

**The McGraw-Hill Companies  
4th Quarter 2008 Earnings Conference Call**

Prepared Remarks  
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**Donald Rubin**

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The McGraw-Hill Companies

Thank you and good morning to our worldwide audience and thank everyone for joining us at The McGraw-Hill Companies' fourth quarter 2008 earnings conference 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 the company issued a news release with our fourth quarter 2008 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](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're aware that we do have some media representatives with us on the call; however this call is for investors and we would ask that questions from the media be directed to Mr. Steve Weiss in our New York office at (212) 512-2247 subsequent to this call. Today's update will last approximately an hour. After our presentation, we will open the meeting to questions and answers.

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

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### **Harold McGraw III**

Chairman, President and CEO

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Good morning everyone and welcome to our review of the full year and fourth quarter 2008 earnings and the outlook for 2009. With me is Bob Bahash, Executive Vice President and Chief Financial Officer.

On today's call, we will be providing information on our performance in 2008 and discussing our guidance for 2009. After my review of operations, Bob will then provide a little bit more in-depth look at our strong financial condition as well as our outlook for free cash flow for 2009. After that, we'll take questions and comments and go in any direction you would like.

As Don said, earlier this morning we announced results for the fourth quarter and for the full year. I am very pleased to report that we delivered on the high end of our guidance for the fourth quarter and for the full year.

Let's briefly recap those results. For 2008 we reported 2008 diluted earnings per share of \$2.51, and that includes a \$0.14 per share restructuring charge. Also, revenue declined 6.2%. For the fourth quarter of 2008 we reported diluted earnings per share of \$0.37, and that included a \$0.05 per share restructuring charge. Revenue declined by 9.8%.

To help control expenses, we reduced incentive compensation in 2008 by \$273.7 million. The restructuring actions in 2008 resulted in a workforce reduction of 1,045 positions. Cost containment was a priority for us in 2008 and it will be the same again for this year. If more actions are necessary this year, we are prepared to take them.

The challenge in the current environment is to manage for today while preparing for tomorrow. We will and still must see how the massive recovery package coming from the federal government will:

1. Stimulate the economy,
2. Relieve budget pressures on state and local governments,
3. Help education funding, and
4. Improve the sentiment in capital markets.

Slower economic growth and the weakened housing sector will affect the state and the local tax base. At the same time, the demand for local government-supported projects may lead to more debt financing. We've seen this trend before. Historically, there is a clear inverse correlation between state and local operating balances and municipal debt issuance.

The changing financial landscape is both a source of new challenges and new opportunities. Where circumstances are favorable, we have responded by investing in fast-growing businesses at Standard & Poor's.

The confluence of content, technology and distribution is also creating opportunities to improve our potential by producing new digital products and services for an audience eager to acquire 21<sup>st</sup> century skills. We are doing so to maintain our leadership.

In this environment, we must also preserve and protect a very strong balance sheet. A strong balance sheet has been the hallmark of this company and we plan to keep it that way. Our cash flow is more than sufficient

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to meet our requirements for operations, making investments, paying down debt and returning cash to shareholders.

We have paid a dividend every year since 1937 and we've increased it every year since 1974. That is 35 years of increasing the dividend. Few companies can match that record of consistency. The next decision on the cash dividend will be made tomorrow at the Board of Directors' regular monthly meeting. And believe me, our Board understands the importance here.

With that background, let's review the operations and 2009 guidance for each segment.

### **Financial Services**

Let's begin with Financial Services.

A resilient and diverse portfolio helped cushion the Financial Services segment in the midst of a credit crunch and very challenging comparisons with a very robust 2007.

Revenue for S&P Credit Market Services in 2008 declined by 22.5% and by 24.5% in the fourth quarter. Revenue for S&P Investment Services, that's our non-ratings business, grew by 15% last year and by 7% in the fourth quarter. In 2007, S&P Investment Services produced about 26% of Financial Services' revenue. In 2008, it rose to 34% of the total. Revenue for the segment declined by 12.9% for 2008 and by 15.4% in the fourth quarter.

In the face of adverse market conditions, we continued to manage our costs diligently. After pre-tax restructuring charges of \$25.9 million for a workforce reduction of approximately 340 positions and a \$166 million decrease in incentive compensation, operating profit declined 22.4% in 2008. In the fourth quarter, after a pre-tax restructuring charge of \$6.6 million for a workforce reduction of approximately 50 positions and a reduction of \$36.6 million in incentive compensation, operating profit declined 18.6%.

All that effort enabled us to report a 39.8% operating margin for the year and a 34.4% operating margin in the fourth quarter. The restructuring charges reduced the 2008 operating margin by 98 basis points for 2008 and by 105 basis points in the fourth quarter.

The decline in new issue volume obviously had a major impact on 2008 results. As these bar charts illustrate, the decline in the U.S. structured finance new issue dollar volume was pronounced all year. For 2008, U.S. structured finance new issue dollar volume was off 79.9% and the weakest in the fourth quarter with an 89.4% decline.

