The McGraw-Hill Companies
4th Quarter 2006 Earnings Conference Call

Prepared Remarks
January 25, 2007

Donald Rubin
Senior Vice President, Investor Relations
The McGraw-Hill Companies

Thank you. And good morning and thank you everyone for joining us today for The McGraw-Hill Companies' fourth quarter 2006 earnings conference call. I'm Donald Rubin, Senior Vice President of Investor Relations at The McGraw-Hill Companies.

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

This morning the corporation issued a news release with our fourth quarter 2006 results. We trust you have all had a chance to review the release. If you need a copy of it and the financial schedules, they can be downloaded from 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 Steve Weiss in our New York office at (212) 512-2247 subsequent to this call.

Today's update will last approximately an hour. After the 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, Harold McGraw III.

Terry.

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

Good morning and welcome to our review of The McGraw-Hill Companies fourth quarter and year-end results.

As Don said, joining me for today's conference call is Bob Bahash, Executive Vice President and Chief Financial Officer of The McGraw-Hill Companies.

We will start today by reviewing the performance of our business and the outlook for 2007. Bob will then review our financial performance and he'll discuss some of our expectations for 2007 as well. When our presentations have concluded, we will be pleased to answer your questions about The McGraw-Hill Companies.

Earlier this morning, we announced full year and fourth quarter results for 2006. We reported that earnings per share increased 8.6% to $2.40 for 2006 and by 12% to $0.56 for the fourth quarter. Revenue grew by 4.2% for the year to $6.3 billion and 3.4% to $1.6 billion in the fourth quarter.

The results include a number of charges, largely due to the expenses for stock-based compensation, which are carefully enumerated in the earnings release and the schedule that accompanies it. Bob Bahash will comment on them later in the call.

The bottom line is that we clearly have had a successful year and were also able to exceed our guidance for both 2006 and the fourth quarter. And we're pleased about that.

With continued strength in Financial Services and a rebounding education market, we are poised for double-digit earnings growth in 2007. All segments will contribute to this performance with improving operating margins. We are using $2.50 as the base for our double-digit earnings guidance for 2007. We arrived at this figure by adding back the GAAP earnings of $2.40, the non-recurring charges in 2006 of $0.04 for the elimination of the restoration stock option programs, and the $0.06 for restructuring. So $2.50 is the base for the double-digit guidance for 2007.

Management is dedicated to creating total shareholder value. We are very proud of the fact that our total return has outperformed the S&P 500 for each of the last ten, seven, three and one-year periods.

As part of our commitment to advancing total shareholder value, we have been steadily returning more cash to shareholders through stock buybacks and increased dividends.

At the end of January, the Board of Directors at the regular monthly meeting on January 31st will review the dividend and the buyback programs. We bought back 28.4 million shares in 2006. Cash dividends have increased at a 10.3% compound annual growth rate since 1974. Obviously, we will have more to say about the dividend and future buybacks in a few days.

As we look ahead, our economists believe slower economic growth should permit the Federal Reserve to lower interest rates around mid-year. The Fed has maintained the federal funds rate at 5.25% but could ease to around 4.5% by the end of 2007. Corporate cash flow is expected to remain strong. So will capital spending. State finances are in good shape, and of course that is a plus for the education market.

With this background in mind, let's look at operations and why we are optimistic about our growth prospects for 2007.

McGraw-Hill Education

Let me begin with McGraw-Hill Education.

The book ends for education in 2006 were:

- Growth in the Higher Education, Professional and International markets, which produced 47% of education's revenue in 2006, and
- A decline in the School Education Group which is largely attributable to a weaker elementary-high school market and tough comparisons after a very successful 2005 performance.

Revenue for the segment declined in 2006 by 5.5%. Operating profit declined 19.8%. That includes incremental expenses of $19.6 million for stock-based compensation and a charge for the elimination of the restoration stock option program.

On a non-GAAP basis the operating margin was 13.8%, and that excludes the charge for the elimination of the restoration stock option program, and restructuring charges of $16 million in the second half. Putting these charges back in, it would be 13%. As part of the restructuring, we vacated some facilities and eliminated 450 positions.

In a weaker year for state new adoptions, we reduced the segment's costs and expenses by nearly 3.0%.

