

**The McGraw-Hill Companies
3rd Quarter 2009 Earnings Conference Call**

Prepared Remarks
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Donald Rubin

Senior Vice President, Investor Relations
The McGraw-Hill Companies

Thank you and good morning to our worldwide audience and thank everyone for joining us this morning at The McGraw-Hill Companies' third 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 third 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.

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Harold McGraw III

Chairman, President and CEO
The McGraw-Hill Companies

Good morning and welcome to our review of third quarter earnings and the outlook for the remainder of the year. With me today is Bob Bahash, executive vice president and chief financial officer.

We will start today by reviewing operating results. Bob will then provide an in-depth look at some of our key financials. After our presentations we will be pleased to answer any questions you may have about The McGraw-Hill Companies.

Let's get started. Earlier today, we reported third quarter results:

- Earnings per diluted share were \$1.07
- Revenue in the third quarter decreased by 8.4%.
- We also raised guidance for the year: We now expect to achieve the top end of our \$2.20 to \$2.25 earnings per share guidance. At the end of the second quarter, we had anticipated coming in at the low end of that range. The new earnings per share guidance excludes second quarter restructuring charge of \$0.03, a \$0.03 loss on the divestiture of Vista Research in May, and a projected \$0.02 gain on the sale of *BusinessWeek*, which will close in the fourth quarter.

As I have said before, in this environment management is reviewing the entire portfolio. That obviously included evaluating strategic options for *BusinessWeek*. *BusinessWeek* in its 80 years with The McGraw-Hill Companies has made significant contributions to this company, but we must focus our resources on areas with the greatest opportunities for growth. That means building size and scale globally in essential markets and expanding our digital capabilities.

In reaching an agreement with Bloomberg, we believe *BusinessWeek* will continue to operate in an organization that shares the same high standards for editorial independence, integrity, and excellence that are the hallmarks of this publication.

In looking ahead, we are encouraged by recent reports that suggest an improving economic picture, although the recovery is still expected to be sluggish. Our economists forecast GDP growth of 1.8% next year after a decline of 2.7% in 2009 and that shows growth GDP growth in the third and the fourth quarter. Stimulus spending is helping the economy, but it appears that funds are being spent more slowly than expected. That certainly seems to be the case this year in education. But we are also seeing some positive indications that Federal Reserve and Treasury programs are contributing to improvement in credit markets.

Financial Services

So let's start our review of operations by examining the outlook for the Financial Services segment.

Our expectations for a pick up in the second half this year at Financial Services started to take shape in the third quarter. Improving market conditions, tighter spreads, and a surge in global debt issuance are evident in our results.

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For the first time in two years, year-over-year quarterly revenue increased at Standard & Poor's Credit Market Services. The modest increase—0.7%—reflects a 6.5% gain in transaction revenue despite continuing softness in the structured finance market.

Revenue at S&P Investment Services, which accounts for about one-third of the segment's top line, declined by 7.6%.

For the Financial Services segment in the third quarter:

- Revenue declined by 2.2%,
- Operating profit decreased by 10.1%, and
- The operating margin was 40.2%.

The results again underscore the position S&P Credit Market Services has established in global markets. With total new issuance in the third quarter growing faster in Europe (up 39.2%) than in the U.S. (up 31.4%), international revenue increased 3.3% in the third quarter, or \$6.7 million, despite a \$7.7 million hit by foreign exchange. Foreign source revenue accounted for 49.1% of S&P Credit Market Services revenue in the third quarter.

Growth in U.S. and European corporate industrial debt issuance was a key factor in these results. In the U.S., new issue dollar volume of industrials increased by 98.9% in the third quarter. In Europe, the growth was 120.1% for this same period.

S&P Credit Market Services also benefited from a 491.3% increase in high-yield issuance off a low base in the U.S. in the third quarter. Speculative-grade issuance was up 226.2% in Europe.

In debt markets, the spread, or excess interest rate over Treasury bonds, is a key gating factor for issuance. As this table shows, spreads for investment- and speculative-grade bonds have narrowed significantly since the beginning of the year. The composite spread for investment-grade at the beginning of the year was 531 basis points. By last week, it was 226 basis points. The composite spread for speculative-grade bonds was 1,628 basis points last January. By last week, it was 693 basis points.

Spreads for investment-grade and high-yield issues are still above their five-year moving average and may remain elevated for some time as investors and the credit markets tread cautiously through the current economic environment.

But signs of progress are unmistakable. Improving credit market conditions enabled many companies to raise cash to fund operations or to refinance current or future maturing debt.

The third quarter global volume for high-yield bonds was the highest in more than a decade. Speculative-grade companies with lower credit ratings were able to raise billions of dollars as risk premiums fell dramatically from the record levels in late 2008.

