# The McGraw-Hill Companies
# 4th Quarter 2007 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.

And thank you everyone for joining us for The McGraw-Hill Companies' fourth quarter 2007 earnings conference call. I am Donald Rubin, Senior Vice President of Investor Relations at The McGraw-Hill Companies.

With me today are Harold McGraw III, Chairman, President and CEO, and Robert Bahash, Executive Vice President and Chief Financial Officer.

This morning we issued a news release with our fourth quarter and full year 2007 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. Frank Briamonte in our New York office at (212) 512-4145 subsequent to this call. Today's update will last approximately an hour. After the presentations, 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.

**Harold McGraw III**
Chairman, President and CEO
The McGraw-Hill Companies

Thank you for taking time to be with us and welcome to our review of The McGraw-Hill Companies fourth quarter and full year earnings for 2007.

Joining me on the conference call is Bob Bahash, our executive vice president and chief financial officer.

I'll begin by reviewing our results and the outlook for 2008. Then Bob will review our financial performance. After his remarks, we will be pleased to go in any direction anyone would like and answer any questions you may have about The McGraw-Hill Companies.

By now, we all know the Federal Reserve cut interest rates by 75 basis points two days ago in an effort to make sure the recession that many are so concerned about will be mild and brief – if it occurs at all. David Wyss, S&P's chief economist, currently thinks the odds of the U.S economy slipping into a slight recession are about 50-50. In assessing economic growth, he thinks the peak probably occurred last November. The trough will come this year in September or October, somewhere in that area.

As we also know, the housing recession will continue to be with us throughout the year. New housing starts should bottom out sometime in the spring, and housing prices will probably hit bottom sometime this Fall or toward the end of 2008. And, by the way, Wyss expects to see more rate cuts this year from the Federal Reserve, with the next one coming in March and probably April, if not sooner.

With that as a brief background, let's review operations.

**McGraw-Hill Education**

Let me start with McGraw-Hill Education.

Some late-ordering in the elementary-high school market and a solid close in higher education in the fourth quarter put the finishing touches on substantial accomplishments for McGraw-Hill Education in 2007.

Revenue for the year increased by 7.2%. Operating profit grew 21.5%, reflecting restructuring charges in the fourth quarter of 2007 and in the second half of 2006. The operating margin was 14.8% versus 13.0% in 2006.

In the fourth quarter, we did a little better than our guidance:

- Revenue increased 4.3%.
- Including a restructuring charge, there was an operating loss of $791,000. Excluding the restructuring charges operating profit increased 5.0%.
- Including the restructuring charges, the operating margin declined, but was unchanged compared to 2006 when the restructuring charges are excluded.

The McGraw-Hill School Education Group's revenue increased by 6.8% in 2007 and by 6.0% in the fourth quarter. We don't have final 2007 industry figures, but after 11 months, industry sales were up 2.6% versus the same period in 2006.

The key to our results was a very strong performance in the state new adoption market. We captured a market-leading 32% of a market that grew by about 19% to approximately $820 million.

We built this record with new products and services and a successful reorganization of what had been separate K–5 and 6–12 operations. The new team obviously got the job done in both the K–5 and 6–12 markets and positions us well for the rest of this decade. It is an advantage, obviously, to have your team ready to go in a consolidating market where some of the competition is reorganizing and is encumbered with high levels of debt.

For 2008, we are again looking at a healthy state new adoption calendar. We expect the state new adoption market to grow by 10% to 15% in 2008 to $900 to $950 million. Once again, we will be competing in virtually the entire market. The three biggest state new adoption opportunities this year are in California for K–8 math, Florida for K–5 reading, and Texas for K–5 math. We are well positioned in all these adoptions with new programs carefully tailored to meet state standards.

Our success in 2007 with elementary school programs will also benefit us in 2008. Elementary programs tend to include more consumable materials and other items that generate residual orders in subsequent years.

Offering a broad spectrum of products has been a key part of our el-hi strategy for some time. We compete in both academic and non-academic areas of the curriculum. Our strong market shares in art and music, family and consumer science, technical and vocational education, and health and business education, contribute significantly to our results each year.

In a still-emerging segment of the el-hi market, we are achieving steady growth with intervention programs. Demand for these programs continues to grow as educators seek well-designed research-based materials for students who need extra help to reach grade-level standards.

