The McGraw·Hill Companies

The McGraw-Hill Companies
1st Quarter 2010 Earnings Conference Call

Prepared Remarks
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Thank you and good morning to our worldwide audience and thank everyone for joining us this morning at The McGraw-Hill Companies' first quarter 2010 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, the Company issued a news release with our first quarter 2010 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 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.

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

Good morning and welcome to our review of first quarter earnings and the outlook for the year. With me today is Bob Bahash, Executive Vice President and Chief Financial Officer.

We're going to start today by reviewing our first quarter operating results and guidance for the segments and the corporation. Bob will then provide an in-depth look at our financials. After the formal presentation, we will be pleased to answer any questions or take comments that you may have about The McGraw-Hill Companies.

Earlier today, we reported a 65% increase in diluted earnings per share for the first quarter. That's 33 cents versus 20 cents for the same period last year.

- Revenue increased 3.7%.
- But excluding the divestitures of *BusinessWeek* and Vista Research, revenue grew by 6.7% in the first quarter.

When the 43.2% increase in fourth quarter earnings per share was announced at the end of January, we said those results set the stage for more growth in 2010. Although the first quarter is seasonally the smallest of the year, we are clearly off to a good start.

The economy will continue to improve this year. Real GDP is expected to rise about 3.0% in 2010. We are encouraged by improvement in financial markets:

- Interest rates are expected to remain low;
- Bond spreads narrowed again in the first quarter; and
- We still expect growth in our key education markets.

With that as an overview, let's now review operations and our prospects by each of the operating segments. Let's begin with the McGraw-Hill Education segment.

McGraw-Hill Education

In higher education, it is called the echo effect—second semester ordering that echoes the pattern of first semester orders from the previous summer. In the seasonally light first quarter for Education, we saw the favorable side of the echo effect as our Higher Education Group once again reported solid results including double-digit growth in digital products and services.

- Revenue for the McGraw-Hill Higher Education, Professional, and International Group grew by 8.3% in the first quarter to $205.7 million.
- Revenue for the McGraw-Hill School Education Group declined by 9.0% to $111.6 million in the first quarter.

For McGraw-Hill Education in the first quarter:

- Revenue increased by 1.5%, and
- The operating loss was cut by 19.3% to $61.8 million.

The first quarter is typically a light one for McGraw-Hill School Education because of the seasonality of the market. It was accentuated this year in the state adoption market because North Carolina did not order. North Carolina is the only adoption state that usually makes substantial purchases of new materials before the end of March. It did so in 2008 and again last year, but not in 2010.

As a result, most of the orders from the adoption states in the first quarter were for supplemental, residual or intervention products. Adoption states sales were down slightly from last year but were offset by stronger results in the open territory.

We benefited from large orders from school districts in Ohio, Maryland and South Dakota that initiated adoptions in 2009 but completed the purchasing earlier this year as funds became available. The increase in the sale of instructional materials in the first quarter was offset by a decline in the testing market where we have elected to discontinue custom contracts in Florida, California and Arizona. In the formative market, we continue to make progress with *Acuity*, our market-leading assessment program. It's early in the year and we are watching buying patterns closely. In some adoption states, local school districts have two years or even longer to purchase materials.

In what may be an indication of the way stimulus funds are reaching districts we have seen a year-over-year increase in industry sales for six consecutive months. It started last September and has continued through February. That's not intuitive because historically the fourth and first quarters are the slowest each year for the el-hi market.

Based on early trends this year, we still expect the el-hi market to grow 6% to 7% in 2010 even though we are trimming our estimate for the state new adoption market. As you know, previously, we had forecasted this market to grow between $925 million to $975 million. We are now forecasting a slight decline in that—$875 million to $925 million, which still represents about an 80% year-over-year increase for the industry.

Although no formal postponements were announced during the quarter, our reduced estimate for the state new adoption market reflects pullbacks that have become apparent in several states. In Indiana, which is officially adopting K–12 math this year, the State Department of Education has recommended that districts delay purchasing until materials are available that align with the Common Core Standards—even though it will probably take the state several years to implement instruction and assessments based on the standards. The adoption has been funded, so it is difficult to gauge district response to this recommendation but some effect is probable.

As an aside, where Common Core Standards are an issue, we have promised to provide online and print supplements to cover any concepts or skills not presented in accordance with the standards in the newly state-approved materials now being sold.

