

# Chief Executive's Review

Dear shareholder,

This year, just as last year, Pearson's results are a record. I'm sure I don't have to tell you that they're due to the ingenuity and dedication of the 32,000 people who work in Pearson, nearly all of whom are owners of this company just like you. We all thank you for the trust and confidence you've placed in us by investing in the company.

We're proud of the numbers in this report, but they signify something more than one good year. They're a trend – one more point on a consistent upward march. That makes them not just a footnote to the past, but a source of confidence in the future.

Our last five years make the point:

- Operating profit has increased from £416m to £631m, at an annual growth rate of 15% (at constant exchange rates).
- Adjusted earnings per share are up from 27.6p to 46.7p, an annual rate of 14%.
- We have more than doubled the cash we produce from operations, from £318m to £684m.
- The return we make on the capital we invest is up from 6% to 8.2%, and now above our cost of that capital.
- And we have increased the dividend by an average of 6% each year. In fact, our record of increasing the dividend above the rate of inflation is now an unbroken 16 years.

I hope the consistency is reassuring to you. It's encouraging to the shareholders who work here, because it validates much of the work we've done to change the company. We had a few goals in mind as we did that: we wanted to make Pearson a cohesive company, rather than a collection of companies; a company of reliable and durable financial performance; a company with big growth possibilities; and a leader and innovator in its markets.

While we've made great progress toward those goals, we're still on the move in that same direction. We don't see any reason to slow down; and the success so far just makes us want to move faster with a strategy that's working well.

That strategy has four parts:

- creating the most compelling content;
- using technology to make our products more useful and more valuable;
- being a truly international company; and
- generating the firepower through efficiency to invest in those goals.

We apply that same strategy across all parts of Pearson. I hope those numbers tell you that it's working; but I'd like to show you how with some highlights from this past year.

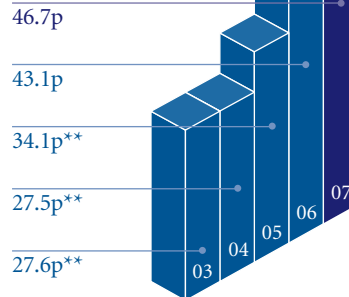
## Content, de-throned?

People in the media world used to assert that 'content is king'. Today many experts would have you believe that technology has staged a bloody coup and taken the throne.

Pearson is still in the court, somewhere in the middle. We're happy with our rich history as a 'content' company which stretches back to the first Longman English dictionary of 1725; the forerunners of the current *Financial Times* in the late 19th Century; and the first Penguin paperbacks in the 1930s. But today our challenge is to live up to the creative standards of those illustrious predecessors; and at the same time to make what we do relevant and useful to our customers of today. That brings a slightly different attitude toward 'content' and what we should be doing with it.

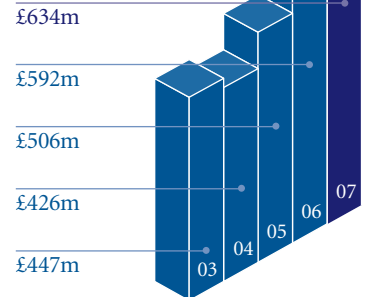
## Adjusted earnings per share

46.7p / 92.9¢  
+8%



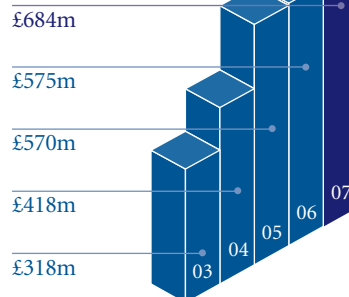
## Adjusted operating profit

£634m / \$1,262m  
+14%\*



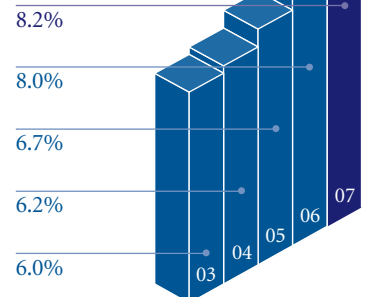
## Operating cash flow

£684m / \$1,361m  
+19%



## Return on invested capital

8.2%  
+0.2% pts



\* Underlying growth

\*\* As reported (before restatement for tax deductibility of goodwill amortisation)

Our investment in content has been steady and unrelenting, even when that has been out of fashion. In each of the past four years, that investment has topped \$1bn.

We sustained our investment in journalism at the *Financial Times*, even when it was making losses during a savage advertising downturn. We believed that a brand built on quality for over a century should sustain its editorial values – and weather the short-term consequences. And it has: profits at FT publishing were up 85% to £56 million last year.

At the newspaper and FT.com our depth of insight in the financial markets made us the place to come for news and analysis of the mortgage crisis and the global credit crunch, the biggest business story in years. We refreshed our design and we introduced to our readers a stable of new writers. All its wonderful content earned the FT many accolades, from the *Newspaper of the Year* title to the biggest accolade of all: a growing audience of readers, in print and online.

