The McGraw-Hill Companies
4th Quarter 2009 Earnings Conference Call

Prepared Remarks
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Thank you and good morning to our worldwide audience and thank everyone for joining us this morning at The McGraw-Hill Companies’ fourth quarter 2009 earnings call. I am Donald Rubin, Senior Vice President of Investor Relations at The McGraw-Hill Companies.

With me this morning 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 fourth quarter 2009 results. We trust you have all had a chance to review the release. If you need a copy of the release and the financial schedules, they can be downloaded at 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’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.
Good morning and welcome to our review of the fourth quarter earnings and the outlook for 2010. With me today is Bob Bahash, executive vice president and chief financial officer.

We will start today by reviewing the fourth quarter operating results and we’ll move on to the prospects for 2010. Bob will then provide an in-depth look at our financials. After the presentation, we will be pleased to address any comments or questions about The McGraw-Hill Companies.

Let’s get started. Earlier today, we reported a 43.2% increase in diluted earnings per share for the fourth quarter.

- Diluted EPS of $0.53 in the fourth quarter included a pre-tax gain of $10.5 million, or $0.02 on the divestiture of BusinessWeek in December.
- That compares with $0.37 last year, which included a restructuring charge of $0.05 per diluted share.
- Revenue increased by 3.3% in the fourth quarter.

The fourth quarter results mark the first quarterly increases in diluted earnings per share and revenue for The McGraw-Hill Companies since the third quarter of 2007. These results set the stage for more growth in 2010. Our assessment of improving prospects is reflected in the guidance of $2.55 to $2.65 per diluted share for 2010.

- We are encouraged by the improvement in the economy, which has finally begun to recover, albeit at a modest pace;
- Financial markets are improving;
- Bond spreads have narrowed;
- Interest rates remain low. S&P’s chief economist, David Wyss, believes no tightening by the Federal Reserve is likely before this summer and perhaps not until after the November elections; and
- We expect a better year in our education markets.

Last week, the Board of Directors underscored its confidence in our financial strength and growth prospects by increasing the dividend by 4.4% and announcing the corporation’s intention to resume share repurchases this year. We will buy back over time the 17.1 million shares remaining in the program authorized by the Board in 2007.

- We have now increased the dividend annually for 37 consecutive years. Since 1974, the dividend has grown at an average compound annual rate of 9.9%.
- Since 1996, we have returned approximately $9.4 billion to shareholders through dividends and stock buybacks.

With that overview, let’s take a closer look at operations and our prospects for 2010. We’ll start with McGraw-Hill Education.
McGraw-Hill Education

A solid finish in key education markets helped produce an upswing in the fourth quarter performance at McGraw-Hill Education.

In the fourth quarter for McGraw-Hill Education:

- Revenue increased by 2.6%;
- Operating profit was $33.5 million. That compares to a loss of $12.7 million in 2008, which included a restructuring charge of $11.4 million;
- The operating margin was 6.4%; and
- Including restructuring charges of $11.6 million, the operating margin for 2009 was 11.6%. Excluding the restructuring charges, the operating margin was 12.0%.

In 2009, education has been a tale of two markets—a steady decline in elementary-high school sales and growth in the U.S. college and university market. But as this bar chart shows, revenue started improving in the el-hi market in September and kept growing in October and November. And while we don’t have AAP figures for December, we expect to see another increase in sales.

Despite the recent gains, industry revenue will be down about 15% in 2009, far better than our previous expectations of a decline of 20% or more. In this challenging environment, we still captured 30% of total available dollars in the state new adoption market which will close out the year in the $500 million to $510 million range. That’s about a 50% decline from the 2008 state new adoption market. We also won a 30% share in 2008.

In the fourth quarter, state allocations that reached local districts later than usual in some regions, together with the arrival of some federal stimulus funds, helped produce the pick up in ordering. We caught the wave with our basal products and our intervention programs, which benefited from the incremental Title I and IDEA funding for disadvantaged and special education students provided in the stimulus package.

These gains were offset by a substantial decline in testing. The result was a 7.6% decrease in fourth quarter revenue for the McGraw-Hill School Education Group. The major reason for this decline in testing was the managed phase out of statewide summative contracts in Arizona, California and Florida as part of a more selective approach to the custom testing market. In rebalancing the testing business, we are increasing our focus on the expanding formative market and the non-custom or off-the-shelf market while decreasing our emphasis on lower-margin custom contracts.