The increasing importance of this market was underscored when both Florida and California adopted intervention programs for purchase this year. Florida lists our *Jamestown Reading Navigator*, an online reading intervention program developed for secondary students and sold by subscription. California added a math intervention category for 2008, and three of our programs have been approved in that category. Each program is designed to complement one of our three adopted basal math series.

Across the country, our strong line-up of skills-based intervention programs contributed to our success in 2007 and should do so again in 2008. These include updated versions of *Number Worlds*, *Language for Learning* and a recently acquired product line, *Reading Success*. *Science Snapshots*, which is a new multimedia intervention program, also shows tremendous promise.

Two satellite programs associated with our elementary reading series *Treasures*—*Triumphs* for intervention needs and *Treasure Chest* for English-language learners—are also generating incremental revenue

A broad spectrum of products and strong state new adoption sales are the key to 2008. The open territory is this year's wild card. We anticipate growth of 1% to 2%, but after two years of lower than expected sales for the industry, there is very likely pent-up demand in the open territory, particularly for new basal programs and for standards-based, research-validated intervention materials.

Limited increases in federal funding and pressures on local and state budgets could be inhibiting factors this year in the open territory growth. Overall, we expect the elementary/high school market to grow 4% to 5% in 2008.

Our testing business improved in 2007 with gains in custom as well as in shelf revenue, and we expect more progress in 2008. The recently enacted Federal education budget will keep all of No Child Left Behind's major programs intact, including state accountability testing. We're not surprised. The public's insistence on accountability in the classroom has not abated.

Accountability is the driver behind the growth of our new formative assessment program called *Acuity*. With *Acuity's* benchmark tests, educators can diagnose students' learning needs in relationship to state standards and adjust instruction throughout the year to ensure improved performance on the big year-end No Child Left Behind tests. *Acuity* is now in use at the district level in many states across the country. Its biggest victory last year was the $80 million, five-year contract with New York City. The program's first state-level wins in Indiana and West Virginia were announced in the fourth quarter. These contracts will produce revenue in 2008 and beyond.

In 2008, as in 2007, we expect that states and districts will continue to increase their expenditures on formative and English-language learner testing. Our *LAS Links* assessment program is very successful in the English-language learner market. During the year, we will also continue to invest in innovative testing products as well as new technology to improve efficiencies in developing, delivering, and scoring McGraw-Hill assessments.

Now, let's turn to our Higher Education, Professional and International Group. Revenue for this group grew by 7.6% for the year and by 3.4% in the fourth quarter.

The digital transformation of the education business is furthest along and moving most rapidly in the higher education and professional markets. Our digital product revenue grew substantially faster than our revenue from traditional products in 2007 and undoubtedly will do so again in 2008.

We expect the U.S. college and university market to grow 3% to 4% in 2008 and think we will outperform that again this year. Digital products and services will be one of the keys. The student-to-computer ratio on today's college campus is essentially one-to-one. Recent studies show that more than 90% of students have high-speed Internet access. With digital products like *Homework Manager* and *eBooks*, we are increasingly successful in meeting the needs of today's college students.

The ongoing digital transformation means we must continue investing to deliver great content and great tools for course management, online instruction courses, and *eBooks* as paper-based products are replaced by electronic products.

Not surprisingly, the demand for digitally-delivered products is most advanced in the professional world. Our digital subscription revenue continues to grow faster than conventional product sales as we expand our offerings in science, medicine, and engineering.

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

- 6% to 8% top-line growth in 2008,
- Margins may decline slightly 50 to 100 basis points due to accelerating investments in technology, and
- Increased prepublication amortization costs.

## Financial Services

Now, let's turn to McGraw-Hill Financial Services.

The year started very strongly enabling the segment to produce solid growth in 2007. Revenue for the year increased by 10.9%. Operating profit, including a pre-tax gain of $17.3 million on the divestiture of a mutual fund business and an $18.8 million pre-tax restructuring charge, operating profit grew by 13.1%. The operating margin for the year was 44.6%, up from 43.8% last year.

As we predicted, the decline in the structured finance market that started last September carried into October, November, and December. To illustrate the fall-off in new issuance, we provided a table in today's earnings release that contrasts strong U.S. new issue dollar volume for the first nine months of 2007 with a sharp decline in the fourth quarter of 2007.

