Thank you, Karl [Choi].


Before we get started today, I need to provide certain cautionary remarks about forward-looking statements. Except for historical information, matters discussed in this presentation may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including projections, estimates, and descriptions of future events. Any such statements are based on current expectations and current economic conditions and are subject to risks and uncertainties that may cause actual results to differ materially from results anticipated in these forward-looking statements. In this regard we direct listeners to the cautionary statements contained in our Form 10-K’s, 10-Q’s, and other periodic reports filed with the U.S. Securities and Exchange Commission.

We welcome this occasion to review for you the prospects for The McGraw-Hill Companies.

I want to take today’s opportunity to update our guidance for The McGraw-Hill Companies. And in view of the current situation in the credit market, I will spend most of my time today focusing on the outlook for the credit market services portion of our Financial Services segment.

The good news is that our basic guidance for The McGraw-Hill Companies this year has not changed. We are still on course to produce the results that we last told the market on July 24, the day we announced second quarter earnings.

- We still expect to achieve our goal of double-digit earnings growth for the year even though the rate of growth is expected to slow during the second half of the year as compared to our very strong first-half performance.
- We still expect improved operating margins at McGraw-Hill Education and Financial Services for the full year. Margin improvement at Information & Media is more problematic due to a softer advertising market.

To be clear, our guidance excludes the following items:

- $0.04 charge for the elimination of the restoration stock option program in the first quarter of 2006,
- $0.06 charge for restructuring in the second half of 2006,
- $0.03 gain from the divestiture of a mutual fund data business at Financial Services in the first quarter of 2007.

On a GAAP basis, inclusive of these items, the 2007 earnings growth would be even stronger. But management believes the non-GAAP financial measures provide more useful information to investors due to the unusual nature of the excluded items.
Today, we have more clarity on the outlook for the second half, so we can more finely tune our guidance for corporate performance in the third and fourth quarters. Given the seasonality of our business, the third quarter is the most critical each year. Unless there is a big surprise in the next two weeks, we are at this point in very good shape.

- We now expect a double-digit revenue increase from McGraw-Hill Education in its most important quarter of the year.
- We also anticipate year-over-year 9 to 12 percent top-line and double-digit bottom-line growth for Financial Services in the third quarter.
- Information & Media will continue to battle the impact of a soft advertising market in the third quarter.

There is currently a good deal of uncertainty about the fourth quarter, particularly at Financial Services, which faces the toughest comparisons of the year. In the fourth quarter of 2006, revenue at Financial Services grew by 22.1 percent. As we all know, Standard & Poor’s market is already showing greater deceleration than originally expected. If it continues, we anticipate flat to declining revenue in the fourth quarter and a reduction in operating profit versus last year. I will come back to this point in more detail a little later.

Seasonally, the fourth quarter for McGraw-Hill Education is less robust and this year is not going to be an exception. The operating margin will also be influenced by increased amortization as well as investments in important digital initiatives for the Higher Education, Professional and International Group.

As a result, for the fourth quarter we expect lower year-over-year operating margins in both McGraw-Hill Education and Financial Services. There could be an up tick in the operating margin at Information & Media in the fourth quarter, but it is too close to call at this time.

With that background, let’s look at our situation in a little more detail.

**Financial Services**

We will start with Financial Services.

One key to the Fed’s concern about the economy, of course, is the housing market. We are in the midst of the worst housing recession since 1991–1992 and the correction probably has another year to run.

David Wyss, S&P’s chief economist, points out that the housing downturn has reduced GDP growth by nearly one percentage point over the last four quarters. The decline in housing prices and sales may bottom out late next spring or early summer. The recovery in new starts will take longer. Wyss expects U.S. GDP to grow by 2 percent this year and 2 percent in 2008.

He also expects the Fed to cut interest rates at its meeting today, again in October, and maybe for a third time in December or next January. Those actions will help maintain the smooth functioning of the financial markets and also help the mortgage market. We will learn this afternoon if the Federal Reserve reduces the benchmark interest rate and what that decision may portend for financial markets and the economy.

The housing recession has also given rise to some classic end-of-cycle problems marked by looser lending practices in the mortgage market and the deterioration of subprime credit performance. Obviously, Standard & Poor’s has not escaped the impact of these events, so we appreciate this opportunity to discuss today our prospects and our view of S&P ratings in the capital markets.
First, let’s examine the outlook for S&P’s business. We started this year by forecasting double-digit top- and bottom-line growth for Financial Services even though the long anticipated decline in the U.S. residential mortgage-backed securities market would lead to a 10 to 15 percent drop in new issuance volume in 2007. New dollar volume issuance was off 11.6 percent at the end of the first half of 2007, but given all the challenges in the mortgage market, we said in July the decline could hit 15 to 20 percent for the year. The market continues to deteriorate and we now anticipate a 30 to 35 percent decline for the year and by more than 60 percent in the fourth quarter. But we still expect Financial Services to produce 9 to 12 percent revenue growth and a double-digit increase in operating profit growth for the third quarter. For the year, we expect double-digit top- and bottom-line growth.

