

**The McGraw-Hill Companies  
2<sup>nd</sup> Quarter 2007 Earnings Conference Call**

Prepared Remarks  
July 24, 2007

**Donald Rubin**

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The McGraw-Hill Companies

Thank you and good morning. And thank you everyone for joining us today for The McGraw-Hill Companies' second quarter 2007 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; Robert Bahash, Executive Vice President and Chief Financial Officer; and Vickie Tillman, Executive Vice President of Standard & Poor's.

This morning we issued a news release with our second quarter 2007 results. We trust 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](http://www.mcgraw-hill.com/investor_relations).

Before we begin this morning, 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 are also 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 the presentation, we will open the meeting to questions and answers.

Now it is my pleasure to introduce the Chairman, President and CEO of The McGraw-Hill Companies, Harold McGraw III.

Terry.

## ***The McGraw-Hill Companies***

### **Harold McGraw III**

Chairman, President and CEO

The McGraw-Hill Companies

Good morning, everyone. Welcome to our review of The McGraw-Hill Companies second quarter results.

Joining me on today's conference call are Bob Bahash, executive vice president and chief financial officer and Vickie Tillman, executive vice president, Standard & Poor's. She's the head of the credit market services and our chief rating officer.

I'll begin by reviewing our results for the second quarter and the outlook for the rest of the year. Then I have asked Vickie Tillman to provide some context for recent rating decisions at Standard & Poor's credit market services and then Bob will review our financial performance. After his remarks, we will be pleased to answer any questions you may have about The McGraw-Hill Companies.

Earlier this morning, we announced our second quarter results. For this period, we reported:

- Earnings per share increased 31.7% to \$0.79
- Revenue grew by 12.5% to \$1.7 billion
- The operating margin improved in all three segments

In looking ahead, we see reasonably healthy economic conditions. In fact, overall economic conditions are quite good, save the housing recession, which is costing the United States about 1 percentage point of growth. Inflation remains moderate at 2.2%, which is at the top end of the Federal Reserve's comfort zone, so we expect more watchful waiting by the Fed before any interest rate adjustments.

Growth in the U.S. Gross Domestic Product picked up in the second quarter. David Wyss, the chief economist at Standard & Poor's, now expects GDP growth of 2.5% for the second half of the year, 2.1% for the full year, and improving into 2008. Again, David estimates that the housing recession has clipped about one percentage point of growth from GDP for the U.S. this year and as we look at the housing recession, new starts will probably bottom out sometime by the end of the year. He doesn't expect housing prices to bottom out until probably the spring of 2008 and losses and foreclosures may not hit a peak until late 2008, but we're in the later innings of the housing recession.

Non-residential construction continues to do well. State budgets are generally in pretty good shape, which is good for the education marketplace.

With that as background, let's now review our operating results.

### **McGraw-Hill Education**

Let's start with McGraw-Hill Education.

In the second quarter, there was more evidence that the good year we expected in the elementary-high school market is certainly taking shape. In the second quarter:

- Revenue increased 5.8%
- Operating profit grew by 18.6%
- The operating margin improved to 12.4%

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Revenue for the McGraw-Hill School Education Group was up 3.3%. Revenue for the McGraw-Hill Higher Education, Professional and International Group was up 10.3%.

This is a great time to be in educational publishing with a well-established team and a well-developed growth strategy in place. We are building for a very promising future and certainly the 2007, 2008, 2009 and 2010 marketplace looks quite good. Contrast that with an industry in flux where we are seeing:

- Changes in ownership,
- Changes in organization, and
- Consolidation that in effect reduces the number of major competitors from four to three in the elementary-high school market.

All the changes and uncertainty will take some time to sort out. In the meantime, we expect to gain share this year in the elementary-high school and the U.S. college and university markets.

We strengthened our School Education Group last Fall by creating a single, well-coordinated K–12 team under the direction of our most experienced and successful managers. As a result, we are improving our performance in both the K–5 and 6–12 markets.

