



The McGraw-Hill Companies

The McGraw-Hill Companies 2nd Quarter 2008 Earnings Conference Call

Prepared Remarks
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The McGraw-Hill Companies

Thanks and good morning.

We are pleased that you could join us this morning for The McGraw-Hill Companies' second quarter 2008 earnings conference call. I am Donald Rubin, Senior Vice President of Investor Relations at The McGraw-Hill Companies.

With me today are Harold McGraw III, Chairman, President and CEO, and Robert Bahash, Executive Vice President and Chief Financial Officer.

This morning we issued a news release with our second quarter 2008 results. We hope you have all had a chance to review the release. If you need a copy of it and the financial schedules, they can be downloaded at www.mcgraw-hill.com/investor_relations.

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.

We're aware that we do have some media representatives with us on the call; however this call is for investors and we would ask that questions from the media be directed to Mr. Steve Weiss in our New York office at (212) 512-2247 subsequent to this call. Today's update will last approximately an hour. After our presentation, we will open the meeting to questions and answers.

It is now my pleasure to introduce the Chairman, President and CEO of The McGraw-Hill Companies, Terry McGraw.

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Harold McGraw III
Chairman, President and CEO
The McGraw-Hill Companies

Good morning and welcome to our review of The McGraw-Hill Companies' second quarter earnings and the outlook for the rest of 2008.

Joining me today on the call is Bob Bahash, our executive vice president and chief financial officer. We will begin the call by reviewing second quarter results and our prospects for the second half. Bob will then review our financial performance and then we will be pleased to answer your questions about The McGraw-Hill Companies.

Earlier this morning we announced second quarter results:

- Earnings per share were \$0.66, including a pre-tax restructuring charge of \$23.7 million, or \$0.05 per diluted share, primarily for severance costs relating to a workforce reduction of 395 positions.
- Revenue for the second quarter declined by 2.6%.

The biggest national housing recession since The Great Depression and the credit crunch in financial markets continue to have an impact on our results. David Wyss, S&P's chief economist, doesn't expect housing prices to bottom out until the first half of 2009. The large supply of unsold existing homes continues to weigh on the market. David expects housing sales and starts to bottom out sometime in the third quarter of 2008, but prices will probably drop by another 10%.

The Federal Reserve is not expected to take any action on interest rates at its August 5th meeting. In fact, the next move expected from the Fed will be a rate hike, probably in the second quarter of next year.

Wyss estimates gross domestic product growth of 1.7% in the second quarter and 1.8% in the third quarter as consumers spend their rebate checks. But he expects negative growth in the fourth quarter of this year and the first quarter of 2009 followed by 3% growth in the second quarter next year.

In this environment, states are dealing with falling tax receipts and challenging budgets. That has raised questions about the outlook for education budgets in the new fiscal year that started on July 1 in 46 states.

States are working very hard to protect educational funding. A new survey of state education budgets by McGraw-Hill Education has pinpointed information on K-12 education budgets in 38 states. We have learned that most of these state education budgets are increasing in the new fiscal year, although at a slower rate than last year. The increase is averaging 3.5% for the new fiscal year versus about 10% last year. We have seen at this point reductions in K-12 education budgets in only three states. Two are flat.

There's another factor to consider in evaluating state budgets. It's bond issuance. In face of declining tax revenue, states are now more likely to step up bond issuance in the new fiscal year—a plus for Standard & Poor's.

With that background, let's turn to our review of operations.

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McGraw-Hill Education

Let's begin with McGraw-Hill Education.

A very good start in what is expected to be a robust state new adoption market this year was a key factor in McGraw-Hill Education's second quarter performance.

For the second quarter:

- Revenue increased 3.6%.
- Operating profit, including a pre-tax restructuring charge of \$8.5 million, declined by \$10.9 million, or 13.5%.
- The operating margin was 10.4% versus 12.4% last year. The restructuring charge reduced the operating margin by 126 basis points.
- The McGraw-Hill School Education Group increased revenue by 6.9% to \$438.2 million.
- The McGraw-Hill Higher Education, Professional and International Group saw a revenue decline of 2.1%.