An aversion to equity and structured finance risk has increased investor appetite for investment-grade industrial bonds. Combined with industrial companies' efforts to avoid refinancing risk over the next 18 months and the lack of new money from the bank market, new issuance has taken off. Investors have also become more comfortable buying lower rated investment-grade bonds; 54% of corporate issuance in this category has been low BBBs. That's up from 28% earlier in the year.

Financial institutions are continuing to deleverage balance sheets and shrink liabilities. As expected, those balance sheet constraints have reduced growth in corporate lending by the banks. But banks are becoming more comfortable in obtaining funds from each other. The key gauge of how banks assess the riskiness of lending to one another is the spread between LIBOR and the Fed's overnight rate. Recently, the spread between the three-month LIBOR and the Fed's overnight rate fell to 0.34%, which is near a pre-2007 level.

Federal actions have clearly helped the financial sector. As the slide shows, the federal programs are wide ranging.

In the midst of the decline this year in the structured finance market, the asset-backed securities market benefited from TALF, the Term Asset-Backed Securities Loan Facility. The program stimulated issuance in a wide array of ABS asset classes, including credit cards, auto loans, auto leases, and student loans. As volume picked up and spreads began to normalize, traditional real money investors have returned to the market and the use of TALF leverage has declined sharply.

The Fed continues to operate two short-term funding facilities to help stabilize the commercial paper market and the money markets which invest heavily in asset-backed commercial paper. The Fed has extended these programs to February 2010.

The U.S. Treasury is preparing to implement PPIP, the Public-Private Investment Partnership, which is designed to increase demand for existing legacy residential mortgage-backed securities as well as commercial mortgage-backed securities.

In the third quarter, the European Central Bank began to purchase euro-denominated covered bonds to stimulate the residential mortgage-backed securities market there.

In short, there are positive signs for S&P Credit Market Services as we head into the fourth quarter.

Clearly, comparisons will be the easiest of the year. In the fourth quarter of 2008, revenue fell 24.5%, the steepest decline of the year.

In the corporate market, a combination of tight spreads, a healthy refinancing calendar, low rates, and investor demand for yield should be a positive for new issuance.

In the municipal market, the third quarter is historically slow. But state and local governments should be active in the fourth quarter as the economic slow down increases the need for deficit borrowing. Federal stimulus plans, including the Build American Bonds, which initially got off to a very slow start, should be a positive in this market.

In the asset-backed securities market, we have seen the benefits of the TALF program. Spreads remain tight and the deal flow looks positive.

In the U.S. mortgage-backed securities market, activity will remain light, particularly for commercial mortgage-backed securities. In the U.S. residential mortgage-backed securities market, resecuritization of existing securities enhanced with additional credit support—the re-REMICs—are the main source of ratings activity.

But while the structured finance market continues to be challenged, the momentum in corporate issuance is expected to help produce a double-digit increase in transaction revenue at S&P Credit Market Services in the fourth quarter.

Given the slow start to the year, we expect transaction revenue for the full year to show a low single-digit decline.

Non-transaction revenue at S&P Credit Market Services slipped by 1.6%, or \$4.9 million, in the third quarter. A reduction in breakage fees and the impact of foreign exchange were the primary reasons for the decline. This remains a durable revenue stream and should finish the year with only a slight decline. Again, the primary reasons for the decline will be the reduction in breakage fees and foreign exchange.

Revenue declined at S&P Investment Services by 7.6% in the third quarter. That reflects the divestitures of Vista Research and CRISIL's Gas Strategies Group, the expiration of the Independent Research Settlement with the banks at the end of July, and some softness in index products and services. Excluding divestitures the decline would be 4.4%.

A mitigating factor is the continued growth of Capital IQ products and services. Despite bank consolidations, downsizings and closures on Wall Street, Capital IQ has increased its customer base this year by 7.5% to more than 2,800 customers.

A reduction in trading volume of over-the-counter and exchange-traded derivatives based on S&P indices is the major reason for the softness in index products and services. We are encouraged by the rebound in assets under management in exchange-traded funds based on S&P indices. As this chart illustrates, assets under management have increased sequentially since the first quarter and are now more than \$17 billion higher than the year-end 2008 closing figure.

We continue to be active in this market. Five new exchange-traded funds using S&P indices were launched in the third quarter. There are now 214 exchange-traded funds using S&P indices. That's up from 189 at the end of the third quarter in 2008. Many more are in the pipeline.

Following the expiration of contracts for independent equity research at the end of July, S&P signed contracts with Citibank and Morgan Stanley for continuation of stock coverage. New post-settlement business will be coming from Merrill Lynch, which recently signed a contract to integrate our stock reports into its research portals for their advisors and clients.

No review of Financial Services is complete these days without comments on the regulatory and legal outlook.

S&P Credit Market Services is complying with new regulations, new rules and new laws. In the U.S., new rules from the Securities and Exchange Commission became effective in April and in August. In September, the SEC approved additional rules requiring more disclosure of rating histories and information underlying structured finance transactions and approved amendments to eliminate references to NRSRO ratings in certain rules and forms. More new rules and proposals were issued in October. S&P will continue to work with the SEC on all these issues.