We continue to win summative contracts with a selective bidding strategy. In the fourth quarter, we were awarded contracts in North Dakota, Alabama, Indiana and New York State. Acuity, which is our formative testing program, continues to show solid growth, retaining existing subscription customers and adding new ones. New York City, the largest school district in the nation, is now in the third year of its Acuity contract and Philadelphia has signed on for the start of the new school year. These are multi-year multi-million dollar contracts. Many district-level opportunities for new business are in the pipeline for 2010. Some states have also included the introduction or expanded use of Acuity in their applications for the federal Race to the Top funding.

Growth in the el-hi market in 2010 hinges on a substantial increase in state new adoption opportunities. We estimate that the state new adoption market this year will be in the $925 million to $975 million range. Given state budget pressures, we expect industry sales in the open territory to
decline in 2010. We also expect a decline in residual sales in the adoption states, which usually fall off in a strong state new adoption year. Given the strength of the state new adoption schedule, we think the el-hi market could grow 6% to 7% off 2009’s low base.

Texas and Florida are the key adoption states in 2010. And we are well positioned in both. The Florida legislative session starts in March. Senate and House leaders have given early indications of full support for funding K–12 instructional materials. Florida is scheduled to buy K–12 math this year. The state recently adopted new math standards which essentially obsoletes books now in the classroom. Adoption activity in Florida is already very brisk at the district level; something we did not see at this time last year when the state still planned to buy literature. Texas returns to the market this year with funding already in place for a K–12 reading and literature adoption. The state legislature has appropriated $465 million for the adoption.

We continue to see evidence of pent-up demand in the market, but budget pressures also remain until the economic recovery is further along. We may also see some purchasing postponed from 2009 in adoption states like California. Funding levels in California remain uncertain, but some districts may buy K–8 reading programs as part of the second year of that adoption. There also is some potential for math sales at middle school (that’s grades 6 to 8) and high school (grades 9 to 12). The governor’s budget proposal for the 2010–2011 fiscal year calls for $332.5 million for instructional materials, which is flat with 2009. We are following this situation closely and will keep you updated on developments there.

A solid 2009 performance in higher education culminated with a surge in second semester ordering late in the year. We don’t have final 2009 figures, but it now appears that the industry is going to outstrip our 8% to 10% growth estimate. Revenue in the fourth quarter at our Higher Education, Professional and International Group grew by 7.5%.

We expect the U.S. college market to grow 5% to 7% in 2010. A surge in enrollments helped drive industry growth in 2009 and is going to do so again in 2010, although probably not at the same pace. Based on a number of surveys and reports, we estimate the most rapid rate of growth was concentrated in two-year colleges and career colleges. We saw the benefits in Career Education. It was the fastest growing imprint in our higher education lineup in 2009.

All our major imprints grew in 2009 and are expected to do so again in 2010. Fourth quarter and full-year digital sales increased at double-digit rates. That includes e-books, online courses and online study tools for students, including McGraw-Hill Connect, the industry’s most advanced interactive platform. There’s clearly acceleration in the pace of integrating content, technology and distribution. We will take full advantage of the rapidly evolving digital opportunity.

There is growing momentum in the e-book market as evidenced by the almost daily announcements of new devices and formats. We will continue to look for optimal ways to deliver data and source files for each of these devices. In the near future, you will undoubtedly see a McGraw-Hill e-book for the college market running on an Apple Tablet.

All our titles on CourseSmart, the industry e-book consortium, are already available to students on an iPhone operating system. That’s because CourseSmart developed an iPhone application last summer with support from Apple. The goal was to have core educational content available on the iPhone operating system, which also makes it possible for e-books to run on new Apple devices using that
system, such as the Tablet. Consider then the Apple tablet computer, which will be introduced shortly. There is a lot of secrecy about the introduction, but many expect that the Apple device will use the iPhone operating system. If that’s the case, we are confident that our CourseSmart e-books should run well right out of the box on any Apple Tablet. Stay tuned.

I should also point out that CourseSmart does not share revenue with Apple. For a student to access our e-books, they must subscribe to CourseSmart or its college bookstore partners. The eTextbooks feature on the iPhone application lets students access our titles on a device that runs on the iPhone operating system. That application is free to subscribers. About 95% of McGraw-Hill Higher Education current titles are available as e-books with interactive features, including search and note-taking functionalities.