As budget pressures drive more district-level postponements than originally anticipated, we are also forecasting lower spending in several other adoption states, including Georgia, California, Virginia and Kentucky. In Florida, the math adoption is looking very solid at K–5, but some districts are delaying high school math purchases for budgetary reasons. There is also a possibility that South Carolina will delay the implementation of its 9–12 math adoption. The reduction in the state new adoption market will be partially offset by higher residual sales in these states as districts buy replacement copies and consumable materials of their older programs.

We still expect a low single-digit decline in the industry's open territory sales. We are seeing some district-level postponements in the open territory, but the field sales force is also identifying new opportunities as the selling season develops and the outlook at this time is reasonably optimistic.

We continue to see pent-up demand in both the open territory and the adoption states. Federal stimulus funding distributed last year helped some districts implement delayed adoptions in the second half of 2009 and will contribute to purchasing in 2010. But the budget pressures are real, so we will continue to monitor market developments carefully.

It is early days in the battle for state new adoption dollars, and let me reassure you that our School Education Group is still aiming for a share of 30% or better this year. In testing, we continue to gain share in the market for formative assessments, which is largely made up of district-level adoptions. We also see new opportunities ahead for both formative and summative testing as the winners of federal Race to the Top grants begin to implement their long-range plans and as the movement toward Common Core Standards and assessments continues to gain momentum.

As many of you know, the Common Core movement represents a cooperative effort among the states to agree upon concepts and skills in math and language arts that all students should master at each grade level in order to meet internationally benchmarked criteria for college and career readiness. Drafts of the standards have been finalized and are now under review. Forty-eight states plus the District of Columbia are taking part in the movement, which has been endorsed by the U.S. Department of Education. The only two states that are not included at this point Texas and Alaska. Applicants that declare their intention to adopt the standards by August 2010 can earn extra points in the Race to the Top grant competition. Delaware and Tennessee have already won Phase 1 awards of $100 million and $500 million, respectively, and Phase 2 winners will be announced in September. Each state will have four years in which to spend its award, half of which will be distributed as sub-grants to the local districts. Later this year the Department of Education will also award a total of $350 million to multi-state consortia with winning proposals for developing new assessments based on the Common Core Standards.

All this means that we expect to see a very active market in the testing business over the next few years, with RFPs coming from consortia, states and districts. McGraw-Hill, with its outstanding reputation for psychometric research and its complete range of assessment and reporting capabilities, will be well positioned to benefit from these new opportunities. Present indications are that testing development work will begin in late 2010 or perhaps early 2011, and that the Common Assessments will be implemented from 2012 through 2014.

The Common Core movement has favorable implications for the instructional materials side of our business as well. We can expect to see more new purchasing as states adopt materials that incorporate the new standards, and we also anticipate delivering more content to the schools in digital form because most of the states' Race to the Top plans involve building out their technology infrastructures. We should also see cost savings in content development, as there will be less need for state-by-state customization in the common core environment.

In Higher Education, we continue to benefit from increased enrollments. According to our own survey and information from other sources, enrollments for the spring semester held steady with the gains recorded last fall. We believe that federal stimulus dollars also helped to increase enrollments last fall and did so again this year, although the effect is not easily measurable. The funding has gone to students in the form of increased Pell Grants, higher allowable tax deductions for college-related expenses, and a new Post 9/11 GI Bill that has provided educational subsidies for more than 150,000 veterans since fall 2009. Student aid got another boost in March when Congress passed the Student Aid and Fiscal Responsibility Act. It includes provisions to keep the Pell Grant program solvent and to continue increasing the maximum awards from $5,550 this year to $5,975 in 2017.

In the U.S. college and university market, students are embracing our digital products at a record pace. We saw strong growth:

- In usage of *McGraw-Hill Connect*™, our new homework management assessment platform;
- In implementations of our online courses; and
- In purchases of e-books.

We now have more than 1.2 million registered users of *McGraw-Hill Connect*™ and our other digital study and homework management products, with more to come. In fact, *McGraw-Hill Connect* will be added to more than170 courses that are planned for release in 2010.

Creating original, media-rich digital products in all our markets is a priority. In the first quarter, we introduced our first digital subscription products for the professional business market: They are:

- *Kiss, Bow or Shake Hands*: a global business etiquette database with information on customs in more than 60 countries; and
- *Perfect Phrases for Managers*: a performance support tool based on a series of successful McGraw-Hill books that helps managers find the right phrase at the right time.