In this next chart, you also can see how new issuance for the final three months of 2007 compared with the extremely robust fourth quarter of 2006.

Those tough comparisons are reflected in our fourth quarter results in 2007. For 2007:

- Fourth quarter revenue declined by 7.2%,
- Operating profit, including a restructuring charge, decreased by 22.8%, or 17.2% excluding the restructuring charge, and
- The operating margin fell to 35.8% including the restructuring charge, or 38.3% excluding the charge.

The very different results from the first nine months of 2007 and the fourth quarter illustrate both the challenge and the opportunity in 2008. We obviously start the year facing tough comparisons, and the prospects of slower growth rates in the first half compared to 2007. We will end the year facing much easier comparisons at a time when the markets may be showing signs of recovery.

During 2008, a number of factors will come into play:

- As the Federal Reserve cuts rates this year,
- As additional liquidity is pumped into the financial system,
- As buyers and sellers agree on appropriate risk/return yields,
- As companies have more maturing debt to refinance, and
- As the backlog of deals starts to come to market.

In short, as the liquidity freeze begins to thaw, and that's exactly what it is, a liquidity freeze, liquidity's there, but as the liquidity freeze begins to thaw and confidence returns, the market will find firmer footing in the latter part of 2008.

In the meantime, we will continue to manage costs very tightly and take advantage of our opportunities inherent in the diversified portfolio we have created in Financial Services. That combination will produce growth for the segment and enable us to hold the operating margin decline in 2008 to between 125 and 225 basis points.

In considering diversity, let's start with Standard & Poor's Investment Services. Here is where revenue grew by 15.6% in the fourth quarter and 16.3% in 2007 to reach $782 million for the full year. These financial data and information index and research services produced 26% of Financial Services revenue in 2007. With a growing family of liquid and investable indices and products like Capital IQ and Compustat, and analytics from the recently acquired ClariFI, we expect another year of solid growth from S&P Investment Services in 2008.

Revenue from Standard & Poor's Credit Market Services — our ratings business — is diversified in terms of geography, fee structure and product mix. In short, ratings is not all about structured finance or new issuance in the United States.

Financial Services starts the year with deferred revenue of approximately $790 million, most of which will be recognized over the next 12 months. That's about 25% of the segment's 2007 revenue. We expect deferred revenue to continue growing in 2008, albeit at a slower pace, because of the current market conditions.

Revenue from non-transaction sources — surveillance fees, annual contracts and subscriptions — provide resilience when new issuance slows. At the end of 2007, non-transaction revenue represented 54% of the ratings business. Non-transaction revenue will be more important in 2008 as new issuance volume, particularly in the U.S. structured finance market, declines.

We also expect growth overseas. We continue to enhance our rating coverage in international markets by expanding in Central and Eastern Europe, the Persian Gulf, South Africa and Turkey, as well as opening new offices in Dubai, Tel Aviv, Johannesburg and so forth. International revenue represented just over 40% of ratings revenue in 2007 and undoubtedly will be a bigger proportion of ratings this year.

Growth in non-traditional ratings will also be important in 2008. Demand by financial institutions for credit risk models, tools, data, and training primarily for Basel II compliance will be a plus in 2008. At the end of 2007, ratings and services that are not directly linked to new public debt issuance accounted for 25.5% of ratings revenue. Non-traditional revenue will also make a bigger contribution in 2008.

There is one more critical point to make about diversity at Financial Services. For some time, we have pointed out that we were reducing our dependency on new issue volume. Today, I want to show you the disparity between the new issue dollar volume in the fourth quarter of 2007 and the revenue at the segment level and at Standard & Poor's Credit Market Services.

As you can see in this table, revenue for the segment declined 7.2% in the fourth quarter while global new volume issuance dropped 33.2% for the same period. Go down a level. S&P Credit Market Services was off 14.1% versus a 33.2% drop in global new issue volume. International revenue at Credit Market Services in the fourth quarter was off only 4.3%, as non-U.S. new issuance dropped 24.2%.

Our new issue figures are based on:
- The domicile of the issuer,
- Only when deals are issued, not when they are priced, and
- Only the ratable part of the market, because that is the true measure of our opportunity.