A broad and deep product lineup has always been important to us because one size definitely does not fit all in large and diverse markets. With a spectrum of products, we are performing well in both academic and non-academic subjects. In non-academic subjects, we are on our way to achieving high market shares in small but profitable categories such as health, business education, technical and vocational education, and family and consumer science.

A key factor in our performance will be the capture rates we achieve in this year's rapidly growing state new adoption market. We expect the state new adoption market to come in between \$750 and \$800 million — a 10% to 15% increase over last year.

We are participating in virtually the entire market this year versus about 80% in 2006. Much of the 2007 business remains to be decided, but based on current trends, we certainly expect to take more than 30% of the available dollars in the total state new adoption market. Math and science offer the biggest opportunities this year for state new adoption sales and we are off to a very good start.

Revenue for the School Education Group in the second quarter was driven by grades 6–12 math orders from Texas, K–12 science orders from California, and K–8 science from South Carolina.

We are optimistic about the performance of *Treasures*, our K–5 balanced basal reading program, which is competing well in Indiana, Tennessee, and Oregon. *Spotlight on Music* is positioned to lead the state new adoption market in its subject.

We are picking up new business in the second year of the California K–8 social studies adoption.

The outlook is also promising in the grades 6–12 literature and reading market in Indiana, Oregon, Tennessee, and West Virginia.

In the open territory, we have won some major adoptions in large urban markets, but most small- and medium-sized districts don't order until the third quarter. We expect the open territory market to grow about 4% this year.

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We will get help in achieving our open territory goals with the new edition of *Everyday Mathematics*, our reform-based program. The new edition is generating new business in Philadelphia, New York City and Seattle and should be a leader in the K–5 New Mexico adoption.

The supplemental market has been soft this year, but this tends to be a second-half business so we will have to wait to see how this works out. The market is looking for targeted skills-based intervention programs and we have created a strong lineup to meet that need at both the elementary level and for 6–12 level as well.

In testing, we experienced softness in both custom and shelf products in the second quarter. But we are getting traction with *Acuity*, our new formative testing product, as more educators look for research-based formative solutions.

*Acuity* is a suite of diagnostic and predictive benchmark assessments designed to indicate student learning needs and track their progress toward mastery of state standards in English/language arts and math.

Last week, *Acuity* won the largest formative testing contract yet awarded in the U.S. — a five-year \$80 million arrangement with New York City. *Acuity* has also been selected by Indianapolis, the biggest district in Indiana, and Mesa, the largest district in Arizona. *Acuity*'s close correlation with state standards, its strong research base, and our reputation for quality are creating a competitive advantage for this product in the testing market. That's why *Acuity Algebra* was selected by the RAND Corporation as the standard measure of student progress for a five-year study being funded by the U.S. Department of Education.

We are off to a good start in the U.S. college and university market. The big challenge, of course, occurs in the third quarter. Our three major imprints are performing well and we are gaining traction in digital products which produce incremental revenue.

Homework management products give students access to an interactive online textbook that allows them quick access to relevant content as they work on problems and practice quizzes. Also proving popular with students are new iPod and MP3 compatible features in our media-enhanced texts. And we're very pleased with the introduction of these iPod icons that are populating all of our higher education texts.

In the second quarter, we also benefited from the publication of a McGraw-Hill classic — the tenth edition of the *Encyclopedia of Science and Technology*, a 20-volume work we issue every five years and, of course, we also provide in an online version as well. The encyclopedia is selling well here and abroad.

Other best-sellers in professional markets were:

- *Harrison's Manual of Medicine, 16th Edition*,
- *The Millionaire Maker's Guide to Creating a Cash Machine for Life*,
- *Nursing Spectrum Drug Handbook 2008*, and
- *Current Medical Diagnosis and Treatment, 2007, 46th Edition*

Let's sum up for McGraw-Hill Education:

- A solid year is taking shape in education
- We expect the el-hi market to grow 5% to 7%
- We expect the U.S. college and university market to grow about 4%
- We expect to outperform in both markets
- We anticipate margin expansion in this segment for the full year

## **Financial Services**

Now, let's look at the Financial Services segment.