Now, corporate and public finance issuance fared better. U.S. corporate dollar volume issuance was off 33.8% for the year as the high-yield market dropped by 73.7%. In the fourth quarter, U.S. corporate dollar volume issuance was down 39.3% as the high-yield market came to a virtual halt, dropping by 96.3%. But while the new issue dollar volume last year was the weakest in the fourth quarter, it is not the whole story for Standard & Poor's.

As this table illustrates, the revenue performance for the segment and S&P Credit Market Services did not come close to matching the fourth quarter decline in the U.S. or the global new issue dollar volume.

A key to our resiliency in the ratings business is the non-transaction revenue, and that number grew by 5.2% in 2008 and represented 73.1% of S&P Credit Market Services revenue. In the fourth quarter, non-transaction revenue declined by 4.8% and accounted for 78.9% of ratings revenue. About 90% of the non-

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transaction revenue is recurring. And as you all know, it comes from surveillance fees, annual contracts, subscriptions and so forth. And the recurring portion grew all year.

Our non-transaction revenue also includes other services such as bank loan ratings which are not reflected in the public bond issuance. A sharp decline in bank loan ratings was a key factor in the fourth quarter decline in non-transaction revenue. We expect non-transaction revenue to grow in 2009. It will be helped by modest price increases. The majority of annually renewable contracts are with large investment-grade companies, financial institutions, governments and government-related entities. These entities will continue to access the public debt markets.

Our subscription services—this would be Ratings Direct and Ratings Xpress—provide vital information and this month we increased their value as a global credit portal to the market with major enhancements.

Given all the uncertainty of current market conditions, the outlook for transaction revenue is very hard to call. To be clear, we define transaction revenue as the new public issuance of corporate, public finance and structured finance instruments. We expect new issuance to get off to a slower start this year, but anticipate a better run rate in 2009 than we experienced in the fourth quarter of 2008. Still, we don't expect growth in new issuance in 2009. At best, we think it could possibly be flat.

Spreads remain a key gating factor in S&P's market. Firms are deleveraging and rationalizing balance sheets, but a more substantial contraction in spreads probably won't materialize until investors see clear signs that deleveraging has run its course.

There are positive signs. Various federal initiatives designed to improve liquidity have had some success at the short end of the market. That's a critical first step for spreads to tighten for long-term credit. Based on what issuers and investors are telling us, there are indications of pent-up demand in the investment-grade market.

LIBOR spreads are the key cost-of-funds benchmark, so we are watching them very closely. The rate has come down sharply in recent weeks and the three-month LIBOR is currently approximately 1.15%. A declining LIBOR rate is an indication of lower perceived risk in the banking industry and helps facilitate more interbank lending, which is something that we need to see.

We are also looking for narrowing spreads on credit default swaps and improvement in spreads for both investment-grade as well as in high-yield bonds.

Stabilization of the housing market would be a big plus for everyone. Home prices on average have fallen 21% since July 2006, and that's according to the S&P/Case-Shiller 20-city index, and there is probably more to go. S&P's chief economist, David Wyss, expects housing prices to bottom out probably around 30%—peak to trough—by the end of this year.

For S&P Investment Services, tough comparisons—revenue grew by 15.6% in the fourth quarter of 2007—and consolidations in the financial market were factors in the lower rate of growth in the fourth quarter than in the previous three quarters of 2008. Probably another factor here is that assets under management in exchange-traded funds hit an all-time high of \$235 billion at the end of 2007 and declined to \$203.6 billion at the end of 2008, but a good year nonetheless. Still, we look forward to more improvement this year in our non-ratings business.

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In one of the worst years for equities since the 1930's, our index services turned in an outstanding performance. We benefited from market volatility which produced increased trading volume of derivatives based on S&P indices. In the fourth quarter alone, there was nearly a 47% increase in the average daily volume of major exchange-traded derivatives, and these are all based on our indices. More than 4.1 million contracts were traded daily in the fourth quarter of 2008, and that's versus just over 2.8 million in the fourth quarter of 2007. And, of course, S&P is paid every time a contract is traded.

Assets under management in exchange-traded funds based on S&P indices declined year-over-year by 13.5%, but we also saw new inflows to exchange-traded funds, creating a substantial increase in the number of shares invested in ETFs. That's a very positive development. We have also seen greater use of exchange-traded funds as hedging tools.

We continue to find new opportunities to expand in this market. In the fourth quarter, 14 new exchange-traded funds based on S&P indices were introduced. For the year, 59 ETFs were launched. There are now 203 exchange-traded funds based on S&P indices and there is more in the pipeline. New products, the growth in shares outstanding in ETFs based on our indices, and the increasing diversity of our offerings should benefit us again in 2009.

Despite the contraction in Wall Street, we continue to make progress with Capital IQ—very pleased here—finishing the year with a client base of over 2,600, a 19% increase for the year. At the end of the month, Capital IQ will add new data and functionality enhancements and a new portfolio attribution tool. To combat the cutbacks and consolidations among financial firms, a key part of Capital IQ's strategy is to add value with the new data offerings and this improved functionality.