There's a lot more detailed information to absorb, so let's take a moment to sum up:

- Financial Services starts the year with $790 million of deferred revenue,
- We have high expectations for our non-ratings business, Standard & Poor's Investment Services, which produces 26% of the segment's revenue, and
- International ratings revenue, which has been growing at double-digit rates and now represents more than 40% of Credit Market Services revenue, should continue to grow offsetting a decline in domestic ratings in 2008.

Non-traditional products and services have been growing faster than traditional ratings. We expect that trend to continue in 2008. These products and services now represent just over 25% of Credit Market Services revenue. With the anticipated slow down in issuance this year, we also expect a bigger contribution from surveillance fees, annual contracts, and subscriptions — the non-transaction portion of Credit Market Services.

And let's not overlook the huge corporate market. Corporates will continue to grow in 2008. Interest rates remain low, and that will help continue to drive debt-financed strategic merger and acquisition deals and investments in infrastructure. Companies will have more maturing debt to refinance this year. One estimate puts corporate investment-grade bond maturities in 2008 at just over $600 billion, up from $483 billion in 2007. Financing conditions remain favorable overseas.

The elephant in the room, of course, is structured finance. This is predominantly a transaction-based market, and in 2007 new dollar volume issuance in the United States structured finance market decreased by 22.2%. We expect conditions in the U.S. structured credit markets to be challenging for most of 2008. Mortgage issuance is expected to decline significantly in the residential sector because of adverse conditions in the housing market, tightening lending standards, and a shift to agency origination. As a result, we expect U.S. residential mortgage-backed securities dollar volume issuance to decline significantly in 2008 after falling by 40.4% in 2007. But it is worth noting that residential mortgage-backed securities issuance in Europe grew by 53.2% in 2007, as the total structured market increased there by 33.3%.

The U.S. commercial mortgage-backed securities new issue market tumbled in the fourth quarter by 56% and finished up 6.8% for the year 2007. The outlook here is uncertain as pension funds and insurance companies, typical buyers, have stayed on the sidelines.

New issue dollar volume in the U.S. collateralized debt obligations (CDO) market finished up by 1.4% in 2007, but a flight to quality will result in a significant decline in U.S. CDO issuance in 2008.

The asset-backed securities market has better prospects. We should see increases in what we would call plain vanilla asset-backed securitization as credit card receivables replace home equity loans and issuers of auto loans tap this market.

S&P Credit Market Services will also benefit from strong demand for two of its key information products: that's *RatingsDirect* and *RatingsXpress*. These global products continue to grow rapidly.

We've come through a difficult time in credit markets and, undoubtedly, there will continue to be headline risk in 2008 on the regulatory and legal fronts. The lack of legal or factual merit doesn't seem to deter some critics, but we are confident that Standard & Poor's will be part of the solution that emerges over the coming months.

S&P is working closely with regulators here and around the world. It is to our benefit, obviously, to do so and we will continue to do so to the best of our ability. S&P is also working on some important initiatives that will be made public shortly. We think these new initiatives will underscore our efforts to strengthen the ratings process and better serve markets.

So summing up now for Financial Services:

- Diversity is more important than ever for 2008,
- Revenue will grow 2% to 4%,
- The operating margin will decline no more than 125 to 225 basis points, and
- Slow growth in the first half followed by pick up in the second half.

## Information & Media

And finally, moving to the Information & Media segment.

Growth in information products and services was the key factor in Information & Media's performance in 2007.

- Revenue for the segment increased 3.6%.
- Operating profit grew 27.2%, including pre-tax restructuring charges — $6.7 million in the fourth quarter and $8.7 million in the second half of 2006.
- The operating margin was 6.2% compared to 5.1% in 2006.
- The segment's 2007 results also reflect a change in revenue recognition in 2006 for the transformation of Sweets from a primarily print catalog to a bundled print and online service for the construction industry.

In the fourth quarter of 2007:

- Revenue increased by 3.6%,
- Operating profit, reflecting the restructurings, declined by 6.1% and was up 9.8% excluding the restructuring charges, and
- The operating margin was 7.2%, compared to 7.9% in 2006.

The transformation in this segment is vitally important and we made progress in 2007, and we expect to do so again in 2008.