The second quarter results underscore what by now is a familiar story. A diversified and resilient portfolio again produced substantial increases in global financial markets. In the second quarter:

- Revenue increased 21.2%
- Operating profit grew by 27.9%
- The operating margin expanded to 48.9%

There were many contributors to our success in the second quarter.

1. There is Standard & Poor's unique blend of fixed income and equity services which reduce our dependency on any single asset class.
2. Financial Services' strong and growing position in international markets. A 10-year compound annual growth rate of 18.9% by financial services in international markets through 2006 underscores that point.
3. Our growing array of new services in both fixed income and equity markets.
4. The durability of powerful growth trends in our markets: securitization, globalization, privatization, and of course the continued disintermediation movement away from the banks into the capital markets.

All these factors contributed to our performance this year.

In the second quarter, the obsession with subprime issues obscured some very positive trends in the ratings market.

- International markets grew at a double-digit rate and contributed 38.9% of ratings revenue in the second quarter, up from 36.6% for the same period a year ago.
- The U.S. corporate market set a new record for issuance for the second quarter in a row as both U.S. investment-grade (up 33.0%) and high-yield (up 42.6%) grew substantially.
- Public finance, coming off a slow second quarter last year, grew solidly because of new money issuance but also because of refundings.
- Structured finance was strong globally despite a 12.4% decline in the dollar volume issuance of residential mortgage-backed securities in the U.S.
- There was strength in the European residential mortgage-backed securities market where subprime is not the factor it is here. In fact, we saw solid performances in all asset classes in Europe.
- The commercial mortgage-backed securities market grew solidly here and abroad.
- In the U.S., the collateralized debt obligation market met our expectations. During the conference call on first quarter earnings, we said new issuance dollar volume would grow by about 60% in the second quarter. It grew by 58%.
- We saw more modest gains in the asset-backed securities market.

In another example of our diversity, ratings and services not directly linked to public new issuance also grew at a double-digit rate in the second quarter. These offerings, which we refer to as our non-traditional ratings, accounted for 22.6% of ratings revenue in the second quarter compared to 24.1% for the same period last year. Bank loan ratings were a key driver.

Standard & Poor's is also a leading provider of data and information, analysis, and other services for equity markets, including our expanding lineup of indices.

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Our client base at Capital IQ continues to grow. We are now at approximately 2,000 — that's a 29% increase over the prior year. More new clients and new services and increased penetration at the ones we already serve should keep this business growing very nicely. We are confident that we have strengthened our position in this market with the recent acquisition of ClariFi, which is off to an excellent start as the newest addition to the S&P family.

In the data and information market, we are also seeing good growth from *S&P Compustat*, *RatingsDirect* and *RatingsXpress*.

Assets under management based on S&P indices continue to increase. It was up 20.9% at the end of June to \$178.6 billion. In June, trading began on nine new exchange-traded funds based on S&P indices. Thirty have been launched so far this year, bringing to 127 the total number of exchange-traded funds based on S&P indices.

The S&P/Citigroup Indices form the backbone of new, fast-growing opportunities to create customized indices, and benchmarks. We are successfully licensing the recently acquired commodity indices from Goldman Sachs. Recent licensees for the S&P GSCI indices include Morgan Stanley, Barclays Bank, Deutsche Bank, the National Bank of Canada, UBS, Wachovia, and Cargill. The pipeline is growing.

And speaking of pipelines, let's spend some time now on the outlook for the second half.

As we have pointed out, we expect low double-digit growth at Financial Services in the second half. Tougher comparisons will make the fourth quarter more challenging.

Corporate issuance is off to a strong start in 2007 and there is a large new-issue calendar. An attractive financing environment, merger and acquisition activity, and balance sheet restructuring will help drive this market. As the chart shows, the fourth quarter last year was the biggest in 2006 for dollar volume issuance in the U.S. corporate market.

In Europe, the corporate sector is off to a solid start and the current pipeline of business is strong across all sectors.

Dollar volume issuance in U.S. public finance started the year on an upswing, but even though this may be a record year for issuance, we expect somewhat slower growth for the balance of 2007.

