The McGraw-Hill Companies

Deutsche Bank Media & Telecommunications Conference

Prepared Remarks
June 9, 2008

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

We are pleased to be here today to review prospects for The McGraw-Hill Companies.

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

I want to go through a number of things with you. There's obviously a lot going on in a lot of different sectors. I'd like to just make sure we're all up to speed and then we'll go any direction you'd like.

I'll talk this afternoon about four things. We're going to talk about some of the recent trends in the marketplace. We'll talk about our operating performance. We're going to talk about our guidance and where we are there. And I'll talk a little bit about the current legal and regulatory environment, especially as it relates to Financial Services.

In this environment, cost containment is especially important. In May, to streamline operations and lower our costs, we reduced our global workforce by approximately 2%. The resulting after-tax restructuring charge for the reduction of 395 positions is $14.8 million or $0.05 per diluted share of second quarter earnings this year. The reductions took place in Financial Services and McGraw-Hill Education.

Our commitment to advancing total shareholder return is never unwavering. We have bought back 3.4 million shares in the first quarter—several blackout periods there. Our target for the year is 15.0 million shares.

Dividends have been increased annually for 35 consecutive years. Cash returned to shareholders through dividends and share repurchases has grown at a compound annual rate of 27.3% between 1997 and 2007. In that decade, we produced a total shareholder return of 10.8% versus 5.9% for the S&P 500.

The current economic outlook is somewhat better than some have expected. Real Gross Domestic Product for the first quarter grew at 0.9% and would seem to indicate positive GDP in the second quarter, according to David Wyss, our chief economist at Standard & Poor's. The effect of the economic stimulus package is already being felt in the second quarter and that is some of the optimism. That should result in more spending in the third quarter where we expect about 2.5% growth, but Wyss now expects a decline in GDP growth in the fourth quarter.

The economic data also reduces the likelihood of more rate cuts any time soon by the Federal Reserve. As David points out, the question really is, "When will the Fed raise rates?" He doesn't expect a rate hike until the middle of next year, but given some of the talk about inflation, commodity prices, oil, and consumer spending, there could be some tightening in between.

Recovery in the housing market is going to take a little bit more time. Wyss expects housing sales to bottom out this summer, I think it already has in terms of new starts, with prices reaching bottom about a year from now. Housing prices peaked in early 2006 and have fallen 17% since then. Our economists expect a total peak-to-trough decline of about 25%.

Other concerns obviously are tied to the rise in oil prices and in unemployment. That will continue to probably rise into next year as part of the economic pullback before we see that recede. The jobless rate went to 5.5% in May, the highest so far this year.

McGraw-Hill Education

With that background, let's review the outlook for operations, starting with McGraw-Hill Education.

In education, the most important part of the year is just ahead of us. I am referring, of course, to the third quarter and the July-August period, which we call the "60-day month." Typically, the third quarter produces more than 40% of the segment's annual revenue and most of the operating profit for Education.

In the second quarter, June is the key month. The order flow in the last few days of June is very difficult to predict and can profoundly influence second quarter results, and third quarter results, due to those timings.

The key point is simply this: the feedback from the market continues to be encouraging and we believe the segment is still on course to increase revenue by 6% to 8% in 2008. And we still expect a slight margin decline this year—50 to 100 basis points—in the operating margin due to stepped-up investments in technology to accelerate the digital transformation of this business.

That decline masks for now some improvement we are achieving in other areas of this segment's performance.

We are facing costs of $18 million for the transition to our new data center and an increase of about $45 million in prepublication amortization this year for the new products we are launching in 2008 and into 2009. As you all know in terms of the adoption market, it's usually anywhere from a little under two years to up to three years in development costs for those programs. The bigger K–12 reading programs take a little longer. Those increases alone would have a negative impact of about 200 basis points on the segment's operating margin this year. And yet we expect a decline of only about 50 to 100 basis points because of the benefits of the restructuring actions taken in the fourth quarter of 2007, some economies of scale, and continued cost containment.

In the elementary-high school market, our School Education Group is showing signs of building on last year's very successful performance.

As you may recall, we reorganized our basal operations in 2006 to improve our competitive position. That paid off in 2007 and will again in 2008. We gained share last year, capturing 32% of the state new adoption market. Our School Education Group revenue last year grew by more than two and one-half times the market rate.

Based on a strong state new adoption market this year, we expect the industry to grow 4% to 5% this year and we believe we can do better. Florida, Texas, and California are key to this year's state new adoption market, which we expect to grow 10% to 15%.

We continue to like our prospects in all three states:

- In Florida, a good year is shaping up for the K–5 reading adoption,
- In Texas, we are competing well in the K–5 math adoption, and
- In California, the signs are very good for first-year math and second-year science adoptions.