Softer market conditions and challenging comparisons were most pronounced in the fourth quarter. The School Education Group's revenue fell 30.2% in the fourth quarter and 12.4% for the year. In 2005, we received $44 million in late new adoption orders from Texas which helped boost our fourth quarter revenue by 23.6%, and so the comparison makes it difficult. In 2006, there was no major order from Texas and there was additional weakness in the testing business.

Our performance in important state new adoptions in 2006 produced some outstanding successes and some disappointments:

- A 5% share of the Florida elementary science adoption, but a 39% share of the larger secondary market.
- A 15% share of the elementary social studies adoption in California, but a 32% share of the middle school and a 40% share of the high school market.

These exceptional capture rates in the middle and high school markets and our year-over-year increase in open territory sales couldn't offset the tough comparisons from 2005 and a 30% decline in state new adoption opportunities in 2006. We had expected the el-hi market in 2006 to finish flat to down 4%. In fact, the market declined by 5.8% and even the industry's open territory sales were off 0.3%—essentially flat in 2006—according to AAP figures.

Our School Education Group outperformed the competition in open territories benefiting from a strong showing from *Treasures*, our new elementary reading basal. Although our secondary science and social studies programs were very successful, we underperformed in the state new adoption market.

In testing, we saw a continuing decline in the sales of norm-referenced shelf tests, which are being displaced by the state-specific, standards-based assessments required under the federal No Child Left Behind legislation. In the fourth quarter, volume from custom contracts declined as states reduced the scope of work on several of our continuing contracts.

We have also discontinued some low-margin custom contracts. Service revenue for assessment contracts declined from $246.1 million in 2005 to $214.4 million in 2006.

The good news is that starting in 2007 the performance of our School Education Group will definitely improve. There are several reasons for this optimism.

One is that we start with a growing market. The state new adoption market enters the first of three consecutive growth years and could increase by as much as 15% in 2007. We now expect open territory sales to grow in the low to mid single-digit range. The combination should lead to market growth of 4-to-6% this year. We expect to outperform that. Clearly, year-over-year comparisons will be easier for our School Education Group in 2007.

But we also expect to do better because the School Education Group will be participating in more of the addressable market in 2007 than it did in 2006.

In most years, we participate in virtually the entire state new adoption market. But in 2006, for strategic reasons, we competed for about 80% of the available dollars in the state new adoption market. We captured about 25% of the market in which we competed, but only 20% of the total available state new adoption market – well below our usual capture rate, which normally runs about 30%.

In 2007, we have timed the introduction and enhancements of new products to pursue bigger growth opportunities in a more robust market.

- In science, we have new elementary and secondary programs which have been customized for major adoption states.
- *Real Math*, a skills-oriented elementary program, won a number of small- and medium-sized adoptions last year and is well positioned for more growth in 2007 in both open territories and adoption states where it has been submitted. Student tests were positive in schools that piloted the program last year and that will add to the momentum for this research-based program in 2007.
- *Everyday Mathematics*, the best-selling program in the reform-oriented segment of the K-6 market, is continuing to win new business. We will extend the brand into the secondary grades with a new program in 2007.
- *Reading with Purpose* for middle schools and *The Reader's Choice* for high schools are new series for the important secondary reading and literature market. We had some early success with these programs last year in the open territory and expect them to be very competitive in the state new adoption market in 2007.
- *Treasures*, the new basal reading program for the elementary schools, will build on the good start it made in the open territory last year.
- We are enhancing and expanding our lineup of products in reading and math for the fast-growing intervention market. For example, we are adding middle school components to our successful *Number Worlds* and *Kaleidoscope* programs. *Jamestown Reading Navigator*, a subscription-based program for grades 6 through 12, was piloted with more than 100,000 students in 2006. The new program had early adoptions last year in Massachusetts, Texas and Florida and recently won state-level approval for purchase in 2007 by districts in California, Tennessee and West Virginia.

We also enter 2007 with a stronger organization to compete in the core basal market. As you may recall, we combined our elementary and secondary basal publishing groups last year. That reorganization is now 100% complete.

We believe this streamlining improves:

- The sharing of resources—very important;
- The delivery of competitive pre K-12 solutions;
- Our cost efficiencies from product development through sales and marketing; and
- The growth of our top line.

We compete with a spectrum of products in the key reading and math markets. This depth-and-breadth strategy encompasses the balanced basal segment in the middle and the progressive and skills-based market. That gives us an extraordinary range of options for meeting the needs of students and teachers in a very diverse marketplace.