For on-the-spot convenience, these products can be downloaded to virtually any digital device.

Also, for the business market, we launched a program called "Select™: E-Chapters in an Instant". This program enables customers to buy downloads of chapters from our best-selling business books as stand-alone items. More than 750 chapters are currently available from major titles in finance and investing.

In medicine, we added a sixth specialty site to our internationally successful *AccessMedicine* suite. It's called *AccessPhysiotherapy* and broadens our addressable market by going beyond medical education and clinical practice into the allied health field. It is a powerful new site, providing searchable access to our leading physical therapy and internal medicine titles, interactive imaging content, curricular management tracking tools and tests, and more than 80 videos and exclusive lectures.

We are also broadening our market geographically by signing a partnership agreement with the Chinese Education and Research Network, which will make our *Access* suite of products available for the first time to Chinese students, educators and researchers.

Just more fuel for the double-digit growth our digital products are already producing in professional markets.

Let's sum up for McGraw-Hill Education:

- Growth in key education markets in 2010;
- 6% to 7% growth in the elementary-high school market;
- 5% to 7% growth in the U.S. college market;
- Segment revenue growth of 6% to 7%; and
- Operating margin unchanged from 2009.

Financial Services

Robust growth in transaction revenue was a key factor in Financial Service's start this year.

In the first quarter for Financial Services:

- Revenue increased by 9.3%;
- Operating profit grew by 12.3%; and
- The operating margin was 39% versus 38% for the same period last year.

For Standard & Poor's Credit Market Services, the 15.4% increase in first quarter revenue was driven by:

- Record high-yield issuance;
- Strong growth in bank loan ratings;
- A solid gain in public finance;
- Modest improvement in structured finance;
- 18.4% growth in international markets; and
- 12.8% growth in domestic markets.

For S&P Investment Services, first quarter revenue declined by 1.5%. The decline can primarily be attributed to the divestiture of Vista Research and the expiration of contracts for independent equity research required by the research settlement.

Let's take a closer look at these numbers:
For S&P Credit Market Services, transaction revenue increased by 33.6%. That's revenue from new issuance in domestic and international markets. The key growth drivers in the first quarter were surging high-yield volume, bank loan ratings and public finance. Corporate high-yield debt issuance grew globally by 564.5% to set an all-time record for the first quarter, and obviously coming off a lower base. It was the best first quarter for speculative-grade issuance since 2007.

The surge was driven partly by private equity-backed companies refinancing the debt they took on for buy outs in the last decade. These companies aim to pre-empt a so-called maturity cliff of largely LBO-related loans coming due in the next few years. High-yield issuers raised billions of dollars in the first quarter as risk premiums tightened. The increase in global bank loan activity was primarily amend-to-extend to push out maturities.

Credit spreads—the excess interest rate over Treasury bonds—decreased dramatically during the past year. Both investment-grade and speculative-grade spreads continued to tighten in the first quarter and, as this table shows, were near or just below their five-year moving averages at the end of March. And, by the way, there was more contraction in April.

We have also seen steady and significant contraction in spreads across all asset-backed securities classes. As this table shows, there has been significant contraction in spreads for auto loans, credit cards and student loans since the beginning of 2009. U.S. public finance issuance in the first quarter of 2010 of $106 billion was up 17.4% and just missed the all-time first quarter record of $112 billion set in 2007. The muni market continues to be fueled by the growth of Build America Bonds. This program enabled municipalities to issue a huge amount of taxable debt. In the first quarter, taxable bonds represented 31% of the muni market, well above the previous record of 11%. Structured finance also contributed modestly to the increase, primarily from asset-backed securities and increases in re-REMIC activity in the U.S.RMBS market.

But the growth of transaction revenue—essentially driven by new issuance activity—is not the whole story. Non-transaction revenue is a critical component and here, too, we grew. Standard & Poor's Credit Market Services' solid base of non-transaction revenue grew by 8.1% in the first quarter and produced 67% of S&P Credit Market Services' first quarter revenue.

To reduce dependency on any single market or asset class, S&P created a deferred revenue stream by emphasizing recurring annual fees through frequent issuer programs, surveillance fees and subscription services. That's how we define non-transaction revenue. And despite changes in debt issuance levels, capital markets and the economic environment, we expect the non-transaction revenue stream to be durable for some time.