As we have already pointed out, the fourth quarter will not end strongly because of challenging conditions in the market. We are already seeing credit quality concerns adversely impact the market as investors re-evaluate and re-price risk and some issuers find it more difficult to sell new issues.

Many of the deals in the third quarter are largely related to committed transactions. Some issuers were able to pull deals forward. At this point, we have preliminary new issue statistics for July and August. New issue dollar volume for U.S. structured finance showed some strength in July:

- Asset-backed securities: Up 111%
- RMBS: Off 31%
- CMBS: Up 263%
- CDOs: Up 40%

Now, of course, the picture began to change in August as growth slowed for some instruments and the rate of decline accelerated in others:

- ABS: Off 22%
- RMBS: Off 60%
- CMBS: Up 75%
- CDOs: Up 35%

We also saw strength in U.S. corporate issuance, which was up 16.4 percent in August after a 31.2 percent decline in July.

We expect the decline in new issuance, for U.S. structured finance, to continue into September and the fourth quarter. For September through the end of the year, we should continue to see:

- Some strength in corporates, particularly in investment-grade but a decline in speculative issuance,
- Continued weakness in U.S. structured finance, which faces challenging comparisons,
- International activity marginally better than the U.S.,
- Continued growth in non-traditional ratings, and
- Continued growth in data and information and index services.

S&P will continue to benefit from its diversified revenue stream. We are well diversified in terms of:

- Products and services,
- Geography, and
- Equally important, fee structures.

Much of S&P’s revenue outside of rating straight transactions is recurring. A large number of our debt rating clients are on annual fee programs. Building that bank of business through annual contracts and other pricing mechanisms has been part of our diversification strategy at Standard & Poor’s. It is evident in the strong growth of our unearned revenue.
For the corporation, unearned revenue grew to more than $1 billion at the end of the second quarter, reflecting an increase of approximately 15 percent compared to the same period last year. The growth was largely driven by outstanding results at Financial Services, which is the largest contributor to our unearned revenue. Unearned revenue at S&P is recognized on a straight-line basis, mostly over a 12-month period. As S&P’s volume has grown, so has unearned revenue.

That underscores again our long-term strategic emphasis at S&P on diversification and resilience.

- That strategy has made us more global: Today, approximately 38 percent of ratings revenue comes from off-shore.
- The strategy has made us more diversified: Today, non-traditional ratings, which are not linked to new issuance, account for 24 percent of ratings revenue.
- That strategy has reduced our dependence on transaction volume: In 1994, transactions accounted for 60 percent of S&P ratings revenue. Today, transactions represent about 51 percent.

In the current environment, you can be assured that we will examine our cost structure more closely than ever. Obviously, reduced revenue will have an impact on incentive compensation. But we also look at discretionary expenses, staffing and hiring, and the leveraging of S&P’s global network. We also continue to use technology to improve productivity. A key is the development of new workflow portals that aggregate in one place critical information ratings analysts need to help develop their credit opinions.

Earlier, I said I would discuss the current situation at S&P ratings, the ratings process, and in particular the legal and regulatory issues that some have raised.

S&P has always lived in a goldfish bowl. Our business model has always been built on transparency and regulators now require it. That’s why we publish our ratings and analyses free to investors and others around the world in real time. Each day S&P publicly issues between 500 and 1,000 ratings opinions across the globe. Today, there are more than 1.2 million public and private opinions on debt outstanding, most of which are available for free at standardandpoors.com. Investors can also access up to 9 million current and historical ratings on S&P’s Ratings Direct.

Because the market wants to scrutinize our ratings, we also host conferences, seminars and teleconferences around the world and publish articles explaining assumptions, methodologies, criteria guidelines, transition studies and performance data on our ratings opinions. We have institutional safeguards in place to ensure the independence and integrity of those opinions.

For all that transparency, we still see misunderstanding, starting with the basic notion of what a credit rating represents. A rating is an impartial and independent opinion on the credit quality of bonds and the likelihood that investors will be paid interest and principal in a timely fashion. At S&P, these ratings are decided by committees — not by individual analysts.