Dollar volume issuance in the U.S. residential mortgage-backed securities market is off 11.6% in the first half of this year and we anticipate a further decline in the second half. We now estimate that dollar volume issuance of U.S. residential mortgage-backed securities will decline by 15% to 20% this year. Our prior guidance here was 10% to 15% and we think it may be just a little bit more — up to about 20% is right. Activity is being driven primarily by Alt-A and Net Interest Margin Securities deals and the refinancing of adjustable rate mortgages. Many potential deals are on hold as issuers reprice to the new criteria and gauge the market's appetite for residential mortgage-backed securities.

The U.S. commercial mortgage-backed securities market is up 36.8% in the first half, driven by low interest rates and strong commercial real estate fundamentals. The pipeline is robust.

Dollar volume issuance in the U.S. asset-backed securities market is up 22.5% in the first half. The pipeline looks very solid.

The U.S. collateralized debt obligation market soared last year and is off to fast start in 2007. We expect more growth in the collateralized debt obligation market in the second half, but at rates well below the blistering pace established in the third and fourth quarters last year. Collateralized loan obligations, cash, hybrids, and synthetics continue to benefit from investor demand, ample liquidity in the market, and broader acceptance of structures such as collateralized debt obligations of commercial real estate.

In Europe, the pipeline for structured finance products looks very good. We expect a solid second half with all asset classes showing strength with the toughest comparison coming in the fourth quarter.

We also expect a solid second half from our data, information and indices.

So, let's sum up for Financial Services:

- Continued strength overseas
- More growth in the structured market
- Solid prospects in the corporate market
- Growing contributions from data, information and indices
- Low double-digit growth in the second half
- Margin expansion for the year

But no summary of the outlook for Financial Services at this time would be complete without a reference to a significant recent Federal court decision and some discussion of decisions S&P has made in the subprime and CDO markets.

On June 5, the Federal court reaffirmed the strong legal protection afforded rating agencies. In dismissing a complaint against the rating agencies brought by the Attorney General of the State of Connecticut on behalf of the state's Resources Recovery Authority, the Federal District Judge in Houston, Texas emphasized the significant public policy reasons for not imposing liability on credit rating agencies for their opinions. I quote from the decision: *"Imposing such liability would open the floodgates of litigation against credit rating agencies by disappointed investors and creditors and chill the agencies from vital and vigorous participation in the ratings process and the marketplace, where the free flow of information and conflicting views ideally establish reliability."*

In recent days, Standard & Poor's has announced some important decisions in the subprime market and that's why I've asked Vickie Tillman, Executive Vice President, Standard & Poor's — she heads the credit market services and is our chief rating officer — to share S&P's perspective on the ratings process and market conditions.

**Vickie Tillman**

Executive Vice President  
Standard & Poor's

Thank you, Terry.

There has been a great deal of commentary recently about the deterioration of the subprime market. Not all of it has been particularly insightful or accurate, so we think it is important to share with you Standard & Poor's perspective on market conditions and our ratings.

In the brief time I have this morning, I would like to make five key points:

1. The current situation did not develop overnight. For more than a year Standard & Poor's has been signaling the market about the deterioration in residential mortgage-backed securities backed by subprime loans and the potential effect on creditworthiness.
2. S&P continues to alert the market to new problems. On June 2, for example, we commented to the market about emerging issues with collateralized debt obligations. S&P said "The covenant-lite juggernaut is raising CLO risks" and that we were raising the collateralized loan obligation loss criteria to reflect potential expectations of increased loss exposure on covenant-lite loans.
3. We do not structure or engineer transactions, nor do we arbitrate on which deals can or cannot proceed. Our guidelines and criteria are publicly available.
4. Criteria is a factor in whether or not S&P is selected to do a rating. Tightening criteria may have an adverse impact on market share, but we will continue to develop and adjust our criteria to reflect how changing conditions impact credit risk. We are driven to improve our ratings process because it is our excellent track record that makes Standard & Poor's a ratings agency of choice.
5. The performance of S&P's structured finance ratings has been exceptionally strong over a long period of time. Our regularly published default studies show the clear relationship between the initial rating assigned by Standard & Poor's and the likelihood of default. Since 1978, the average five-year default rate for investment-grade structured securities is 0.87%. The default rate for speculative-grade securities is 15.42%.