In Europe, the European Parliament and Council last April approved a regulation of rating agencies. Formal approval of the legislation is expected shortly. The effective date to be in compliance is expected by mid 2010.

In the next year, we also expect additional regulation of rating agencies to become effective in Japan and Australia.

All these changes could affect the performance of S&P Credit Market Services, but we don't believe they will have a material adverse effect on its financial condition or operations.

In the fall or early in 2010, we expect the U.S. Congress to pass legislation on the rating agencies as part of an omnibus financial reform bill. The drafting process is underway and the situation is still fluid.

We continue to review our concerns with decision makers in Washington and abroad. These include:

- Making sure we are looking at beginning-to-end solutions so that regulations cover all aspects of capital markets to ensure effective and efficient functioning
- Analytical independence. That is fundamental.
- Foster competition in the ratings industry by establishing a fair and level playing field, and
- International consistency because ratings are issued and used globally and contribute to the global flow of capital.

So, globally consistent regulation has to be a benchmark. We think our concerns are being heard, but we will continue working with policymakers, legislators and others to help restore investor confidence in ratings. In short, this is still a work in progress.

In previous discussions on legal proceedings, we have grouped the lawsuits into three general categories:

1. Lawsuits alleging S&P is an underwriter or seller of securities, which they are not.
2. Lawsuits alleging corporate statements on earnings and ratings were misleading—the so-called stock drop suits.
3. Lawsuits based on state law claims.

All these lawsuits are at relatively early stages of litigation.

In category one, several motions to dismiss are or will soon be fully briefed before courts. An oral argument was held in mid-August on our motion to dismiss the case Public Employees Retirement System of Mississippi versus Merrill Lynch & Co., et al.

In category two, motions to dismiss have been fully briefed in each of four cases. Two of these cases have had fully briefed motions to dismiss pending since May. We're just waiting for court time to be able to get judgments there.

In category three, we are waiting for decisions on two cases, Oddo Asset Management versus Barclays Bank PLC et al and Grassi versus Moody's Investor Services, et al. In two cases, our motions to dismiss have been fully briefed and argued before the court. We're waiting for judgment there.

The Abu Dhabi case is also in this category and we continue to see mangled reports in the media on the latest decision by Judge Scheindlin. As you may recall, the Judge on September 2 dismissed 10 of 11

claims and permitted only the claim of fraud to proceed into the next phase of the litigation. As I have pointed out in previous sessions, the Court is legally required to accept as true all of the facts alleged by the plaintiffs in the fraud charge. That's a critical but little noted point.

Judge Scheindlin had dismissed some of the ten other claims without prejudice. That allowed the plaintiffs to replead them. They did and on October 15, the Judge dismissed those reasserted claims with prejudice, which means the plaintiffs lost their opportunity to proceed with them. We think that's progress.

Overall, we continue to believe our legal risk is low.

There is so much noise in the system that I want to take a moment to make a fundamental point about some very important developments at Standard & Poor's Credit Market Services.

Next year, S&P celebrates its 150th anniversary. In its long history, S&P has achieved world-wide recognition for the value and quality of its credit ratings. To help the market analyze trillions of dollars of debt and millions of securities, S&P:

- Created a common basis for analyzing credit risk,
- Developed a common vocabulary for describing credit risk, and
- Provided a simple, one-dimensional scale for measuring credit risk.

It is a remarkable achievement that enables S&P to play an important and productive role in the capital formation process in global financial markets. But we can't rest on that achievement in today's environment.

To meet new market needs, to maintain a leadership position, and to grow the business, S&P must find new ways to increase the value of its credit ratings for investors. That is one of the greatest lessons of this credit crisis and it is one that S&P has learned well. As investors seek more tools and analytics to assess risk more effectively, S&P is responding.

In the last 18 months, S&P has taken important steps to:

- Improve ratings stability,
- Add value to ratings through more analysis and features,
- Increase comparability of ratings,
- Increase the transparency of its processes,
- Add more checks and balances to the ratings process, and
- Continue to educate the market about ratings and the ratings scale.

In applying the lessons of the past to improve ratings for the future, S&P starts with criteria—the framework S&P uses to rate debt. By providing additional detail regarding rating definitions and then reassessing criteria in structured finance we have improved the transparency of ratings' definitions and criteria.

S&P has been making important qualitative and quantitative revisions in its ratings criteria for collateralized debt obligations, or CDOs, U.S. residential mortgage-backed securities and U.S. commercial mortgage-backed securities.

Strong analytics underlying our rating definitions and our rating criteria are key to enhancing the comparability of ratings across sectors. Since ratings provide a common vocabulary to describe credit risk, we pursue comparability. When ratings are more comparable, an investor can better assess credit risk across different types of bonds.