With litigation about S&P ratings in the news, there was some confusion earlier this month when the European Commission announced that it was opening formal proceedings with Standard & Poor's. And the matter raised some questions, so let me clarify that situation.

First, the proceedings have nothing to do with ratings. Second is that we are not dealing with a lawsuit or anything like that; it's only a review regarding our licensing practices. And third, the proceedings involve complaints against the CUSIP Service Bureau, which S&P operates on behalf of the American Bankers Association.

And as many of you know, CUSIP is the acronym for the Committee on Uniform Security Identification Procedures. This system started in 1968 when the American Bankers Association appointed Standard & Poor's to develop and administer a system for uniquely identifying each U.S. stock and bond with a permanent nine-digit code to facilitate the smooth settlement and clearance of securities transactions. For 30 years, the CUSIP Service Bureau has been licensing commercial databases containing CUSIP numbers and associated descriptive data. Financial institutions seek access to these databases for a wide array of purposes that go far beyond the clearance and settlement activities.

So, last summer the European Commission received a complaint from several associations representing financial institutions and asset managers that the CUSIP Service Bureau was allegedly abusing its position in the European market by requiring licensing fees for use and access to the CUSIP Service Bureau's database of 12-digit ISIN numbers, which are derived from CUSIP and associated data. They challenged the legal right of the CUSIP Service Bureau to control access to its valuable and proprietary databases. These institutions wanted free access.

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In essence, the dispute is not about access to ISIN numbers for their primary purpose of settlement of cross border securities transactions. These identifiers are available to market participants free of charge. Rather, these Europeans have developed other uses for these identifiers, such as the management of internal databases, and demand free access to our commercial databases.

The complaint is without merit. It misrepresents the licensing activities of the CUSIP Service Bureau and ignores the fact that our licensing practices and changes are wholly transparent and in line with industry practices.

There also is a new shareholder derivative lawsuit. As a shareholder, the Teamsters Allied Benefits Funds is suing the Board of Directors and some corporate executives. The faulty premise of this Complaint is that our Board of Directors and corporate executives allegedly knew there were problems with ratings followed by purported misstatements in public filings on the results and operations of the S&P ratings business. And again, the suit is totally without merit.

On the regulatory front, there is more work to be done here and the outreach to key policymakers, regulators and politicians here and literally around the world is an ongoing process. And we're very active here. In Europe, we are meeting with European member states and members of the European Parliament. We are participating in member state and pan-European meetings. Finance ministries, central banks, supervisors are all on the itinerary. In the U.S., we are awaiting the publication of final NRSRO rules by the Securities and Exchange Commission. S&P continues to discuss global regulatory developments with the SEC, and that's an ongoing issue.

We believe that smart regulation will help strengthen financial markets and S&P is working very hard to be a very integral part of that solution.

In this environment, we also continue to strengthen our organization. As part of the leadership actions, we appointed an Ombudsman for Standard & Poor's Credit Market Services effective February 16<sup>th</sup>. Ray Groves will be S&P's first Ombudsman. He was with Ernst & Young for 37 years. He served as the firm's chairman and chief executive officer for 17 years until his retirement in 1994.

The Ombudsman will address concerns about conflicts of interest and analytical and governance issues raised inside and outside the company. The Ombudsman reports directly to me and has accountability to the Audit Committee of the Board of Directors. He will also report annually to the public.

Now, many ideas have been suggested about the regulation of rating agencies and we think they should be thoroughly explored. Managing the potential for conflicts of interest in the ratings process is a key issue. We agree. We have always agreed to that.

We also believe that no system is completely free of conflict. But we do believe conflict can and should be managed through greater transparency. In fact, the key issue for financial markets is transparency. That's why S&P has taken 27 leadership actions—these are action steps to improve its processes and procedures. And that's a forever and ongoing process. That's the reason for creating the Office of the Ombudsman. And that's why S&P makes its ratings available at no charge to the market and in real time. Because S&P's opinions are freely available to everyone, the market is free to assess our decisions. And our business model makes this transparency possible.



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Let's sum up then for the Financial Services segment:

- Growth in non-transaction revenue will help cushion the uncertainty in the new issue market in 2009, and we may start to see some pick up in new issuance—especially in the second half,
- Growth in S&P Investment Services will continue, and
- A slower start to 2009.

Our guidance for 2009 for the Financial Services segment:

- Low, single-digit revenue—probably about 1.5% to 2% growth, and
- A margin decline of 250 to 300 basis points—that's excluding the 2008 restructuring charges.

### **McGraw-Hill Education**

Let's now take a look at McGraw-Hill Education.

Gains in U.S. higher education partially offset a decline in the elementary-high school market in 2008. McGraw-Hill School Education Group's revenue decreased by 5.4% in 2008 and by 18.6% in the fourth quarter compared to 2007. McGraw-Hill Higher Education, Professional and International Group's revenue increased by 1% in 2008 and declined by 2.0% in the fourth quarter. This group accounted for 48% of the entire segment revenue in 2008. Revenue for this segment decreased by 2.5% for the year and 8.0% in the fourth quarter.