The growth of non-transaction revenue in the first quarter primarily came from increased subscriptions and annual fees. We are also benefitting from:

- Increased demand for products and services not tied to new issuance such as Ratings Evaluation Services;
- An increase in new credits under surveillance;
- Price increases; and
- A modest favorable foreign exchange impact.

Turning to the Investment Services side of S&P, Capital IQ and S&P Indices were primary drivers in the first quarter. Capital IQ continues to add clients. With more than 3,000 at the end of the first quarter, the number increased 13.5% from the same quarter last year and sequentially 4.8% since the end of 2009. To meet growing client demand, Capital IQ is expanding European and Asian operations by opening new offices in Milan and Tokyo.

S&P Indices are experiencing a rebound in asset-based revenue which is earned from issuers of exchange-traded funds and mutual funds benchmarked to our indices. Assets under management in exchange-traded funds based on S&P indices set a new record of $254.2 billion at the end of the first quarter, topping the record established at the end of 2009 by 2.9%. In the first quarter, 21 new exchange-traded funds based on S&P indices were launched, bringing the total to 238 exchange traded-funds, and endless permutations, as an index for every type of investment is our goal.

In March we introduced indices in:

- Commodities
- Fixed income
- Equities
- Strategy
- Customized for a number of clients

And more are on the way.

As we look at the pipeline for S&P Credit Market Services, here is what we see:

- High-yield issuance should continue at a good pace with proceeds predominantly used for leveraged loan repayments.
- The bank loan market will continue to be active.
- Refinancing needs will be a factor for some time with $2 trillion in debt maturities due through 2014.

- We anticipate a greater number of investment-grade corporate transactions in 2010, although at moderate par amounts compared to the high levels of 2009.
- The muni market still looks promising despite constant headlines about state and local budget deficits.

What the financial press fails to recognize is that these conditions have not translated into reduced ability to issue debt. Taxable bonds are expected to drive growth although traditional tax-exempt securities will continue to comprise the largest share of issuance.

- The structured finance market has improved, but new federal rules and regulations will increase the cost of securitization and could temper new issuance.
- Longer term, these new rules underscore the importance of securitization as a funding tool.

No discussion of prospects for Financial Services is complete these days without a review of the legal and regulatory outlook. Since our last update on litigation in late January, the courts have begun to issue significant decisions in lawsuits brought against The McGraw-Hill Companies and Standard & Poor's. At last count, 12 cases have been dismissed by eight federal court judges, 11 of which have been dismissed since the beginning of the year. During that same period, a motion to dismiss two related cases alleging fraud has been denied pending discovery; as in the Abu Dhabi case last September, the Court—and by the way, the same Judge Scheindlin who issued the Abu Dhabi ruling—was required to assume the plaintiffs' allegations to be true at this preliminary stage of the litigations. We believe both of these cases are without merit and will ask the Court to dismiss them as soon as discovery is concluded.

The 12 dismissals have occurred in all three of our major categories of claims. Again, the three major categories of claims are:

1. The "Underwriter" lawsuits that claim we are a distributor or seller of securities (which we're not);
2. The "Stock Drop" suits; and
3. Suits involving state law claims, including alleged fraud.

These recent favorable decisions have not attracted a lot of attention, so let's review what has happened since many of the key allegations against Standard & Poor's are starting to unravel under judicial scrutiny. Significantly, none of the dismissals have been based on the assertion of a First Amendment defense, underscoring again the erroneous claim by critics that Standard & Poor's uses the First Amendment to shield it from all legal claims.

In the first category, plaintiffs alleged that McGraw-Hill is liable under the Securities Act of 1933 as an underwriter or seller of residential mortgage-backed securities rated by Standard & Poor's. To date, four federal judges have granted our motions to dismiss in six separate "underwriter" actions. In light of these favorable rulings in the "underwriter" cases, class action counsel in another "underwriter" case has recently amended its Complaint in the Fort Worth Employees' Retirement Fund litigation by dropping all claims against Standard & Poor's and two other rating agencies.

In the second category, this is in the stock drop area, our motions to dismiss were granted in three cases in which purchasers of McGraw-Hill stock alleged the Company's statements about its earnings and ratings business were misleading and purportedly violated the Securities Exchange Act of 1934 and ERISA. In the third category, we can report three dismissals of various state law claims.