We still expect the open territory market to grow about 1% to 2% this year, but we continue to be encouraged by the opportunities our field staff has been tracking for this year. If there is an area of upside, I would expect it to be in the open territory. Just again for those that don't cover this market, 20 states are called "adoption states" where requirements for material are centrally developed; the rest of the states are called "open territory."

We continue to monitor state budgets on education. Forty-six states start their new fiscal year on July 1, so the budget process is not quite complete. In tracking budgets for the 2009 fiscal year in 15 key states, we have seen, on average, better increases in the education budget than in overall state budgets.

On balance, we continue to believe there is strong support for educational funding. State support for educational funding has been consistent in this decade. As this table shows, we've seen growth every year since 2001.

In testing, we benefit from a growing lineup of products that serves the needs of all learners from pre-K to adults. Acuity, our new formative assessment system, continues to show tremendous promise with new state-level contracts in Indiana and West Virginia. As you may be aware, Acuity has already been implemented here in New York City in a 5-year, $80 million contract, the nation's largest school district, and has won many other large district-level adoptions.

For adult students, we developed TABE, the Test of Adult Basic Education. It provides diagnostic assessments and instruction support for adult students in basic education and English as a second language. TABE recently won a five-year contract with the federal Jobs Corp.'s youth training program.

The Grow Network continues its leadership in parent engagement with a new $600,000 agreement to produce assessment reports for New York City parents. We have just launched an enhanced version of the Parent Network, a unique online system that has proven effective in providing parents with timely access to their children's assessment results.

The Parent Network can now provide families with personal action plans, vital educational resources, and home activities so parents can play an essential role in their children's academic progress. Grow's Parent Network has been adopted statewide by Florida, Nevada, and Indiana.

The assessment business is continuing to shift, requiring increased investments in digital and custom offerings. Technology enables us to provide solutions in a more cost-effective manner while improving capacity, quality, and reliability. The realignment of the testing organization is reflected in the restructuring actions we took at McGraw-Hill Education in the second quarter. The majority of those actions in the segment were in the assessment business.

In higher education, we are wrapping up the spring selling season on a positive note, but it is too early to make predictions on this summer's activity. The U.S. college and university market is expected to grow 3% to 4% this year and could go higher. We still hope to at least match those expectations.

Growth in digital and custom products for the college and university market is accelerating. We are:

- Adding more disciplines to our Homework Manager program;
- Rolling out more online courses. There are 40 so far and continuing;
- Using the industry-sponsored website CourseSmart to introduce new downloadable and media rich e-Book options and distribute samples to instructors. By replacing print sample copies with eComps, we are improving our efficiency and reducing costs.

So summing up for McGraw-Hill Education:

- Segment revenue growth is projected at 6% to 8%,
- Operating margin will probably decline 50 to 100 basis points due to stepped-up investments in technology, and
- We have growing confidence in our forecast for the year based on sales results to date.

Financial Services

Now, let's look at Financial Services.

In face of the conditions in the credit markets, we have pointed out that there are four key questions about our prospects in Financial Services. They are quite straightforward:

1. What is the severity of the downturn in the market?
2. What is the duration of that downturn?
3. What are the regulatory risks?
4. What are the legal risks?

Today, we believe the answers to these questions are still the key to assessing the outlook for Financial Services. Based on what we know now, let me share our current assessment.

The tone of business at Standard & Poor's Credit Market Services, that's the credit rating side, started to improve in April after a very slow start during the first quarter, but we aren't sure yet how sustainable that pick-up will be. As illustrated by these bar charts on new issue volume in May, issuance is spotty, but year-over-year gains are hard to come by.

Structured finance remains slow overall. U.S. structured finance new issue year-over-year volume is down every month so far this year: It is off:

- 70.1% in January,
- 85.2% in February,
- 75.0% in March,
- 75.4% in April, and
- 81.8% in May.

We said coming into this year, and certainly once we got into the first quarter, that this was going to be a first half/second half year. We hated to be right on this one because as you can see from the chart, the comparisons are being made to very, very strong first and second quarters one year ago.

The situation isn't made any easier because comparisons with 2007 are challenging. The second quarter of 2007 set the high water mark last year for revenue and operating profit at Financial Services. Operating profit for the segment grew by 27.9%. Revenue for Credit Market Services alone grew by nearly 24%.

In this environment, cost containment is clearly a top priority. We have taken measured steps in recent months to streamline operations and lower our costs. At the end of the fourth quarter last year, there was a staff reduction of approximately 170 positions with a pre-tax restructuring charge of $18.8 million. Last month, we eliminated another 246 positions. The impact of restructuring within Financial Services was $15.2 million pre-tax, which will be reflected in our second quarter results.

Containing costs is only one step we've taken to cushion the declines we're seeing in the new issue market. Our efforts to diversify in Financial Services are paying off as we continue to invest in our businesses.