We expect some improvement in the testing market as technology investments help us increase our efficiency. We will also be making new investments to improve our penetration of the rapidly growing formative testing market. This is the so-called low-stakes market because educators use formative assessments during the school year to gauge how well students are prepared to take the summative or high-stakes test at the end of the academic year. With the *No Child Left Behind Act's* emphasis on accountability for student performance, the market is looking for better ways to monitor and diagnose classroom progress. Teachers are realizing that there are issues with many of the homegrown assessment programs they've been using. Most are not online and turnaround time is slow.

Our new formative program is online and customized to meet state standards. It provides predictive and diagnostic tests to meet the market's evolving demand for measurement-based formative assessment. We are very encouraged by the initial response to the program.

We're also expecting more improvement in 2007 from our Higher Education, Professional and International Group.

In 2006, our higher education and professional products grew both here and abroad. We had a strong finish in the international and professional markets. Our performance in the U.S. college market softened in the fourth quarter with only the Business and Economics imprint showing a gain for the period. The best performance for the year was turned in by our Science, Engineering and Math imprint, which had solid growth.

For 2006, it now looks like the U.S. college and university market grew by about 3%, somewhat better than our performance. We expect the market to grow about 4% in 2007 and think our strong list of new products will give us an opportunity to do better. Higher education is expected to grow faster in international markets.

Our growing array of digital products and services contributed to growth in 2006 and will do so again in 2007. In the college and university market, we are getting some traction with *Homework Manager* and similar digital products in accounting, math and world languages. We have also introduced 40 new online courses for the college market that should have a positive impact in 2007.

These online courses incidentally are finalists in two categories — "Best Education Solution" and "Best Postsecondary Course and Content Management Solution" — for the prestigious CODIE Awards from the Software & Information Industry Association.

In the professional market, we will continue to add to our lineup of digital products for medical professionals. We started with *Access Medicine*, which is now used in more than 42 countries and by virtually all U.S. medical schools. Last July, we launched *Access Surgery*. It follows the *Access Medicine* model and combines leading McGraw-Hill reference texts with digital video. This month, we will launch *Access Emergency Medicine*. At mid-year, we will introduce *Access Pharmacy*. Other specialties will follow. These are all subscription products that sell on a global basis.

So, let's sum up for McGraw-Hill Education:
- Improved prospects in a growing elementary-high school market in 2007,
- A robust state new adoption market starting in 2007,
- A growing spectrum of products to serve a diverse el-hi market,
- Growing global growth prospects in higher education and professional markets,
- More growth in digital products as the convergence of technology and content increases the addressable market, and
- Margin expansion in 2007.

Financial Services

Let's now review the Financial Services segment and go through those results and prospects.

This segment finished the year on an upswing with revenue improving 22.1% in the fourth quarter and with a good pipeline to start 2007 — all the more impressive since the hot U.S. residential mortgage-backed securities market started cooling down a bit in 2006.

Revenue in 2006 increased 14.4%, but by 19.4% on a non-GAAP basis, reflecting the sale of Corporate Value Consulting in September 2005.

Operating profit increased by 18.0%, reflecting $30 million in incremental expenses for stock-based compensation and a one-time charge for the elimination of the restoration stock option program.

The operating margin for the year was 43.8%, up from 42.5% in 2005.

Solid growth in equity and fixed income information products and services produced new records at Standard & Poor's for revenue, operating profit and operating margins in 2006.

The year was marked by solid contributions from rating services, data and information products, and index services. We have said that before and we are confident that we will say it again in 2007. Clearly, the solid and growing lineup at S&P continues to contribute to the sustainability of its performance while reducing dependence on any single product or asset class.

In ratings, we grew solidly domestically and abroad. In the fourth quarter, the share of revenue from international ratings and services topped the 40% mark for the first time in S&P's history, accounting for 41.8% versus 38.4% for the same period last year. For the full year, international produced 38.6% of ratings revenue, up from 37.0% in 2005.

The structured finance market continues to be a strong driver. In the fourth quarter, structured finance's performance was primarily attributable to growth in collateralized debt obligations and commercial mortgage-backed securities.

In the CDO market, there was strong investor demand in the cash flow and synthetic sectors as well as increases in collateralized loan obligations, which benefited from growth in leveraged loans stimulated by merger and acquisition activity.

