Pearson plc Annual Report 1997

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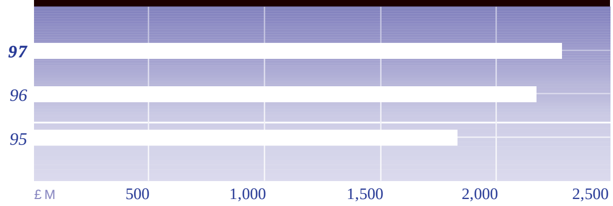
PEARSON

PEARSON'S YEAR

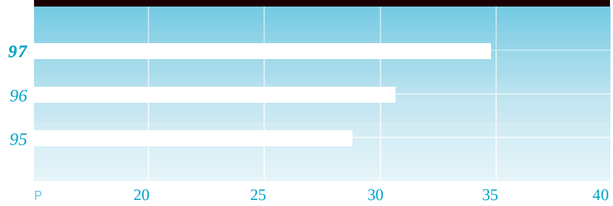
2 1997 Financial Highlights
3 Chairman's Statement
4 The Management Team
6 Chief Executive's Review
9 The Financial Times Group
11 Addison Wesley Longman
13 The Penguin Group
15 Pearson Television
17 The Tussauds Group
17 Recoletos
19 The Group
20 The Pearson Targets
21 The Business Review
33 Board of Directors
34 Report of the Directors
39 Personnel Committee Report
46 Auditors' Report
47 Profit and Loss Account
48 Balance Sheet
49 Cash Flows
51 Notes to the Accounts
80 Five Year Summary
82 Shareholder Information
83 Principal Offices
Financial Index

	1997	1996	%
Sales	£ 2,293.1m	£ 2,186.0m	+ 5
Sales - continuing operations	£ 2,265.5m	£ 2,048.9m	+ 11
Operating profit	£ 323.2m	£ 281.3m	+ 15
Adjusted earnings per share	34.9p	30.6p	+ 14
Dividends per share	19.5p	18.0p	+ 8

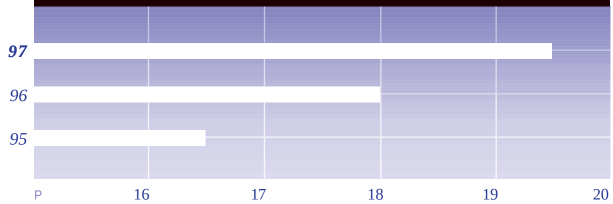
SALES

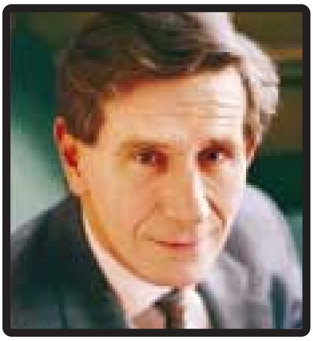


ADJUSTED EARNINGS PER SHARE



DIVIDENDS PER SHARE





The Pearson board is very pleased with the headway *we have made this year and the platform that has been established for long term growth. Although Pearson had good assets and good prospects when we began the year, with a new chairman and a new chief executive, there was work to do. We have made a good start.*

In 1997, sales rose to a record of nearly £2.3 bn. Operating profits were up 15%, with earnings up 14%. If currency exchange rates hadn't moved against us, our sales would have been £101m higher and our profits £17m higher. The board recommends a dividend of 19.5p for the year, up 8% over last year. While this rise is lower than the rise in our earnings, it is on a par with the market average and represents adequate dividend cover and our belief that we can offer shareholders a better return long term by investing in the Company's future.

We've made progress by concentrating on attracting good people and setting tougher objectives and tighter financial disciplines. We are looking analytically and strategically at all our businesses, but at the same time we've applied a pragmatic determination to making the Company more valuable for our shareholders. Pearson operates in an industry changing quickly and constantly. It is our ability to manage the complex creative and commercial mix of that environment that gives us our competitive edge. To deploy it to our shareholders' advantage, we have to make Pearson greater than the sum of its business parts.

We have dynamic new management at the head of Pearson. Marjorie Scardino and the members of the team at the centre and in the businesses know how to provide leadership. They know how to work together and are beginning to exploit the money-making opportunities available to the Group as a unit. The board has confidence in them and in all of the people at Pearson who have done a superb job in this first year of a new chapter in our Company's history.

David Veit, who retires from the board at the AGM, and Pehr Gyllenhammar, who retired last December, helped us make this transition. Pehr, a non-executive sans pareil for fourteen years, was a source of wise judgement and always fun. David, an executive director since 1981, served longest and most recently as president of our Company in the United States. He brought a combination of intelligence, energy, loyalty and integrity. We thank both men sincerely.

We still have a way to go before we achieve all our plans. By the time we do they probably will have changed, because the world will have changed. But I'm confident we now have the ability to take advantage of that changing world while producing good results and value for our shareholders.

Dennis Stevenson CHAIRMAN

Marjorie Scardino

spent four years as chief executive of The Economist Group before taking on the role of Pearson chief executive in January 1997. Has set the target of achieving annual double-digit earnings growth and of at least doubling the value of Pearson over five years. Writes 'Dear Everyone' notes to staff about important events. Recently wrote to all her colleagues in the Pearson Group that "these goals are going to be a stretch and are going to require every business to be in top form".

John Makinson

was brought in as group finance director of Pearson plc in March 1996, after a stint running the FT newspaper. Believes in stronger financial controls and procedures: "If we are going to be ambitious for this business we must have a strong control environment so that we are taking the risks we choose and calculate, not those we don't know we have." Is forging closer links between the centre and operating companies and stronger bonds between finance and other functions.

David Bell

after a career spanning editorial and commercial roles on the newspaper, became chief executive of the Financial Times in 1993 and is now chairman of the Financial Times Group. Has led the FT and other Group publications through successive record years while building the global electronic information services and sharpening the focus of Pearson's information business. Sees the FT as one of the "strongest information brands in the world" and his group's mission "to fight our way to the very top in the markets we have chosen."

Peter Jovanovich

joined in September 1997 to run Addison Wesley Longman (AWL) from his job as president of McGraw-Hill's Education and Professional Publishing Group. Believes his appointment reflects Pearson's commitment to education and sees great scope to grow the US and international businesses. The brief is to make AWL the world's leading education business. The task is "to focus on our marketing, editorial and sales — first, last and always."

Michael Lynton

took charge at Penguin in January 1997. Armed with great experience of global consumer brands from the Walt Disney Company, is convinced there is a huge and exciting market for the 'ultra-mobile, ultra-bendable and ultra-lendable book' in the multi-media world — but only for those publishers who can come up with the right product. "Publishing", he says, "is still about finding the best writers, giving them the best editorial support and producing the best books, with marketing to match."