We are expanding ratings information services. We're investing more in ratings models and tools both for surveillance and for sale to the financial community. We're adding new data and functionality to products such as Capital IQ and RatingsDirect.

Growth in surveillance fees, annual contracts, and subscriptions help buffer the downturn in transaction volume. For the Financial Services segment, unearned revenue grew by 13.6% to $812 million in the first quarter of 2008. We expect deferred revenue at Financial Services to continue growing this year.

We still forecast double-digit revenue growth this year for Standard & Poor's Investment Services. Revenue for these non-ratings businesses grew by 18% in the first quarter and represented 34% of the segment's total revenue.

There is still untapped potential in this business. That's why we recently created Standard & Poor's Fixed Income Risk Management Services, or FIRMS, under Lou Eccleston, who joined us earlier this year as executive managing director and head of global sales and client services. By integrating and rebranding many of S&P's products under Lou's leadership, we are creating a new unit that can provide market intelligence and analytical insight for risk-driven investment analysis, including the debt, structured finance, derivative, and credit markets.

FIRMS includes structured finance analytics and modeling, risk solutions, counterparty risk management, securities pricing and evaluation, securities classification from CUSIP, and research and information from S&P Credit Market Services.

Financial institutions today are clamoring for credit and risk analysis. Through FIRMS, S&P is now organized to meet that demand with a targeted and growing array of services and capabilities in models and analytics. In the coming months, our goal is to become an integral part of the investment analysis process by integrating our models and data with investors' workflow. We see important opportunities in this space and will keep you informed of our progress.

Our index services continue to grow as we find new ways to expand. At the end of May, assets under management in exchange-traded funds based on S&P indices had increased 19.2% to $214.9 billion.

In May, S&P signed an agreement with the Korean Exchange to develop new tradeable indices that will be the basis of exchange-traded funds and index derivatives for investors there. S&P already has partnerships with primary exchanges in Australia, Tokyo, Milan, Toronto, Hong Kong, and India. It is all part of a strategic drive to make the business more global and expand across multiple asset classes.

S&P's growing family of indices has contributed to the rise of exchange-traded portfolios. Our work is now underpinning the development of exchange-traded notes. In March, S&P introduced two real-time currency indices. The S&P Chinese Renminbi Index and the S&P Indian Rupee Index are the first in a series of real-time currency indices S&P will launch this year. The new S&P indices are the benchmark Morgan Stanley is using to launch exchange-traded notes on Chinese and Indian currency. If you want to check it out, the ticker for the S&P Chinese Renminbi Total Return Index is SPCBCNY.

S&P also earns revenue from exchange-traded derivatives such as the S&P 500 futures and the S&P 500 options. S&P's total share of the Chicago Mercantile Exchange equity and index futures and options on futures was 71% in 2007. S&P's share of total Chicago Board Options Exchange Index and ETF options was 45% in 2007. That business is growing in 2008.

Clearly, as some recent innovations demonstrate, there are many ways for us to get paid for indices:

- In real estate with the S&P/Case Shiller index for the residential marketplace;
- In fixed income with the S&P National Municipal Index, which is the ETF market leader;
- In options-based indices such as VIX, or implied volatility index at the CBOE; and
- In alternative investment indices, such as the S&P 130/30 index.

There are still more innovations in the pipeline, and we'll be bringing them out throughout the year.

Earlier, I mentioned that I'd share our view of the current outlook for legal risk, regulatory risk, and financial risk at Financial Services. The financial risk, I think we have a pretty good view on. Our view of the legal risk hasn't changed. We still think the legal risk is modest.

There are now a total of five lawsuits, including three filed recently against several defendants including banks and some of the ratings agencies. The allegations in these new actions basically concern RMBS securities purchased by the plaintiffs which have lost value and have had ratings downgrades. Our attorneys tell us there is no merit to any of the claims made against S&P and we'll be going for early dismissal.

On the regulatory front, June is turning into quite a month and it is not clear how or if the regulatory burden will increase or decline. But the takeaway is simply this: we continue to believe that any pending or likely governmental or self-regulatory proceedings will not result in a material adverse effect on our financial conditions or on the results of our operations.

We have already seen a report from CESR to the European Commission and, on May 28th, a revised Code of Conduct proposed by IOSCO, the International Organization of Securities Commissioners. S&P has been in discussions with both CESR and IOSCO and is currently reviewing the recommendations. IOSCO called for more transparency, a step up in due diligence by others in the market, and new measures to protect the integrity of the ratings process. Many of the steps IOSCO recommends are already reflected in the 27 voluntary Leadership Actions—initiatives S&P already announced and is taking to strengthen and enhance our governance, quality of analytics and data, transparency, and investor education.

Last week, we reached a settlement with the New York Attorney General. It was the right thing to do and underscores our commitment to transparency, openness, and strengthening of governance of the ratings process. More about that in a moment.

