The McGraw-Hill Companies

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Prepared Remarks
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Thank you, Scott and good afternoon.

We appreciate the invitation to appear at this conference. The timing couldn't be better for a review of the key issues facing The McGraw-Hill Companies and how we are dealing with them.

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.

Let me set an agenda of what I'd like to address today. It's based on a lot of the questions we have been getting of late.

First, we will look at lawsuits. We have been in the news in recent days because of a Federal District Court Judge's decision on September 2 in response to our motion to dismiss a case pending against Standard & Poor's and another rating agency, among other defendants.

I understand it is often challenging for journalists to report on complex legal matters particularly under the pressure of deadline, so we welcome the opportunity to provide perspective on all the speculation in the media about the significance of the Judge's decision.

Some observers may be surprised to learn that the Judge's September 2 decision in response to our motion to dismiss breaks no new legal ground—particularly regarding the significant First Amendment protection already afforded rating agencies. The District Court's ruling is fundamentally a favorable litigation development for Standard & Poor's and is another reason why we continue to believe our legal risk in the various lawsuits pending against S&P and the Corporation is low. I will discuss these points in just a bit.

Next, I want to review the regulatory situation for the rating agencies since it is clearly another factor affecting our outlook. It has been a year since the sudden and unanticipated collapse of Lehman Brothers. In that time, the Administration, Congress and the U.S. Securities and Exchange Commission have started to look for new ways to bring regulation, oversight and greater transparency to the financial markets. We have worked very hard to participate in that process and become part of the solution.

That's why in the last two years there have been many changes at Standard & Poor's. Taking ongoing steps to strengthen our governance and analytics is S&P's commitment to the marketplace.

The third issue is the pace of recovery in the bond market. We are encouraged by developments there and will review the latest figures.

Finally, I will discuss the outlook for the education market in view of problems with state budgets, the impact of Federal stimulus dollars, and why a new generation of digital products holds so much promise in education.

In closing, I will review our guidance by segment and the full year for the Corporation.

So that's my agenda for today:

- Legal risk,
- The regulatory outlook,
- The recovering bond market,
- The outlook for the education market, and
- Guidance for 2009.

Financial Services

Let's start with an examination of our legal situation since the September 2 decision by Federal District Court Judge Scheindlin. We are concerned that some of the recent speculation in the media will confuse the marketplace about the true strength of our legal position and the continuing viability of the First Amendment protections generally provided to rating agencies such as Standard & Poor's.

Let's be clear: As the District Court expressly reaffirmed, it is well-established that rating agencies such as Standard & Poor's are generally afforded legal protection under the First Amendment. The Court also noted that the First Amendment provides no protection from potential liability for opinions not honestly held when issued. It never did. It never will.

Here is the inescapable conclusion: The Court's unremarkable ruling in this regard broke no new legal ground. Like all other participants in the financial markets, we can be sued for purported fraud if a complaint is brought containing sufficient allegations.

These fundamental legal points continue to elude some of our critics. We have approximately three dozen lawsuits from plaintiffs and their counsel who clearly think they have stated causes of action against S&P notwithstanding the First Amendment.

It is an extraordinary occasion when as Chief Executive Officer of this Corporation, I have to explain that the Company can be sued for fraud even when I don't believe for a moment that fraud ever occurred here. But I am making that explanation today to address the extraordinary level of confusion and false speculation we continue to see in public commentary about our legal situation.

That's the context for our evaluation of Judge Scheindlin's decision earlier this month in allegations by the Abu Dhabi Commercial Bank and King County against S&P and others. Let's objectively look at her opinion in more detail.

In ruling on a motion to dismiss, the Court is legally required to accept as true all of the facts alleged by the plaintiffs. That's a critical but little noted fact. The Judge underscored that critical legal requirement in her decision with the following point: *"All facts are drawn from the First Amended Complaint and are presumed to be true for the purpose of these motions."*

Even with this significant legal hurdle to overcome, 10 of 11 claims filed against Standard & Poor's were dismissed, including all of the plaintiffs' negligence-based allegations.

Furthermore, the Court's decision on the remaining claim is not a definitive ruling on the factual or legal merits of the claim against S&P. It simply allows the claim to move to the pre-trial phase of the case, or what the attorneys call "discovery."

There has been some confusion about the fraud claim and a First Amendment defense. In the complaint, the plaintiffs alleged that our ratings were intentionally misleading and not broadly disseminated. As I pointed out earlier, the Court had to accept all of these allegations as true and accordingly ruled that First Amendment protections are not available based on the specific allegations made in this case.