Our goal is to make our benchmarks more consistent and more comparable across all asset classes, geography, and time. In our view, a rating symbol over time should aim to represent approximately the same general degree of credit worthiness whether it was for a municipal security or a corporate bond.

Credit stability is another important factor in adding value to our ratings. We want to account for the fact that some issuers may be prone to gradual decay in credit quality before they default while others may be more vulnerable to sudden deterioration. So last year, S&P went beyond its primary consideration of default risk to introduce explicit stability measures in its ratings criteria. With the additional stability factor, we evaluate two securities with similar default risks, but will provide a lower rating if we believe one is more prone to sharp deterioration in periods of economic stress. S&P also considers other factors in its ratings such as payment priority of an obligation following default and potential payment after default.

To increase transparency, S&P now regularly provides more information about:

- The assumption in its models,
- The use of “what if” scenarios, and
- Stress tests. S&P has published specific economic scenarios for each rating category that illustrate the level of stress an instrument might withstand without defaulting.

S&P has expanded and enhanced its compliance efforts, which are now headed by a chief compliance officer and a team of independent compliance professionals, who oversee compliance with regulatory requirements, as well as S&P policies, including policies related to managing potential conflicts of interest.

A Risk Assessment Oversight Committee has been established. It assesses risk that could impact the ratings process and operates independently of the ratings business.

We also have separated the quality and criteria functions from the ratings groups.

- S&P’s quality function consists of a group of experienced professionals, headed by the Chief Quality Officer. They oversee the quality of S&P’s processes and the consistent application of S&P’s criteria.
- The independent criteria group, headed by S&P’s Chief Criteria Officer, performs a number of key functions, including leading S&P’s efforts to develop timely, relevant, credible, transparent and analytical criteria and overseeing periodic reviews of existing criteria in light of potentially shifting credit risks.

And finally, we continue to educate market participants about ratings, what ratings represent, and how to use them. That undertaking includes a comprehensive report in June on understanding S&P’s ratings definitions and other publications, including a “*Guide to Credit Rating Essentials*” which explains what credit ratings are and how they are useful to capital markets.

That brings me full circle. After nearly 150 years, S&P is still a learning institution determined to find new ways to service capital markets more effectively. Strengthening analytics, increasing transparency,

and reinforcing the integrity of the ratings process are important steps that will enable S&P to enhance the value to investors of its global benchmarks for credit risk.

Let's sum up for Financial Services for 2009:

- A slight decline in revenue
- An operating margin decline of 175 to 200 basis points versus earlier guidance of a 225 to 275 basis point decline, excluding 2008 and 2009 restructuring charges and the loss on Vista Research. The new guidance implies an operating margin of 39.5%.

McGraw-Hill Education

Now, let's review McGraw-Hill Education.

All year, education has been a tale of two markets and the trend continued into the seasonally important third quarter. Our third quarter results reflect both the:

- Counter-cyclical growth in the U.S. college and university market that has been fueled by a surge in enrollments, and
- A declining elementary-high school market that's grappling with budget pressures and so far has realized only a modest benefit from federal stimulus funding.

In the third quarter for McGraw-Hill Education:

- Revenue declined 11.6%,
- Operating profit decreased 15.9%,
- The operating margin was 29.8%,
- Revenue for McGraw-Hill School Education Group was off 19.6%, and
- Revenue for McGraw-Hill Higher Education, Professional and International Group declined by 1.8%.

Reduced potential and postponed spending are key factors in the el-hi market this year. In challenging circumstances, we still expect to win more than 30% of the total available dollars this year in the state new adoption market—a capture rate that will probably match our performance last year.

But in 2008 the total available dollars in the state new adoption market were an estimated \$980 million. In 2009, the opportunity now appears to be only \$500 million to \$510 million, which is down from our original forecast for the year of \$550 million to \$600 million.

As the bar chart illustrates, the el-hi market has declined all year. Only in the month of August did industry sales come close to matching last year's results.

Sales for the industry declined only 0.7% in August versus the same month last year, but year-to-date after eight months, the market was down by 21.4%, according to the Association of American Publishers.

We now expect the el-hi market to decline by 20% to 25% this year, down from the 15% to 20% decline originally projected.

District-level postponements in reaction to state and local budget pressures were clearly evident in such adoption states as California, Florida, Kentucky, Oregon, and Georgia. Postponements are somewhat

harder to track in the open territory, but it is clear that they also had a negative impact on third quarter purchasing in those states. Sales in the non-adoption states declined by 12.7% through August year-to-date, according to the AAP statistics.