Greg Dyke

has led Pearson Television since early 1995. Was the driving force behind the acquisition of Grundy, ACI and the international television producer and distributor, All American. These moves have taken PTV's annual sales from under £100 million to over £400 million. Sees long term success in owning and transferring branded formats worldwide: "In this market the more powerful you are seen to be, the more effective you are. The trick is to globalise programming and make it local; to own the popular formats that you can make in different countries."

It's hard to simplify complicated things.

Simpler things cut cleanly through resistance, moving faster and more efficiently toward their destination.

That's what we've been trying to do for the last year at Pearson. Our approach to simplification — and therefore better returns and long term value — has been to improve our results; to build world-class businesses; and to weave them into a web of operations stronger together than apart. We're making progress.

We promised to generate double-digit earnings growth each year, expecting that such results, consistently delivered, would double the value of the Company over the next five years. Double-digit growth was a simple message. Some critics said we shouldn't have promised it, but most of our shareholders and employees appreciated the guidance.

We have delivered double-digit growth for 1997. This report records all-time high sales and profits, and they set the pace for next year. We achieved these earnings by aiming high on our three performance measures: revenue, margin and cash. Throughout the Group, we scored strongly in two of these, revenue growth and margins. Our cash generation was hampered by the improper accounting in our trade book business.

Part of what drove these good results was some tough management and good selling in a good market for the Financial Times. Another part was a hard-fought turnaround in Mindscape. The quick and thorough integration of Putnam with Penguin yielded rewards, too. A new management team brought disciplines and excitement to Addison Wesley Longman and set that business up for great things, while managing to keep it stable. All in all, every business made progress toward either a broader strategic goal or in financial terms.

While we were working on results, we were also working on our other goal of building businesses with global franchises or strong market positions. As a first step, we set about divesting assets that we didn't manage, that we couldn't achieve a leading position in, or that were worth more to others than to us. As a consequence, in 1997 we raised £220m in asset sales, and we added £320m more by the time this report came out.

As a second step, we began investing in some of our strongest global brands. We spent the first phase of our £100m investment in the Financial Times, attracting new readers throughout America and Europe. We also improved the possibilities for the Financial Times brand by bringing its operations together under one banner.

In television, we took a big step toward building a global franchise. The acquisition of All American in November made us the world's largest independent

But it's usually worth doing.

international producer of television entertainment. Its integration with Pearson TV was accomplished smoothly and to greater advantage than we had foreseen.

Our efforts at cross-company sharing of rights and skills began to look more like real money and less like flights of fancy, too. Addison Wesley Longman and the Financial Times are joining together to create a management education business that will be a leader in its field. Penguin and AWL are pooling their efforts to improve our English Language Teaching businesses' offering both for consumers and for institutions. Our intellectual property rights committee, drawn from across the Group, has started on ideas that could create completely new products.

All our successes this year stemmed from a common root. The markets for our products were buoyant, but that was not the reason we did well. Our brands showed their power in all kinds of places, but they don't deserve all the accolades. Our competitors stumbled in critical areas, but we didn't credit our strengths to their weaknesses. We were successful because of the people who work in Pearson. We have begun to build a talented team, 18,000 strong, and they will create the web we believe will bring our shareholders the greatest value.

To recognise the contribution of people to this business, we re-vamped our bonus and long term share ownership plans in 1997. We want people to take home a share of their achievement, and to have a stake in the Company that puts them in the same shoes as any other shareholder. These plans will help.

We won't spin our Pearson web overnight. We'll do it deliberately and with a careful eye toward fulfilling our promise of double-digit earnings growth and a more valuable company. Along the way, we may choose to take some leaps to gain major market positions. In the end, we will likely be in fewer businesses than we are now. But in the process, we will be a stronger, more reliable performer for our shareholders to own, a more exciting and fulfilling Company for our employees to work in, and a world-class competitor.

In general, a simpler, surer company.

Marjorie Scardino CHIEF EXECUTIVE

MARCH 1998

Full coverage in any climate

The Financial Times Group

In 1997 we defined what gave our information businesses their competitive edge — and sharpened it. We began to invest more in building the Financial Times brand as the international business community's authoritative source of general business news and analysis.

The *Financial Times* newspaper is the flagship of these businesses. Last year, its worldwide editorial coverage, circulation and advertising were higher than at any time in its 110 year history. New printing sites drove faster deliveries across the main financial time zones. Marketing and promotional spend doubled. We think we got our timing right. A growing number of business people need a truly global outlook on world markets, and we re-doubled our efforts to give it to them. The US was the prime target of this assault. We launched a new US edition which has the global business perspective for which the FT is known and devotes more space to the international activities of US companies.

At the same time, we continued to extend the FT brand and the scope of our information businesses into new territories and media. Our constellation of electronic publishing services for general business markets is now integrated through the gateway of our website, FT.com, and we are investing in the very best delivery systems. Via the Internet and corporate intranets, our electronic publishing business provides its corporate audience with general business information, a new real time news alert system and fast, desktop access to research and analysis, drawing on over 50 million articles from more than 5,000 sources.

The Group also enlarged and deepened its FT-branded specialist intelligence on particular industries — energy, media, telecommunications and finance. And with a wealth of management development material, the Group continued to equip business managers at all levels with superior knowledge, skills and understanding. At the same time, its asset evaluation business again grew its sales and reputation in double digits. The strength of this business is that it draws on fundamental data on 12,000 quoted companies from 53 countries, covering some 3.5 million securities to purvey, for portfolio evaluation, the key financial data on which many of the world's investment managers depend.

We also aim to publish the best national business newspapers in important markets. *Les Echos*, *Expansion* and *Financial Mail* and *Business Day* — which command the same position of authority in France, Spain and South Africa as the FT does internationally — have achieved powerful growth in circulation and advertising. They too are investing in the electronic provision of information, research and analysis for the business community. Last year, each one gained ground toward its goals.

In all our information businesses, we will go on building on the integrity of the FT brand and what it stands for — the international business community's premium source of global business news, comment and analysis.

Essential learning in any market

Addison Wesley Longman

In 1997, Addison Wesley Longman began anew. A new management team began to examine both our products and our ways of doing business, and then started to push on and invest in the business. We want to be one of the strongest and best educational publishers—both in schools and higher education—in the US and in the UK. Internationally, we want to build on our claim to be the world's leading publisher in English Language Teaching (ELT), and a good local language publisher in a number of countries.

Education is a good business to be in. Governments throughout the world see investment in education as a top priority. And parents are prepared to spend their own money to ensure their children get the best possible start in life. In the US, the school and college population is growing, increasing demand for textbooks and electronic educational materials by at least 7% per year over the next five years. Internationally, the market for education is growing even faster.

The US schools market is the biggest single segment of the business. Sales are dominated by state adoption cycles which determine the choice of textbooks for as much as seven years ahead. To do well, we need to develop the books and programmes which find favour with teachers and which really help students learn. Last year we continued to invest in the innovative and well-tended educational programmes we need to be successful in the important rounds of state adoptions over the next three years. We took steps to improve the management, production, sales and cost structure of the schools business and to use the combined book business clout of AWL and Penguin. In the US college business, we stepped up the signing of the new authors we need to build a profitable list of books with attractive shelf lives.

