still below LT mean/median</td>
</tr>
<tr>
<td>• De-linking of US &amp; Int’l economic cycles and market performance</td>
<td>• Overdue rise in creditor risk aversion should reduce the issuance of riskiest corporate debt... knock-on to CLOs?</td>
</tr>
</tbody>
</table>
Corporate spreads widening, but still favorable
Moody's Revenue & Op Inc vs. Credit Cycles

- Moody's quarterly revenue growth has averaged 19.9% since 1998

- Quarterly revenue growth has never been negative during this period
  - The most recent period of low growth was in the first half of 2000 when revenue increased by about 1.5% in Q1 and Q2.

- Quarterly operating income growth has been negative once since 1998, though by only 0.2%
  - In Q3 1998, during the credit problems associated with Russia, Korea and LTCM.

- The last three credit crunches have occurred in 98, 01, and 02
  - Decelerating growth rates occurred during in two of the three crunches; sustained (and higher than average) growth in one of three
  - The two crunch periods of decelerating growth have each been followed by three quarters out of four of accelerating growth
Spotlight on Mortgages: Quality Continues to Erode

Delinquent Residential Mortgage Debt (%)

Sources: Equifax, Moody's Economy.com
House Prices Are Falling...

Median Existing House Price – % Change vs Prior Year

Source: Realtors

3 month moving average
Mortgage Payment Resets are Mounting

Mortgage Debt Facing First Payment Reset ($ Billion)

Source: CreditSuisse

- Prime
- Agency
- Unsecuritized
- Option
- Alt-A
- Subprime
1.3 MM Mortgage Defaults Forecast 2007-08

First Mortgage Loan Defaults (000s)

Source: Equifax/Moody's Economy.com
On the Horizon...?

- Credit crunch
- More hedge fund failures
- Sub-prime problems spread to Alt-A & Prime
- LBOs
  - 9 postponed so far, 32 in the pipeline
  - Banks holding significantly more risk than planned – how long?
- CLOs
  - Markets appear to be closing – how long?
- CMBS
- States Attorneys’ General investigations
2007 Strategic Priorities
## Critical Few Priorities

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<tr>
<th>Strategic Priorities</th>
<th>Supporting Strategies</th>
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<tr>
<td>Market Relevance</td>
<td>Execution</td>
</tr>
<tr>
<td></td>
<td>- Corporate Positioning (brand &amp; identity, communications, etc.)</td>
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<tr>
<td>Product Development (esp. around proprietary data/analytics)</td>
<td>- Organizational design</td>
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<tr>
<td>International Expansion</td>
<td>- Information Strategy</td>
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<td>Corporate Development (acquisitions)</td>
<td>- Human Resources Management</td>
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<tr>
<td>Synergies (revenue &amp; expense)</td>
<td>Financial Strategy</td>
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<td>Legal &amp; Regulatory Strategy</td>
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Selected 2006-07 Accomplishments

Market Relevance
- Created Investor Advisory Councils
- Strategic Calling Officers
- Customer Service Steering Committee
- Brand Strategy Project

New Products
- SFG New Products Group
- MKMV RiskFrontier
- Corporate Financial Metrics
- M3 Sub-prime Mortgage Model

International Expansion
- Joint venture in China
- Acquisition of CRA Ratings in the Czech Republic, CA Ratings in South Africa, and Kasnic Ratings in Indonesia
- Moody’s office in Dubai

Corporate Development
- Adopted investment criteria & scoring
- LOBs taking more active role in deal identification
- WSA acquisition; international expansion (see above)
- Actively pursuing deals: e.g. Fermat, KIS Ratings, Strat Analytics

Synergies
- Project Athena
- Established Global Project Finance Group
- SFG New Products Group
Significant H1 '07 Issues
Major First Half Challenges

- Joint Default Analysis for Banks
- Challenges with foreign regulators – China; European scrutiny of structured finance
- SEC Rule-making Process
  - The notching debate
- U.S. Sub-prime
  - Spawning private litigation & state AG investigations
  - Creating significant scrutiny of our role & performance; misinformation & disinformation