Digital publishing is also a bright spot in our professional markets with subscriptions to our services growing at a consistent double-digit pace. We continue to innovate in this space. In the first quarter of 2010, we will launch AccessPhysiotherapy, the sixth vertical or specialty site in the AccessMedicine family of online medical information subscription sites. The new specialty offers an excellent opportunity to broaden the market for the respected Access brand beyond medical education and clinical practice to the allied health field.

Our professional business group will also launch more digital products in the first quarter. Kiss, Bow or Shake Hands is a new subscription-based reference for international business etiquette. Clearly, that’s a digital product with widespread global appeal.

Change is coming rapidly in our markets. Growth in the digital world will be transformational. For the prepared, it will unlock huge new opportunities. We are not waiting for the tipping point. That means we will continue to ramp up our investments in learning platforms and content management capabilities to stay ahead of the curve in creating the next generation of innovative products and programs. The increase in marketing and sales expenses associated with the robust state new adoption schedule will also put some pressure on operating margins in 2010.

Let’s sum up for McGraw-Hill Education:
- Growth in key education markets;
- 6% to 7% increase in the elementary-high school market;
- 5% to 7% in the U.S. college and university market;
- Revenue growth of 7% to 8%; and
- Operating margins unchanged from 2009.

Financial Services
With that, let’s go over to Financial Services. In Financial Services, improving conditions in financial markets marked by narrowing spreads, low interest rates, and a growing investor appetite for yield were important factors in the strong finish this year. In the fourth quarter for Financial Services:
- Revenue increased by 10.6%;
- Operating profit grew by 14.6%; and
- The operating margin was 36.3%.
Excluding the loss on the divestiture of Vista Research and the net restructuring charge, the segment’s operating margin for the year was 39.4%. This 2009 operating margin also reflects the costs of compliance to meet the increased regulation of Standard & Poor’s Credit Market Services.

The improvement in 2009 in investment-grade industrials and high-yield issuance culminated in a 19.4% increase in fourth quarter revenue against the easiest comparisons of the year at Standard & Poor’s Credit Market Services.

In the United States, we saw 181 industrials issued with a par value of $93.0 billion compared to 94 deals with a par value of $78.1 billion in the fourth quarter of 2008. That’s a 92.6% increase in the number of issues and a 19.0% increase in the par value of the issuance. There were 101 high-yield industrial and financial institution issues for $44.1 billion in the fourth quarter compared to three for $1.3 billion for the same period in 2008—obviously tremendous improvement.

In Europe, the dollar value of industrial issuance was $93.6 billion, up 36.9% in the fourth quarter. That represented 154 deals, an increase of 46.7%. There were 27 high-yield deals in the fourth quarter of 2009 in Europe and none in the same period in 2008—obviously a clear pickup.

All this activity helped produce a 62.5% increase in fourth quarter transaction revenue at S&P Credit Market Services. For 2009, transaction revenue was up 0.2% after being down 20.2% for the first six months.

Non-transaction revenue, which represented 69.2% of S&P Credit Market Services’ total revenue in 2009, grew by 6.0% in the fourth quarter to finish the year at just over $1.2 billion. It was the first quarterly increase in non-transaction revenue in 2009. This continues to be a durable revenue stream. It includes annual and surveillance fees and subscription revenue. If you back out the impact of breakage fees, non-transaction revenue grew by 2.0% in 2009 instead of the reported decline of 0.6%.

We expect growth in 2010 in transaction and non-transaction revenue for S&P Credit Market Services. And we expect growth in domestic and international markets in 2010. International markets finished strongly in 2009. S&P Credit Market Services’ international revenue in the fourth quarter was up 17.7%. All regions—Europe, Canada, Asia-Pacific and Latin America—grew in the fourth quarter and provided 49.4% of the total revenue. Improving financial market conditions are clearly making a difference in the worldwide outlook for S&P Credit Market Services.

Consider the changes in spreads:

- Spreads to U.S. treasuries, always a key factor in the level of issuance, are continuing to narrow for investment-and speculative-grade issues. As this table shows, since the record highs at the start of 2009, investment- and speculative-grade spreads have tightened and are near the range of their five-year daily moving averages. Spreads continued to tighten in January; another indication of why the month is off to a good start. That’s a reflection of optimistic sentiment in the credit markets and an expectation of some stabilization in credit quality.
- The spread between the three-month LIBOR and the Federal Reserve’s overnight rate, a key gauge of how banks assess the riskiness of lending to one another, is down to 0.25%.
- We have also seen spread contraction across the major consumer asset-backed securities during 2009. As this table shows, the spreads narrowed dramatically in autos, credit cards and student loans.
S&P expects further contraction in credit spreads this year.