Outside the US, the Longman heritage gives our education business an international outlook and global reach that is a real competitive advantage. We are the market leader in teaching people English and we want to keep it that way. AWL and Penguin have set up a joint venture to pool their efforts to capture both the institutional and the consumer markets for ELT. We also have a respectable publishing network in educational institutions throughout the world. We have built on this platform by reorganising our non-US operations into regional companies, each representing the full range of AWL interests publishing in English and local languages. They form intense local hubs for sales, marketing and editorial development. Specialised knowledge in different educational fields can be shared, and integration will free up resources for investment.

Throughout the world, school enrolment is growing. This is accompanied by an increased emphasis on rigour and standards which in turn increases demand for quality teaching materials. We aim to be in the best position to tap this worldwide growth. So that we can claim to be not just in the education business, but be the company that defines that term over the next decade.

Best-selling covers in any store

The Penguin Group

Penguin is one of the best known consumer publishing names in the world. The acquisition of US publisher Putnam Berkley at the end of 1996 brought it renewed vigour, fresh talent and new titles. We now have the global clout to be the highest quality and most innovative trade publisher in the business. Our strength comes from our brands, our internationalism, our leadership in children's publishing and our very strong front and backlists. In 1997 we began to make the most of them.

The Penguin and AWL distribution networks started to work much more in tandem, enabling us to capture the benefits and scale that come from having the widest international reach of any major publisher. We also have a leading position in children's publishing, giving us the chance to copy our successful exploitation of the Beatrix Potter brand with other children's characters we own all over the world.

Over 70% of our sales are now in adult general fiction, so it is vital that we publish a steady stream of best-selling titles. In 1997, we did. In the US, we had 43 best-selling paperbacks on *The New York Times* list — more than any other publisher — and the second largest number of hardback best-sellers. And we also notched up a string of best-sellers in the UK and Australia. This success was in part due to the fact that the Putnam acquisition enhances our appeal to top authors, editors and publishers. Our scale helps us to attract more attention when we seek worldwide sales for some of our biggest names — it also helps us when we want to get a new author or a mould-breaking work noticed. But it isn't scale alone that matters. We are determined to be even better at promoting Penguin to authors and their agents; to be more innovative in the ways we publish their books; and to be more skilful at marketing them.

For example, last year we proved that extended shelf life, typically a paperback phenomenon, can be achieved with hardcovers, too. Our backlist — with some 25,000 titles in the full Penguin catalogue – is an important competitive edge. It gives us a size and scale that works for us as new sales channels spring up from book superstores, where customers browse at leisure over a coffee, to instant ordering over the Internet. Sales of Penguin titles through the Internet are rising by more than 40% every quarter: it will soon be one of our biggest sales outlets, especially for our backlist titles.

Reports of the death of the book have been greatly exaggerated. People are buying books in the same numbers as they always did. Commercial links between books and other forms of entertainment — films, TV and on-line — continue to grow. But the way books are conceived, made and sold is moving quietly towards revolution. Penguin is in a good position to help to create — and gain from — the new order.

So the future success of Penguin depends on its ability to anticipate and shape change in the publishing industry and its success in balancing creative and commercial demands. We aim to build Penguin's profitability by doing better what we have always strived to do best — bring books to everyone.

Compulsive viewing in any home

Pearson Television

Pearson Television's aim has been to become one of the world's largest independent international television producers. In 1997, with the acquisition of All American, the US syndicator and producer of programmes, we achieved that goal. Now, every month, some 200 million viewers in 70 countries watch Pearson-produced television programmes.

All American gave us a clear franchise in an important genre of mass market television programming. Its formats and production interests fitted those of Pearson TV like a glove. It combined our strong UK game show portfolio with a strong game show business, including an extensive library of formats, in the US. It brought us the critical mass we needed in US drama syndication and production, perfectly complementing our own record in international serial drama. The increased scale of the combined business gave us greater access to broadcasters' schedules for our shows and made it easier to shoulder the risk of developing new shows and formats. Overnight, this acquisition transformed the scale of Pearson TV, increasing both production revenues and profits by more than half. It will enhance Pearson's earnings in its first full year.

This move crowned four years of expansion. In 1993, we acquired Thames Television, a leading UK producer with a world-class catalogue. In 1995, we bought international producer, Grundy. In 1996, we exploited the programme formats that came with these and other acquisitions, making our way into production schedules worldwide. Now, with the acquisition of All American, we have the ingredients we need — a New York-based domestic syndication business and a Los Angeles-based production business — to expand in the US, one of the world's hungriest consumers of television programming. As importantly, our strengths in international television distribution open up a reverse flow of All American formats into the emerging markets of Europe and Latin America, which are growing by up to 40% per year.

Pearson TV now owns many of the best game show formats ever produced, and a significant library of well-known and long-running programmes that have become brands in their own right — *Neighbours*, *The Bill*, *Baywatch*, *The Price is Right*. These, coupled with unique skills in creating formats that are exportable around the world and an ability to transfer mass production techniques to local markets, make a powerful television business.

We will go on investing in broadcast outlets where this helps our production business. As part of a consortium, we successfully bid for the licence to run one of Hungary's two new commercial channels. Through Recoletos we now own a share of Antena 3, a Spanish commercial channel. And we are a significant shareholder in Channel 5, the UK's new terrestrial channel. But, our main aim will continue to be the creation or acquisition of formats adaptable and saleable across national and cultural boundaries. These are the prized assets which will secure earnings growth in the next decade.

Great figures in any language

The Tussauds Group

The Tussauds Group has a strong brand name; a unique franchise in wax portraits and history-based attractions; and a formidable reputation as one of Europe's largest developers and operators of paid-for attractions. After 200 years in London (and 30 in Amsterdam), 1997 marked a concerted effort in the global expansion of the brand.

Madame Tussaud's — the flagship brand — is strong enough to make it London's top-ranked commercial visitor attraction. A similar exhibition, which will travel to other locations in Australia and Southeast Asia over the coming years, opened in Melbourne where the brand proved equally strong. At the same time, we broke ground on a new permanent site in the heart of Manhattan, and considered a raft of other global opportunities that build on the Madame Tussaud's franchise.

In addition, the continuing success of our theme parks, backed by constant investment in new rides and new facilities, in the UK and Spain demonstrates our ability to mastermind attractions that are special, imaginative and offer exceptional visitor experience and value.

Recoletos

Pearson does most of its business — and makes most of its money — in the English-speaking world, particularly the US and the UK. But English is not our only language. Through our very successful Spanish business, Recoletos, we are building our media business in the Spanish-speaking world — a market of some 250 million people.

In 1997, we established an ambitious strategic alliance between Recoletos and Telefónica, the leading Spanish telecommunications company. This alliance aims to give Recoletos the resources and connections to broaden its position in its domestic market and reach into the fast growing Spanish language markets of Latin America.