There also have been some significant decisions in cases in which Standard & Poor's and other rating agencies were not parties. In these cases, the plaintiffs attempted to assert claims against an issuer or an underwriter on the basis of allegedly misleading statements about ratings included in the disputed offering documents. Many of these claims were based on much-publicized testimony regarding rating agencies given at congressional hearings.

In three cases, the federal courts have rejected these legal claims outright. We believe that these decisions constitute meaningful legal precedent which should help guide judicial rulings in the remaining cases. The courts have been clear and unambiguous in their decisions. Here is what I mean:

- In dismissing the "underwriter" claims against the rating agencies in the New Jersey Carpenters Vacation Fund case, Judge Baer wrote: "Plaintiffs' allegations do not support an inference that the Rating Agency Defendants were involved in the sale or distribution of the securities such that they could be considered underwriters…"

- In rejecting claims that the rating agencies somehow "controlled" Lehman, Judge Kaplan wrote in the Lehman Brothers Securities and ERISA Litigation: "This complaint, fairly read, alleges only that the Rating Agencies had the power to influence Lehman with respect to the composition of the pools of mortgages to be securitized and the credit enhancements the Rating Agencies regarded as necessary to obtain the desired rating. But these allegations fall considerably short of anything that could justify a reasonable trier of fact in concluding the decision making power lay entirely with the Rating Agencies."

- In concluding that ratings are opinions and not statements of fact that are actionable under the securities laws, Judge Baer also pointed out that: "Credit ratings and the relative adequacy of protective credit enhancements are statements of opinion, as they are predictions of future value and future protection of that value."

- In dismissing the allegations, based upon alleged purported failures to disclose rating agencies conflicts of interest, Judge Kaplan wrote: "The Securities Act does not require disclosure of that which is publicly known, and the risk that rating agencies operating under a conflict of interest because they were paid by the issuers has been known publicly for years." And by the way, I might add for more than 40 years as a matter of fact.

- Another critical point was recognized by the court in the New Jersey Carpenters Vacation Fund case. In ruling that investors were adequately cautioned in offering documents about the risks and limitations of using credit ratings, Judge Baer wrote: "The Offering Documents adequately bespoke caution about the risk entailed by the credit ratings and credit enhancements…[and] disclosed the risks of relying on credit ratings, the potential inadequacy of credit enhancements and that a lack of historical data made future predictions about value inherently difficult. In other words, the Offering Documents "warn investors of exactly the risk the plaintiffs claim were not disclosed."

A few minutes ago, I said that the federal courts were making important decisions in three similar cases in which Standard & Poor's and the other rating agencies were not defendants. They are:

- *Plumbers Union Local versus Nomura Asset Acceptance Corp.*
- *New Jersey Carpenters Health Fund versus DLJ*
- *New Jersey Carpenters Health Fund versus RALI*

Addressing after-the-fact criticism of rating agencies, Judge Stearns pointed out in the *Plumbers Union Local No. 12 Pension Fund versus Nomura*, that: “None of the purported comments made by S&P and Moody’s employees in the wake of the collapse of the sub-prime mortgage market (in 2007) ‘support the inference’ that the ratings were compromised as of the dates (in 2005 and 2006) when registration statements and prospectus supplements became effective.”

We think there are some clear takeaways from these recent decisions. The courts are ruling that:

- Rating agencies are not underwriters under the securities laws.
- Rating agencies are not sellers of securities under the securities laws.
- Rating agencies are not controlling persons under the securities laws.
- Ratings are opinions, not statements of fact.
- After-the-fact criticisms of rating agencies such as those which have appeared in the press do not support an inference that rating agencies did not believe their ratings were appropriate at the time they were issued.
- Rating agencies’ alleged conflicts of interest were widely known by investors.
- Investors were adequately cautioned about the risks and limitations of using credit ratings. For example, they are not recommendations to buy, sell or hold securities. They never were.

Clearly, the courts are also demonstrating that they understand the difference between credit risk and market risk. That others do not is on display almost daily by some sophisticated investors who claim they relied on ratings to make their investment decisions for themselves or as fiduciaries for others.

Turning to the regulatory situation, it remains a fluid situation. Legislation in the Senate is paradoxical and a potential problem. A core tenet in the proposed legislation—expressed unambiguously in the Preamble to the Senate bill—says NRSROs should be subject to the same standards of liability and accountability as 1) securities analysts who recommended the buying of securities; 2) the investment banks that structured and sold securities; and 3) auditors who certified the issuers’ financial statements and other market participants.