Cost cutting was a priority for the segment as market conditions softened during the year. Including pre-tax restructuring charges of \$25.3 million for a workforce reduction of approximately 455 positions and a \$29.3 million decrease in incentive compensation, operating profits declined by 20.9% in 2008.

In the fourth quarter, including a pre-tax restructuring charge of \$11.4 million for a workforce reduction of approximately 215 positions and a \$7.8 million decline in incentive compensation, the segment had an operating loss of \$14.3 million. The operating margin for 2008 was 12%. The restructuring charge reduced the operating margin for the year by 96 basis points.

For the most part, the fourth quarter in education is not seasonally significant except in some years for the U.S. college and university business. December is traditionally the key month of the fourth quarter for higher education and that certainly proved true again in 2008. A late surge in sales enabled higher education to finish the year on an upswing and in a good position for 2009.

Still, we didn't quite match the U.S. college market's estimated 3.0% sales gain in 2008. Our performance in 2008 resulted primarily from the fact that we published fewer major titles in 2008 than we did in 2007. With a more robust list for the new year, we expect to stay in step with the industry in 2009. We also will benefit from a growing lineup of new digital offerings that include individualized online tutoring, a lecture capture service that gives students access to course-critical lectures, and assessment placement tools that enable schools to determine the most appropriate courses for entering students. And that we are developing off of the ALEKS artificial intelligence capability.

For 2009, we have also launched a new generation of homework managers. Already our best-selling digital product line in the higher education market, these subject-specific platforms allow instructors to organize all of their course assignments and their assessments for online use by students.

Our robust new platform, which we're calling *McGraw-Hill Connect*, offers many more features for both faculty and students. Available initially for 12 different disciplines, the *McGraw-Hill Connect* product line will be promoted with the tag line, "Connect. Learn. Succeed."

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At year-end we also had 741 titles live on CourseSmart, that's the industry's eBook website. And we think the college and university sales market could grow 3% to 4% in 2009. Historically, higher education has been a counter-cyclical market. During economic downturns, postsecondary enrollments tend to increase as unemployed workers return to school to upgrade their skills and current students remain in school longer to become more competitive in a tight job market.

Our sales of professional books were hurt by weakness at retail as consumers cut back spending. In 2009 we will be launching key titles in the scientific, technical and medical markets, which are less vulnerable to economic downturns than the general retail market.

Our digital products and services have enjoyed solid growth in 2008 and we'll continue to build on that success in 2009. In the first quarter, we will launch three major new digital products for professionals:

- *JAMA Evidence*,
- *AccessAnesthesiology*, and
- *AccessEngineering*.

Very quickly on those three, *JAMA Evidence* was developed jointly with the Journal of the American Medical Association. It provides subscribers with the fundamental tools for applying the medical literature to clinical diagnoses. It also includes full-text access to two of our major references: *The User's Guide to Medical Literature* and the newly-published *Rational Clinical Examination*.

*AccessAnesthesiology* is a comprehensive online resource covering pain management, critical care and perioperative medicine. It takes the subscriber from the reference desk into the anesthesiologist's workflow.

*AccessEngineering* features fully-searchable content from hundreds of our publications, including such classics as *Perry's Chemical Engineers Handbook*. Users can customize *AccessEngineering* for their own projects and for their own individual studies.

What I am really describing are outstanding examples of a convergence, again, of content and technology. It takes knowledge, creativity and innovation to leverage our content and create such products.

Professionals around the world recognize the value proposition because they require 21<sup>st</sup> century skills to succeed. That's why our digital products are growing globally, and at a very good pace. We're seeing a steady increase in new subscriptions from around the world and the renewals are strong. We also expect more growth overseas in higher education and professional markets.

The challenge in 2009 will be the elementary-high school market where we now anticipate a 10% to 15% decline in industry sales after a decrease of approximately 4% in 2008. It's a market in which we captured approximately 30% of available state new adoption dollars. That market topped \$980 million, exceeding our earlier projection of \$925 million to \$950 million.

In 2009, the state new adoption calendar is simply not as robust. The upturn in state new adoptions starts in 2010 and carries into 2011. We currently estimate the 2009 state new adoption market at \$675 million to \$725 million, down from an earlier estimate of \$850 million to \$900 million.

State and local budgets are obviously under pressure and funding concerns could affect the outlook in two of this year's key adoption states, California and Florida. Both states are grappling with deficits that could affect the purchase of instructional materials. Florida has already eliminated the call for a K-12 music



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adoption. Only the 6-12 literature adoption will be funded this year and many districts may elect to postpone purchasing until next year or even 2011. We just don't know.

We have a strong program entered in the California K-5 reading market this year. Appropriately, the program is called "*California Treasures*." We also are very well positioned for the second year of the math adoption in California, particularly with the Los Angeles Unified School District. But here, too, there is budget pressure and the situation is highly fluid.