Asset-Backed Alert, an industry newsletter, reported on January 19 that in 2006 S&P for the ninth straight year rated more asset- and mortgage-backed securities than any other agency. The measures are S&P's ratings of dollar volume issuance and the number of deals.

S&P also benefited from a substantial pick up in the corporate market in the fourth quarter. Public finance issuance finished the year strongly. Some, but not all of the strength, was captured by the quarterly flow of new dollar volume issuance this year.

As this bar chart shows, U.S. corporate dollar volume issuance grew year-over-year in each quarter of 2006 and finished with a surge in the fourth quarter. For the year, U.S. corporate issuance was up 43.8% as investment-grade and high-yield issuance both set records.

Public finance issuance was off about 7% in 2006, but produced a gain of nearly 17% in the fourth quarter as December volume soared. This was the most active December market in public finance since 1985. Seven of the 14 largest deals of the year were sold in the fourth quarter.

The U.S. residential mortgage-backed securities market rose at the start of 2006, but dollar volume issuance started declining in the third quarter. That trend continued into the fourth quarter. Thanks to a strong start in 2006, U.S. residential mortgage-backed securities issuance for the year finished ahead by about 1.4%.

In Europe, the residential mortgage-backed securities market dollar issuance was up for most of the year and was exceptionally strong the fourth quarter. For the year, European issuance in this asset class was up 58.9%.

The commercial mortgage-backed securities (CMBS) market produced year-over-year gains in dollar volume issuance for each quarter of 2006 and surged dramatically in the fourth quarter. As you may recall, we started talking about this issuance demand starting to pick up in early 2005, and it has, and it is steadily increasing. For the year, commercial mortgage-backed securities dollar volume issuance was up 27.6% in 2006. The CMBS market was also very strong in Europe in the second half as issuance continued to build. For 2006, CMBS issuance in Europe was up 37.3%.

Asset-backed dollar volume issuance in the U.S. showed year-over-year gains in the first and third quarters, but ended the year off by 4.4%.

The market was also strong for ratings and services that are not directly tied to new issuance. These services accounted for 24.5% of ratings in the fourth quarter and 23.9% for the year. We expect revenue in this area to increase again in 2007. Bank loan ratings, counterparty credit ratings, financial strength ratings and credit estimates will lead the growth. In fact, we expect growth in all asset classes in 2007 except for the U.S. residential mortgage-backed securities where issuance will probably decline around

10-to-15%. International growth will be strong again in 2007 with all regions expected to produce increases for the year.

We've also worked very hard in recent years to reduce our dependence on transaction revenue through the growth of frequent issuer and surveillance programs. A measure of our success is the growth of unearned revenue. The corporation's unearned revenue grew by more than 15% last year to $983.2 million. The increase is primarily attributable to Financial Services' ratings products.

In equity markets, S&P continues to expand and grow. Assets under management in exchange-traded funds based on S&P indices increased 19.3% in 2006 to $161.2 billion. We will continue to expand and add index services in new asset classes, such as real estate. Our goal is to provide an index for every type of investment style.

In the fourth quarter, 10 new exchange-traded funds based on S&P indices were introduced bringing the year's total of new exchange-traded funds to 35. All told, there are now 87 exchange-traded funds worldwide using S&P indices. We anticipate 13 more ETFs will be launched in the first quarter of 2007.

There is continuing global demand for our equity and fixed income information products and services. Since we acquired Capital IQ in 2004, the client base has doubled to more than 1,700. Last fall, we added data from S&P ratings to the Capital IQ offering. Leveraging and extracting greater value from S&P's content is a key strategy and we are pleased with the progress we're making here.

So, let's sum up for Financial Services:
- Continued strength in ratings,
- Solid growth in international markets,
- Excellent growth in data and information and indices,
- Another year of double-digit top- and bottom-line growth in 2007, and
- More margin expansion.

Information & Media

Now, let's review Information & Media.

As we know, this is a segment in transition as we take advantage of new opportunities to deliver information and analytics over the Internet to our customers in the business-to-business markets. We are also pleased with the performance of J.D. Power and Associates, which we acquired in April 2005.

These factors contributed to the 5.7% increase in revenue for the year, the 17.6% decline in operating profit, and an operating margin of 5.1%.

Operating profit included:
- $14.1 million in incremental expenses for stock-based compensation and a one-time charge for the elimination of the restoration stock option program.
- Restructuring charges of $8.7 million for employee severance costs for the reduction of approximately 150 positions, and
- A change in revenue recognition for the transformation of Sweets from primarily a print catalog to a bundled print-and-online service. As a result of this change, there were reductions of $23.8 million in revenue and $21.1 million in operating profit in the fourth quarter.