And yet as currently written, other parts of the legislation would lead to the opposite result. They would impose materially different legal pleading standards for federal securities fraud claims distinguishing NRSROs from all other defendants in the same case. In other words, a separate, lower pleading standard would apply only to NRSROs in the same cases alleging federal securities fraud violations.

And let me be clear here. We are not looking for special legal treatment in lawsuits for securities fraud. We are simply saying that NRSROs should be subject to the same legal pleading standards as everyone else. No more. No less. To impose a lower pleading standard on NRSROs is clearly unprecedented and discriminatory. We fully support Congressional proposals to increase accountability, transparency and oversight of credit rating agencies. They should be accountable if they knowingly issue misleading ratings. We continue to work with Democrats and Republicans to make our position very clear.

Passage of the bill by the Senate and reconciliation with the version passed by the House of Representatives is difficult to predict. Some expect the Senate to vote on its bill before Memorial Day, but there is also uncertainty on when the Senate and House would convene a conference committee to work out differences. Stay tuned.

S&P is also focused on new SEC regulations that go into effect on June 2. A key new rule is known as 17g5. It requires issuers and arrangers to make the underlying information they provide on structured financing available to all NRSROs whether they are paid or not to produce a rating. The goal is to encourage NRSROs which have not been asked to rate transactions to issue unsolicited ratings.

S&P is working with market participants to implement this new rule. S&P is also working to meet new disclosure rules on its history of ratings actions. We also continue to work with regulators overseas to ensure timely compliance with their new rules and regulations. We continue to push for a regulatory framework that provides consistent standards across all jurisdictions.

So, let me sum up for Financial Services:

- The market is clearly recovering;
- We are making progress in the courts;
- We are proceeding to meet the new regulatory requirements;
- The outlook for legislation in the U.S. remains fluid—and by the way, Europe, Australia and Japan are complete;
- Revenue is expected to grow in high single-digits with improvement at S&P Credit Market Services and S&P Investment Services; and
- Operating profit will grow.

Operating margin will decline by about 100 basis points reflecting investments in infrastructure to support future growth and comply with new regulatory requirements.

Information & Media

In the first quarter:

- Revenue declined 8.5%.
- Operating profit increased by $25 million to $27.8 million.
- The operating margin was 13.5% compared to 1.2% for the same period last year. The last time we had a full-year margin in this range was in 2004. That year the segment reported an operating margin of 14.9%.

In the business-to-business market, we have been building on leading industry positions where Information & Media products and services represent the standard or provide leading benchmarks.

A lot of our progress has been masked by deterioration in the advertising market experienced by *BusinessWeek*. In the first quarter, the impact on operating profit and the operating margin is apparent now that *BusinessWeek's* expenses have been eliminated. And because *BusinessWeek* was not divested until December 1, 2009, the positive impact on year-over-year comparisons will be with us for 11 months of 2010.

Excluding the divestiture of *BusinessWeek*, revenue for the segment grew by 4.3% and the revenue for the Business-to-Business Group increased 4.5% instead of the reported 9.5% decline. Revenue growth at Platts was the primary driver in the Business-to-Business Group's first quarter. Demand for our global energy data and information products produced strong growth in both domestic and international markets. There also was improvement at J.D. Power and in aviation. Softness in construction reflected difficult conditions for smaller regional contractors in the current downturn.

The digital transformation of this segment continues to be a positive factor. Business-to-Business digital products and services accounted for more than 60% of the Group's first quarter revenue and contributed to margin improvement. Broadcasting produced a 2.2% revenue increase in the first quarter, benefiting from a pick up in auto advertising and political advertising.

Summing up for Information & Media:

- The 2009 sale of *BusinessWeek* will impact revenue and the operating margin in 2010.
- Revenue will decline in the mid single-digits, but excluding $99 million from *BusinessWeek* will increase in the mid single-digit range.
- Operating margin will rebound, climbing into the mid-teens.

That completes our review of operations and the outlook for the segments in 2010. Summing up for the Corporation:

- The year is off to a good start.
- But until we get greater visibility on trends in our key markets, we are maintaining our original guidance of diluted earnings per share of $2.55 to $2.65.