The budget pressures are also evident in our testing business. Revenue for custom contracts was off for the year and the fourth quarter as well due to lower volume of work on several contracts and the discontinuation of two contracts that produced income in 2008. Replacing that revenue with new or expanded contract work became increasingly difficult as state budgets tightened in the second half of 2008.

There is some good news in testing. Despite state and district budget pressures, *Acuity*, our formative testing program, is adding new districts and retaining current customers. Renewals continue to be strong. We are benefiting from interest at the district level for technically sound classroom assessments. And let's not forget that testing is still a required part of state education programs and a focus of districts seeking to move schools ahead and accurately measure achievement and growth. We anticipate that grants to states for summative—that's the high-stakes end of testing—under the *No Child Left Behind Act* will probably be funded at or near the 2008 level—about \$410 million—in the new education budget.

At the end of December, 41 states and the District of Columbia reported budget deficits for their current fiscal years, which end in most cases June 30. Of the top 16 states in terms of instructional materials purchasing, five had already enacted mid-year cuts in their educational budgets totaling about \$370 million and cuts from additional states are expected.

On a macro level, it is not possible to quantify possible reductions in the purchasing of instructional materials based on reductions in overall education budgets because there are so many variations in funding practices across the states. But it seems prudent to assume that some budget cuts will affect purchasing by schools in the first half of 2009.

There also is some concern about budgets for the next fiscal year. But we are not likely to have much clarity on the 2009-2010 state educational funding until May, or just a little bit after that, when the spring tax revenue comes in and legislatures begin to complete budgets for the new fiscal year.

A new federal education budget from the Obama administration has been promised for February. It may contain an increase in Title I grants to districts with high numbers of disadvantaged students. These funds can be used for the purchase of instructional materials, along with other purposes. More immediately, any funding of school infrastructure improvement included in the general economic stimulus package would benefit education and the industry indirectly by freeing up more state and local education allocations for instruction-related expenses.

This week, as we all are watching, the U.S. House of Representatives is scheduled to vote on a stimulus bill which sends \$41 billion to local school districts. It also includes \$79 billion in state fiscal relief. The effort to prevent cutbacks in key state services provides \$39 billion to local school districts and public colleges and universities. All told, there is \$140 billion in the stimulus package for education.

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A stimulus bill from the Senate is in the works. It will include tax credits for tuition fees and, for the first time, the purchase of course materials. Congress is on track to pass the economic stimulus package before adjourning on February 13 for President's Day.

Clearly, there are many developments that could influence prospects this year in the school market. We are following these developments closely and will keep you posted on how we're seeing it. None of the current proposed stimulus is in our financials.

Let's sum up for McGraw-Hill Education:

- Federal funds may help alleviate pressure on state and local funding for education,
- A 10% to 15% decline in the elementary-high school market in 2009, and
- Growth of 3% to 4% in the U.S. higher education market.

And for the segment:

- A low single-digit revenue decline, and
- A 300 to 400 basis point decline in the operating margin, excluding the 2008 restructuring charges.

### **Information & Media**

And finally, let's now review Information & Media.

Growth in business-to-business markets and a record year of political advertising for Broadcasting were key factors in this segment's performance in face of weakness for print advertising.

Revenue for the Business-to-Business Group increased by 4.1% for 2008 and by 0.2% in the fourth quarter. Revenue for the Broadcasting Group increased by 4% for 2008 and by 11.3% in the fourth quarter. The segment's revenue increased by 4.1% for 2008 and 1.3% in the fourth quarter.

Including pre-tax restructuring charges of \$19.2 million for a workforce reduction of approximately 210 positions and a \$22.6 million decrease in incentive compensation, operating profit increased by 45% in 2008.

In the fourth quarter of 2008, including a pre-tax restructuring charge of \$5.3 million for a workforce reduction of approximately 70 positions and a \$6.4 million decrease in incentive compensation expense, the operating profit increased 61.7%. The operating margin was 8.7% for the year and 11.4% for the fourth quarter. Restructuring charges reduced the operating margin by 181 basis points for the year and 186 basis points for the fourth quarter.

Volatility in energy markets increased the demand for information and we clearly benefited in 2008. Platts' news, pricing and conference businesses produced solid results all year. We look forward to solid results again in 2009.

J.D. Power and Associates benefited from strong results in Asia-Pacific markets, primarily automotive in China for the year, but experienced some softness in the fourth quarter.

At McGraw-Hill Construction, a gain in our project news network was offset by softness at Sweets and a fall-off in media advertising.

And advertising pages at *BusinessWeek* were down 16.1% for the year and 19.6% in the fourth quarter.

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Political advertising was another story. Our Broadcasting Group had a record year in political advertising with more than half of it coming in the fourth quarter. Total revenue from political advertising topped \$27 million in 2008. A recessionary environment and a year without significant elections will challenge the advertising market here in 2009.

Problems in the automotive market will be an issue for advertising and J.D. Power and Associates in 2009. Another factor in our revenue picture is a shift to online services at J.D. Power, which impacts the timing of revenue recognition. Bob will have a few more details on that in his presentation.