- Favorable developments over certain disputed billings also benefited segment comparisons by $8.3 million.
- There was also the impact of eliminating *BusinessWeeks'* European and Asian editions. They produced approximately $26 million in revenue in 2005.

The year in advertising was mixed.

Political advertising at our Broadcasting Group was very strong in the fourth quarter and for the year. Races for governor in California and Indiana, contests for the House of Representatives in Denver and Indianapolis and issue and proposition advertising in California were key factors in producing more than $16.8 million in political advertising in 2006. Some of that gain was offset by the loss of Monday *Night Football* at all our ABC affiliates and a decision not to renew the *Oprah Winfrey* show in two of our markets, San Diego and Denver.

Broadcasting revenue increased 7.5% to $120.6 million for the year and 3.5% in the fourth quarter to $33.6 million.

Off a small base, revenue at *BusinessWeek.com* grew by 45.7% last year and we are looking for more growth in 2007. *BusinessWeek's* ad pages were essentially flat in 2006 and up 1.6% in the fourth quarter. We expect some improvement at *BusinessWeek* this year.

In total, advertising contributed slightly less to the corporation's revenue in 2006—about 5.3% of our revenue is advertising. That compares to 5.6% of the total revenue in 2005.

In looking ahead, we expect our information products and services to drive improvement in the segment. We will be delivering higher value-added information to readers and advertisers by focusing on a few areas:
- News and information in text, audio and video formats,
- Data and analytics and workflow tools and services,
- Search advertising and lead generation, and
- Online community portals producing user-generated content.

Construction will obviously benefit from a pick up in Sweets as revenue for the bundled print and online services will be recognized as earned in 2007. This is a significant transformation for a 100-year-old service.

J.D. Power and Associates had a solid gain in the fourth quarter and is poised for another good year in 2007 and more global expansion. We're seeing strength in the non-auto segment. Financial services and insurance, real estate and construction all showed gains.

As this graph shows, the outlook for the global automotive market over the next several years is very strong, particularly in the Asia-Pacific region. In China alone, auto sales are expected to rise in seven years from 6.7 million to 12.9 million units. Given the complex and fast-changing nature of the Chinese automotive market, solid information on industry and customers is critical.

That's why J.D. Power and Associates last September acquired Automotive Resources Asia, which has been specializing in the Asian car markets since 1993. The combination with J.D. Power, which has been providing voice-of-the-customer information in China's auto market since 2000, adds a whole new dimension to our services for the fast-growing region and enhances our prospects.

Additionally, news about oil and pricing in a volatile market will continue to drive demand for Platts' products and services and we're pleased with the performance in '06 and expect more in '07.

Let's sum up for Information & Media:
- Expanding services in a digital world,
- Growth in higher value-added information products, and
- Margin expansion in 2007.

For the corporation in 2007, we look for:
- Double-digit earnings growth,
- Another year of double-digit top- and bottom-line growth at Financial Services,
- Solid gains in our School Education business,
- Good growth in the global higher education market,
- More progress at Information and Media, and
- Margin expansion in all three segments.

With that, let me turn it over to Bob Bahash. Bob will talk a little bit about our financial performance and strength.

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

Thank you Terry.

As part of The McGraw-Hill Companies' commitment to produce total shareholder value, we have been returning cash to shareholders through increased dividends and share repurchases. We built on that record again in 2006 by returning $1.8 billion to shareholders in this manner. In fact, since 1996 dividends and share repurchases have returned $5.9 billion to McGraw-Hill shareholders.

As Terry mentioned earlier, the Board of Directors reviews the dividend and the share repurchase program at its January meeting, which takes place next Wednesday.

This morning, I am going to discuss our strong financial condition at the end of 2006 and provide some indication of what to expect for 2007.

We are debt-free. Our cash position at the end of 2006 was $353.5 million, which is $395.3 million lower than the year-end 2005 balance and consists primarily of our foreign holdings. I'll speak to the specifics of key components of cash flow in detail, but it is important to note that our strong cash flow for the year, along with our beginning cash balance, was sufficient to fund:
- All operating investments,
- Capital expenditures,

- Pre-publication investments, and
- Our return to shareholders in the form of dividends and increased share repurchases, net of option exercise proceeds.