Backed by the continued strength of *Marca*, Europe's best-selling sports newspaper, and Recoletos' other successful publishing ventures, we can expand into new markets and find new channels for Pearson businesses. And, in the process, we can establish a profitable regional model for development in other non-English speaking markets.

Strong links in any venture

Making Pearson greater than the sum of its parts

Pearson has been a collection of discrete businesses tied together by some common values. In 1997 we started to make the collection more cohesive and reinforce the thread that binds it with some more direct profit-enhancing properties. We've been careful, because we know part of Pearson's power is in its ability to balance the creative and the commercial, to give businesses room to operate inventively and still enjoy the power of the whole.

Cost-savings have been the first to deliver. We started sharing purchasing, for instance, and are saving considerably by pooling our buying clout for paper, insurance, travel and other commodities and services used throughout the Group. We also worked on sharing processes. Our *Shared Services* initiative has been in the works for almost two years, and will begin to show rewards in the costs of our book businesses first in 1999, and in other businesses later. This new operation will handle accounting and transactions currently duplicated around the Group. By investing once, we can afford set-ups with the kind of efficiency and capacity that companies couldn't afford on their own. In the bargain, our customers and suppliers will get better service *and* better prices.

But more important to our future than cost savings are ways to generate revenue through being part of a Group. In 1997 we began to make some headway there, too. Throughout Pearson, we own a large amount of intellectual property — words in books, newspapers and magazines; images on television and computer screens; fictional characters; software. By sharing these rights around our businesses, transforming them into different media, presenting them in new contexts, or merchandising them through external partnerships, we can make them more valuable. This approach has already spawned some new products, and it will produce more.

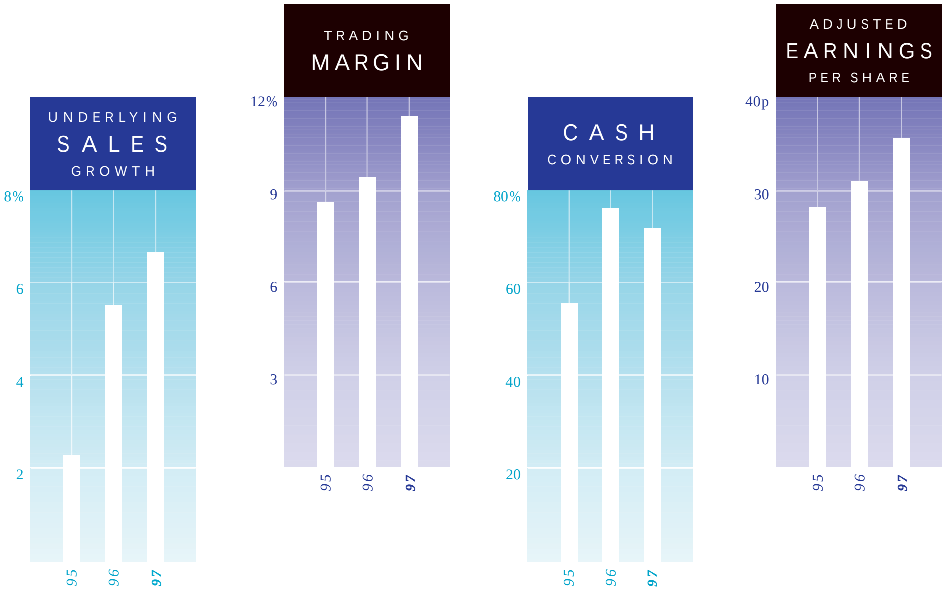
To bind the Group together, we also needed to provide better rewards for achieving our goals. So we initiated the Change*gear* programme to help. Performance bonuses are based on success at reaching challenging targets; share options plans will be open to more people. And for the first time, all our staff will have the right to a Pearson bonus if the Group does very well; and all will have the chance to save to buy Pearson shares at a discount. The more we all become shareholders, the more we will all be concerned about the success of the Group as a whole.

Being part of Pearson also means taking our wider social and community responsibilities seriously. Last year as a company we donated £1.3m to charities world-wide, focusing on education and the arts. For the future, we are working to focus our giving more meaningfully, and to find ways we can invest time as well as money in the communities we do business in.

Throughout the Group we are striving for ways to strengthen the Pearson web — the connections that can help all our businesses produce more and be worth more and be better able to compete. To ensure that the sum of the parts is reflected in the real world of Pearson's performance, and in its contribution to the future.

The Pearson Targets

Delivering our financial goals



* BEFORE IMPACT OF PENGUIN IMPROPER ACCOUNTING

Our goal is to achieve double-digit growth in adjusted earnings per share every year. We hope to see that progress reflected in the Pearson share price, thus doubling the value of the company within five years. To underpin these objectives we aim, in each of our businesses, to increase the rate of underlying sales growth; improve trading margins; and raise the proportion of our profits that we convert into cash. We track the performance of each operating company against these targets and gear bonus payments to reflect them.

In 1997 we made progress toward these targets. Adjusted earnings per share, the measure of the Group's underlying earnings, increased by 14% to 34.9p, allowing us to recommend an increase of 8.3% in the annual dividend and at the same time strengthen the Group's dividend cover.

Underlying sales growth, which represents the year-on-year increase in sales, taking into account factors such as portfolio changes and movements in exchange rates, was 6.5%. Total sales increased by 5%, boosted in 1997 by the acquisition of Putnam Berkley in late 1996 but reduced by the absence of revenue from Westminster Press, which was sold at the same time.

The trading margin, which represents the proportion of operating profit to sales (excluding profits from associates and passive investments), increased from 9.2% to 11.5%. Operating profit (excluding the charge for improper accounting at Penguin USA in 1996) increased by £42m (15%) but the underlying increase, taking into account changes in the portfolio, exchange rates and restructuring charges, was a very healthy 22%.

Cash conversion, the proportion of operating profits received as cash in the full year, fell from 78% to 49%, reflecting the impact on cash flow of the improper accounting at Penguin USA reported in the 1996 accounts. Stripping out this exceptional impact, cash conversion, at 75%, was just under the 1996 level. Penguin aside, the principal restraint on cash conversion was the investment of £21m in a Group project to modernise and standardise business processes throughout our publishing companies. This investment in the *Shared Services* initiative was capitalised and consequently not reflected in operating income during the year. The benefits of this investment will begin to be seen in 1998, as the first companies go live with new systems.

The Business Review

ADJUSTED
EARNINGS *up fourteen percent to new high*
PER SHARE

SALES *and trading margins ahead*

ACQUISITIONS *integrated and performing well*

PROCEEDS *from disposals invested for growth*

This Business Review analyses the performance of the Group, and each of our businesses, in the financial year ended 31 December 1997. It also describes the key considerations in determining financial policy and the management of risk.