There are other important favorable trends in the credit markets:

- There is strong demand for non-financial institution paper by investors who want to diversify their portfolio.
- Investors have already demonstrated that they are increasingly comfortable in buying lower-rated bonds. In the fourth quarter of 2009, 60% of speculative-grade issuance was rated at single B plus or below.

In corporates, the high-yield bond market has become more attractive than the leveraged-loan market and companies with riskier credits are lining up to tap it. Some issuers choose speculative-grade bonds because covenants are less restrictive and, in some cases, maturities are longer.

Because it is widely expected that corporate borrowing costs will increase as the economy improves, some non-financial firms are borrowing now to repay expensive debt, including commercial paper and bank loans. Some companies are beefing up their balance sheets with an eye on merger and acquisition activity or buying new equipment.

The deleveraging of financial institutions is another factor in credit markets. As these institutions shrink the liabilities on their balance sheet and tighten lending standards, credit availability is declining systemically. Limited availability of bank loan funding will result in a greater reliance on the primary bond market.

S&P believes 2010 may offer a window of opportunity for refinancing debt. Refinancing of current and future maturities was robust in 2009 and should be again in 2010. About one-third of the estimated $300 billion coming due in 2010 was refinanced in 2009. Let me repeat that, about a third of the estimated $300 billion coming due in 2010 was refinanced in 2009.

There is a dramatic rise in corporate debt coming due from 2011 through 2014. It’s estimated at $2 trillion. Some of that debt may be refinanced in 2010, adding to the remaining $200 billion that is coming due this year.

In public finance, 2009 was a solid year and 2010 looks even better:

- Municipalities sold the second heaviest volume of debt in 2009—$468.3 billion. The all-time record of $468.4 billion was set in 2007. The biggest factor boosting issuance was the Building America Bonds program, which authorized municipalities to sell taxable debt and receive a federal subsidy equal to 35% of their interest costs. Munis sold $84 billion in taxable debt in 2009, about 18% of total issuance.
- S&P expects sales of taxable bonds to help drive growth in this market in 2010, although tax-exempt securities will continue to comprise the largest share of overall issuance. Lower tax receipts and added expenses for pensions and infrastructure needs should keep state and local governments active in this market.

The outlook for structured finance in 2010 remains more problematic with asset-backed securities showing the most promise:

- In the U.S. residential mortgage-backed securities market, we expect to see a continuation of the re-REMIC activity in 2010 as financial institutions continue to seek ways to improve balance sheet capital requirements.
In the commercial mortgage-backed securities market, we saw a small but marked note of confidence as issuers brought single-borrower instruments to market in the fourth quarter of 2009. For the near-term, S&P expects very modest pick up in activity in this market.

The asset-backed securities market continues to be a positive story. Volume began to grow last March as the TALF stimulus program took hold. By the end of 2009, there was activity outside of the TALF program. Dollar volume issuance in the U.S. market grew by 179.1% in the fourth quarter of 2009. Although our outlook for U.S. ABS issuance is relatively flat in 2010, there is a healthy pipeline as we move into the first quarter with a good mix of TALF and non-TALF activity. Tighter spreads have limited the economic incentives for using TALF leverage for many issuers. The collateralized debt obligation market will continue to be soft in 2010.

About 33% of Financial Services’ revenue was produced last year by Standard & Poor’s Investment Services. Fourth quarter revenue was down 4.8% in 2009 but was down only 1.7% excluding divestitures. For the full year 2009, revenue declined 4.2% to $861.9 million, but was off 1.5% if you exclude divestitures. The expiration of the Independent Equity Research Settlement in July also was a factor in the fall off in revenue.

But in some key markets, the year ended strongly. A new high of $247.0 billion was established at the end of 2009 for assets under management based on S&P indices. The previous high was $235.3 billion, and that was set at the end of 2007. From a small family of equity indices, S&P has expanded into commodities, fixed income, real estate, custom, and thematic indices. S&P indices have successful relationships with the exchanges around the world.

At the end of 2009, there were 217 exchange-traded funds based on S&P indices. Five were added in the fourth quarter and more are coming in 2010 in the areas of commodities, equities, fixed income and alternative investments. It is our strategic goal to provide an S&P index for every type of investment. In 2009, S&P introduced 90 new indices. And we expect more new products and more growth from S&P indices in 2010.