With the decision-making largely completed in the adoption states, we have a pretty good idea of our prospects there. In 2007, we captured 32% of a state new adoption market worth about \$820 million. In 2008, we expect to capture about one-third of an even larger state new adoption market. We estimate that this year's market will come in between \$900 million and \$950 million.

The biggest opportunities this year are in reading and math. The key adoption states are Florida, Texas, and California. We expect to produce solid results in both key disciplines and all of the key adoption states.

In the second quarter, we saw the first signs of our successful campaigns as orders came in for reading from Florida and math from Texas.

An exceptional year is taking shape in Florida where *Treasures*, our balanced basal program has been widely adopted. But that is not the whole story. We compete with a spectrum of products because U.S. education is not a one-size-fits-all market. So, we will take additional market share in Florida with our alternative basals, *Imagine It!* and *Reading Mastery Plus*. As a result, our products will account for more than half of this year's Florida K-5 reading market.

We also did very well in Texas with our new state-specific balanced basal math program.

In California, we expect to build on last year's success in science with an excellent performance in the sizeable second-year K-8 adoption. We also anticipate good results there in K-8 math with our new state-specific balanced basal and with *Everyday Mathematics*.

In the overall K-12 reading and literature state new adoption markets, we expect solid results in Alabama, Indiana, Louisiana, and Oklahoma.

Spotlight on Music is leading the elementary market. And our fine arts, health, business and vocational lines are performing well in states adopting these categories.

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The supplemental market remains sluggish, although we are enjoying some success with intervention products. Our prospects in this market got an unexpected boost last week when the Texas Education Agency announced a new \$15 million opportunity for reading intervention programs. That new funding will be spent during the 2008–2009 school year on the Texas intensive reading initiative for grades 4 through 8. Three of our intervention programs have been adopted—*Reading Triumphs*, *Corrective Reading* and *Jamestown Reading Navigator*. They represent comprehensive print and digital solutions for students reading below grade level.

Summing up the outlook for the elementary-high school market in 2008:

- A solid year is taking shape in the state new adoption market.
- The bulk of open territory orders traditionally come in the third quarter and we're still looking for some increase in these states. This market should grow 1% to 2%. Obviously we are hoping for more.
- We still expect to gain share in the overall K–12 market, which will grow 4% to 5% this year.

In the testing market, we compete with a spectrum of assessment products. *Acuity*, our new formative product, continues to win new customers. We are also winning new business with our *TABE* series, which offers diagnostic assessments and instructor support for adult students, and with our *LAS Links* series for English-language learners. Last week, Nevada, for example, extended its contract for *LAS Links* for three years to serve nearly 80,000 English-language learners in the state. Our system helps states ensure compliance with No Child Left Behind Title III requirements.

We are seeing some changes in No Child Left Behind requirements that play to our strength in testing. The U.S. Department of Education has been permitting states to add a growth component to their school accountability programs. The growth model looks at the academic performance of individual students to determine if they are on track to become proficient. If students score below the proficient standard in reading or math but are still making progress and appear likely to achieve proficiency, they may be counted among the school's proficient students.

Eleven states have now been permitted to add a growth component to their state accountability plans. Growth components require the development of a vertical scale. We have strong industry-recognized expertise in vertical scaling, which links one grade to another so schools can see how students are progressing from grade to grade. Our *TerraNova* testing series has vertical scales. The same is true for our *Acuity* predictive tests, which enables us to show growth through formative assessment—a significant competitive advantage.

In the higher education, international and professional markets we saw some softness in the second quarter as bookstores cut orders and reduced inventory. Some college textbook distributors also shifted the timing of their orders for the fall semester from late June into July.

We expect softness in professional markets for the balance of the year. It's a combination of tough comparisons—last year we had the benefit of the new edition of the *Encyclopedia of Science and Technology*—and this year we are facing the impact of the economy on bookstore sales.

We now expect our U.S. college and university business to grow about 4% to 6% this year. However, sales of our digital, custom, and career product lines are showing stronger growth. The outlook is mixed in international markets.