Postponements severely reduced purchasing in California, which originally offered this year's biggest industry sales potential. School districts there normally have two years in which to buy new state-approved programs in core subjects, and 2009 was the first year of the K–8 reading adoption and the second year of the K–8 math adoption. As the first two quarters progressed, it became apparent that purchasing levels would fall short of historical levels. But the number of deferrals increased sharply in July following the passage of an austerity budget by the state legislature, which also gave districts the flexibility to use their allocations from the \$334 million state instructional materials fund for other purposes. The legislature also suspended the requirement that districts buy new K–8 core curriculum programs within two years after their approval by the state.

The result was a statewide first-year reading implementation rate of about 10% as compared to the 40% rate we had estimated in January, and the 60% to 70% rate that is more typical of California in better economic times. The deterioration in California is the primary reason for the reduction in our estimate for the total available dollars in this year's state new adoption market.

Heavy postponements also suggest future demand, so let's look at the situation more closely.

In California, the last reading adoption took place in 2002 when our *Open Court* program was only one of two state-approved K–5 programs. It proved to be very effective in improving student performance across a wide variety of districts, and many loyal customers are looking forward—as funding allows—to implementing the new edition, called *Imagine It!*

But California approved a broader K–5 list for the 2009 adoption, and we are also competing there with a state-specific edition of *Treasures*, the program that was so successful in Florida last year. Each of our programs offers a full range of classroom resources, including Spanish and ESL ancillaries and sophisticated digital assessment tools.

With a new school year under way, greater clarity on the retention of teaching positions, and some cushioning from the distribution of federal stimulus funds, a number of California districts are now considering using their state text book funding for its intended purpose. Furthermore, districts eligible for incremental Title I stimulus funds can use them for new reading purchases.

And here is a real paradox. Just as uncertainty drove 2009 postponements, fear of mid-year deficits that may lead to additional cuts in education funding could drive purchasing in the first half of 2010. That possibility is a reason why our field personnel are seeing new adoption activity late in the season, particularly in school districts with No Child Left Behind performance issues.

In Florida, we don't see much opportunity for late ordering in the 6–12 literature market, although we may see some middle school activity for reading intervention materials. Many educators feel that content of literature texts doesn't change that much and they can get along with their older books supplemented, if necessary, with paperbacks and library books.

The second year outlook for K–12 music is better. This non-core subject can be implemented during a school year and can be phased in a few grades at a time, making it a flexible purchase for districts.

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In Kentucky, the outlook for 2010 is promising for K–12 math because first-year postponements were pushed by the State Department of Education due to funding concerns and the delayed release of new standards. McGraw-Hill School Education still did brisk business in Kentucky in 2009 and should do well again next year.

Oregon is another state with many first year postponements in math. McGraw-Hill School Education captured a solid share of available business in Oregon in 2009 and anticipates doing well in 2010 and 2011.

In short, pent-up demand is certainly very real in some places, but the extent to which it can drive revenue may depend on improving economic conditions. Of course, the decision to continue using older programs could also result in increased replacement sales as existing copies become tattered and as enrollments continue to grow.

With Texas back on the adoption calendar in 2010 and Florida preparing to buy K–12 math, we still expect the state new adoption market to top \$950 million next year, but probably won't reach the \$1 billion mark.

We expect to have a solid lineup of products and services to compete for the state new adoption dollars in 2010. In Texas, all grades of our 6–12 literature program were recommended for the state's conforming list and reviews of our *Imagine It!* and *Treasures* K–5 reading programs continue to do well. Florida has not made its state-approved list official yet, but our math programs are being well received in districts that are already reviewing programs for next year's adoption.

With states still struggling with budget deficits, the \$100 billion for education from the American Recovery and Reinvestment Act of 2009 will be an important factor in 2010. Funds have been moving slowly into the pipeline. Following the money down to the district level is not easy.

Most of the stimulus dollars that reached the market by the third quarter appeared to have come from IDEA special education distributions. Title I funds reached the market more slowly, but could stimulate some fourth quarter purchasing with more activity next spring for implementation in the Fall of 2010.

The other main program is the \$39.5 billion dollar State Fiscal Stabilization Fund, which is intended to help states fill deficits created in their education budgets. Some states have already received their grants, and all distributions are expected to be made by the end of the year. Much of this funding has been earmarked for staff retention and professional development, but some districts have indicated that they will use part of their allocations to buy instructional materials. The greatest impact on the el-hi market will probably occur in 2010.

There also are several programs still being finalized by the U.S. Department of Education that could offer new opportunities for providers of el-hi instructional materials or assessments beginning in 2010, but with even greater impact in the out years. These include the "Race to the Top" fund, which will offer \$4.3 billion in competitive grants to encourage state-level initiatives and "Investing in Innovation," which will offer \$650 million in competitive grants to local districts and non-profit educational groups.

Finally, and perhaps more significantly for 2010, Congress is working on the Fiscal Year 2010 budget for the U.S. Department of Education. As proposed by the administration in May, the budget would provide an increase of \$1.3 billion, or 2.8%, over the current fiscal year, a figure that does not include

American Recovery and Reinvestment Act stimulus appropriations. The new budget includes important new programs that represent renewed federal support for reading, which had been sharply curtailed in recent years by Congress because of perceived problems with the Reading First program.