GROUP SUMMARY

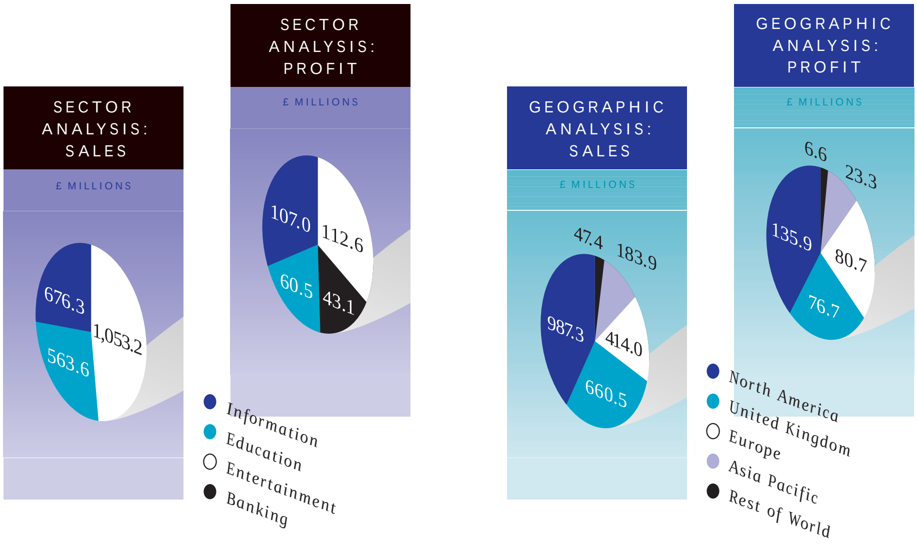
Operating performance We report the performance of the Group under the three principal headings of Information, Education and Entertainment. Within these categories there have been a few changes in the basis of presentation, and these are described under the relevant headings. Across the Group, we now reallocate central costs to operating companies based on a formula related to sales. This change in presentation brings Pearson into line with best corporate practice and, we believe, provides a truer guide to the underlying performance of each operating company. It also increases the accountability of the Group's central operations.

As we have tightened the portfolio of the group over the last two years, focusing on a smaller number of actively managed businesses, the distribution of sales and profits by activity and geography has shifted. The acquisition of the USA adult general fiction publisher, Putnam Berkley, in December 1996 increased Entertainment's share of total sales from 37% in 1996 to 46% in 1997. This, together

OPERATING PERFORMANCE

ALL FIGURES IN £ MILLIONS	1997	1996
Sales	2,293.1	2,186.0
Operating profit		
Information	107.0	88.2
Education	60.5	60.2
Entertainment*	112.6	58.4
Investment Banking	43.1	40.8
Continuing	323.2	247.6
Discontinued	–	33.7
Total	**323.2**	**281.3**
Adjusted earnings per share (p)	34.9	30.6
Operating cash flow	158.8	219.0

* EXCLUDES £100M CHARGE FOR IMPROPER ACCOUNTING AT PENGUIN USA IN 1996



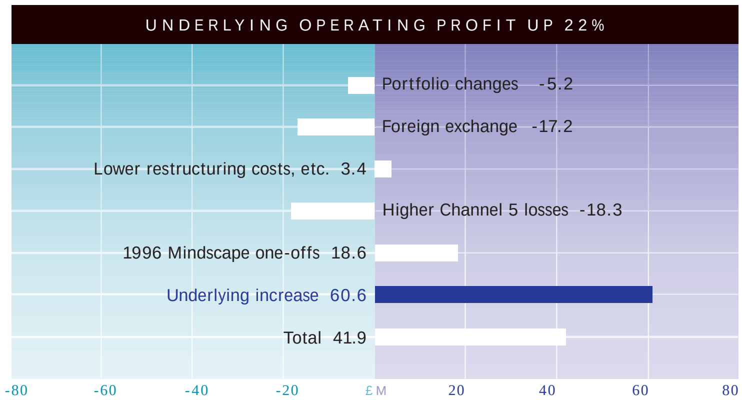
with a first full 12 months trading at HarperCollins Educational, means that North America now accounts for 43% of total sales, compared with 37% in 1996.

The table below analyses the various influences on operating profit in 1997. Acquisitions were a significant feature, with a maiden profit contribution estimated at around £24m from Putnam Berkley being the most material single item. The effect of portfolio changes, after taking into account the absence of Westminster Press which was sold at the end of 1996, was broadly neutral.

The Group earns a significant proportion of its sales and operating profits in overseas currencies (in particular the US dollar and the Spanish peseta) and the strength of sterling in 1997 had a negative effect on our published results. If exchange rates had remained at 1996 levels, it is estimated that Group sales would have been higher by £101m and operating profit higher by £17m.

Pearson holds a 24% share in Channel 5, which incurred further start-up losses in 1997, consistent with its business plan. The effect of these losses was almost exactly offset, however, by the absence of one-off charges at Mindscape following restructuring.

Taking into account the factors discussed above, underlying operating profit increased by 22%.



INFORMATION

The Financial Times Group In 1997, the businesses of Pearson's Information division, now classified as the Financial Times Group, achieved aggregate sales of £676.3m and operating profits of £107m, a 21% increase on 1996. In March 1998, we restructured our Information division to create a more integrated set of businesses, built around the reputation of the Financial Times as one of the strongest information brands in the world. This new approach to the management of the business is reflected in the segmental analysis shown below. The principal change from previous years is the creation of Financial Times branded businesses. This incorporates our electronic information interests (formerly FT Information), our professional publishing interests (formerly Pearson Professional) and the on-line publishing activities of the FT newspaper. The 1996 results have been restated on the new basis and we have also shown the impact on profit of entities which were sold in 1997 and in the first three months of 1998.

FINANCIAL TIMES NEWSPAPER The operating profits of the *Financial Times* newspaper more than doubled to £34.8m. It benefited from record circulation and buoyant advertising revenues, which increased by 15% in 1997, and it also continued to reduce the size and increase the variability of the cost base, lessening the exposure to any downturn in advertising expenditure.

We invested £16m in the international expansion of the *Financial Times*, the first tranche of a new £100m investment programme. The FT achieved record sales in 1997 with the December ABC audit confirming circulation growth of 13.9% over the December 1996 figures. Daily copy sales in December reached 342,000, of which 47% were sold overseas, boosting circulation revenues by 10%. Circulation of the US edition of the newspaper increased by 32% to over 47,000.

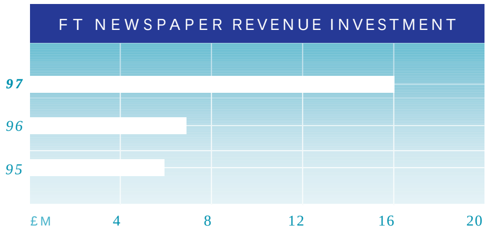
The new-look *Weekend FT*, launched in March, was the UK's fastest-growing Saturday newspaper and its monthly supplement '*How to Spend It*' was named 'Best Colour Supplement of the Year' in the Newspaper Design Awards.