When the evidence is fully developed, we are very confident we will prevail. Fraud is a serious charge that requires a very high level of proof. Simply put, we do not believe the plaintiffs can show that there was any fraud by S&P in connection with the ratings issued in this matter. There will be an opportunity for us to ask the Court to dismiss the case by summary judgment when the Court will be permitted to consider the actual facts and applicable law—and not just plaintiffs' allegations.

To sum up, the Court's ruling did not break new legal ground—far from it. It was procedural and preliminary, based upon the legal requirement that on a motion to dismiss the Court must accept as true all the factual allegations in the complaint. Our First Amendment protections are undiminished.

In the weeks and months ahead, there will be more decisions in the various lawsuits that have been filed against S&P. We are prepared for a marathon that will run its course. This is not a sprint. We can't predict when the Courts will make decisions. There's no legal calendar with that information. But we do know the rulings will require a knowledgeable and thoughtful assessment in order to avoid some of the misunderstandings we have seen in recent days.

In following the litigation, it may be helpful to recognize the lawsuits fall into three broad categories.

The first are underwriter claims based on the Securities Act of 1933. This category includes a number of class actions by purchasers of subprime residential mortgage-backed securities rated by S&P as well as one case involving Fannie Mae ratings. These cases assert claims that S&P is liable as an underwriter or seller of securities under Section 11 and/or Section 12 of the Securities Act of 1933. S&P is not an underwriter or seller of any securities and never has been. The company intends to seek early dismissal of each of these actions.

The next decision in one of these underwriter cases could be announced fairly soon. The case is known as Public Employees' Retirement System of Mississippi v. Merrill Lynch and others, including S&P. In mid-August, we had our first oral argument in Federal Court in New York City in connection with this case. We now wait for District Court Judge Rakoff to issue a ruling on our motion to dismiss.

In the second category, there are McGraw-Hill shareholder claims, including a class action under Section 10(b) of the Securities Exchange Act. This is the Reese case. It has been brought by purchasers of McGraw-Hill stock who allege the Company's statements about its earnings and ratings business were misleading. A motion to dismiss this action has been filed. There are three other cases that involve essentially the same facts. We have filed all the necessary papers with the Courts.

The third category concerns state-law claims. These include a group of cases asserting state-law claims, including fraud relating to S&P's ratings of a variety of securities, including SIVs, SIV-Lites, CDOs, and Lehman Brothers debt. In one of these cases in New York Supreme Court, Oddo Asset Management v. Barclays Bank PLC, McGraw-Hill has moved to dismiss the complaint against it.

In addition to these three categories I've cited, there are other cases, which include a complaint filed with HUD under the Fair Housing Act of 1968 and actions filed in Israel and Italy relating to Lehman Brothers. Legal responses to these matters are being prepared and filed.

On the regulatory front, we continue to work for globally consistent oversight, preserving analytical independence and maintaining a level playing field for everyone.

A lot of progress has been made in the last two years with regulators and policymakers around the world. I think there is growing awareness among policymakers that coordination when establishing new regulation is necessary if global consistency is going to be achieved in financial markets. Clearly, a regulatory framework with consistent standards across jurisdictions around the world will benefit global capital markets and help restore investor confidence.

In Europe, we are working with CESR, the European Commission, IOSCO, and others to prepare for regulation that will take effect by mid-2010. We are also in communication with policymakers and regulators in Japan, Australia, and Canada.

In the United States, we share our views on proposed new legislation with the U.S. Securities and Exchange Commission, the Treasury Department, and Congress.

The timeline for legislation in the United States remains somewhat fluid, although it is now possible that a new bill may emerge in the House of Representatives some time in the next month. This is a work in progress. In discussions in Washington, we continue to emphasize the importance of maintaining a level playing field so rating agencies are not subjected to liability or other standards that are unfair when compared to other market participants. And we continue to convey how S&P's own wide-ranging initiatives to strengthen its own analytical and governance processes complement proposed new oversight both here and abroad.

Quality of ratings, prevention of potential conflicts, increased transparency and accountability are all measures we are focused on. We are still optimistic that Congress could take some conclusive actions by the end of the year, but depending on priorities legislation could slip into 2010. And for that, we all need to continue to watch.