Federal stimulus dollars have also contributed to the growth in enrollments this fall in U.S. colleges and universities. The effect was more indirect because it has taken the form of higher Pell Grants scholarships and a higher tax credit that allows students or their families to deduct up to \$2,500 a year for tuition and other college-related costs, including course materials. And there is separate legislation known as the Post 9/11 GI Bill that helps veterans pay for tuition, housing, and course materials while they are enrolled in college. By the end of September, more than 24,000 veterans had been approved for stipends under this new bill. For many students, the support afforded by these programs undoubtedly made a difference between enrolling or not enrolling or between attending full-time or part-time.

In difficult economic times, the higher education market has tended to be counter-cyclical as people return to school to gain new skills or remain in school because of limited employment opportunities. The confluence of federal stimulus funds and the counter-cyclical trend have resulted in enrollment numbers that are easily outstripping earlier government estimates, particularly at community colleges and career schools. Although no official, fully aggregated statistics are available, it does appear that there could be close to a 10% increase in overall post secondary enrollments this fall.

Surging enrollments clearly helped strengthen the market for higher education products, which is up 11.0% through August, according to AAP reports. McGraw-Hill Higher Education experienced growth in the third quarter in all four major imprints.

With our digital products growing at a double-digit rate, it is also evident that the imaginative use of technology is expanding our opportunities in higher education.

As this diagram illustrates, digital products like *McGraw-Hill Connect*TM create new ways to connect with students beyond the traditional text book. For years, publishers have focused their sales efforts almost exclusively on instructors because they select the texts for the courses. They still do, and their decisions are still critical to success in higher education publishing, but the new digital products have broadened the college market by offering optional resources for purchase by students.

By focusing on the students' workflow, we are providing critical course-related content that can help them master the material they need to earn good grades. It's an online market and we have been gaining traction quickly.

In international markets, strong demand for higher education products was offset by softness in school and professional sales and unfavorable foreign exchange rates.

In domestic professional markets, digital subscription products in science, medicine and technology continue to be a bright spot in a challenging retail environment as booksellers reduce inventory and limit new orders.

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So let's sum up for McGraw-Hill Education:

- Because of the decline in the elementary-high school market, we are reducing our revenue guidance for McGraw-Hill Education. We now expect a decline of 10% to 11%. Our earlier forecast called for 8.5% to 9.5% decline this year.
- But with tight cost controls, we now expect a margin decline of 300 to 350 basis points, excluding 2008 and 2009 restructuring charges. The previous estimate called for a 300 basis point to 400 basis point decline.

Information & Media

Now, let's shift to Information & Media.

In the third quarter for this segment:

- Revenue declined by 10.1%.
- Operating profit increased 29.3%, reflecting a pre-tax restructuring charge in the third quarter last year that reduced operating profit by \$13.9 million.
- The operating margin was 12.4%.

In a non-election year, revenue at our Broadcasting Group declined by 23.6% in the third quarter.

Decreases in advertising, declines in the automotive industry and softness in the construction market were all factors in the 8.7% revenue decline in our Business-to-Business Group. Ad pages in *BusinessWeek's* global edition declined 29.3% in the third quarter.

The stand out performer continues to be Platts in global energy markets. Oil prices are approximately half of what they were a year ago. Such volatility in crude oil prices and other commodities continue to create demand for our data and information services.

That strength in data and information products for business-to-business markets will be a key to our future development.

Let's sum up the outlook for Information & Media in 2009:

- Revenue will decline 9% to 10% versus our previous guidance of 8% to 9%.
- Operating margin will decline 200 to 250 basis points versus our previous guidance of a 300 to 400 basis point decline, excluding 2008 and 2009 restructuring charges.

That completes our review of operations. Let's sum up the outlook for the Corporation in 2009:

- We now expect revenue to decline approximately 7% this year because of continued weakness in school education and advertising. We had previously forecasted a decline of 5.5% to 6.5%.
- With stringent cost controls, we now expect to achieve the top end of our \$2.20 to \$2.25 diluted earnings per share guidance for 2009. Previously, we had guided to the low end of that range.
- The new guidance excludes a second quarter restructuring charge of \$0.03, a \$0.03 loss on the divestiture of Vista Research and a projected \$0.02 gain on the sale of *BusinessWeek* in the fourth quarter.

That concludes my remarks. Let's hear now from Bob Bahash.

Robert J. Bahash

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

Thank you Terry.

This morning, I would like to review key factors affecting our third quarter results, and our full year guidance and what it implies for the fourth quarter.