We identified heightened credit exposure with so-called affordability products and the layering of multiple risk factors in loan programs over a year ago, and adjusted our assumptions going back to April 2006.

In any rating decision, we are concerned about the duration and severity of issues affecting future credit performance. We need sufficient time and data to see how collateral pools are performing. Our recent actions are a continuation of that view in applying our adjusted assumptions to the delinquency default and loss trends to make decisions on some of the RMBS transactions.

Let me quickly sum up our latest actions in July:

- S&P downgraded 562 classes of S&P-rated RMBS transactions backed by first lien subprime loans from fourth quarter of 2005 through the fourth quarter of 2006. It's worth noting that the \$6.3 billion in securities represent only 1.1% of all first lien loans subprime RMBS deals rated during this period.
- We also downgraded 418 classes of S&P-rated RMBS transactions backed by closed end second liens. That represented \$3.8 billion in volume, or 6.1% of this class.
- As a result of Standard & Poor's first lien subprime downgrades, 74 synthetic CDOs were downgraded and 19 classes of cash flow and hybrid CDOs were placed on CreditWatch negative. 17 classes of cash flow and hybrid CDOs were placed on CreditWatch negative as a result of the closed end second lien downgrades.
- Yesterday, an additional 33 tranches from 8 U.S. cash flow and hybrid CDOs were also placed on CreditWatch negative, again the result of downgrades of first lien subprime transactions.

The downgrades we announced on first lien subprime collateral did not impact any AAA ratings. Also note that while eight classes of AAA second lien RMBS deals were downgraded, none of the ratings fell below investment grade.

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Of course, we will continue to monitor these issues and will take any further ratings actions which we deem to be appropriate.

In fact, the actions we have taken in July are part of S&P's ongoing process of adjusting its assumptions and ratings to reflect current trends in the housing market, the mortgage finance market, consumer credit, and the overall economy as they move over time.

We have provided the market with information on our approach for rating new CDOs containing RMBS securities backed by non-prime collateral. S&P is currently reviewing RMBS transactions backed by Alt-A and net interest margin collateral. That will be completed over the next several weeks.

Transactions issued after January 2007 have not had adequate seasoning. We are monitoring these transactions under new assumptions and will take such rating actions as we deem appropriate and as more loss data becomes available.

In our view, loans made prior to January 2005 are not at the same level of risk as those made since then.

I'll wrap up with one final observation. Our role is to provide an independent opinion on creditworthiness based on demonstrable facts. Sometimes that puts us at odds with the ebb and flow of market sentiment. While the market doesn't always agree with our ratings, we take a longer term view and do what we believe is right for the market.

And I would make one further note. Tomorrow, Standard & Poor's Structured Finance group will be holding a teleconference to discuss the details of the downgrades that I have gone over with you today, as well as some future actions and the changes and assumptions that we have made. I encourage any of you that are interested in this detail to please dial in. The teleconference facts will be made available today.

Thank you.

### **Harold McGraw III**

Chairman, President and CEO  
The McGraw-Hill Companies

### **Information & Media**

Thanks very much Vickie. Now, let's look at Information & Media.

Growth in information products and some shortfalls in advertising were the hallmarks of this segment's second quarter performance. In the second quarter:

- Revenue grew by 4.7%
- Operating profit increased by 13.1%
- The operating margin was 5.9%

The segment benefited in the second quarter from the change in accounting for the transformation of Sweets which I've asked Bob to discuss in his remarks. In the second quarter, Sweets contributed an incremental \$6.5 million to revenue and \$5.8 million to operating profit.

In the Business-to-Business Group, revenue increased 7.9% to \$223.1 million. This group includes some of our company's best-known brands — J.D. Power and Associates, Platts, *BusinessWeek*, McGraw-Hill

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Construction and Aviation Week. Information products and services were a key to our progress in the B-to-B group. The incremental revenue from Sweets due to the accounting change was part of the picture.