FT BRANDED BUSINESSES 1997 was a year of transition for the former FT Information and Pearson Professional businesses. We now have a much tighter focus on businesses which provide corporate customers with information and analysis in chosen specialist areas (energy, finance, telecommunications and the media). In addition, the FT Group publishes information on management development and furnishes investment managers with high-quality, daily data on equities and financial instruments. By the end of this year, even more of this news, information and analysis will be delivered in on-line interactive formats.

At the same time, the asset management data business centred in the US continued to show strong growth. The company also had a successful year in Asia. Profits from FT branded businesses were lower than in 1996 principally because of a higher level of investment in new products and platforms, together

INFORMATION OPERATING PROFIT

ALL FIGURES IN £ MILLIONS	1997	1996	%
FT newspaper	34.8	14.6	+138
FT branded businesses—continuing	15.3	26.3	−42
FT branded businesses—sold	3.1	2.9	+7
Les Echos	8.8	(1.3)	—
Recoletos	30.4	33.4	−9
Associates	14.6	12.3	+19
Total	**107.0**	**88.2**	**+21**



with an ambitious programme to reduce fixed costs. Revenue investment in our electronic publishing interests will continue in 1998.

As part of the Group restructuring, Pearson Professional was disbanded on 31 December 1997. Churchill Livingstone was sold for £55m in August. FT Law & Tax businesses were sold for £70m in March 1998.

LES ECHOS Despite the strength of sterling against the French franc, *Les Echos* turned a loss of £1.3m in 1996 into an operating profit of £8.8m in 1997, on the back of strong advertising and circulation growth. 1996 profits were depressed by the closure of *Argent*, a personal finance magazine, which incurred losses of £5.6m.

Overall, the Les Echos Group increased sales by over 10% in local currency, with advertising growth particularly strong in the business division. *Les Echos* continues to be by far the most profitable French business newspaper. *Enjeux*, the monthly business magazine, increased revenues by 12% and the medical division, despite the postponement of education reforms which would have boosted trading activity, benefited from tight cost controls.

RECOLETOS In Spanish pesetas, Recoletos increased sales by 4% and operating profits by 10%. However, the strength of sterling meant that this translated into an operating profit of £30.4m, down on £33.4m for the previous year.

Marca, the leading Spanish sports newspaper, faced increased competition from both national and regional rivals. Circulation declined by 9% in the course of the year, although the impact on revenue was mitigated towards the end of the year by a 14% cover price increase. Other Recoletos titles performed strongly with *Expansion*, the nation's leading business daily, boosting its circulation by 26%.

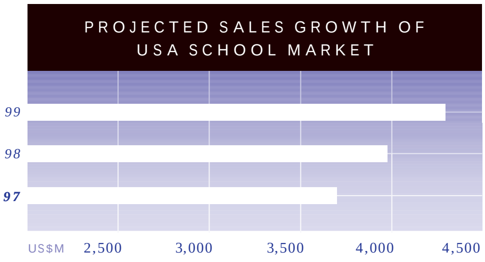
In September 1997 Recoletos entered into an agreement with Telefónica, the Spanish telecommunications group, to promote joint investment by the two companies in media opportunities in Spain and Latin America. Under the terms of the agreement, Telefónica undertook to subscribe for a 20% interest in Recoletos at a price of Pts23.1bn (£90m), while Recoletos agreed to pay Pts11.54bn (£45m) to subscribe for a 10% stake in Antenna 3, the Spanish commercial television channel. The transaction was completed in March 1998.

THE ECONOMIST (50%) The Economist had another record year, with the portion of profits

FT NEWSPAPER CIRCULATION

NUMBERS IN THOUSANDS	DECEMBER 1997	DECEMBER 1996	%
United Kingdom and Ireland	180.4	171.2	+5
The Americas	47.3	36.0	+31
Europe	100.0	84.1	+19
Asia	14.4	9.2	+57
Total	**342.1**	**300.5**	**+14**

SOURCE: AUDIT BUREAU OF CIRCULATION



allocated to Pearson increasing to £14.4m, ahead of the previous record of £12.1m for 1996. Average circulation for *The Economist* newspaper, responsible for half the profits of The Economist Group, edged further ahead to 644,391 from 640,385 in 1996.

In February 1997, Pearson acquired a 50% stake in *Business Day* and *Financial Mail*, the leading daily and weekly financial and business publications in South Africa.

EDUCATION

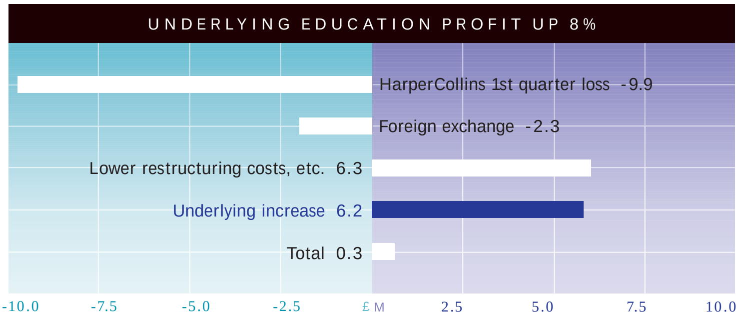
Addison Wesley Longman AWL achieved underlying profits growth of 8% after taking account of the impact of adverse exchange rates, the timing of the acquisition, in 1996, of HarperCollins Educational and lower restructuring costs in 1997. Revenues were up 6% in constant currency, but the effect of a strong pound masked improvement over 1996 in sterling terms.

Half-way through the year, a new chief executive and a number of top managers joined AWL, bringing substantial experience to their new company. This new management team has set about developing new products and marketing programmes, restructuring the worldwide financial, managerial and sales organisation and reducing operating expenses. These initiatives resulted in restructuring costs of £11.7m in 1997. These were partially offset by savings achieved through the successful integration of HarperCollins Educational, acquired in 1996.

US SCHOOLS A slow start to the year was improved by a strong early performance by the newly published elementary math programme, which bodes well for adoptions campaigns in 1998. Even so, sales of £186.4m were down marginally on those achieved in 1996.

US HIGHER EDUCATION Sales were higher at £146.9m, with the majority of the increase coming from higher sales in Math, Physics and the Reading Hub and a 15% increase in new product signings.

INTERNATIONAL PUBLISHING This business comprises all school and college products published and distributed outside the USA, including the UK, together with worldwide sales of ELT products. Sales of £213.6m for this Group were higher than those achieved in 1996. A new adult ELT course, True Colours, was launched, as well as our first programme in Brazil.