I will focus on:

- The decrease in consolidated costs and expenses, which were down 5.4% in the third quarter, or 3.8% excluding last year's restructuring charge. This decrease occurred despite the impact of incentive compensation, which increased by \$68.3 million in the third quarter,
- The influence of foreign exchange on our results,
- The pending *BusinessWeek* divestiture, and
- The improved outlook for free cash flow in 2009.

Let's start with a look at our costs and expenses and the impact on each segment's performance.

For McGraw-Hill Education, expenses declined 9.0% in the third quarter excluding the 2008 restructuring charge, and were down 8.2% at constant currencies. Higher incentive compensation was more than offset by stringent expense controls, savings from previous restructuring actions, lower sales and marketing costs, and lower cost of goods sold due to the reduction in revenue.

For the full year, we now expect a high single-digit decline in expenses versus our previous guidance of a mid single-digit decline in expenses, excluding the 2008 and 2009 restructuring charges.

For Financial Services, expenses increased 5.1% excluding the 2008 restructuring charge, and were up 7.0% at constant currencies. Excluding the impact of increased incentive compensation—which was most significant in this segment—expenses for the segment would have declined slightly due to continued tight cost controls and restructuring savings, as well as benefits from the divestitures of Vista Research and CRISIL's Gas Strategies Group.

For the year, as Terry indicated, we now expect margins for the segment to decline 175 to 200 basis points, which implies roughly flat expenses year-over-year versus our previous guidance of a slight increase, excluding restructuring charges in both years and the loss on the divestiture of Vista Research in 2Q 2009.

Year-to-date, margins are down 240 basis points, but 4Q 2008 had the lowest margins of the year because the fourth quarter revenue was depressed by low debt issuance. That had a pronounced impact on margins given the high fixed costs of this business. With an expected double-digit increase in transaction revenue, fourth quarter margin should improve although the increase will be mitigated by increased incentive compensation.

For Information & Media, expenses decreased 8.6% excluding restructuring charges in 2008. Restructuring savings and lower cost of goods sold due to the reduction in revenue were key drivers, partially offset by increased incentive compensation. Our new margin guidance implies a high single-

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digit decline in expenses versus our previous guidance of a mid single-digit decrease, excluding restructuring charges in both years and the gain on the divestiture of *BusinessWeek* in the 4th quarter.

As we have indicated on previous calls, Information & Media's results have been affected 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 that we mentioned to you back in 2006.

For the full year, we continue to expect a \$12 million decrease in revenue and a \$7 million decrease in profit due to the impact of Compass. For the third quarter, the Compass conversion resulted in a \$5.4 million decrease in revenue and a \$2.6 million decrease in profit. The fourth quarter impact is expected to be minimal.

Corporate expenses in the third quarter were \$27.9 million, an \$18.2 million increase from the same period last year largely due to higher stock-based and short-term incentive compensation. We now expect full year corporate expense to increase by \$20 million to \$25 million, excluding the 2008 restructuring charge, and that's down from our previous estimate of a \$25 million to \$30 million increase. This implies 4Q corporate expense of \$36 million to \$41 million. Growth is largely due to increased incentive compensation.

Clearly, changes in incentive compensation were an important factor in our results. Significant reductions in both long-term and short-term incentive compensation accruals taken in the third quarter of last year made expense comparisons extremely challenging. In total, incentive compensation increased by \$68.3 million during the third quarter of this year, including a \$34.7 million increase to stock-based compensation.

The impact of the \$68.3 million increase in incentive compensation by segment is as follows:

- McGraw-Hill Education: \$13.0 million
- Financial Services: \$32.1 million
- Information & Media: \$5.7 million, and
- Corporate: \$17.5 million

On our second quarter earnings call, I indicated that incentive compensation would increase by about \$90 million in 2009. We now believe that the full-year increase will be closer to \$75 million due primarily to reductions in stock-based compensation accruals as well as reductions in short-term accruals at McGraw-Hill Education.

Year-to-date, incentive compensation increased approximately \$40 million, comprised of the \$68 million increase in 3Q, partially offset by the \$29 million decrease in the first half of the year. We expect increased incentive compensation of approximately \$35 million in 4Q because the fourth quarter of 2008 also benefited from reduced incentive compensation accruals, though to a lesser extent than 3Q 2008.

Foreign exchange also continues to influence our operating results. The dramatic strengthening of the U.S. dollar in the second half of 2008 reduced year-over-year growth in revenue by \$74.6 million and expenses by \$82 million in the first half of this year. This impact lessened in the third quarter, as changes in currency reduced revenue growth by \$21.6 million and expense growth by \$15.3 million. As

a result, operating profit growth was reduced by \$6.3 million. If current foreign exchange rates hold, the situation will change in 4Q. Revenue comparisons in 4Q will benefit from foreign exchange, but expense comparisons will be negatively impacted.