Exceptional financial performance with challenging regulatory and credit environments is similar to 2002-03 (post-Enron)
Relationship of Current Challenges to Long-term Strategic Priorities
Common Themes to 1st Half Challenges

■ Understanding of ratings lags sensitivity to rating actions
  - Performance assessed by anecdote, not data

■ Significant & irreconcilable conflicts between user groups for ratings
  - "Standards" users vs. "alpha" seekers; longs vs. shorts
  - Ratings being adopted for uses beyond credit

■ Rating agencies assessed as a collective, not individually
  - But MCO is only public company in industry – the example

■ Behaviors/actions intensely scrutinized both for independence & competence
Observations & Implications

*Is the current environment any different than what we’ve had to confront historically?*

- Rating agencies today have a more prominent role in the capital markets than 5 years ago – and much more than 10 years ago...Why?
  - Hard-coded into global financial system infrastructure (Basel II, Reform Act, IOSCO)
  - Embraced by emerging market authorities/companies as a "stamp of arrival" (accelerating use ahead of need)
  - Proliferation of structured finance driving more demand for independent, credible opinion & guidance to cope with financial complexity
  - Global disintermediation
Observations & Implications

- Capital markets are more accessible to more people, becoming directly linked to the "real world" – rating agencies are increasingly relevant to real people, e.g.:
  - Ratings with more obvious social, political & geo-political implications (securitization of housing and consumer finance, China, "national champions", etc.)
  - Expansion into general economic commentary with MEDC

- As a U.S. public company, MCO is the symbol of an industry perceived to be very profitable, powerful and – possibly – conflicted
  - External actions to-date have not broken our position
  - Good results = bad publicity?
Observations & Implications

Confronting and managing multiple "big" issues at once is an aberration historically, but prospectively?

- We are perceived as having "system lock-in", in an industry that has system lock-in, in a system that matters more to more people.

- We’ve always taken unpopular positions, but complaints about us have a wider and more willing audience in the media, among bankers, in Washington, Brussels...
  - Our environment breeds intense scrutiny of everything we do.
  - Many parties resent us for the position that we have & for lack of control over us.

We need to better deal with the Real World’s opinions about – and interference in – our business, and its desire to define our role and to influence our activities to suit various purposes.
Observations & Implications

More interest and involvement from the real world requires us to:

- Understand our customers and our customers' customers more deeply
- Anticipate reactions to our actions on an interdisciplinary basis
- Develop and communicate messages rigorously & simply
  - Our role and function in the capital markets
  - How we manage the rating system
  - How we compete
  - Where we invest
- Stay on message and drive key messages down and out
- Operate in a world of zero tolerance for ambiguity and error – being right without being persuasive is failure
**Critical Few Priorities**

*We must transmit implications into actions consistent with the major ideas we are discussing with the board:*

<table>
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<th>Strategic Priorities</th>
<th>Supporting Strategies</th>
<th>Actions, for example...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Relevance</td>
<td>Execution</td>
<td>Reinforce clear, core corporate identity – internally/ externally</td>
</tr>
<tr>
<td>Product Development (esp. around proprietary data/analytics)</td>
<td>Corporate Positioning</td>
<td>Data, analytics, advisory, etc. that satisfy emerging demands beyond the purview of traditional ratings</td>
</tr>
<tr>
<td>International Expansion</td>
<td>Organizational design</td>
<td>Org structure that encourages cohesive, interdisciplinary orientation to customers and markets</td>
</tr>
<tr>
<td>Corporate Development (acquisitions)</td>
<td>Information Technology</td>
<td>Centralize Communications function</td>
</tr>
<tr>
<td>Synergies (revenue &amp; expense)</td>
<td>Human Resources Management</td>
<td>Instill/reinforce behavioral patterns that preserve legal protections (without losing customers)</td>
</tr>
<tr>
<td></td>
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