In a challenging market, Capital IQ added new clients in 2009 to end the year with more than 2,900, an increase of 9.9% for the year. Sales to new customers and increases from current customers are expected to produce another year of growth for Capital IQ in 2010. With more growth from S&P Indices and Capital IQ, we expect revenue to increase in 2010 at S&P Investment Services. The divestiture of Vista Research in May 2009 and the expiration of the Research Settlement last July will be mitigating factors in the first part of the year.

Let’s complete this review of Financial Services with a few comments on the current legal and regulatory situation. The regulatory situation is still evolving and we continue to strive for global consistency, trying to avoid a patchwork of regulatory frameworks. This is very important. The good news is that we are getting close to the finish line on global regulation.

In November, the European Union issued its final regulation for credit rating agencies. By next September, S&P will need to apply for registration in Europe. Regulations are being developed in Europe by the Committee of European Securities Regulators, better know as CESR. We are following that process closely. In general, the proposed regulations are based on the International Organization of Securities Commission’s Code of Conduct. That’s IOSCO out of Madrid, and that’s a very good thing for them to take the leadership in terms of providing those Code of Conduct principles.
Starting on January 1, 2010, S&P has been licensed in Australia to provide its ratings to wholesale investors. We continue to work with regulators in Canada, Japan and India. In the U.S., both the House and Senate continue to consider regulation of the rating agencies as part of the omnibus financial markets reform legislation. We continue to work with Congress on draft legislation. We are somewhat concerned that proposed discriminatory liability standards would create an uneven playing field and have unintended consequences for financial markets.

In the legal arena, there is not much to report. In the underwriter cases, we continue to make applications seeking dismissal and oral arguments have been proceeding in several of them. In the stock drop suits, motions to dismiss have been fully briefed and oral arguments have been held in two of these cases. In state law claim cases, we also are making applications or awaiting decisions on motions to dismiss. We are in the discovery phase of the Abu Dhabi case.

Summing up then for Financial Services in 2010:

- There will be a return to growth in revenue at S&P Credit Market Services and S&P Investment Services.
- The segment’s operating profit will grow, but there will be pressure on margins as S&P makes investments in the infrastructure of its business to support future growth and to comply with new regulatory requirements. The majority of these costs support the credit ratings business. They include investments in surveillance systems and the infrastructure for quality, criteria, compliance and risk management. We will also continue to invest in key S&P Investment Services businesses so they are well positioned to take advantage of an improving market.
- There is an additional factor. S&P Investment Services is primarily subscription based. In a challenging market in 2009, the S&P Investment Services added fewer net subscribers than in 2008 and that will have some impact on revenue in 2010. Prospects look good for increasing net subscribers this year, which will lead to a more favorable impact on revenue in 2011.
- Revenue for the segment is expected to grow in high single digits. Operating margin will decline about 100 basis points.

**Information & Media**

Now, let’s shift over to Information & Media.

In Information & Media, continued strength in global energy markets, a soft advertising market and the divestiture of BusinessWeek were major factors in the fourth quarter performance.

In the fourth quarter for Information & Media:

- Revenue declined 11.4%;
- Including a pre-tax gain of $10.5 million from the divestiture of BusinessWeek in December, operating profit increased 40.6%;
- Excluding a pre-tax gain on the sale of BusinessWeek and a prior year restructuring charge, operating profit declined 6.8%; and
- The operating margin was 18.1% compared to 11.4% in the fourth quarter of 2008.

Reflecting the gain on the sale of BusinessWeek, the operating margin for the year was 9.7%. Excluding the gain and the 2Q 2009 restructuring charge of $4.0 million, it was 9.0%.
The weak advertising market and problems in the automotive sector were evident in the 9.5% revenue decline in our Business-to-Business Group in the fourth quarter. Revenue for the Broadcasting Group was off 26.6% in the fourth quarter, especially with the absence of political advertising. In 2009, advertising represented approximately 3.5% of total corporation revenue, down from about 4% in 2008. Virtually all of it is in this segment. With the sale of *BusinessWeek*, our exposure to the cyclical advertising market will be reduced to approximately 2% in 2010.

Political advertising in the Broadcasting Group will be a positive factor in 2010. There are U.S. Senate and House races in Indiana, Colorado and California. There will also be races for governor in Colorado and California, plus spending on issues and propositions. The outlook for political spending on local television stations also got a boost from last week’s U.S. Supreme Court decision to remove campaign spending restrictions from corporations. The Broadcasting Group also recently renewed its affiliation agreement with ABC. The new agreement will have an adverse but immaterial impact on the segment’s future revenue and profitability.