The Business-to-Business Group increased revenue by 6.2% for the year and 6.3% in the fourth quarter, even though advertising pages at *BusinessWeek's* global print edition declined 21.8% in the fourth quarter and 18.2% for the full year.

Clearly, providing higher-value information was a key to our performance. That includes:

- News and pricing services delivered online to the world energy market, and
- Improved market penetration of studies and proprietary services from J.D. Power and Associates, as well as growth in the Asia-Pacific markets.

Growth in information products also helped offset the decline at our Broadcasting Group. In a non-political year, Broadcasting Group's revenues were off 14.6% in 2007 and 14.9% in the fourth quarter. Of course, 2008 is a political year, so we expect to see a big rebound at Broadcasting.

We expect advertising to stabilize at *BusinessWeek*. The publication is holding its rate base at 900,000 while increasing ad rates by 4% over 2007. The one-year subscription price will remain at $59.97.

In the information business, we will continue to migrate to higher value-added opportunities, ranging from online syndicated studies from J.D. Power and Associates to the growth of subscription-based products in the energy markets.

Summing up then for the Information & Media segment:
- 6% to 8% top line growth in 2008,
- Increased political advertising at Broadcasting,
- More growth in information products, and
- An improved operating margin.

That wraps up the outlook for our three segments.

To recap and go through our guidance one more time:
Revenue growth of 6% to 8% for McGraw-Hill Education and McGraw-Hill Information & Media and 2% to 4% for McGraw-Hill Financial Services.

In Financial Services, the diversity and breadth of the portfolio will again be a significant factor in its performance in 2008. The negative impact on the segment's operating margin from the fall-off in the structured finance will be partially offset by growth in other ratings markets and by Standard & Poor's Investment Services. As a result, the segment's operating margin may decline between 125 and 225 basis points in 2008. Continued uncertainty in the financial markets could impact this.

At McGraw-Hill Education, we expect operating profit to grow in the low single-digit range because of a substantial increase in prepublication costs due to the demand associated with the new adoption markets and stepped-up investments in technology to accelerate the digital transformation of our business. Consequently, the operating margin in this segment may decline 50 to 100 basis points in 2008.

In Information & Media, we anticipate improvement in the operating margin.

As a result, we now expect to produce another year of growth with earnings per share increasing 3% to 5% for the corporation in 2008. Again, we expect to produce another year of growth in 2008. Net income, reflecting increased interest expense for share buybacks, will decline slightly.

Our guidance for 2008 excludes:
- $0.08 restructuring charge in the fourth quarter of 2007, and
- $0.03 gain from the divestiture of a mutual fund data business in 2007.

We got off to a very fast start in 2007, so comparisons in the first half of 2008 will be very challenging. We expect a better performance in the second half to finish 2008 on an upswing, positioning us well for 2009.

With that, let me turn it over to Bob. After his remarks, we'll go to any questions.

**Robert J. Bahash**
Executive Vice President and Chief Financial Officer
The McGraw-Hill Companies

Thank you, Terry.

I will begin this morning with an update on our share repurchase program.

We continued our buyback program in the fourth quarter, purchasing 7.0 million shares at a cost of $322.7 million. This brings our full-year total to 37.0 million shares for a cost of approximately $2.2 billion.

Through a combination of share repurchases and an increased dividend, The McGraw-Hill Companies returned approximately $2.5 billion to shareholders in 2007 — demonstrating management's commitment to increasing shareholder value. Since 1996, we have returned approximately $8.4 billion to shareholders through dividends and stock buybacks.

Last October, the Board signaled its approval for the repurchase of the remaining 35.0 million shares, over time, from the 2007 repurchase program authorized by the Board of Directors. MHP purchased 7.0 million shares in the fourth quarter of 2007, as I previously stated, and we now start 2008 with 28.0 million shares remaining in this program.

On January 30th, the Board will review the cash dividend at its regular monthly meeting. The Board has raised the cash dividend annually for the last 34 years. Since 1974, the dividend has grown at a compound rate of 10.4%.

Share repurchases are impacting shares outstanding, debt, and interest expense, so let's look at these items now.

Because of the share buybacks, diluted weighted average shares outstanding declined in the fourth quarter to 330.8 million shares. This reflects a 7.0 million share decrease compared to the third quarter of 2007 and a 33.4 million share decrease compared to the same period last year.