And now I'd like to update you on the pending divestiture of *BusinessWeek*. On October 13th, we signed an agreement to sell *BusinessWeek* to Bloomberg. We will receive \$5 million in cash, and Bloomberg will assume certain liabilities, including our unfulfilled subscription liabilities. The transaction is expected to close in the fourth quarter of this year. We will recognize a \$9.3 million pre-tax (\$5.9 million post-tax) gain, or approximately \$0.02 per diluted share. Given the timing of the transaction, we expect minimal financial impact in 2009.

In 2010, the divestiture will reduce year-over-year revenue growth by approximately \$100 million. We expect to realize savings next year of approximately \$20 million to \$25 million pre-tax, or \$0.04 to \$0.05 cents per diluted share. This is net of the portion of allocated expenses, such as shared services and rent that will no longer be absorbed. Savings will vary depending on the length of transition services with Bloomberg and the ability to consolidate or sub-lease space.

The divestiture will reduce our dependence on advertising revenue. Following the divestiture of *BusinessWeek*, advertising will represent about 2% of pro forma total revenue, versus approximately 4% previously.

Let's now review the improved outlook for free cash flow. To calculate free cash flow, we start with after-tax cash from operations and deduct investments and dividends. What's left is free cash flow—funds we can use to repurchase stock, make acquisitions, or pay down debt.

As expected, we made a pension contribution during the third quarter, in the amount of \$20.5 million. Despite the pension contribution and lower operating results relative to prior year, our year-to-date free cash flow is ahead of last year by \$323 million. As discussed in our calls earlier this year, this increase is driven mainly by the significant reduction in incentive compensation payments, prudent investments, continuing focus on working capital improvements, and cost containment initiatives.

We continue to expect the fourth quarter to be negatively impacted by lower anticipated receipts. However, given our strong cash flow performance to date, we are raising our guidance. We now expect free cash flow for the year to be in excess of \$500 million, up from our previous guidance of \$430 million to \$450 million.

Clearly the Corporation's financial position remains strong. Net debt decreased to \$240.5 million, down \$490.7 million versus the second quarter and \$555.5 million versus year-end reflecting the strong free cash flow generation in 3Q, which is generally our strongest cash flow quarter.

On a gross basis, total debt at the end of the quarter was \$1.2 billion and is comprised of long-term unsecured senior notes. This is offset by \$957.3 million in cash. There was no commercial paper outstanding at the end of the third quarter.

Interest expense was \$17.8 million in the third quarter, a \$4.2 million decline from prior year. The decline was largely driven by a reduction in interest accruals related to uncertain income tax positions. For the full year, we still expect interest expense to be roughly comparable to 2008.

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The company's effective tax rate was 36.4% in the third quarter versus 37.1% in the same period prior year. We still expect the full year 2009 tax rate to be 36.4%.

Our diluted weighted average shares outstanding were 313.6 million in the third quarter, a 3.6 million share decline versus the same period last year, and roughly flat compared to the second quarter of 2009. The year-over-year decrease is primarily due to 2008 share repurchases and the decline in our stock price. Fully-diluted shares at the end of the quarter were approximately 314 million.

In today's challenging environment, we are continuing to manage investments prudently without negatively impacting the enterprise. Prepublication investments were \$44.7 million in the third quarter, a decrease of \$20.6 million compared to the third quarter of 2008. For 2009, we still expect prepublication investments of approximately \$200 million.

Purchases of property and equipment were \$15.7 million in the third quarter compared to \$17.7 million in the same period last year. We expect an uptick in CapEx in 4Q primarily related to technology spending and international expansion and continue to expect approximately \$75 million to \$80 million for the full year.

Now let's review non-cash items.

Amortization of prepublication costs in the third quarter was \$127.2 million versus \$124.6 million last year. For the full year, we continue to expect prepublication amortization of \$275 million to \$280 million versus \$270 million in 2008.

Depreciation was \$26.0 million in the third quarter; \$3.9 million lower than the same period last year. We now expect full-year depreciation to be approximately \$120 million, versus our previous forecast of approximately \$130 million.

Amortization of intangibles was \$11.1 million for third quarter of 2009 versus \$13.6 million for the same period last year. For the full year we continue to expect approximately \$50 million.

I'll conclude with a comment on the growth of unearned revenue, which ended the third quarter of 2009 at \$1.1 billion. That is roughly flat with the prior year and the second quarter. In constant currency, it grew 1.9% versus prior year. At the end of the third quarter, Financial Services represented approximately 73% of the corporation's total unearned revenue. Financial Services' unearned revenue was roughly flat versus prior year. For the full year, we still expect unearned revenue to grow slightly, excluding the impact of the divestiture of *BusinessWeek*. Including the divestiture of *BusinessWeek*, we expect unearned revenue to experience a slight decline for 2009.

In summary, on the last call, we promised that we would maintain stringent expense controls. We have delivered on the promise. Our cash flow generation and our strong financial position leave us well positioned for growth as we move forward.

Thank you.

To access the accompanying slides online, go to:

<http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=2479868>

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