With all the reporting on the problems of the Big 3 auto companies in Detroit, it is easy to lose sight of the fact that J.D. Power operates successfully in a recovering global automotive market. Here’s a snapshot of J.D. Power’s latest forecast for the global market. Global light vehicle sales are expected to rise to 65 million units, an increase of 1.6% over 2009 after a decline of 3.1% last year. Growth continues in China—an increasingly important market for J. D. Power. The recovery begins in North America with volume up 10% to 13.9 million units in 2010. J. D. Power will also complete the migration of its syndicated study deliverables to an online platform, which will reduce costs and improve the quality and utility of its research data.

The digital transformation of this segment will continue to be a plus in 2010. Business-to-Business digital revenue grew again in 2009 and now represents more than half of the B-to-B Group’s sales in 2009. In 2008, it was under 50% of the Business-to-Business Group’s revenue.

Platts continues its global expansion, strengthening its benchmark status in core commodity markets. Platts has launched a series of new oil price benchmarks for Indian markets. In December, Platts announced the launch of a new price assessment for the very first Russian petroleum stream flowing through the Eastern Siberian Pacific Ocean pipeline for Asian markets. It’s an interesting example of how Platts keeps abreast of developments in its market. The pipeline, rail and port facilities in Russia’s Far East provide the country with the logistics to target increasing amounts of oil to Asia rather than to the West. Over time, the operation is well positioned to serve the market as a major price indicator of spot oil values in the Far East. The exports are set to grow and the oil has wide equity ownership—key elements for an emerging benchmark.

Summing up then for Information & Media:

- The sale of *BusinessWeek* will impact revenue and the operating margin in 2010.
- Revenue will decline in the mid single-digits but excluding $100 million from the *BusinessWeek* divestiture, revenue will increase in the mid single-digit range.
- Operating margin will rebound, climbing into the mid-teens.

That completes our review of operations and the outlook for the segments in 2010. For The McGraw-Hill Companies, we expect diluted earnings per share of $2.55 to $2.65 in 2010.

Thank you. Now, let’s hear from Bob Bahash.
Robert J. Bahash  
Executive Vice President and Chief Financial Officer  
The McGraw-Hill Companies

Thank you Terry.

A major focus during 2009 was our balance sheet management. We did that in order to maintain and enhance our strong financial position to ensure adequate and appropriate access to capital.

This morning, I want to review how we maintained and improved upon the corporation’s financial strength in 2009. We will also look at our plans for this year, 2010. We start 2010 in a strong financial position. Due to strong free cash flow, we ended 2009 with cash and short-term investments of $1.23 billion. Total debt at year-end was $1.2 billion. It is comprised entirely of long-term unsecured senior notes. No commercial paper was outstanding at the end of 2009. As a result, we are now in a slight positive net cash position versus a net debt position last year of $796 million.

Keeping a tight grip on costs and expenses was a year-long priority. Terry has discussed revenues and margins, so I will concentrate on providing some additional color on expenses. For purposes of this discussion, I will deal with “adjusted” expenses, which represent reported expenses adjusted to exclude restructuring charges in both years as well as the loss on the divestiture of Vista Research and the gain on the divestiture of BusinessWeek. Adjusted expenses are shown on Exhibit 3 of the press release.

Despite increases in incentive compensation, consolidated adjusted expenses (that’s segment expenses as well as corporate expense) declined by 0.3% in the fourth quarter and 4.7% for the year. If you exclude the impact of currency, adjusted expenses declined 3.3% in the fourth quarter and 3.4% for the full year.

Now let’s look on a segment basis. For McGraw-Hill Education, adjusted expenses declined 4.2% in the fourth quarter and 8.4% for the year. At constant currencies, adjusted expenses declined 6.2% in the fourth quarter and 7.3% for the full year. Full-year expenses declined despite higher incentive compensation as declining revenue opportunities resulted in lower cost of sales and reduced selling and marketing costs. The segment also benefited from savings from previous restructuring actions.

For 2010, we expect McGraw-Hill Education expenses to increase 7% to 8% versus 2009 adjusted expenses. Expense growth is driven by an increase in selling and marketing costs given the robust state new adoption opportunities that Terry mentioned. As I have mentioned in the past, we incur significant promotion and marketing expense in the first year of a new adoption. Profit contribution increases in the subsequent years from residual sales.