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So, summing up for McGraw-Hill Education overall:

- Slower growth in our higher education, professional and international markets may reduce the rate of increase in revenue this year for McGraw-Hill Education,
- Our original forecast called for revenue growth of 6% to 8%. We now estimate revenue growth of 4% to 6% in 2008, and we will have to see as orders come in August—again, July-August we call the “60-day month,”
- We are not changing our estimate of a 50 to 100 basis point decline in the segment’s operating margin.

Financial Services

For Financial Services, the second quarter will probably be the most challenging of the year. S&P peaked last year in the second quarter, achieving its highest levels of revenue and operating profit as the structured finance market continued to surge. In face of tough comparisons this year, diversification and cost containment were critical factors in our performance.

For the second quarter:

- Revenue declined 10.4%,
- Operating profit, including a \$15.2 million pre-tax restructuring charge, was down 25.4%, and
- The operating margin was 40.7%, down from 48.9% last year. But restructuring charges reduced the operating margin in the second quarter by just over 200 basis points.

In a difficult first half, Financial Services produced an operating margin of 40.5% including the second quarter restructuring charge. The restructuring charge reduced the operating margin by 110 basis points.

The performance underscores some very key components about the outlook for Financial Services:

1. Diversification contributes importantly to our results.
2. Our strategy buffers Standard & Poor’s against the decline in new issuance.
3. Cost containment will continue to be a priority.
4. And while there have been more headlines and new rule and regulatory proposals in recent weeks, there is no change in our assessment of legal or regulatory risks. In my opinion, both remain low.
5. Our guidance for this segment in 2008 remains unchanged.

If the decline we experienced in the first half in structured finance continues for the remainder of the year, revenue for Financial Services could be off 7% to 9% in 2008. Under these circumstances, we would also expect a 500 to 600 basis point pullback in the segment’s operating margin.

Now, let’s examine these points in more detail starting with the impact of diversification.

A key aspect of diversification is illustrated by this table which compares results at Financial Services with new issue dollar volume in the bond market.

- Revenue for Financial Services declined 10.4% and S&P Credit Market Services was off 20.1%, but global new issue dollar volume fell 32.5% in the second quarter.
- Domestic revenue for Credit Market Services was off by 30.6% while total U.S. new issue dollar volume fell by 44.4%.
- In the second quarter, international revenue for Credit Market Services was down by 3.3% while international new issue dollar volume declined by 20%,

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As we had forecasted, Standard & Poor's Investment Services produced double-digit revenue growth: up 22.8% for the second quarter and 20.4% for the first half. We still expect double-digit revenue growth from these non-ratings businesses for the full year.

We continue to expand in data and analytics both here and abroad. The Capital IQ products are attracting new customers in both domestic and international markets. Capital IQ now has more than 2,400 customers worldwide, a 23% increase compared to second quarter last year.

Our index services are still rolling ahead, adding new products and more customers:

- Assets under management in exchange-traded funds based on S&P indices grew by 15.5% to \$206.3 billion versus the same period last year.
- Sales of our custom indices and data also increased,
- Trading in exchange-traded derivatives based on S&P indexes has been robust. The average daily volume of contracts for the major exchange-traded derivatives was 2,820,000 in the second quarter, up 25% from the comparable quarter last year, and
- Trading of over-the-counter derivatives also increased substantially due in part to our products, including the S&P GSCI index, the S&P Diversified Trend Indicator, the S&P Commodities Trend Indicator, and the S&P Select Plus Custom Series.
 - Investment banks license these products from S&P to create structured vehicles that are linked to their performance. For example, to pick one of them, the S&P Diversified Trend Indicator is a composite of 24 highly-liquid futures contracts grouped in 14 sectors, evenly weighted between financials and physical commodities. The S&P DTI positions each sector, except energy, either long or short based on its price behavior relative to its moving average.

It is just another example of all the things that I think are possible with these kinds of instruments. It is all about innovation and creativity. And there is an endless permutation with the numbers you can come up with, and we continue to expand. Let me quickly recap this year's activity for S&P indices:

- 18 new exchange-traded funds were launched in the second quarter,
- 31 new exchange-traded funds were launched in the first half compared to 46 for all of 2007, and
- There are now a total of 175 exchange-traded funds based on S&P indices.
- We have more new indices on the launch pad for the second half.