ENTERTAINMENT OPERATING PROFIT			
ALL FIGURES IN £ MILLIONS	1997	1996	%
Penguin	56.9	25.5	+123
Pearson TV	46.2	43.4	+6
Channel 5	(24.1)	(5.8)	—
BSkyB	3.9	2.4	+63
Tussauds	22.3	21.0	+6
Mindscape	1.6	(46.1)	—
PNE	5.8	1.7	+241
Cedar Fair	—	16.3	—
Total	**112.6**	**58.4**	+**93**

ENTERTAINMENT

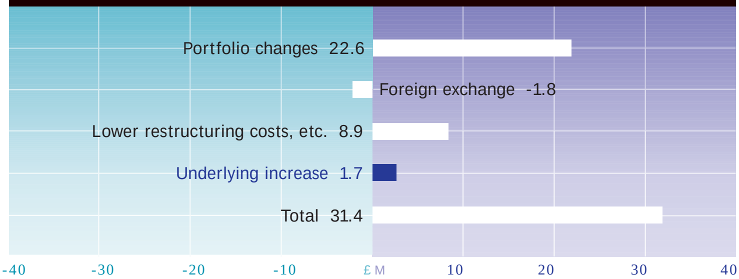
Penguin With the acquisition of Putnam Berkley in December 1996, revenue increased by 38% to £524.8m. Operating profits rose by 123% to £56.9m.

Operating profits in 1997 were boosted by first-year savings of $9m on the integration of Penguin's and Putnam's paper purchasing, freight and sales operations. Those integration savings are projected to double to $18m in 1998 and exceed the expectations in our acquisition plan. In 1997, Penguin's new management started to change some of its economic approaches to publishing. They began signing multi-book deals to build relationships with authors, aiming for best-selling books which will bring long term revenues, focusing on popular literary fiction, philosophy, science and business.

Operating cash flow was worse than in 1996, primarily due to lower collections in the early part of the year as a consequence of improper accounting at Penguin USA. Following the discovery of this problem, we conducted, with our new external auditors, an extensive review of financial controls, and corrective measures were completed early in 1998.

Pearson TV Sales of £246.6m included £20.1m for All American, the production company acquired in November. Excluding this, sales were up 11% on 1996. Operating profits, excluding All American, Pearson's share of Channel 5 and income from BSkyB, increased by 22% before the adverse

UNDERLYING PENGUIN PROFIT UP 5%



effect of exchange rates reduced the increase to 9%. The post-acquisition profits of All American were offset by restructuring costs. The Group has a 24% economic interest in Channel 5, the UK terrestrial channel launched in April 1997. The Group equity accounts for its share of losses and is amortising certain initial costs over the 10 year licence period. The charge to profits was £24.1m in 1997, in line with budgeted expectations.

In 1997, Pearson exchanged its share in UK Gold and UK Living for shares in Flextech plc. Part of this shareholding was sold in June, realising a profit of £23.9m. Pearson retains 3% of Flextech plc, valued at 31 December 1997 at £25.3m. Also in 1997, the Group's investment in Television Broadcasts Limited (TVB) was sold for £109m, realising a profit of £4.1m. In February 1998, Pearson sold its 6.3% holding in Société Européenne des Satellites SA (SES) for £159.5m, realising a profit of £132.2m.

The Tussauds Group A number of market factors, including the impact of a strong pound on spending by overseas visitors, resulted in slower growth in admissions, revenue and operating profit in 1997. Sales were up by 3% to £107.3m, admissions increased by 5% to 12.9 million and operating profits were up by 6%. Scenerama in Amsterdam continued to enjoy record admissions; a new exhibition which will tour the Pacific opened in Melbourne, Australia in October with admissions 10% higher than anticipated; and construction started on the new exhibition planned for New York.

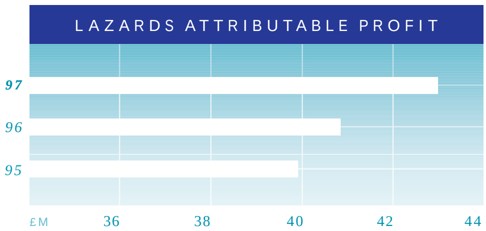
Inclement weather and safety concerns about a new ride at Port Aventura, in Spain, were a factor in admissions being down by 300,000 on 1996, but we expect the park to get back on track in 1998. Construction of major new attractions at Alton and Chessington parks were completed to budget and in time for a March 1998 opening.

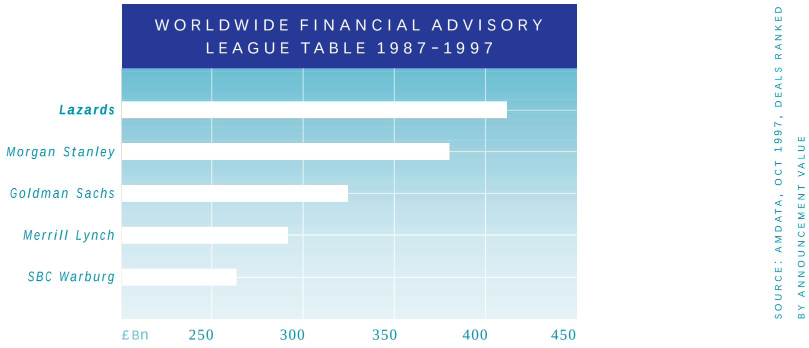
Mindscape Mindscape, which develops and publishes consumer entertainment software, enjoyed a strong recovery from loss in 1997, as a result of the implementation of a focused product strategy by a new management team. In spite of that, and in view of the fact that the Group has no synergies to offer the Mindscape business, Pearson announced on March 6, 1998, that it had reached an agreement to sell Mindscape to The Learning Company, a US software publisher, for $150m (£91m) in cash and stock.

Pearson New Entertainment Sales at Pearson New Entertainment (PNE) grew by 43% to £90.8m and operating profits more than trebled to £5.8m. Future Publishing, the UK consumer magazine publisher, contributed sales of £70m. The French magazine business contributed strongly, too.

INVESTMENT BANKING

Pearson owns, directly and indirectly, a 50% interest in Lazard Brothers, the UK merchant bank, and smaller holdings in the Lazard banking houses in New York and Paris. In 1997, income from the three Lazard Houses reached a record £43.1m. Lazard Brothers headed the UK mergers and acquisitions league





tables, advising on over £20 billions' worth of transactions. The investment management operations of Lazard Brothers and Lazard Frères New York were combined to create a single entity. The new entity, Lazard Asset Management, is experiencing strong growth. The three houses continue to find ways to enhance co-operation.

GROUP FINANCIAL REVIEW

Non-operating items These were significant in both 1996 and 1997 and affected pre-tax profits in a way that masks the real progress of the Group. The disposal of Westminster Press in 1996 resulted in an exceptional profit of £231.3m, while the 1997 accounts were affected by the decision to take a charge of £212.0m in relation to the value of Mindscape. These two items were the principal reason for the reduction in pre-tax profits from £356.8m in 1996 to £128.6m in 1997.

Interest The net interest charge rose by £7.8m to £37.3m in 1997, reflecting the increase in debt levels resulting from the acquisition of Putnam Berkley.

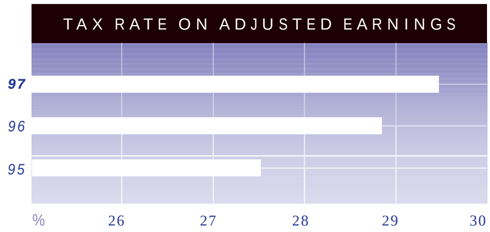
Changes in interest rates did not have a significant effect. US dollar interest rates were little changed from 1996, and the impact of higher sterling interest rates was limited because, for most of the year, we had more cash in sterling than floating rate sterling borrowings.