We achieved our previously announced 28.4 million share repurchase target for 2006 by repurchasing 2.4 million shares in the fourth quarter. We repurchased the 28.4 million shares at an average price of $54.23 per share, totaling approximately $1.5 billion. 20 million shares remain from the 45 million share repurchase program approved by the Board in January 2006.

The fully-diluted weighted average shares outstanding, or WASO—and I'm going to refer to WASO a couple of times now—WASO for 2006 was 366.9 million shares, a 15.7 million share decrease compared to full-year 2005. The decrease is primarily driven by the weighted impact of the 28.4 million shares repurchased during 2006, partially offset by stock option activity and the 31.7% increase in our stock price in 2006.

In the fourth quarter, WASO actually increased 3.2 million shares compared to the third quarter, and was influenced by the three factors mentioned above:
1. A 17% increase in the stock price for the fourth quarter, resulting in more in-the-money stock options,
2. Increased option exercise activity, and
3. There were no share repurchases in the third quarter.

Hopefully this illustrates how these factors can influence the WASO calculation using the required treasury stock method of determining outstanding shares.

Net interest expense was $13.6 million for 2006, which is slightly lower than we had projected. It declined to only $70,000 in the fourth quarter—a seasonally strong period of free cash flow—as the interest income earned on investments from excess cash balances offset the fixed components of interest expense relating to bank fees, deferred compensation, and the accounting for the Rock-McGraw sale-leaseback transaction that occurred in December of 2003.

For 2007, we expect the full-year interest expense to range between $16-18 million. This is higher than 2006 as we begin this year with $395 million less in cash than the same period last year. 2007 interest expense includes the same fixed items as 2006—with the largest component being the $9 million for accounting relating to the Rock-McGraw transaction.

There are a number of ins and outs affecting 2006 and 2005 for both the full year and the quarter, so I want to point them out now to you. The earnings release this morning reviewed the 2006 earnings results of $2.40 per share. The results include:
- A one-time charge of $0.04 for the elimination of the restoration stock option program,
- $0.11 for incremental stock-based compensation, and
- $0.06 in charges for restructuring started in the third quarter and completed in the fourth quarter. The restructuring eliminated approximately 700 positions across the company. The action brought our total restructuring charge for the year to $31.5 million.

That compares to 2005's EPS of $2.21 which included:

- A $0.04 restructuring charge for employee severance costs related to the reduction of approximately 500 positions across the Corporation in the fourth quarter of 2005,
- A $0.03 increase in income taxes on the repatriation of funds made possible by the American Jobs Creation Act, and
- A $0.01 gain on the sale of Corporate Value Consulting.

Now looking at the quarter, for the fourth quarter of 2006, diluted earnings per share increased 12% to $0.56 compared to the same period last year. The results include:

- $0.01 for incremental stock-based compensation,
- A $0.03 restructuring charge for positions eliminated in the fourth quarter, and
- $0.04 for a change in revenue recognition for the transformation of Sweets that we discussed at previous meetings.

That compares to 2005's fourth quarter EPS of $0.50 which included the two items I just mentioned for full-year 2005 EPS:

- The $0.04 restructuring charge and
- The $0.03 increase in income taxes for the repatriation of funds.

In the beginning of 2006, we indicated we were transforming Sweets, the McGraw-Hill Construction Group's popular building products database, from a print catalog to a bundled print-and-online service. This move resulted in a change in our revenue recognition for the Sweets product sales. Accounting standards require us to recognize revenue for subscription products over the contract period, rather than solely in the fourth quarter, which was how we recognized Sweets revenue in the past when only the standalone print product was delivered to customers in December.

The shift reduced Sweets' fourth quarter 2006 revenue by $23.8 million and operating profit by $21.1 million, or $0.04 per share. The difference between the revenue and operating profit impact is due to the deferral of $2.7 million in related expenses that will be recognized in 2007.

In 2006, the Company incurred incremental stock-based compensation expense of $85.1 million, which includes a one-time charge of $23.8 million from the elimination of the Company's restoration stock option program. The $85.1 million expense represents $0.11 per share for the incremental expensing plus an additional $0.04 one-time charge for the elimination of the restoration program.