In today's heavily regulated environment, you have to expect more rule-making, more proposals and more hearings. This month is no exception. On Thursday, September 17, the SEC Commissioners will hold an open meeting to discuss a number of items:

- New rules on disclosure and conflict of interest requirements for NRSROs,

- The elimination of references to NRSROs in some rules and forms and whether to seek more comment on the issue,
- Proposals to address credit rating shopping, and
- The future of SEC rule 436(g), which permits issuers to disclose ratings in registration statements without obtaining the prior consent of the rating agencies.

Also, on September 24, the National Association of Insurance Commissioner has scheduled a public hearing on the role of credit rating agencies in the insurance regulatory system.

Turning to the credit market, we are also closely tracking the pace of recovery in the bond market. At the end of July, we pointed out that there were signs of a thaw in credit markets and that we expected a double-digit increase in transaction revenue at S&P Credit Market Services in the second half. We still believe in that forecast.

Typically, July and August are lighter months for new issuance in the bond market and there was concern that the increased dollar volume issuance in the industrial and high-yield sectors in the second quarter would evaporate even though year-over-year comparisons in the third quarter were easier.

As this chart shows, U.S. corporate issuance produced a year-over-year gain of 43.0% in July and 27.0% in August. The keys were year-over-year increases in investment-grade and high-yield issuance in both months. U.S. industrial issuance was up 18.7% in July and 83.2% in August. U.S. speculative-grade issuance was up triple digits in both months, but off a small base. U.S. public finance issuance was up 21.5% in August.

As this chart shows, activity in U.S. structured finance was lighter in August than in July. As we had expected, the asset-backed market produced the most dollar volume issuance in both months for all structured products. As a result of the softness in structured finance, total U.S. issuance declined 13.1% in August, but industrial issuance showed a 19.4% sequential improvement over July.

There are indications of continued new issue activity in September as companies consider funding new capital requirements in response to signs of economic recovery.

To sum up, the tone of business in financial markets is continuing to improve. That is an important reason why we expect a year-over-year increase in the second half.

McGraw-Hill Education

Now, let's spend a few minutes on prospects for another key business, McGraw-Hill Education.

Growth in the college and university market and growth in the demand for digital products and services continue to be the bright spots in education this year. The elementary-high school market probably won't show any improvement until 2010. We expect the college market, which is a countercyclical business, to grow 5% to 7% this year.

We like our long-term prospects in the education market. A very important reason why is that the confluence of content, technology and distribution is improving our ability to develop new sources of education revenue.

Technology is changing the landscape of education.

In the el-hi market, digital components are already integrated into virtually every program we produce. In fact, it is misleading to speak of el-hi textbooks because we are really offering multimedia packages. The mix of components varies by grade and by subject, but interactive, online student editions are part of the future that is already here. Use of these exciting learning tools will grow steadily as more and more schools acquire the technology needed to make them available to all students.

And teachers are enthusiastic about the digital resources we provide them, including content-specific software that interfaces with interactive whiteboard technology in their classrooms.

In the college market, more than 95% of our textbooks can be downloaded as e-books through CourseSmart.com, the industry's cooperative.

The application of technology is already expanding the college market. To illustrate that, look at this diagram of a typical college student's workflow. In it, there are the four basic steps a college student will take to pass a course. If students want an A in the course, listening to the lectures is probably not enough. Skipping the lectures and reading the text book probably won't be sufficient either. Students will have to attend lectures, read the text and study, and do other work if they hope to ace the exams.

My point is that traditionally we never had products and services for students to help them assess their progress in a course or study more effectively in preparation for exams. Today, with McGraw-Hill Connect we provide powerful online study tools that will help students make the grade and pass the course. This is an important new business opportunity for us.

McGraw-Hill Connect is a research-based interactive assignment and assessment platform that incorporates cognitive science to customize the learning process. It is now available in 18 disciplines and will soon be expanded to 30.

To connect instructors and students, we have such features as:

- Online assignments with immediate, automatic feedback,
- Recorded class lectures, which are searchable. Students can replay specific portions of any lecture by simply searching on a key word or phrase,
- Interactive e-books, and
- Smart software that diagnoses what a student has—or has not—mastered for success in the course.

We believe McGraw-Hill Connect is the most advanced and most flexible all-digital teaching and learning platform on the college market today. McGraw-Hill Connect's subscription-based model represents an opportunity to diversify our college business by offering new products and services that diversify our revenue stream.