Our effort to diversify is not limited to S&P Investment Services. Diversification is also an important strategic activity at S&P Credit Market Services.

Reducing S&P's dependence on the new issue market and expanding internationally are key initiatives. The 13.7% increase in non-transaction revenue for the second quarter and 12.5% for the first half are tangible measures of our success. Clearly, growth in this area helped partially offset the decline in new issue markets.

Non-transaction revenue includes surveillance fees, annual contracts, and subscriptions. All three categories grew in the second quarter, as did deferred revenue for the Financial Services segment. Deferred revenue for this segment increased 12.0% in the second quarter to just over \$840 million. We expect deferred revenue in this segment to continue growing.

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In this environment, cost containment is vitally important. We are closely managing costs while making investments to ensure that S&P is prepared for the turnaround in credit markets and growth in our non-ratings business:

- We have taken a measured approach to restructuring by eliminating approximately 170 positions at the end of 2007 and another 246 in the second quarter,
- We have also reduced incentive compensation,
- In our effort to streamline the organization, we will continue to examine the management structure and make process improvements,
- Hiring remains selective, and
- Reduction of discretionary expenses is a priority. Bob Bahash will provide more information on costs and expenses in just a moment.

The U.S. structured finance market continues to show major declines in the second quarter. New issue dollar volume was down:

- 75.4% in April,
- 81.8% in May,
- 84.0% in June, and
- 79.0% for the first half.

Only the issuance of asset-backed securities is up after six months—but not by much. Just 0.2%.

With these bar charts, we have been illustrating the monthly comparison in U.S. new issue volume since the beginning of 2008. There is a sequential improvement in U.S. corporate new issuance in the second quarter and June was the best month of the second quarter for public finance. But even a sequential pick up in structured finance is hard to spot.

Based on early indications in July, we don't expect to see much change in these patterns this month. Year-over-year comparisons don't start to get easier until September.

There are signs that the market is healing, but has not yet healed. Despite the turmoil in credit markets investment-grade issuers showed strength in the second quarter as better known issuers attracted receptive investors. Nearly all of the recent deals have been substantially oversubscribed—an indication that there is plenty of cash available.

- We think the corporate outlook for the second half is promising although speculative-grade issuance will remain weak,
- We expect more growth in public finance. The state and local government pipeline continues to look strong,
- We expect growth in international markets in the second half. We will benefit from our geographic expansion into the Gulf and Central and Eastern Europe. Refinancing requirements of industrials in Europe should also be a source of growth, and
- Activity remains very slow in the structured market.

But we are seeing some interesting developments in the U.S. residential mortgage-backed securities market. The focus will probably continue to be on secondary market trades and re-packaging. As a result, S&P may have some opportunities to rate some resecuritizations, or Re-REMICs.

There is also growing U.S. interest in covered bonds, which have been issued in Europe since the 1700s. Some market participants believe covered bonds could stimulate the U.S. mortgage market. But since

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the U.S. does not have an explicit legal framework for covered bonds, there is now an effort to resolve that issue. Treasury Secretary Hank Paulson was referring to that just the other day. If that effort succeeds, large capitalized banks could be important issuers.

The structure of covered bonds makes them attractive in today's environment because the investor has essentially two levels of protection. Covered bonds are senior debt obligations of the issuing institution secured directly on a portfolio of specific assets. The issuer is obligated to pay interest and principal on the bonds. But, for example, if the issuer defaults, the assets in the covered-asset pool also are available to repay the covered bonds.

Another opportunity for S&P is also emerging in structured finance. In the last eight years, an estimated \$25 trillion dollars of securitized assets have been issued. The majority of these assets is still in the market and needs to be monitored, revalued, and priced for trading in the secondary market.

To tap this market potential, S&P recently created Fixed Income and Risk Management Services, or FIRMS, under the direction of Lou Eccleston. It will provide market intelligence and analytic insight for risk-driven investment analysis, including debt, structured finance and derivatives markets.

As this slide shows, we have specific strategic initiatives for our target markets:

- The acquisition of IMAKE last year is the key to offering a new integrated credit risk modeling, surveillance and evaluation platform,
- We have already established the partnership with Super Derivatives to create the largest coverage of assets in a single offering, and
- The re-design and re-launching of RatingsDirect™ is on track for next January.