Our net debt position at the end of December was $801 million, down about $77 million from a net debt position of $879 million at the end of the third quarter. As of year-end, on a gross basis, our debt is approximately $1.2 billion offset by $396 million in cash, primarily in foreign holdings. This compares to 2006 when we were debt-free and had a cash position of about $353 million. This change is primarily due to the share repurchases.

The debt is comprised of $1.2 billion of unsecured senior notes issued in November of 2007 and is spread evenly across 5-, 10-, and 30-year tranches, adding term debt to our capital structure.

We ended the year with no commercial paper outstanding, but we do plan to enter the commercial paper market in 2008 due to the seasonal nature of our businesses.

Interest expense was $12 million in the fourth quarter compared to only $70,000 in the same period last year. For the full year, interest expense was $40.6 million. For 2008, we project interest expense in the range of $80 to $100 million.

Let's now look at our corporate expenses. Corporate expenses increased $5.2 million, or 12.6%, to $46.0 million in the fourth quarter of 2007. The fourth quarter includes a pre-tax restructuring charge of $1.9 million for the elimination of 21 positions. For comparison purposes, the fourth quarter 2006 results included a $2.7 million pre-tax restructuring charge.

The year-over-year increase is driven by increased incentive compensation, as well as expenses related to our corporate program to improve operating efficiency — Business Process Management, or BPM. In addition to operating efficiency programs across the entire Corporation, other programs include reviewing our digital publishing workflow systems, related off-shoring activities, and other general business process improvements. For 2008, we expect a low single-digit increase.

As Terry discussed, we expect operating profit at McGraw-Hill Education to grow in the low single-digit range. I would like to spend a few minutes elaborating on several of these factors.

First, as a result of significant prepublication investments, 2008 will incur a substantial increase of approximately $45 million in prepublication amortization. Second, as Terry pointed out earlier, the digital transformation in the education market requires increased investments in technology.

The trends are unmistakable:

- In the elementary-high school market, we are seeing a growing number of states requiring more technology products for all disciplines. Understandably, they want to provide teachers with a broad spectrum of tools to help improve student learning. The computer is the ultimate tool for individualizing instruction and rapid measurement of results.
- In testing, it is clear that the paper-and-pencil world is giving way to online products and services that meet the classroom technology requirements of educators. In this market, we must invest in technology to keep our products at the cutting edge, launch new ones, and to improve efficiency to help relieve the margin pressures that we are currently experiencing in our testing businesses.
- In higher education, today's college freshmen were born five years after the Apple Macintosh was introduced. These students do not know a world without laptops, desktops, iPods and high bandwidth connectivity. An estimated 3.5 million college students are taking one or more courses online.

The convergence of content and technology is furthest along in the professional markets. In the global medical information market, more than 50% of the content today is accessed digitally.

Clearly technology is transforming the education market and to maintain and improve our competitive position, we must continue to invest. In addition to the significant investments in technology we must make in Education, we anticipate $18 million in costs for this segment in 2008 related to the migration to our new state-of-the-art data center. I will come back to this point in a moment.

In light of these factors, we expect that the operating margin at McGraw-Hill Education may decline 50 to 100 basis points in 2008. Given the expected decline in margins in 2008, we no longer expect to achieve a 20% operating margin by 2010, but we remain committed to improving McGraw-Hill Education's operating efficiency and its operating margin. Since investments, expenses, and revenues vary from year-to-year, the operating margin doesn't necessarily increase in a straight line. However, we remain focused on various efforts that together will result in a higher operating margin for the Education segment. To help our prospects, we restructured business operations in the fourth quarter and incurred a pre-tax restructuring charge of $16.3 million for severance relating to a workforce reduction of 304 positions.

Now let's switch over to unearned revenue, which was approximately $1.1 billion for 2007, and represents 10.4% year-over-year growth. About $790 million, or 73% of that unearned revenue, comes from S&P's surveillance and fee structures and data and information products. We expect unearned revenue growth to moderate given the slower revenue growth forecast. This revenue will be largely recognized over the next twelve months.

I'll comment on the effective tax rate before moving to investments. The effective tax rate was 37.5% in 2007 compared to 37.2% last year. For 2008, we expect the rate to be approximately the same as 2007 on a full-year basis.