We are also experimenting with rentals of textbooks in the college market with Chegg, an online college textbook rental service. In return for a portion of the rental revenue, we are supplying approximately 25 titles for the pilot program. We also are exploring relationships with other textbook suppliers in the college marketplace. By sharing in rentals, we will get access to revenue we otherwise would not have realized.

The rental model is not so different from the traditional purchase and re-sale market as it might seem. Essentially, some students only want the information in a textbook for a very defined period—such as the semester—and then readily give up access to that content by selling the book back when the course is over. That, in effect, is a rental market. The net price of the purchase model—the purchase price minus the resale value—is close to the rental price or fee.

E-books represent a similar opportunity. In making e-books available at about half the price of the print version, we are also recognizing the economics of the rental market and the fact there is no used book market for them.

Today, the sale of used books accounts for approximately one-third of the college market. Technology is clearly creating new opportunity to reclaim a part of the market that college publishers and authors lost years ago to used books.

I've spent a lot of time on the impact of technology in the college market. But it is growing in importance in the elementary-high school market, too. That's why this summer we created a new Center for Digital Innovation. It is the first of its kind research and development center focused on bringing to elementary and secondary classrooms the same digital environment that today's students have embraced outside of school.

Two products the Center has in development are:

- *Planet Turtle*, a K-3 social network where children can interact with their peers in a protected Web environment, and
- *Cinch*, a collection of Web 2.0 tools for collaborative learning projects featuring a community-based website where teachers and students can create digital profiles and participate in group activities.

A growing lineup of digital products and new revenue models are not the only reasons for optimism about education markets:

- Enrollments will continue to grow,
- The administration recently announced a multibillion dollar proposal to boost enrollment in the nation's community colleges,
- By increasing financial aid, the administration is clearly trying to get more students into school and to improve graduation rates,
- Federal stimulus funds will make a difference to education, particularly in 2010,
- In the el-hi market, the state new adoption calendar improves in 2010 to $950 million to $1 billion, up from $500 million to $550 million this year. Texas K–12 reading and literature and Florida K–12 math represent more than 70% of the opportunity and funding for these programs is solid,
- We will realize the benefits of the 2009 restructuring of our education business in 2010, and
- Comparisons will get easier.

On that point, it is clear that the el-hi market in 2009 is weak. As the chart shows, the market has been soft all year and is off 27.6% after seven months according to the AAP.

There is still hope that more than $100 billion in federal stimulus money from the American Recovery and Reinvestment Act of 2009 will make some difference this year in education, but the funds are reaching the market relatively slowly and the initial distributions are basically being used to plug holes in budgets and save some teaching and staff positions.

Last month, The Department of Education announced it was accelerating stimulus spending by making nearly $11.4 billion in Title I, IDEA special education, and Vocational Rehabilitation funding available to states one month earlier than planned. These funds became available on September 1. The federal effort to expedite stimulus funding could lead to some ordering of classroom materials later this year, but it seems more realistic to expect the funding to have greater impact in 2010.

That's a close look at some important trends affecting our business outlook. In closing, let me sum up the outlook now for The McGraw-Hill Companies:

- Our financial position will remain strong,
- We will protect a healthy balance sheet and maintain liquidity,
- Cost control will be stringent,
- We anticipate minimal growth in costs the second half and a low single-digit decline for the year, excluding 2008 and 2009 restructuring charges and the loss on the sale of Vista Research,
- Free cash flow after dividends is estimated at $430 million to $450 million, although probably at the low end of the range, and
- Continued working capital improvements, cost containment, and prudent investments will enable us to produce free cash flow that is about equal to 2008 despite lower profit.

For McGraw-Hill Education in 2009:

- Revenue to decline 8.5% to 9.5%, and
- Operating margin will be in the 9% to 10% range, excluding 2008 and 2009 restructuring charges.

For Financial Services this year:

- Revenue to decline slightly, and
- Operating margin at approximately 39%, excluding 2008 and 2009 restructuring charges and loss on the sale of Vista Research.

For Information and Media in 2009:

- An 8% to 9% decline in revenue in view of continued weakness in advertising, and
- The operating margin will decline 300 to 400 basis points excluding 2008 and 2009 restructuring charges.

Summing up for the corporation in 2009:

- Revenue to decline 5.5% to 6.5%, and
- With continued tight expense controls, we expect earnings per share in the $2.20 to $2.25 range, excluding the second quarter restructuring charge and divestiture of Vista Research, although it appears we will come in at the low end of the range.

Thank you.

To access the accompanying slides online, go to:
http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=2421035

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