Let me shift now and talk about the legal situation and a little bit of the regulatory situation as we see it right now.

We recently won our first court decision related to subprime litigation. Last week, the Court dismissed the Blomquist action—a suit filed in California last August alleging various state and federal claims against numerous financial institutions, government agencies, McGraw-Hill and individuals, including me. Last May, we filed a motion to dismiss all claims, which was granted by the Court on July 23. Significantly, the Court dismissed the case against us without giving the plaintiff the opportunity to amend the complaint.

A new suit was filed in July, so there are now five. The latest suit was filed in New York Supreme Court by Oddo Asset Management against essentially Barclays Bank but lots of others, including McGraw-Hill. The suit alleges losses in two structured investment vehicles and the confirmation of allegedly “false” ratings by S&P.

In May and early June, New Jersey Carpenter Health and Vacation Funds filed three separate lawsuits against issuers, underwriters and others, including McGraw-Hill. These actions concern losses on mortgage-backed securities and allegedly inappropriate credit ratings.

The class action suit filed last August in the District of Columbia is being moved to the U.S. District Court for the Southern District of New York. The plaintiffs seek damages relating to the decline in the value of McGraw-Hill's stock price—these are traditional stock-drop type suits—because senior management allegedly failed to warn investors about problems in the structured market and S&P's RMBS and CDO ratings.

To wrap this up, we believe all of the remaining lawsuits are without merit and we fully intend to mount a vigorous defense. In our view, the legal risk from these actions remains low.

S&P remains actively engaged with regulatory issues and is making progress on its intense commitment to be part of the solution. That's why we are working closely with policymakers and market participants around the world to enable greater transparency. And this is the most important thing in terms of helping to restore confidence in our markets.

Separating the facts from the headlines is not easy in this environment. The level of activity increased substantially in June and July, so let's review some of the recent developments.

On June 5th, S&P and two other ratings agencies announced agreements with New York Attorney General Cuomo. The focus was on U.S. residential mortgage-backed securities. As part of that undertaking:

- There were no findings of wrongdoing.
- There were no payments.
- The New York Attorney General closed his investigation of the rating agencies.

The agreement underscores our strong, strong commitment to transparency, openness and the strengthening of the governance process.

The SEC held two public meetings in June to discuss proposed new rules and regulations for the NRSROs. On June 11, the SEC discussed a comprehensive set of rules that have the potential to bring more transparency to the structured market including additional disclosure, increased recordkeeping, and strengthened management of potential conflicts.

The SEC asked for comments by July 25. I will summarize the comments we submitted to the SEC in just a moment.

On June 25, the SEC met to discuss use of NRSRO ratings in its rules, mainly the broker-dealer net capital rule, and the money market fund investment rule. Comments to the SEC regarding these proposals are due by September 5. I will also review these potential changes in a moment.

But first I want to comment on the report issued by the SEC on July 8 after its comprehensive 10-month examination of three rating agencies. Amid all the news stories on the SEC report, some critical conclusions got very scant attention. According to the SEC report:

- No evidence was found by the SEC staff that decisions about ratings methodology or models were based on attracting or losing market share,
- There was no indication that the rating agencies compensated analysts in a manner contrary to their policies, and
- The SEC recognized the rating agencies enhanced their procedures in connection with their registration as NRSROs in 2007. The SEC report did note that further improvements can be made in the management of conflicts of interest.

At the conclusion of the examination, the SEC called for more documentation of the ratings process and recommended that S&P conduct reviews in certain areas. S&P is committed to doing just that. S&P will be implementing these recommendations and taking steps to strengthen its ratings processes accordingly. As you all know, in the first half of this year we introduced 27 Leadership Actions in four categories: governance, analytics, information, and investor education.

As I noted earlier, S&P on July 24 responded to the SEC's request for comments on its proposed rules. First, I want to point out that S&P overall supports the SEC proposals.