Capital expenditures include prepublication investments and purchases of property and equipment. Prepublication investments were $89 million in the fourth quarter and $299 million for the year. The full-year investment is slightly less than our guidance due to timing and operating efficiencies. For 2008, we project that prepublication investments will be about $300 to $310 million. This reflects the necessary investments to take advantage of strong adoption opportunities.

Purchases of property and equipment were $83.2 million in the fourth quarter. There was about $230 million for 2007, which compares to $127 million in 2006. This came in slightly lower than our recent forecast of $250 million. The increase versus 2006 is driven by technology investments we are making to digitize our products and services and the investment for the construction of our new data center. The migration of our applications will begin in April, and will take approximately one year to complete. As I mentioned on the third quarter call, in 2008, each of our segments will incur migration costs. We have now sized that effort, and total costs are expected to be in the range of $40 million.

We project capital expenditures to approximate $170 million for 2008. In addition to normal replacement expenditures, this reflects additional purchases of software and technology equipment for the new data center in the first half of 2008, as well as continued technology investments for the creation of new and enhanced products and services, as well as the final stages of the completion of the data center construction.

Now for the non-cash items.

Amortization of prepublication costs was $240 million for 2007, slightly less than the $250 million projected. It was $45 million in the fourth quarter. As I discussed a few minutes ago, for 2008 we expect amortization to increase $45 million, or 19%, to $285 million.

Depreciation was $113 million for 2007. It was $29 million for the fourth quarter. We expect depreciation to grow to $125 million in 2008, reflecting the completion of the data center, purchase of new technology equipment for the center, and other capital expenditure increases in property and equipment.

Amortization of intangibles was $48 million for 2007. It was $14 million in the fourth quarter. For 2008, we expect approximately $52 million.

That brings me to free cash flow. In defining free cash flow we start with operating cash flow and reduce that amount by certain cash outflows for investing and financing activities that are recurring by nature.

As you see from the table, Cash Provided by Operations, per U.S. GAAP, was $1.7 billion for 2007. We then subtract the following, which we have already described:

- Investments in prepublication costs: $299.0 million,
- Purchases of property and equipment: $230 million
- Additions to technology projects: $17 million and
- Dividends paid to shareholders: $277.7 million.

Under this definition, free cash flow for 2007 was about $900 million versus $825 million in 2006. We achieved this record free cash flow — despite increased investments — as a result of strong operating results and favorable changes in working capital.

For 2008, we anticipate free cash flow in the range of $850 to $900 million, which is about equal to 2007. This guidance reflects:

- Lower net income,
- Continued investments,
- Prudent management of working capital, and
- Cash outflow for the 2007 restructuring actions, which will be largely offset by savings from these actions.

Thank you, and now back to Terry.

**Harold McGraw III**
Chairman, President and CEO
The McGraw-Hill Companies

Thank you very much, Bob.

Now, obviously we're pleased with the 22.5% EPS growth for 2007, albeit, the slowdown in the U.S. structured finance market in particular in the fourth quarter. For 2008, it's going to be a first half/second half situation. The first half obviously is going to be slower. The second half should pick up. But by the end of the full year, we're projecting EPS growth of 3% to 5% for the year.

From an economy standpoint, it's very similar. We see a recession or recession-like environment in the first half improving in the second half. The housing recession will start to come to a conclusion. New housing starts will probably bottom out somewhere in the spring, a little bit more to go on housing prices to the fall, as the equilibrium in terms of supply and demand of existing home sales works itself through. But it is a much better situation for the second half.

Thank you.

**To access the accompanying slides online, go to:**
http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=1738923

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This presentation includes certain forward-looking statements about the Company's businesses, 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 2008 adoptions and in open territories and enrollment and demographic trends; the level of educational funding; the strength of School Education, Higher Education, Professional and International publishing markets and the impact of technology on them; the level of interest rates and the strength of the 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 mortgage and asset-backed securities and related asset classes; the regulatory environment affecting Standard & Poor's; the strength of the domestic and international advertising markets; the volatility of the energy marketplace; the contract value of public works, manufacturing and single-family unit construction; the level of political advertising; and the level of future cash flow, debt levels, 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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