Additionally we are investing in both technology and personnel to support our digital initiatives, particularly at Higher Education and Professional, in order to provide value and choices for our customers. Expense growth is partially mitigated by savings from our second quarter 2009 action to combine our core basal publishing operations with our alternative basal and supplemental publishing operations.
For Financial Services, adjusted expenses increased 10.3% in the fourth quarter and 1.6% for the full year. But at constant currencies, adjusted expense increased 4.1% in the fourth quarter and 3.4% for the full year. The full year expense growth was driven by increases in incentive compensation and compliance costs, mitigated by the benefits of restructuring, tight expense control, and the impact of divestitures.

For 2010, we expect expenses to increase roughly 9% to 10% versus 2009 adjusted expense. Expense growth is largely driven by:

- Continued investment in our fast-growing businesses;
- The carry over impact of 2009 new staff hires;
- Planned new hires in 2010, and
- Additional investment to support our regulatory and compliance efforts.

For full year 2009, costs related to regulatory and compliance initiatives resulted in approximately $20 million of additional costs versus 2008. Our expense guidance assumes a comparable increase in 2010, though this is obviously highly dependent on the final form of regulation.

For Information & Media, adjusted expenses declined 12.1% in the fourth quarter and 8.7% for the full year. At constant currencies, adjusted expenses declined 12.7% in the fourth quarter and 7.9% for the full year. Restructuring savings and lower cost of sales due to reduced revenue were key drivers for full-year expense decline. Fourth quarter expense of course benefited from the divestiture of BusinessWeek.

For 2010, reflecting primarily the divestiture of BusinessWeek, expenses are expected to decline in the low teens versus 2009 adjusted expenses. You’ll recall from our third quarter call that we expected the BusinessWeek divestiture to benefit 2010 pre-tax profit by approximately $20 million to $25 million. We have refined our estimate and now expect to benefit roughly $25 million. The Information & Media segment will actually reflect savings from the BusinessWeek divestiture of $38 million as we manage vacant space and certain other support costs within corporate expense, which is increasing approximately $13 million due to the divestiture.

As we have indicated on previous calls, Information & Media’s 2009 results were negatively impacted by the non-cash accounting impact of converting studies onto Compass, J.D. Power’s online reporting and analytical tool. Revenue previously recognized at the time of our syndicated studies’ release will now be recognized ratably over the 12-month life of the subscription. This is similar to the Sweets transition activity in 2006.

For the full year, there was an $11 million decrease in revenue and a $7 million decrease in profit due to the impact of Compass. In 2010, we expect all customers to be accessing this digital delivery platform. The impact in 2010 is expected to be similar to 2009.

Corporate expense in the fourth quarter was $36.4 million, a $7.4 million increase versus previous year, excluding the 2008 restructuring charge. The increase was primarily driven by a $10.3 million increase in incentive compensation. For the year, excluding the 2008 restructuring charge, expenses were up $20.9 million, driven by a $23 million increase in incentive compensation.
For 2010, we expect corporate expense to increase $25 million to $30 million. The primary reason for the increase is driven by higher excess space in New York resulting from the BusinessWeek divestiture as well as excess space generated from the restructuring actions at McGraw-Hill Education.

Incentive compensation has increased in previous quarters and again in the fourth quarter when compared to a depressed 2008. Incentive compensation increased by $96.2 million for full-year 2009 and $56.6 million in the fourth quarter, driven primarily by stronger than anticipated results and reversals taken in accruals in the previous year. For 2010, incentive compensation should now grow in normal patterns with MHP’s projected performance. However, stock-based compensation is expected to reach about $50 million compared to the $22.3 million in 2009, due to the three-year earning and vesting period, which is off a depressed base.

Foreign exchange had a significant impact on our operating results in 2009. For nine months, foreign exchange decreased revenue and expense but had a minimal impact on profits. In the fourth quarter, the trend reversed, benefitting revenue by $25.8 million while increasing expenses by $36.3 million. As a result, operating profit declined by $10.5 million. For the year, foreign exchange decreased revenue by $70.4 million and expense by $60.9 million, resulting in a decline in operating profit of $9.5 million.

Prudent management of investments and tight cost controls contributed to a strong free cash flow performance. For the year, free cash flow was $769.9 million compared to $502.9 million in 2008. We define free cash flow in the following manner: We start with Cash Provided by Operations, per the GAAP Cash Flow Statement. We then subtract the following items:

- Prepublication investments;
- Purchases of property and equipment;
- Additions to technology projects, and
- Dividends paid to our shareholders.