So summing up for the Information & Media segment:

- A low single-digit decline in revenue, and
- A 200 to 300 basis point reduction in the margin, and that's excluding 2008 restructuring charges.

And, therefore, summing up for The McGraw-Hill Companies:

- 2009 will be another challenging year,
- Tight credit markets,
- Budget pressures on state and local governments will affect some spending on education, and
- Some softness in advertising.

Obviously, there's a great deal of uncertainty in this environment, but we are encouraged by yesterday's *USA Today's* new economic survey of 52 top economists and prospects for the second half of this year. Growth in U.S. GDP resumes in the third quarter of 2009 and expands in the fourth quarter according to these median estimates. Encouraging, but we'll have to see how the stimulus package impacts our markets—that's hard to predict—so we have not factored it into any aspect of our forecast.

At this point in the year we expect consolidated 2009 revenue to decline 1% to 2% compared to 2008. And earnings per share in a range from \$2.20 to \$2.30. And we'll have to see from there.

With that, let me now turn it over to Bob. Bob's going to provide a little bit more granularity about our performance and some of the key assumptions underpinning our guidance that are baked into our overall plans in terms of budget considerations for 2009.

### **Robert J. Bahash**

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

Thank you, Terry.

I'm going to focus most of my remarks this morning on providing guidance for 2009, but before I get to this discussion, I'll mention some key points as to how we finished 2008.

The environment clearly continues to be challenging, but as Terry pointed out, we did achieve \$2.65 per share, excluding restructuring charges, which is at the high end of our guidance. Our cash flow, under our definition, which is after all investments and the dividend, came in at \$455 million. Share repurchases, which mainly occurred in the earlier part of the year, totaled 10.9 million shares, resulting in a cash outflow of \$447 million.

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Now to the fourth quarter operating performance highlights.

We'll start with Financial Services. Credit Market Services' revenue declined 24.5% as debt issuance was minimal during the difficult months of October and November. As you know, December started to show some signs of life, particularly in the U.S. investment-grade issuance. Investment Services' revenue grew 7%, but clearly at a slower rate than in the first three quarters, which were double digit, from the weakness that was felt in the banking and investment services sectors.

Expenses continue to be prudently managed. However, fourth quarter margins at 35.5% versus 38.3% in the prior year, excluding restructuring charges, were clearly influenced by softer revenue, as Credit Market Services' revenue was the lowest of all four quarters for 2008.

Now, for McGraw-Hill Education. Higher Education, Professional and International Group's revenue declined 2% influenced by currency. Solid performance in the U.S. college and university market was offset by a challenging retail environment for professional, as well as weaker overseas sales, due to the strengthening dollar and weakening economic conditions in our Spanish-language markets.

Softness in the supplemental market and residual sales contributed to an 18.6% revenue decline at School Education Group. The 4.8% decline in expenses, excluding restructuring charges in both years, could not offset the impact of the revenue decline for the quarter.

Now, for Information & Media. Revenue grew 1.3% driven by Broadcasting's strong political sales in the Denver market and continued growth from Platts' news and pricing services. Offsetting this growth was softness in Broadcasting's local and national advertising revenue as well as declines in advertising revenue from *BusinessWeek*. Expenses here were managed effectively, and coupled with the revenue growth, resulted in margins expanding to 13.3%, excluding restructuring charges.

There were significant restructuring actions during 2008, so I'd like to take a moment to provide an update on employee headcount. The total number of employees ending 2008 was 21,649. This reflects an increase of 478 employees compared to year-end 2007. This is net of the restructuring actions taken during the past year. And keep in mind that the most recent fourth quarter action relates to terminations that will mainly occur in 2009.

The net increase in headcount is due to hiring at Financial Services, particularly internationally, to support our fast-growing data and information business, as well as CRISIL's rapidly growing ratings and equity research services outsourcing support businesses located in India. In fact, employment has grown only in our overseas markets, as it declined in the U.S.

Now, let's move to 2009. And, of course, there's a great deal of uncertainty that we are facing and this guidance will give you broad parameters on how we have built our plan. So for the company, as Terry pointed out, we expect revenue to decline 1% to 2%.

I'll begin with Financial Services. Our guidance of 1.5% to 2.0% revenue growth for Financial Services in 2009 is a blend of:

- High single-digit growth at Investment Services,
- With a slight decline at Credit Market Services. And as you know, Credit Market Services is approximately 66% of total Financial Services revenue.

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Our guidance is based on current foreign exchange rate projections which clearly influences growth as the strengthening dollar will negatively impact this growth in 2009. On a constant currency basis, revenue is projected to grow approximately 5% to 6% for the segment. Investment Services' revenue is primarily billed in U.S. dollars so foreign exchange largely impacts Credit Market Services' revenue.

Credit Market Services' revenue will benefit from growth of 1% to 2% in non-transaction revenue which is recurring in nature, such as relationship fees, surveillance fees and subscriptions, as Terry discussed. Modest price increases will help as well. The reason we are able to forecast growth in 2009 is because certain non-recurring items that showed significant declines in 2008, such as bank loan ratings, should not hamper us in 2009.