Now, looking at how this all breaks down between the segments and corporate:

- McGraw-Hill Education had incremental expenses of $19.6 million for stock-based compensation, which includes $4.2 million for the one-time charge.
- Financial Services had incremental expenses of $30.0 million for stock-based compensation, including $2.1 million for the one-time charge.
- Information & Media had incremental expenses of $14.1 million for stock-based compensation, including $2.7 million for the one-time charge.
- Finally, Corporate had incremental expenses of $21.4 million, including $14.7 million for the one-time charge.

Now let us take a look at corporate expense. Corporate expense increased $38 million to $162.8 million for 2006. This includes the $21.4 million of incremental stock-based compensation expense I just mentioned. The full-year amount also includes a portion of the restructuring charge of $6.8 million versus $2.8 million in 2005, as well as a revaluation charge for certain equity venture investments.

In 2006 we had dilution of $0.05 from the acquisitions made in 2004 and 2005. In 2007, we expect they will be cash positive. The Company, of course, did not make any material acquisitions or dispositions in 2006.

The effective tax rate in the fourth quarter was 37.2%. The blended effective income tax rate for 2006 was also 37.2%. For 2007 we expect the rate to be approximately the same as 2006 on a full-year basis.

Let's take a look now at capital expenditures, which include pre-publication investments and purchases of property and equipment.

Our pre-publication investments were $87.5 million in the fourth quarter and $276.8 million for 2006. This is $19.0 million higher than in 2005, but is lower than our original projection for 2006 due to timing as well as some efficiencies from our Global Resource Management program. For 2007, our pre-publication investments will be about $330 million. As Terry mentioned earlier, we compete with a spectrum of products in the key reading and math markets and these investments are targeted to those opportunities. This level of investment is driven mainly for products we are currently developing to realize significant opportunities in the el-hi market in 2007 through 2009.

Purchases of property and equipment were $69.8 million in the fourth quarter and $126.6 million for 2006, which is $6.4 million higher than in 2005. As we mentioned during the last call, the primary construction phase for our new data center has shifted to 2007. In addition, we anticipate increased technology investments due to the continuing digitization of our products and services. As a result, we project $250 million for 2007, which is a $123.4 million increase compared to 2006.

Now for some non-cash items:

- Depreciation was $113.2 million in 2006. For 2007 we expect $130 million reflecting the higher level of capital expenditures in 2007 and a full year of depreciation from capital expenditures made in 2006.
- Amortization of pre-publication costs was $228.4 million in 2006. For 2007 we expect $260 million, as a result of the new el-hi programs we are publishing to take advantage of the strong adoption opportunities.
- Amortization of intangibles was $48.4 million in 2006. For 2007 we expect $50 million, virtually flat compared to 2006.

That brings me to free cash flow. In defining free cash flow we start with operating cash flow and reduce that amount by certain cash outflows for investing and financing activities that are recurring by nature. As you see from the table, Cash Provided by Operations, per U.S. GAAP, was $1.5 billion for 2006. We then subtract the following, which we have already talked about:

- Investments in pre-publication costs: $276.8 million,
- Purchases of property and equipment: $126.6 million,
- Additions to technology projects: $23.0 million, and
- Dividends paid to shareholders: $260.3 million.

Under this definition, free cash flow for 2006 was $825.4 million versus $896 million in 2005. That's a 7.9% decrease due to increased investments and a return to a more normalized level of working capital.

For 2007, we anticipate free cash flow in the range of $700-750 million, primarily reflecting higher investment spending. We have ample cash and borrowing capacity for dividends, share repurchases, strategic acquisitions, and to meet our requirements for internal investments.

Thank you, and now back to Terry.

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

Thanks Bob. Again, as we entered 2006, we did so knowing that we were going to have a slower education market and we needed to reflect the expensing of stock-based compensation. But with all of that, we're very pleased with how we completed 2006 and we're pleased that we were able to outperform the guidance that we gave for the full year and for the fourth quarter.

Now that we are in 2007, we obviously have a much better look for all of our businesses. We look for double-digit earnings growth for the corporation, another year of double-digit top- and bottom for Financial Services. We're looking for solid gains in our School Education Group. Again, good growth in higher education and more progress in information and, again, margin expansion across the board.

Again, we are using $2.50 as the base for our double-digit earnings guidance. We arrived at that figure by taking the GAAP earnings of $2.40 and adding to that the non-recurring charges in 2006 of $0.04 for the elimination of the stock restoration program and $0.06 for restructuring, so $2.50 is the base line.