The result is free cash flow that would be available for acquisitions, share repurchases, or to pay down debt.

I will spend a moment reviewing the changes in free cash flow in 2009 compared to 2008. As the table highlights, Cash Provided by Operations increased $152 million over 2008 despite a reduction in net income. The primary drivers of the strong free cash flow were:

- A significant reduction in cash incentive compensation payments;
- Lower inventory purchases reflecting decreased revenue opportunities for McGraw-Hill Education;
- Significant improvement in accounts receivable collections generating $50 million as the company’s Days Sales Outstanding was reduced by nine days, and
- Investments declined $116.2 million, primarily driven by a reduction in prepublication costs of $77.1 million, reflecting continuing efficiency gains in the development process as well as lower investments due to a lighter adoption calendar.

Based on our operating guidance for 2010, we anticipate free cash flow in the range of $550 million to $600 million. Reduction in free cash flow versus 2009 is due largely to more challenging working capital comparisons as well as increased investment that I will discuss in just a moment. We took advantage of our strong free cash flow to contribute approximately $50 million to our U.S. pension plan. The U.S. plan continues to be in an underfunded position following significant market declines.
in 2008, though it has improved since last year-end. Based on current projections, we anticipate no funding requirements in 2010. However, we do expect an increase in pension expense of approximately $20 million in 2010.

Our strong cash flow generation and balance sheet leave us well positioned to fund investments and return cash to shareholders while maintaining financial flexibility. Last week we announced a 4.4% increase in our dividend, the 37th straight increase. We are one of fewer than 30 companies in the S&P 500 that can make that statement. We also announced that we plan to resume share repurchases, as there are 17.1 million shares remaining from the 2007 authorization from the Board of Directors.

Unlike previous years, we have not indicated either a share or dollar repurchase target for the year. I reiterate it is our plan to resume the program, but the economic environment remains uncertain so we will watch this carefully in determining when we will commence share repurchases.

We plan to increase our investments in 2010 to take advantage of the opportunities we see in our growing global markets.

- Prepublication investments for 2010 are expected to be $225 million to $235 million versus $177 million in 2009, a $48 to $58 million increase, primarily due to opportunities in the growing state new adoption market.
- Purchases of property and equipment for 2010 are projected at $90 million to $100 million versus $68.5 million in 2009, largely due to increased technology spending.

Let’s now review non-cash items:

- For 2010, we expect amortization of prepublication costs to be $260 million to $265 million versus $270 million in 2009. This decrease reflects the lower level of investment made in 2009. We expect depreciation to grow to $120 million in 2010 versus $113 million in 2009.
- Amortization of intangibles was $16 million for the fourth quarter of 2009 due to the acceleration of the amortization of certain acquired intangibles. That brought the total for 2009 to $52.7 million. For 2010 we expect amortization to decline and to be approximately in the $40 million range. The decline is due to the accelerated amortization of certain intangibles in 2009 as well as other items fully amortized also in 2009.

Our fully-diluted weighted average shares outstanding was 314.5 million in the fourth quarter, a 1.6 million share increase versus the same period last year and a 0.8 million share increase from the third quarter of 2009. Full-year WASO was 313.3 million shares, a 5.4 million year-over-year decline driven largely by full year impact of 2008 share repurchases. Fully-diluted shares at the end of the 2009 were approximately 315 million.

Interest expense was $20.0 million in the fourth quarter, compared to $15.4 million in the same period last year and $17.8 million in the third quarter. For the full year, interest expense was $76.9 million, compared to $75.6 million in 2008. We expect 2010 to be roughly comparable to 2009. Regarding the company’s effective tax rate, we finished 2009 with a full-year tax rate of 36.4%. We expect a comparable rate in 2010.

I’ll end with a recap of growth in unearned revenue. Unearned revenue ended 2009 at $1.1 billion, up 1.5% from the prior year. At constant foreign currency exchange rates and excluding the impact of divestitures, most notably BusinessWeek, it grew 2.8%.
Financial Services makes up 74% of the corporation’s total unearned revenue. Financial Services’ unearned revenue was roughly flat as strong growth for subscription products, including Ratings Direct, was offset by reductions in equity research due to the end of the independent equity research settlement, as well as declines driven by lower structured finance revenues. While comparatively small, McGraw-Hill Education’s strong unearned revenue growth was driven by an increase in subscription-based products, particularly at Higher Education, where digital products are growing at a double-digit rate.

For 2010 we expect mid single-digit growth in unearned revenue.

Thank you.