We are committed to cooperating with the regulators and policymakers both here and abroad. We believe that dialogue is extremely important—and so do policymakers and regulators. They recognize that the issues are complex and merit discussion. That's why the SEC asked for comments on the proposed rules. This is not a game of "gotcha." It is all about transparency, openness, and helping to restore confidence in our capital markets.

That's the context for S&P's response to the SEC on July 24. S&P responded to the SEC on two levels:

- Commentary on proposals, and
- Observations on specific legal and related questions raised by the SEC staff.

S&P's goal was to be constructive and seek clarifications where the proposals were not necessarily clear.

We share the SEC's desire to enhance investor understanding and address potential conflicts of interest in the credit ratings industry. At the same time, we believe that any new SEC rules must be narrowly tailored as required by law and should not regulate the substance of credit ratings or otherwise impair the value of the rating agencies' independent opinions.

For example, S&P fully supports the principle underlying the proposed rules that public ratings decisions should be made broadly and publicly available. However, S&P also believes that it should be able to control how it disseminates its proprietary historical data and intellectual property.

S&P agrees with the SEC that it should have policies and procedures that prevent it from structuring the products it rates. We already do that. But we are concerned about interference with the free flow of information between the ratings agencies and issuers. This is not a black box business and communications between rating agencies and issuers should be encouraged, not inhibited.

S&P also believes the costs of the proposed rules both for the rating agencies and the market have been underestimated by the SEC. That's why S&P offered to share a detailed breakdown of its research on these matters with the SEC.

These are some highlights from the 33-page letter S&P sent the SEC last week. If you have time, I hope you will read it. You can access the letter at www.standardandpoors.com.

We look forward to working closely with the SEC and market participants so that any new regulations lend themselves to openness, transparency and market competition while remaining compatible with existing law and regulation.

The SEC is also seeking comment on rule changes affecting the use of ratings to meet capital requirements. I would observe that we didn't make the rules and believe we can continue to operate successfully if they are changed. We already do this outside the United States. We would be concerned if the proposed changes lead to unintended disruption in financial markets.

Soon, we expect to see a draft of proposed regulations from the European Commission. Insofar as European regulators may consider additional oversight of rating agencies, we believe such steps would best be addressed through a globally-coordinated approach recognizing the benefits of consistency for

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investors and issuers operating in international businesses. On this basis, we will continue to communicate regularly with regulators around the world.

That's a lot of information on the legal and regulatory outlook, but I want to make sure you had a complete look at the current situation. To sum up, we continue to believe that any new or currently proposed legislation, regulations or judicial determinations would not have a material adverse effect on our financial condition or results of operations.

Now, let's sum up for Financial Services:

- Legal and regulatory risk remains low,
- Double-digit revenue growth for S&P Investment Services,
- Revenue for the segment could be off 7% to 9% for the year if the first-half decline in structured finance continues for the remainder of the year, and
- A 500 to 600 basis point drop in the operating margin.

Information & Media

Moving over to Information & Media, growth in business-to-business products were key to second quarter results at Information & Media.

In the second quarter:

- Revenue increased 6.8%,
- Operating profit improved by 68.2%, and
- The operating margin was 9.3% compared to 5.9% for the same period last year.

Revenue for the Business-to-Business Group grew by 7.8% even as advertising pages declined 11% at *BusinessWeek* in the second quarter. Strong global growth in Platts' news and pricing services and international and auto consulting growth at J.D. Power and Associates were the key factors in this segment's second quarter performance.

Platts is simply the company's most global product. Proportionately it does more business overseas than any other McGraw-Hill product or service. The demand for petroleum and natural gas products, which shows no sign of diminishing in today's volatile energy markets, is clearly benefiting Platts.

But Platts is expanding in new areas too. Steel is the world's third-largest commodity. Platts launched *Steel Markets Daily* in 2006 and is working with market participants to bring price transparency to this market.

We continue to make progress in construction. The electronic delivery of our information is a critical part of the transition and is continuing to produce an increasing share of McGraw-Hill Construction's sales.

The advertising outlook at *BusinessWeek* is challenging. Ad pages through the issue of July 28 are off 17.3%, according to the Publishers Information Bureau. At the same time, *BusinessWeek's* circulation is growing and new syndicated studies indicate that our audience is younger and more affluent than in years past.