Rating the ultimate credit risk, of course, is not the same as pricing the bond. In our view, credit ratings do not — and should not — fluctuate like bond prices. Bond prices are anticipatory while bond ratings are based upon current and expected credit performance. In other words, bond ratings are an assessment of the current creditworthiness of an obligation in accordance with its terms.

We are not operating a buy, sell, hold business. Ratings, in comparison to the ebb and flow of market prices, are designed to be stable. They do change, of course, but that is based on new information or fundamental adjustments to risk profiles that drive the assumptions behind our credit opinions.
We do not structure transactions nor do we determine which deals can or cannot proceed. We are not investment advisors and we are not consultants.

There is no distinction between rating a corporate bond or rating just one tranche of a structured finance transaction. In both cases, Standard & Poor’s is applying its own pre-determined, non-negotiable, and publicly-available criteria and assumptions to the facts presented. So while there may be more dialogue between S&P and an issuer in a structured finance transaction, that does not change the reality that at its core S&P is still just applying its own pre-determined, non-negotiable, and publicly-available criteria in a factual context.

As part of the ratings process, we do have regular dialogue with bond issuers. We think it is necessary and the international regulatory community insists on openness, transparency, and dialogue. This dialogue helps issuers understand our ratings criteria and helps S&P understand the structured securities so it can arrive at better informed opinions on creditworthiness.

S&P has been criticized by some for moving too fast or too slow. Moving too slowly is the charge in the subprime market. The problems in the subprime market did not develop overnight. By early 2006, S&P was informing the market about increased risk. Here’s a headline from S&P’s RatingsDirect in January 2006: U.S. RMBS Market Still Robust, but Risks are Increasing and Growth Drivers are Softening

In April of 2006, S&P told the market that it was raising the level of credit support required for riskier subprime deals. Here’s a headline from S&P’s Ratings Direct in May 2006: A More Stressful Test of a Housing Market Decline on U.S. RMBS

By July 2006, S&P was reporting: Sector Report Card: The Heat is on for Subprime Mortgages

The point is that S&P was already clearly informing the market in early 2006 about risks it perceived in residential mortgage-backed securities backed by subprime loans and the potential effect on creditworthiness. We continue to comment on those risks today.

These are not the actions of an agency that critics claim will rate every deal that reaches its door. Simply put, S&P does not rate instruments that fail to meet its criteria. The most recent example took place in Canada where some asset-backed commercial paper became illiquid. The paper did not meet our minimum criteria and so S&P simply did not rate that paper.

Nevertheless, some claim that S&P has potential conflicts of interest with the issuer pay model, but these claims fail the test of our own self-interest. Our excellent long-term track record of assessing risk has a 90-year history. It is simply not in our economic interest to compromise the integrity of a rating. To do so would destroy the value of a rating and that clearly is not in our self interest or in the interest of market participants who use and value the performance of our ratings.

In the past five years, we have been reviewed by regulators; including the SEC, the Commission of European Securities Regulators, and the European Parliament. As a global business, S&P routinely has dialogue with governments and regulators around the world.

A report published by two Federal Reserve Board economists found “no evidence” that rating agencies acted in the interest of issuers due to a conflict of interest. The report concluded that “rating agencies appear to be relatively responsive to reputation concerns and so protect the interests of investors.”
Recently, Erik Sirri, director of the SEC’s division of market regulations, told a Congressional hearing (and I quote): “Typically, [rating agencies] are paid by the underwriter or the issuer. That presents a conflict. But we believe that conflict is manageable. Credit rating agencies should have policies and procedures in place, and they should adhere to those policies and procedures when they evaluate deals.”

Clearly, we have such policies and procedures in place and just as clearly we take them very, very seriously. In our view, ratings criteria and assumptions must be publicly available, non-negotiable, and consistently applied.

So, we welcome new opportunities to set the record straight and point out that S&P has an exceptionally strong record on the ultimate measure of ratings effectiveness.

- Since 1978, the average five-year default rate for investment-grade structured securities is less than 1 percent. For speculative-grade securities, it is just over 15 percent.
- The average one-year default rates since 1978 were near zero (0.04 percent) for investment-grade securities and 2.33 percent for speculative-grade securities.

Such a record also underscores a lack of proportion in assessing S&P’s recent downgrades in July. Those downgrades affected approximately 1 percent of the $565.3 billion in first-lien subprime residential mortgage-backed securities that S&P rated between the fourth quarter of 2005 and the end of 2006. Of course, S&P will continue to assess the ongoing creditworthiness of these securities.

A final point on our legal liability since questions have also arisen on that topic.