Penguin, the UK's *Publisher of the Year*, made bestsellers of some of the books by the world's best-known authors and thinkers – and created some new superstars along the way:

- Just as the world was waking up to that global credit crunch, Alan Greenspan's *The Age of Turbulence* came out and was snapped up by one million buyers – and bemused investors – all over the world.
- No one has done more to explain life in Afghanistan than Khaled Hosseini, who followed up *The Kite Runner* with another wonderful story, *A Thousand Splendid Suns*, this past year.
- And Kim Edwards' first novel, *The Memory Keeper's Daughter*, was a bestseller in the US, Canada, Australia and the UK, and a story that will stick with us for a long time.

Our largest investment of all was in our education business. Here our bestsellers might be a little less famous than those in Penguin, but they are no less valuable to their readers. For instance, we had a new edition of Reading Street, last year's leading programme for America's elementary school students. It helps teachers lay a foundation of reading skills and, we hope, inspires children to love reading all their lives.

We also extended our programmes that help people of all ages learn English, enrolling such familiar characters as Donald Duck and Buzz Lightyear in the effort through our worldwide elementary school programme, English Adventure, now used in 60 countries from Argentina to Yemen.

We extended and modernised many of the bestsellers that have been central to the learning and understanding of each generation of college students, in subjects from ancient history to computer science; fundamentals of biology to applied healthcare; mathematics to accounting and finance; creative writing to literature; social science to marketing.

And with our acquisition of Harcourt's assessment and testing business, we took on some of the most popular and reliable assessments of educational skills and intellectual progress, among them the Stanford Achievement Test and the Wechsler Intelligence Scale.

### **Technology, made central**

Proud as we are of that kind of content, for some years now we've insisted that it is not enough. Today our customers expect products and services that are built to meet their needs and easy to use. Our education customers, for example, are asking for 'solutions,' not textbooks. Technology helps us create those.

For decades, the end-of-term or end-of-year test has come too late for too many students. If a test can establish how each child is learning, and pinpoint where he might be falling behind, why would anyone wait until the end of the course to check? Shouldn't the teacher take that information along the way, analyse it and use it to accelerate the student's learning?

That is precisely the 'solution' that has been our strategy, and a new generation of our education products provide that. For college students, our 'MyLabs' are online programmes that allow each student to practice new concepts at their own pace, in their own time. The software records their responses to practice test questions and intervenes: if a student shows he's mastered one kind of problem, he moves on quickly; if he seems to be struggling, we slow him down, serve up more practice and help him discover strategies to find the right answers. In educational jargon, this is known as 'adaptive learning': the path to learning is built around the student.

Not surprisingly, demand for these kinds of services is growing very fast. We now cover about 40 of the main disciplines for university-level courses, and students who buy the programmes are really using it – usage has grown 50% a year for the past five years. And we believe the opportunity is a worldwide one: these MyLabs are now available in more than 50 countries.

And that kind of service is valuable to younger students, too. In 2006 we unveiled a revolutionary new kind of school programme for California: a digital service allowing teachers to fashion their lessons from a rich mix of video, audio, class exercises, tests and digital books. That social studies programme was a huge hit, so this year we've applied a similar approach to mathematics, one of the biggest and most important subjects in any country's school curriculum. This new programme, enVisionMATH, blends beautiful graphics, animation

and text to get young children inspired about learning maths. It's a little too early to know how this new experiment will fare – but so far the teachers are excited, and that means we are too.

Digital products like these now account for \$1.3bn or about 25% of our total education sales. Today Pearson is a technology company, as much as we are an 'education' or 'publishing' or 'media' company.

Those kinds of changes are taking place at Penguin, too. Travel guides, for example, are still much in demand, but technology now allows travellers to create their own customised travel guides with Dorling Kindersley material.

And last year we created what we like to refer to as 'the most written novel in history,' a Wikinovel called *A Million Penguins* that attracted online contributions from nearly 1,500 people – who made over 11,000 edits. In Britain, a new Penguin social networking site called 'Spinebreakers' is run by teenagers, and it's not only inspiring them to read books and write about books; it's helping Penguin to get a deeper understanding of the reading habits of young people.

Perhaps helped along by these kinds of conversations, online sales of Penguin books grew rapidly last year, through both our own websites and other online retailers such as Amazon.

In the Financial Times Group, great content was not confined to pink paper. We started new features on FT.com like our live markets blog Alphaville and 'View From the Top', a regular video interview with business leaders. Monthly unique users of FT.com were up 30%, with a 2007 average of 5.7 million users.

Interactive Data, our financial information company, grew its sales by 8% as it introduced new services – for example, delivering information about mergers, tender offers and rights offerings for securities throughout the day. Meanwhile our new addition Mergermarket provided must-have intelligence about potential deals for companies, bankers, lawyers and advisers. Its revenue grew by more than half and more than 90% of its customers renewed their subscriptions.