With that, let me turn it over to Bob Bahash, our CFO, and go into a bit more depth on the financials.

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

Thank you Terry.

Maintaining a strong financial position is a corporate priority. We had a healthy balance sheet at the end of 2009 and we ended the first quarter in roughly the same position. Some key measures were virtually flat with our year-end position.

- Total debt stood at $1.2 billion, and
- Cash and short-term investments at $1.235 billion, which resulted in a slight positive net cash position.

Our debt is comprised entirely of long-term unsecured senior notes, as we have no commercial paper outstanding. We will look at our free cash flow in more detail in a few minutes, but first I want to focus on expenses for 2010.

Segment expenses were down 2.6% in the first quarter, but we expect some ramp up for the balance of the year as we make investments in technology, incur additional expense related to selling and marketing at McGraw-Hill Education and also incur expenses to increase our talent base in each of our segments to contribute to our future growth. Increased investments later in the year are a key reason why we are not changing our guidance after reporting a substantial increase in earnings per share in the seasonally small first quarter.

So, let's look at what we anticipate in each of the segments as the year unfolds. As a reminder, for purposes of full year expense guidance, I will speak to "adjusted" expense growth, which represents expense growth adjusted to exclude 2009 restructuring charges as well as the loss on the divestiture of Vista Research and the gain on the divestiture of *BusinessWeek*.

Let's start with McGraw-Hill Education. The year is off to a good start. First quarter expenses declined 2.6%, or 4.7% at constant currencies. The segment benefited from savings from the 2nd quarter 2009 action to combine our core basal publishing operations with our alternative basal and supplemental publishing operations, as well as reduced expenses due to the planned phase out of statewide custom contracts in California, Florida and Arizona.

For the full year 2010, as Terry indicated, we now expect segment revenue growth of 6% to 7% versus the previous guidance of a 7% to 8% increase. Despite the reduced revenue growth, we are maintaining our guidance of an unchanged adjusted operating margin as we now anticipate expenses to increase 6% to 7% compared to our previous guidance of a 7% to 8% increase.

Expense growth is driven by an increase in selling and marketing costs due to the robust state new adoption opportunities. Given the seasonality of the business, these costs are generally not significant in the first quarter. Additionally, we continue to invest in both technology and personnel to support our digital initiatives, particularly at Higher Ed and Professional, in order to provide value and choices for our customers.

For Financial Services, expenses increased 7.5% in the first quarter. At constant currencies and excluding the impact of the divestiture of Vista, expenses increased 5.4%. For full year 2010, we continue to expect expenses to increase roughly 9% to 10% versus 2009 adjusted expense. Expense growth is largely driven by:

- Continued investment in our fast growing businesses;
- The carry over impact of 2009 hires as well as planned hires in 2010; and
- Additional investments to support our regulatory and compliance efforts.

The impact of investments, including new hires, will be more pronounced as the year progresses. Our expense guidance assumes approximately $20 million in additional costs related to our regulatory and compliance initiatives, though this is obviously highly dependent on the final form of regulation.

At Information & Media, first quarter expenses declined 19.9%, or 20.5% at constant currencies. The divestiture of *BusinessWeek* reduced revenue by $27.8 million, and expenses by $40 million, for a positive profit impact of roughly $12 million in the quarter. The segment also benefited from restructuring actions taken in 2009. For the full year, Information & Media will reflect savings from the *BusinessWeek* divestiture of $38 million, as we manage vacant space and certain other support costs within Corporate Expense, which is increasing approximately $13 million due to the divestiture.

For 2010, reflecting primarily the divestiture of *BusinessWeek*, expenses are expected to decline in the low teens versus 2009 adjusted expenses. Corporate Expense in the first quarter was $35.8 million, a $2.4 million increase versus prior year. The increase was primarily driven by increased excess space. For 2010, we continue to expect corporate expense to increase $25 to $30 million. The primary reason for the increase is driven by higher excess space in New York resulting from the *BusinessWeek* divestiture as well as the restructuring actions at McGraw-Hill Education. Excess space will increase later in the year when *BusinessWeek* moves to the Bloomberg offices.

Now let's discuss free cash flow. As a reminder, we define free cash flow in the following manner: We start with Cash Provided by Operations, per the GAAP Cash Flow Statement. We then subtract the following items:

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

The result is free cash flow that is available for acquisitions, share repurchases or to pay down debt. For the quarter, free cash flow improved to a negative ($12.8) million compared to negative ($56.2) million in the prior year. Since this is by far our smallest quarter due to the seasonal nature of our businesses, we normally incur a net cash outflow in quarter one. Improved operating results reduced our cash outlay.