Revenue for the McGraw-Hill Broadcasting Group was off by 1% in the second quarter. Declines in the base business, primarily national, offset our gains in political advertising.

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We expect political advertising to be strong in the second half. In August, our Colorado stations will benefit from a state primary, which includes contests for the U.S. Senate and two House of Representative seats. This fall in California we expect the ballot to include at least 11 propositions, including a controversial same-sex marriage proposition.

Of course, all of our TV markets will benefit from the general election on November 4th.

Let's sum up for Information and Media:

- More progress this year,
- Revenue growth of 6% to 8%, and
- Operating margin improvement.

That wraps up our review of operations. In looking ahead for the corporation, it is clear that year-over-year comparisons get easier in the second half. Excluding second quarter restructuring charges and related benefits, we still expect earnings per share in the \$2.65 to \$2.75 range.

Let me turn it over to Bob Bahash. He will go through the specific financials for you.

Robert J. Bahash
Executive Vice President and Chief Financial Officer
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Thank you, Terry.

I will begin with an update on our share repurchase program. We are approximately half way to our 15 million share repurchase target for 2008. In the second quarter, we repurchased 4 million shares for a total cost of \$170.8 million at an average price of \$42.69 per share. That brings the first-half repurchases to 7.4 million shares for a cost of \$304.8 million at an average price of \$41.19 per share. 20.6 million shares remain in the 2007 program authorized by the Board of Directors.

Net debt as of June 30 was \$1.4 billion. This is up approximately \$170 million from the end of the first quarter and is driven primarily by seasonal cash requirements as well as funding for share repurchases.

As of June 30, on a gross basis, total debt was \$1.7 billion and is comprised of \$1.2 billion of unsecured senior notes and \$526 million in commercial paper outstanding. This is offset by \$355 million in cash, primarily foreign holdings. Due to the seasonality of the business, debt levels tend to be higher in the first half of the year and, for the later part of the year, we are focused on maintaining debt levels comparable to year-end 2007.

Let's review the outlook for free cash flow. As I indicated in our first quarter earnings call, we expect free cash flow this year to be approximately \$600 million, prior to any acquisitions or share repurchases, versus approximately \$900 million in 2007. To calculate free cash flow, we start with after-tax cash from operations and deduct investments and dividends. What's left is free cash flow—funds we can use to repurchase stock, make acquisitions, or pay down debt.

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Free cash flow for the first half of this year reflects a \$319 million decline compared the same period last year. The decline is due to:

- Reduced profits at Financial Services and the corresponding impact on working capital,
- An increase in working capital usage as McGraw-Hill Education prepares for strong adoption opportunities,
- Cash outflows for construction costs for the new data center that were accrued in 2007, and
- A one-time shift in the timing of our employee profit-sharing contribution from 2007 to 2008.

Additionally, the payout of the 2007 incentive compensation awards in the first quarter of 2008 negatively impacted 2008 cash flow. The cash savings from reduced 2008 incentive compensation will not be realized until the awards are paid out in 2009.

We had anticipated first-half comparisons would be particularly challenging due to the factors I just mentioned. We generate the majority of our free cash flow in the second half of the year, primarily due to the seasonality of the education business. In the second half of 2008, we will benefit from:

- Easier profit comparisons at Financial Services,
- Reduced investments for purchases of property and equipment as the second half of 2007 reflected significant investments in our data center building,
- Anticipated lower cash tax payments, and
- Normal seasonal working capital improvements.

As a result, we expect free cash flow in the second half of this year to approximate free cash flow for the second half of 2007, resulting in about \$600 million for the full year as we had forecasted.

Regarding net interest expense, in the second quarter we had \$20 million compared to \$12 million in the same period last year, an \$8 million increase. We continue to expect it to be in the range of \$75 to \$85 million for 2008.

Our diluted weighted average shares outstanding for the second quarter was 321.1 million shares, a 29.2 million share decrease compared to the second quarter of 2007 and a 2.3 million share decrease compared to the first quarter of 2008.