But we also had contributions from Platts' news and pricing services for oil, natural gas, and power markets. The price of energy commodities continues to be volatile and is driving demand for our news and pricing services.

We also benefited from the new J.D. Power and Associates studies in the financial services and healthcare sectors as well as increased penetration from existing studies. Listening to the "Voice of the Customer" is a powerful concept and we continue to build on it.

Advertising pages for *BusinessWeek's* global print edition were off 20.0% in the second quarter, according to Publishers Information Bureau figures.

*BusinessWeek.com* continues to expand. The new Company Insight Center utilizing Capital IQ's extensive database of company fundamental data, is attracting a global audience. Search traffic has been growing steadily since the launch.

Revenue for the Broadcasting Group declined by 16.0% to \$26.8 million in the second quarter in a non-election year. Automotive, a key category, was also off sharply. Political campaigns are starting sooner and lasting longer, so while 2007 is not an election year, we may still have some political advertising in the second half. At the moment, Broadcasting's third quarter pacing is off 4%.

Summing up for Information & Media:

- A soft year in advertising
- Growth in information services
- Margin expansion for the full year

That completes our review of the three operating segments, so summing up for Corporation:

- We expect to achieve our goal of double-digit earnings growth in 2007, even though the growth rate will probably slow during the second half of the year as compared to our very strong first half performance.
- Although we expect low double-digit growth from Financial Services in the second half, tougher comparisons will make the fourth quarter more challenging.
- Some operating margin compression may occur in our segments in the second half, but we still expect improved operating margins in all three operating segments for the full year.

So with that, let me leave that and go over to Bob Bahash, and then we'll take your questions.

### **Robert J. Bahash**

Executive Vice President and Chief Financial Officer  
The McGraw-Hill Companies

Thank you Terry.

I will begin with an update on our share repurchase program. We began this year intending to buy 15 million shares in 2007. After we purchased 13.2 million shares during the first quarter, the Board of Directors at its April meeting approved an increase of up to an additional 15 million shares, bringing this year's total repurchase authorization to up to 30 million shares for 2007.

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In the second quarter, we purchased 6.3 million shares on a trade-date basis at a total cost of \$431.6 million. That brings the first-half repurchases to 19.5 million shares for approximately \$1.3 billion. Half a million shares remain available to be repurchased under the 2006 buyback program and 45 million shares remain under the 2007 program.

Since 1996, the Corporation has returned \$7.3 billion to shareholders through dividend payments and share buybacks, including more than \$1.4 billion returned to shareholders in the first half of 2007.

The diluted weighted average shares outstanding for the second quarter of 2007 is 350.3 million shares, a 15.2 million share decrease compared to the second quarter of 2006 and an 11.2 million share decrease compared to the first quarter of this year, of course due to the impact of share repurchases.

We have ramped up our borrowings to fund the additional share repurchases and seasonal cash requirements and ended the second quarter in a net debt position of approximately \$636 million, which is up from net debt of \$178 million at the end of the first quarter. As of June 30, on a gross basis, our debt is \$994.5 million offset by \$358.1 million in cash, primarily foreign holdings. This debt reflects a diversified mix of short-term borrowings in the commercial paper, extendible commercial note, and money market loan markets.

Interest expense was \$12.1 million in the second quarter, a \$3.5 million increase compared to last year, due to the borrowing.

If market and business conditions support the completion of the full 30 million share repurchase program for 2007, we would be in a net debt position at year end. We would also expect the full-year interest expense to range between \$40-42 million, again if we complete the whole program, up from our previous estimate of \$24-26 million, due primarily to the additional 15 million in assumed share repurchases.

As we discussed last quarter, in 2006 we transformed Sweets, McGraw-Hill Construction Group's popular building products database, from a primarily print catalog to a bundled print-and-online service. The associated accounting change benefited year-over-year comparisons for Information & Media. Second quarter 2007 results reflect \$6.5 million of incremental revenue and \$5.8 million of incremental operating profit resulting from the Sweets transformation.