S&P has also been recently asked by the SEC to report on methodological or model errors, if any, that led to erroneous ratings in structured finance. Our team is working on a response for submission to the SEC which will be coming shortly. We will provide more information when their work has been completed.

On June 11, the SEC is holding a public meeting to discuss proposed rules for NRSROs. Once the rules are issued, we expect industry participants will have an opportunity to comment on them. I'm not going to try to predict what the SEC will propose, but I do believe S&P has had very good and productive discussions with SEC.

We also expect a report from the SEC later this month on its examination of the ratings agencies.

We anticipate some more recommendations from the Europeans later this month. Here, too, there has been healthy dialogue. We also want to keep an eye on the G7 finance ministers meeting, which is on the 13th and 14th of this coming week, and the G8 meeting in the first week of July.

But let's look back a moment to last Thursday and the agreement S&P and two other ratings agencies signed with New York State Attorney General Andrew Cuomo. The agreement focuses exclusively on U.S. residential mortgage-backed securities non-prime issuance.

There are six substantive parts to it that underscore our commitment to transparency, openness and strengthening of the governance of the ratings process.

First, we will be changing our fee structure for RMBS ratings. We will break the rating fee into components so that a portion of the total fee will be charged for each of the four stages in the ratings process. S&P's rating fees will not be dependent on the closing of the transaction or the issuance of a final rating.

Secondly, there will be quarterly disclosure of collateral pools we are asked to rate in order to discourage shopping for ratings.

Three, four and five—the next three parts—call for improvement in the quality of data submitted to us for ratings. We will be establishing enhanced criteria for reviewing mortgage originators. We will be setting enhanced criteria for representations and warranties on the underlying loans, addressing issues such as fraud, misrepresentations, data quality, adherence to underwriting guidelines and early payment defaults. Finally, we will be establishing new criteria for due diligence on the underlying mortgage loans undertaken by those seeking ratings and requiring a statement of due diligence as part of the RMBS ratings process.

Sixth, S&P will be required to review annually its RMBS rating processes to assess for and remediate any practices that could compromise its independence.

I also want to point out that the New York Attorney General has agreed to terminate all outstanding investigations of S&P and not to commence any action against S&P related to such investigations or their subject matter.

The bottom line: As New York Attorney General Andrew Cuomo said last Thursday, these steps should provide the market greater confidence that our ratings process is not subject to potential conflicts of interest and strengthen the quality of data provided to S&P for transactions it rates.

The settlement with the New York Attorney General sends a strong message to the market about our continuing efforts to improve the transparency of the ratings process and to restore investor confidence. In fact, our commitment goes beyond the principles embodied in this agreement. That is demonstrated again by S&P's development of the 27 Leadership Actions that were announced last February. These efforts are reflected in our earnings outlook.

Summing up for Financial Services:

- We expect double-digit growth for S&P Investment Services,
- The first half remains challenging in terms of comparisons to a very strong first half last year for Credit Market Services,
- If there is little or no improvement in the financial markets this year, particularly in structured finance, we would expect the Financial Services segment's revenue to decline 7 to 9% and the operating margin to be reduced by 500 to 600 basis points.
- Our guidance excludes the second quarter restructuring charge and associated benefits.

Information & Media

Now, let's review the outlook for Information & Media.

Our guidance for this segment is unchanged. We still expect a 6% to 8% increase in revenue this year and improvement in the operating margin.

We have a framework for growth in this segment to integrate our products within the customers' workflow and infrastructure. As this diagram shows, that means making changes across a broad range of products and services as we focus on value-added relationships, marketing intelligence, and user-centric platforms.

That means offering more benchmarks, analytics, and solutions from some of our most valuable brands:

- Turning industry performance benchmarks into actionable information is a key to J.D. Power and Associates' expansion,
- Platts' information is increasingly the benchmark for global energy markets, and
- The McGraw-Hill Construction Network is improving its value proposition by enhancing analytics and by providing customers the analysis and forecasts they can use to reduce risks.

And since this is an election year, our television stations expect a very solid year in political advertising. There are a number of local, state, and congressional races in our markets. And in California, the number of propositions on the ballot will also make a difference.

Print advertising is still lagging, but we are working very hard to stabilize the situation.

Let's sum up for Information and Media:

- A segment in transition,
- Growth in benchmarks, analytics and solutions,
- A solid year shaping up for political advertising,
- Still on track to produce a 6% to 8% increase in revenue, and
- Improved operating margin.

That completes a review of operations.

Let's sum up now for the Corporation. With the seasonality of our business concentrating earnings in the second half and despite continued uncertainty about the pace of recovery in the capital markets, we are not changing our previous 2008 earnings per share guidance of $2.65 to $2.75. That excludes both the impact of the May restructuring charge and associated benefits.

Thank you.

To access the accompanying slides online, go to:
http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=1857818