We expect a 10% to 12% decline in transaction revenue. This is based on better comparables and some recovery in the latter part of the year following a 55% decline in 2008. While transaction revenue was particularly depressed in the fourth quarter, the month of December, as I previously indicated, showed improvement. While our projections do not anticipate any meaningful uptick in new issue volume, particularly in non-investment grade issuance, we do expect that December will be a better proxy for 2009, with some potential market pick up in the second half. This should help transaction revenue.

While Investment Services' fourth quarter revenue grew 7% year-over-year, as I mentioned earlier, it did decline sequentially compared to the third quarter. Our customer base is facing challenges, and growth in index services in the quarter was hampered by significant market declines. However, ETF asset inflows continue to grow strongly, which leaves us well positioned when the market rebounds. As a result, we expect high single-digit revenue growth in 2009 for Investment Services based on:

- Continued growth for indices,
- Sales of new products and services—particularly Capital IQ, and
- Benefits from modest price increases.

As Terry indicated, we are projecting a 250 to 300 basis point margin decline at Financial Services in 2009. This guidance implies that expenses will increase approximately 6% for an operating margin in the range of 37.7% to 38.2%

On a constant currency basis, we expect expenses to increase approximately 10% reflecting:

- The full year impact of 2008 hires, particularly at Investment Services—most of whom were added overseas, as I pointed out earlier,
- Continued investments in our fast-growing businesses, though at a reduced pace, as well as
- Increased stock-based compensation.

Partially offsetting these are the benefits of our restructuring actions. I will provide more detail on the impact of incentive compensation later.

One final comment on margins. While we are projecting margin contraction at Financial Services for the full year, we do expect margins to improve from the 35.5% margin in the fourth quarter of 2008, which excludes restructuring charges. The fourth quarter's margins were depressed since it was the lowest revenue-producing quarter of the year. This is primarily driven by the fact that fourth quarter revenues, particularly transaction revenue, were depressed in light of the low debt issuance, particularly in October and November. As a result, they had a more pronounced impact given the high fixed costs of this business.

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I'll now turn to McGraw-Hill Education. Terry covered most of the revenue issues, but there are a couple of items I'd like to address.

For our Higher Education, Professional and International Group, the U.S. college market is expected to grow 3% to 4%. And we expect to grow in line with the market. However, growth in the overall HPI Group will be negatively impacted by a very challenging professional market and the impact of the stronger dollar on overseas sales.

And to underscore Terry's point about the weakening state new adoption market in 2009, I'll point out that California makes up approximately one third of the total new adoption market. And this naturally bears watching.

We expect a 300 to 400 basis point decline in the segment's margin for 2009. This implies a 9% to 10% margin. Expenses are expected to be roughly flat despite plant amortization increasing \$15 million and increased investments at Higher Education with its greater emphasis on digital products. The segment will benefit from:

- Restructuring actions taken in 2008,
- The completion of the data center moves, and
- Lower marketing costs due to reduced opportunities in the adoption markets.

For Information & Media, we expect revenue to decline in the low single digits. We expect continued growth for energy information from Platts, however, this growth will not be enough to offset:

- The loss of political advertising in a non-political year,
- An extremely challenging advertising environment, and
- Turmoil in the automotive market.

Additionally, our results for the year will be adversely impacted by a non-cash accounting change at J.D. Power relating to the introduction of Compass, a more robust reporting and analytical tool for our clients. Revenue previously recognized at the point of syndicated studies' release will now be recognized ratably over the 12 month life of the subscription. This is similar to the Sweets transition that we had talked about back in 2006. For 2009, this will result in a \$15 million revenue decline and \$10 million decline in profits. This migration will also impact 2010 and 2011, but to a lesser degree.

Our guidance for Information & Media's margin is a 200 to 300 basis point decline. This essentially implies a 7.5% to 8.5% margin with expense growth flat, largely due to restructuring actions taken in 2008.

Now for the impact of incentive compensation. As Terry discussed in his remarks, incentive compensation was reduced by approximately \$274 million in 2008. There will be some incentives reinstated in 2009, but in the amount of approximately \$110 million across all segments and corporate. Corporate expenses in 2009 will increase \$25 to \$30 million, and this largely reflects increased stock-based and short-term incentive compensation.

The data center construction was largely completed and virtually all of the applications, systems, and equipment migrations were finished in 2008. A little bit carried over into January. The migration costs totaled \$31 million, and were \$10 million for the fourth quarter. McGraw-Hill Education represented about half of the migration effort in order to support their full range of digital offerings for the elementary, high school, college, and professional markets. The migration effort, in fact, was completed during this past weekend, and these costs are minimal in 2009.



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Regarding the company's effective tax rate, we expect a lower effective tax rate for 2009. It will be approximately 37%, which is lower than the 37.5% rate for 2008. Two changes in our business are influencing this decline. The continued higher growth in our international operations has a favorable impact on the rate. Also, we recently formed Standard & Poor's Financial Services LLC, a Delaware limited liability company. In addition to operational benefits, we expect this new structure to be more tax efficient.