Let's take a look now at our corporate expenses. Corporate expenses increased \$6.9 million, or 20.1%, in the second quarter compared to a year ago and is primarily attributable to several factors:

- Expenses associated with the new Business Process Management program that is focused on our core processes and ensuring alignment with customer needs while improving operational efficiency,
- Higher incentive compensation accruals due to better operating performance.
- Our corporate advertising program, which I'm sure many of you have heard, and
- An increase in vacant space from downsizing and business rationalization initiatives implemented in 2006.

The effective tax rate in the second quarter was 37.5%. We expect to maintain this rate for the balance of the year.

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

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In the second quarter our prepublication investments were \$75.2 million compared to \$63.5 million for the same period last year. For 2007, we continue to project that prepublication investments will be about \$310 million.

Purchases of property and equipment were up significantly this year to \$60.7 million, compared to \$20.5 million for the same period last year. This increase is driven by the construction of our new data center—which is underway and expected to be completed in the first half 2008—along with technology investments we are making to digitize our products and services. We continue to project \$250 million for 2007.

Now for some non-cash items.

Amortization of prepublication costs was \$56.8 million in the second quarter compared to \$53.0 million for the same period last year. We ramped up our publishing schedule last year in anticipation of the strong el-hi new state adoptions in 2007, 2008, and 2009. We continue to expect \$260 million in amortization of prepublication costs for 2007.

Depreciation was \$28.8 million in the second quarter compared to \$28.3 million in the same period last year. We continue to expect it to be \$130 million in 2007, reflecting the higher level of capital expenditures in 2007 and a full year of depreciation from capital expenditures made in 2006.

Amortization of intangibles was \$11.5 million compared to \$12.1 million in the same period last year. For 2007 we continue to expect \$50 million.

Unearned revenue grew to over \$1 billion in the second quarter, which is up from \$893 million for the same period last year, reflecting an approximately 15% year-over-year growth driven by continued growth in Financial Services. Last year included a mutual fund data business that was divested in March 2007. Excluding the fund business, the year-over-year increase would be even slightly higher than the 15%.

Thanks, and now back to Terry.

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

This presentation includes certain forward-looking statements about the Company's businesses, new products, sales, expenses, tax rates, cash flows and operating and capital requirements. Such forward-looking statements include, but are not limited to: the strength and sustainability of the U.S. and global economy; Educational Publishing's level of success in 2007 adoptions and in open territories and enrollment and demographic trends; the level of educational funding; the level of education technology investments; the strength of School Education, Higher Education, Professional and International publishing markets and the impact of technology on them; the level of interest rates and the strength of the economic recovery, profit levels and the capital markets in the U.S. and abroad; the level of success of new product development and global expansion and strength of domestic and international markets; the demand and market for debt ratings, including collateralized debt obligations (CDO), residential mortgage and asset-backed securities and related asset classes; the regulatory environment affecting Standard & Poor's; the level of merger and acquisition activity in the U.S. and abroad; the strength of the domestic and international advertising markets; the volatility of the energy marketplace; the contract value of public works, manufacturing and single-family unit construction; the level of political advertising; and the level of future cash flow, debt levels, product-related manufacturing expenses, pension expense, distribution expenses, postal rates, prepublication, amortization and depreciation expense, income tax rates, capital, technology, restructuring charges and other expenditures and prepublication cost investment.

Actual results may differ materially from those in any forward-looking statements because any such statements involve risks and uncertainties and are subject to change based upon various important factors, including, but not limited to, worldwide economic, financial, political and regulatory conditions; currency and foreign exchange volatility; the health of capital and equity markets, including future interest rate changes and concerns regarding the credit quality of subprime mortgages adversely impacting future debt issuances of U.S. residential mortgage backed securities and CDOs backed by subprime residential mortgages and related asset classes; the implementation of an expanded regulatory scheme affecting Standard & Poor's ratings and services; the level of funding in the education market (both domestically and internationally); the pace of recovery in advertising; continued investment by the construction, computer and aviation industries; the successful marketing of new products, and the effect of competitive products and pricing.