Corporate expenses were \$33.5 million in the second quarter, a \$7.5 million or 18% decrease versus the same period last year. This is primarily driven by reduced incentive compensation accruals as well as stringent expense controls. For 2008, we still expect a mid single-digit decrease in corporate expenses.

I would like to take a few moments to discuss expense growth at Financial Services and McGraw-Hill Education in the second quarter.

At Financial Services, expenses in the second quarter increased \$17 million, or 4%. Excluding the \$15 million second quarter restructuring charge, expenses were essentially flat compared to the same period a year ago with growth of just 0.4%, or \$1.5 million. This year-over-year expense comparison benefits from a \$30 million reduction in incentive compensation and savings from the fourth quarter 2007 restructuring actions. These expense savings were partially offset by the impact of acquisitions made in 2007 and 2008, the impact of the weakening U.S. dollar on non-U.S. dollar expense, and investments in fast-growing areas, such as CRISIL, Capital IQ, and Index Services.

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Financial Services' sequential second quarter expenses increased \$52 million, or 13.5%, versus the first quarter. The primary contributors to this expense increase are:

- The previously-announced restructuring charges of \$15 million,
- A \$20 million increase in an incentive compensation provision versus the very depressed first quarter levels, and
- A \$17 million increase for our strong growth businesses, for example, Capital IQ, Index Services and CRISIL.

Expenses at McGraw-Hill Education increased 6.1% in the second quarter. Adjusted for the second quarter restructuring charge, expenses grew \$26 million, or 4.6%. The increase is driven by:

- \$9 million in higher prepublication costs,
- Increased marketing costs related to the strong state new adoption market opportunities,
- As well as investments in technology, including \$3 million in data center migration costs.

These increases were partially mitigated by benefits from the fourth quarter 2007 restructuring and reduced stock-based compensation. Benefits from the second quarter restructuring will be largely realized in the second half of the year.

I'd like to provide an update on the migration of our digital products and services to the new data center—a key effort as we increasingly deliver products and services electronically.

The migration is going very well. In the second quarter, the migration cost was \$9 million. For the first half, it was \$13 million. We continue to expect that the overall cost will be about \$40 million for 2008. McGraw-Hill Education represents \$18 million—almost half of those costs—as the segment continues to deliver more digital content and services.

I will now review unearned revenue, which was \$1.1 billion at the end of the second quarter and reflects a 7.5% year-over-year increase. Financial Services represents approximately three quarters of unearned revenue and experienced growth of 12%. This growth was partially offset by a reduction at McGraw-Hill Education due to accelerated fulfillment of orders for basal texts and related components including increased use of electronic delivery. For 2008, we continue to expect unearned revenue growth will be in the mid single-digit range compared to last year given the forecast for slower revenue growth at Financial Services.

In terms of our effective tax rate, we expect the rate to be 37.5% in 2008, approximately the same as 2007 on a full-year basis.

Let's now look at capital expenditures, which include prepublication investments and purchases of property and equipment.

In the second quarter, our prepublication investments were \$65 million compared to \$75 million in the same period last year. We have firmed up our estimates and now expect \$270 million for 2008, versus the previous projection of \$290 million that we provided during the first quarter earnings call.

Purchases of property and equipment were \$25 million in the second quarter compared to \$61 million in the same period last year. This was higher last year while we were building the data center, but we have returned to a more normalized rate this quarter.

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For 2008, we continue to project \$160 million for CapEx. This includes:

- Normal replacement expenditures,
- Additional purchases of software and technology equipment for the new data center, and
- Continued investments in technology.

And finally, non-cash items.

Amortization of prepublication costs was \$66 million compared to \$57 million last year. For 2008, we are lowering our guidance to \$275 million. This represents a \$35 million increase versus 2007 and is driven by significant prepublication investments to take advantage of opportunities in the el-hi market.

Depreciation was \$30 million compared to \$29 million in the same period last year. We still expect it to be about \$125 million in 2008, reflecting completion of the data center, the purchase of new technology equipment for the data center, and other increases in capital expenditures.

Amortization of intangibles was \$13 million compared to \$11.5 million in the same period last year. For 2008 we continue to expect approximately \$52 million.

Thank you, and now back to Terry.

To access the accompanying slides online, go to:
<http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=1898119>

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