Let's now review free cash flow. We continued to generate sizable free cash flow in 2008 despite a challenging environment. As you can see from the table, Cash Provided by Operations, per U.S. GAAP, was \$1.2 billion for 2008. We then subtract the following items:

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

The result is free cash flow that is available to the company for share repurchases, acquisitions, and to pay down debt. Free cash flow for 2008 was \$455 million. The strengthening dollar reduced the value of our overseas cash balances by approximately \$50 million and this change is reflected in our free cash flow.

Based on our operating guidance for 2009, we anticipate free cash flow in the range of \$430 to \$450 million. Despite our projection for lower operating results, this level of free cash flow is comparable to 2008 and is the result of easier working capital comparisons as well as reduced investments that I'll discuss in just a moment.

An item that we have not factored into the free cash flow guidance is the potential for any pension plan contributions. The U.S. plan is now in an underfunded position following last year's significant market declines. We continue to follow the guidance we are receiving from the government agencies regarding contribution formula changes. Based on what we are now seeing, we may have no funding requirement in 2009, or if one is required, it could be in the range of \$30 million to \$50 million. And if it is required, it would be payable in the second half of the year.

Now, let me recap the Corporation's strong financial position. On a gross basis, total debt at year end was \$1.27 billion. It is comprised of \$1.2 billion in unsecured senior notes that we issued in 2007, as well as \$70 million in commercial paper. This is offset by \$472 million in cash. We did repatriate cash from overseas in the fourth quarter; however our cash balance still consists largely of foreign cash, plus some cash held in the U.S. for operational purposes.

Our net debt at the end of December was \$796 million, down from \$801 million last year—virtually flat. We do plan to access the commercial paper market in early 2009, as we do each year, due to the seasonal nature of our education businesses.

As I mentioned at the start of my remarks, we did repurchase 10.9 million shares in 2008 for a cost of \$447.2 million at an average price of \$41.03 per share. 17.1 million shares remain in the 2007 program authorized by the Board of Directors. Given our desire to maintain debt levels comparable to year end 2007, we did not make any additional share repurchases in the fourth quarter.

Our diluted weighted average shares outstanding was 312.8 million in the fourth quarter, a 17.9 million share decline versus the same period last year and a 4.4 million share decline from the third quarter of 2008. The sequential decline was minimal since we did not repurchase shares in the fourth quarter. Year-end

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WASO, or weighted-average shares outstanding, was 318.7 million shares, a 26.1 million share year-over-year decline. The figure for fully-diluted shares at the end of the year was 315 million.

Interest expense was \$15.4 million in the fourth quarter, compared to \$12 million in the same period last year. For the full year, interest expense was \$75.6 million, compared to \$40.6 million in 2007. And we expect 2009 to be roughly comparable to 2008.

We are also focusing on our investments, and our capital expenditures will decline in 2009. Prepublication investments for 2009 are expected to be \$225 million versus \$254 million in 2008. This lower spend level is due to reduced revenue opportunities in 2009, as well as prudent investments and continued offshoring benefits. Purchases of property and equipment for 2009 are projected at approximately \$90 million versus \$106 million in 2008. This \$16 million decline is largely due to reduced technology spending.

Let's now look at some non-cash items.

- For 2009, we expect amortization of prepublication costs to be \$285 million versus \$270 million in 2008. This increase reflects the higher level of investment made in 2007 and 2008.
- We expect depreciation to grow to \$130 million in 2009 versus \$120 million in 2008.
- Amortization of intangibles was \$17.5 million for the fourth quarter of 2008 due to the acceleration of the amortization of certain acquired intangibles. This brought the total for 2008 to \$58.5 million. For 2009 we expect it to be approximately \$55 million.

I'll end with a recap of growth in unearned revenue. Unearned revenue ended 2008 at \$1.1 billion, which is up 1.3% from the prior year. At constant foreign currency exchange rates, it grew 3.8%.

Financial Services makes up 74% of the corporation's total unearned revenue. Financial Services' unearned revenue grew 2.7% driven by strong growth for subscription products, including Ratings Direct. At constant foreign currency exchange rates, Financial Services' unearned revenue increased 6.1%.

For 2009 we expect low single-digit growth in unearned revenue.

Thank you, and now back to Terry.

**To access the accompanying slides online, go to:**

<http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=2069807>

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

This presentation includes certain forward-looking statements about the Company's businesses and our prospects, new products, sales, expenses, tax rates, cash flows, prepublication investments 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 2009 adoptions and in open territories and enrollment and demographic trends; the level of educational funding; the strength of School Education including the testing market, Higher Education, Professional and International publishing markets and the impact of technology on them; the level of interest rates and the strength of the economy, 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 and commercial mortgage and asset-backed securities and related asset classes; the continued difficulties



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in the credit markets and their impact on Standard & Poor's and the economy in general; 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 strength and the performance of the domestic and international automotive 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, manufacturing expenses, distribution expenses, prepublication, amortization and depreciation expense, income tax rates, capital, technology, restructuring charges and other expenditures and prepublication cost investment.

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