We continue to anticipate free cash flow this year in the range of $550 million to $600 million. Reduction in free cash flow versus 2009 is due largely to more challenging working capital comparisons as well as increased investments, which I will address in a moment. Regarding our U.S. pension plan, we still anticipate no cash funding requirements this year, but continue to expect an increase in pension expense of approximately $20 million in 2010.

Earlier, I pointed out that our investments would grow in 2010. So let's take a look at some of the growth areas:

- Prepublication investments were $29.9 million in the first quarter, a decrease of $12.8 million compared to the first quarter of 2009, largely due to timing. We expect prepublication investments to ramp up in the second half of the year. For full year 2010, we continue to expect prepublication investments of approximately $225 million to $235 million, a $48 million to $58 million increase versus 2009, primarily due to opportunities in the growing state new adoption market.
- Purchases of property and equipment were $7.6 million in the first quarter, a slight decrease versus the first quarter of 2009. But we continue to expect full year expenditures of approximately $90 million to $100 million versus $68.5 million in 2009, and this is largely driven by increased technology spending.

Let's now review non-cash items:

- Amortization of prepublication costs was $25.8 million in the first quarter 2010, a $1.5 million decrease versus the prior year. In 2010, we continue to expect $260 million to $265 million, versus $270 million in 2009. This decrease reflects the lower level of investment made in 2009.
- Depreciation was $25.9 million in the first quarter versus $29.4 million in the first quarter 2009. We now expect depreciation to be closer to $115 million versus our previous estimate of $120 million due to a shift in timing of certain capital expenditures.
- Amortization of intangibles was $10 million for the first quarter of 2010 and we continue to expect it to be approximately $40 million for the full year.
- Our diluted weighted average shares outstanding was 316.3 million in the first quarter, a 4.2 million share increase versus the same period last year and a 1.8 million share increase from the fourth quarter of 2009. The increase was driven by stock price appreciation as well as issuance related to employee plans. Fully-diluted shares at the end of the quarter were approximately 317 million.

- Net interest expense was $22.0 million in the first quarter. That compares to $20.6 million in the same period last year and $20.0 million in 4Q 2009. We continue to expect full year interest to be roughly comparable to 2009, which was $76.9 million.

Regarding the company's effective tax rate, the rate in the first quarter 2010 was 36.4%. That's unchanged from 2009. And we expect a comparable rate for the full year. Now, while it does not impact the tax rate, I did want to point out that in the first quarter we made a cash tax payment of approximately $35 million due to organizational restructuring actions related to our international operations that will largely be recovered through reduced tax payments in the second half of the year.

There has been a great deal of publicity recently regarding The Patient Protection and Affordable Care Act (signed into law on March 23, 2010) and the Health Care and Education Reconciliation Act of 2010 (signed into law on March 30, 2010) which together eliminate the tax deductibility of employer-paid retiree prescription drug benefits which are reimbursed by the government in accordance with the Medicare Modernization Act of 2003. Our post-retirement benefits program does not include a very significant portion of retiree prescription drug benefits which are reimbursed per the Medicare Modernization Act. So, in short, the impact of this new legislation on our financials is immaterial.

Our unearned revenue continues to grow, ending the quarter at $1.1 billion, up 2.8% from the prior year. At constant foreign currency exchange rates and excluding the impact of divestitures, most notably *BusinessWeek*, it grew 4.3%.

Financial Services makes up 75% of the Corporation's total unearned revenue. While comparatively small, McGraw-Hill Education continues to show strong unearned revenue growth driven by an increase in subscription-based products, particularly at Higher Education. For 2010 we continue to expect mid single-digit growth in unearned revenue.

Lastly, I would like to provide an update on our share repurchase program. In January, we announced that we planned to resume share repurchases in 2010. In the first quarter we did not make any repurchases, so there continues to be 17.1 million shares remaining from the 2007 authorization from the Board of Directors. We remain committed to resuming the program in 2010.

Thank you.

To access the accompanying slides online, go to:
http://investor.mcgraw-hill.com/phoenix.zhtml?c=96562&p=irol-EventDetails&EventId=3012033

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