And to that online library of sources, the FT Group added new companies – Money-Media for the fund management market and Exec-Appointments in the recruitment field. These moves have not only given us new growth possibilities, they've also diversified our revenues away from print advertising, notoriously vulnerable to economic cycles. In 2000 some 52% of the FT Group's revenue was from advertising; now it has just 30%, even though its advertising has grown in the last few years.

### **Flatter, and wiser**

Content and technology are big opportunities for us, and we're pursuing them intently. But for a company that is the world leader in learning and information of all kinds from kindergarten children to adults, there may be a bigger opportunity still.

While developing countries are home to 80% of the world's population, only half the world's college students come from those nations. Globally, adult illiteracy is estimated at around 800 million people and about half the world's population will be speaking or learning English – the global language of business and international politics – over the next decade.

So, in every part of Pearson, we're stepping up our efforts to be a truly international company.

## Chief Executive's Review *continued*

At Penguin, we're publishing more books on a worldwide basis at the same time as we build our presence in fast-growing markets like India, China and parts of Africa. Last year, Penguin announced plans to publish its first Penguin Classics in Mandarin. Meanwhile, we've taken Jiang Rong's *Wolf Totem* – a huge bestseller in China and the winner of the inaugural Man Booker Asian Literary Prize – and we're publishing it in English around the world this year.

During our celebration of Penguin's 20th anniversary in India last year, we agreed on a strategy to invest heavily in that country, as a vibrant source of writing talent and as a centre for high-quality publishing services like design, technology and software development, many of which we already use in our business around the world.

This kind of international outlook features heavily on every page of the *Financial Times*. Its whole mission in life is international: to explain and illuminate business, finance and politics in a global context. That attitude sets the FT apart both editorially and commercially.

In circulation, last year the US overtook the UK as the FT's biggest single market. (I know of only one other newspaper anywhere in the world, *The Economist*, which has achieved the feat of selling more copies outside its home market than inside.) In advertising, we are providing global companies the ability to talk to the world's senior decision-makers in business and politics on a worldwide basis – and that's a valuable niche. That explains the consistent increase in the FT's advertising for each of the past three years.

In education, we have steadily grown the sales and profits of our international (meaning non-US) businesses. We've had particular success in English Language Teaching through the world-famous Longman brand; in investing in local editions of our major textbook programmes for school, college and professional students; in school testing in the UK through Edexcel and in professional qualifications and testing worldwide; and in digital programmes.

This past year we accelerated that strategy through the acquisition of the Harcourt International education businesses. That makes us the leading school publishing company in the UK, and it extends our strong positions in key markets including Australia, New Zealand and South Africa.

Meanwhile eCollege, our recently-acquired online distance learning company, has a big opportunity to become international now that it is a part of our worldwide education business.

Altogether, our education businesses outside America had sales of close to \$2bn this past year – and we believe the worldwide demand for skills and learning can keep pushing that number higher.

### **Leaner, and stronger**

We have the firepower to do all this – invest in high-quality content, innovative technology and international expansion – for one reason. Pearson has become much more efficient in the way we do business because we've become a cohesive company.

Today we have a strong centralised operations structure, in charge of quality and efficiency in a whole range of centrally-purchased and administered services across technology, property, warehousing, distribution, printing and many other areas. In some markets our book publishing companies operate as one business. In almost every one they now share warehouses and distribution and anything else they can.

So while sales growth was strong last year, up an underlying 6%, increased efficiency meant that profit growth was especially rapid, up 14%, with excellent results across all our businesses. On an underlying basis, adjusted operating profit rose 9% in education, 20% at Penguin and 30% at the FT Group.

Our overall profit margin increased last year to 15% – from 10.8% just three years ago – reflecting broad margin improvement across every business.

And by reducing the cash that's tied up in our businesses, we lowered our working capital-to-sales ratio for the sixth straight year to 25.6% last year – compared to 31.9% in 2001.

### **The numbers, and more**

Our goal has been to create a kind of virtuous circle – to take those efficiency savings and to invest them in the kind of content, technology and international expansion that can sustain our growth. So far, that circle is spinning nicely, and we're determined to move it faster.

But as we've said many times before, our goal as a company goes beyond those financial targets, as crucial as they are to our continued progress. In a company like ours, our profits endure and grow as the result of our seeing the broader picture – working for a broader purpose than profits. Whether that is helping a child learn to read; helping a teacher inspire her class; helping a business person understand the markets and make good decisions about them; helping a professional move on in his career; helping a talented writer to find her voice and her audience. Helping people make progress in their lives.

We're extremely proud of what we accomplished in 2007, in improving both our financial performance and our customers' lives. And we're confident that the steps we took last year to bolster all our strategies will yield even more in 2008. That is the kind of progress we can all look forward to celebrating.



Marjorie Scardino, *Chief executive*