Rating agencies have rarely been sued and have a long record of success when they have been. The strong legal precedent in favor of the rating agencies is long standing. It has been established over many years in a broad array of cases. For one thing, ratings — whether corporate debt or structured transactions — are opinions and protected under the First Amendment. In a decision dismissing a complaint against another rating agency on August 23, 2007, a federal court of appeals said a credit rating “is a predictive opinion, dependent on a subjective and discretionary weighing of complex factors.”

Federal statutes make it clear that legal claims against rating agencies are not at all favored. The new Credit Rating Agency Reform Act of 2006 that took effect just a few months ago makes clear that individuals are not authorized to sue S&P under that law. The new law also unambiguously provides that it does not diminish or affect existing rights and privileges under existing law of any sort. As you know, the SEC has already begun to act under provisions of the new law. Of course, we are working with the SEC as it undertakes the new responsibilities Congress has given the commission.

We are obviously coming through a challenging period in Financial Services. But we believe the issues are short term and can be addressed. Furthermore, the favorable long-term trends will continue to drive our business for some time to come. They are:

- Globalization of financial markets,
- Securitization,
- Disintermediation of the banks in favor of public markets, and
- Privatization.
So, let’s sum up for Financial Services:

- We expect year-over-year 9 to 12 percent revenue growth and a double-digit increase in operating profit in the third quarter.
- Against tough comparisons, we expect flat to declining revenue and a reduction in operating profit in the fourth quarter.
- For the full year, we expect double-digit top- and bottom-line growth.

As I said at the start of these remarks, I would spend most of my time on the credit rating markets. I hope it has been helpful. But no presentation on McGraw-Hill would be complete without some comments on McGraw-Hill Education.

**McGraw-Hill Education**

This is an interesting time in education. We are seeing:

- Changes in ownership,
- Changes in organization within companies, and
- Consolidation that will reduce the major competitors in the elementary-high school market from four to three.

In a time of flux, it is good to have a stable base to build upon — and we certainly have that at McGraw-Hill Education.

The third quarter, of course, is the biggest each year in the education business. Just to give you some perspective, the third quarter typically produces more than 40 percent of the Education segment’s annual revenue and practically all of its operating profit.


Education’s key revenue months — July and August — are behind us, but elementary-high school purchasing in the adoption states is continuing well into September this year, particularly for materials in non-core curriculum in health, music and art, which are important markets for us. We are also receiving open territory orders well into September and the volume of this business will be an important factor in our final results.

We expect to improve market share in 2007. We expect to capture 30 percent and possibly more in the state new adoption market which is growing 10 to 15 percent this year.

- We will show solid results in the Texas 6–12 math adoption and for K–8 science in California and South Carolina.
- Treasures, our new elementary reading program, is winning significant market shares in Indiana, Oregon, and Tennessee.
- Six adoption states are buying music and our program, Spotlight on Music, will lead the market.

The open territory is more problematic. We are benefiting from a number of large adoptions that were announced earlier in the year. These include:

- Science in New York City and Washington, D.C.
- K–5 music in St. Louis, Missouri and Prince George’s County in Maryland.
- The new edition of Everyday Math, which is performing well across the country.
But the latest AAP report on open territory performance shows the industry’s basal sales were down 3.7 percent through July — well short of the 4 percent growth that was forecasted for this part of the market. However, the late ordering pattern could produce some improvement in these statistics. To date, we are doing better than the industry in the open territory and we expect that trend to continue.

Although the third quarter is less pivotal in the testing business, we have recently seen an increase in some custom work and promising gains in the formative market for our new Acuity product.

The outlook for higher education is favorable. Here, too, we expect to gain market share in 2007. We’re anticipating increases in all three of our major imprints:

- Business and Economics
- Science, Engineering and Math
- Humanities, Social Sciences and Languages

Custom products, both in digital and print versions, are showing solid growth across disciplines. The performance in international markets is encouraging.

So, let’s sum up for McGraw-Hill Education:

- A solid third quarter is taking shape: We expect double-digit revenue growth.
- We expect to gain share in both the elementary-high school and higher education markets.

I would also like to update you on our share repurchase program. The Board of Directors authorized the purchase of up to 30 million shares this year. By the end of the first half, we had bought back 19.5 million shares. We completed the authorized program by buying 10.5 million shares in the third quarter. For 2007, the Corporation’s repurchase of 30 million shares resulted in the return of nearly $1.9 billion to shareholders.

That completes my review, so I will sum up for the Corporation:

- We expect to achieve our goal of double-digit earnings for the year even though the rate of growth is expected to slow during the second half of the year as compared to our very strong first-half performance.
- We still expect improved operating margins at McGraw-Hill Education and Financial Services for the full year. Margin improvement at Information & Media is more problematic due to a softer advertising market.

Thank you for your time.

“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.