Interest cover, operating profit expressed as a multiple of net interest expense, was nine times in 1997, at the upper end of the Group's target range of five to nine times.

Taxation The tax charge of £88.6m represents an effective rate of 68.9%: this very high rate results from the fact that there is no current tax relief for the charge of £212.0m against Mindscape goodwill. Excluding this provision, the effective rate was 26.0% compared with 30.4% in 1996. The overall tax rate on non-operating items, excluding Mindscape, was very low, mainly because tax payable on UK disposals was reduced by capital losses and indexation.

A more meaningful comparison can be made between the tax rates on adjusted earnings. This rate increased from 28.8% to 29.4%, notwithstanding the reduction from 33% to 31.5% in the rate of UK corporation tax applicable to the Group's profits for the year. The largest single factor in this effective increase was that 1996 earnings reflected a non-recurring benefit of £8.8m arising from Pearson's holding in BSkyB, the UK satellite television operator. The main reason for the tax charge remaining below the UK statutory rate was that tax losses available in the USA allowed us to provide no significant tax on the Group's profits arising there. This more than offset the fact that, in most other countries where the Group operates, the local tax rate exceeded the UK rate.

Looking forward, the prospective reduction in the UK corporate tax rate to 30% will clearly benefit the Group, although this will be offset by the acceleration of tax payments which will result from

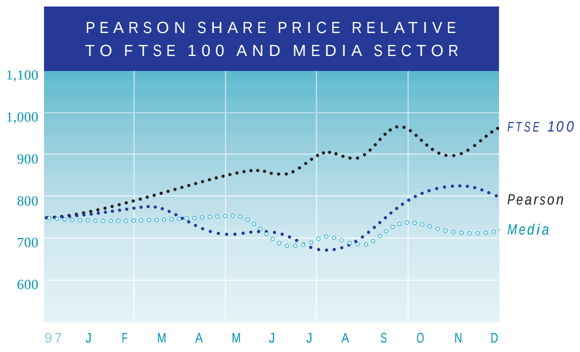


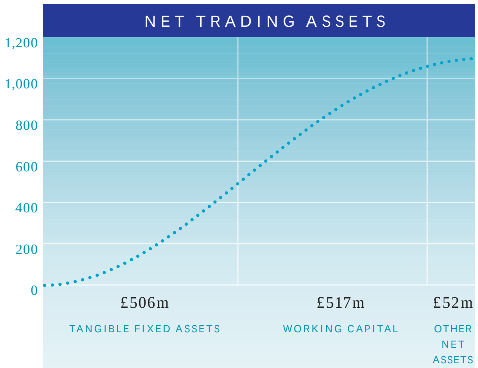
the move to a quarterly payments system in the UK. Our present best estimate is that the net effect will be broadly neutral to the Group. The prospective abolition of Advance Corporation Tax (ACT) should not affect our stated tax rate, since we have not had to write off ACT in recent years. The additional flexibility which the abolition of ACT will provide to Pearson in planning its affairs is, however, helpful.

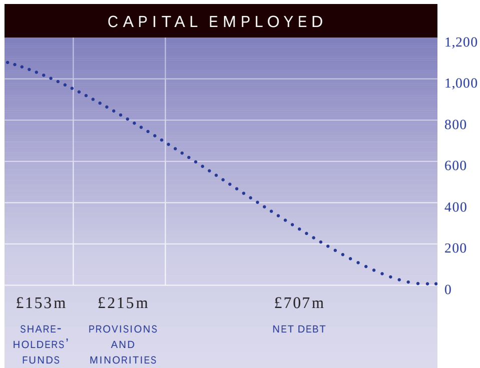
Minorities Minority interests decreased from £7.7m in 1996 to £1.7m in 1997 following the increase in our shareholding of Recoletos to 94.2% towards the end of 1996. The strategic alliance with Telefónica, Spain's leading telecommunications company, will mean, however, that the minority interest in Recoletos will increase again in 1998 as Telefónica takes a 20% stake.

Dividends Pearson has an excellent record of increasing the dividend paid to shareholders. The Company's management is committed to build on that tradition, increasing dividends at a rate comfortably in excess of the UK inflation rate. At the same time, management currently sees opportunities to earn a return in excess of the Company's cost of capital through investment in the business and will therefore be aiming to rebuild dividend cover (adjusted earnings per share expressed as a multiple of net dividend per share) from the present level of 1.8 times (based on the 1997 recommended dividend) to a minimum level of two times. We do not expect this increase to be achieved in a single year, and we shall also be mindful, in considering the appropriate level of the dividend, of the level of the company's cash earnings. In addition we shall actively consider the return of capital to shareholders when that course of action is justified by a high level of corporate liquidity, a shortage of investment proposals which meet our criteria or the level of the Company's share price. The board is recommending to shareholders a final dividend of 12p per share to produce a total for the year of 19.5p, which represents an increase of 8.3% on the 1996 payment.

Cash flow The significant influences on operating cash flow, the knock-on effect of the Penguin problem on 1997 receivables collection and the heavy investment in the *Shared Services* initiative, have been described above. They resulted in 1997 dividend payments being less than fully







funded by the cash flow available after interest and tax. This cash shortfall resulted in some increase in debt levels in 1997, although a much more significant factor was the excess of acquisition spending over disposal proceeds. This resulted in a year-end net debt level of £707m, up from £430m a year earlier. By the end of March 1998, disposals had reduced net debt to a pro forma level of £392m.

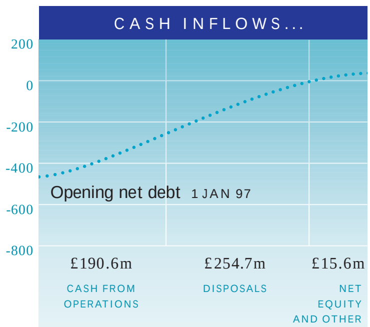
GROUP FINANCIAL POLICY

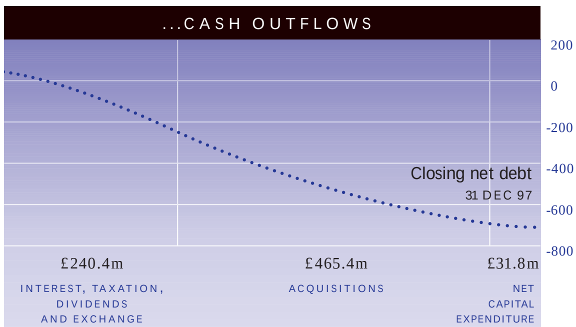
Treasury policy Treasury activities are carried out in accordance with policies approved by the board and implemented by the finance director. The finance director and a treasury committee of the board receive reports and review and comment upon the treasury policies of the Group. The treasury department is not operated as a profit centre and is subject to audit.

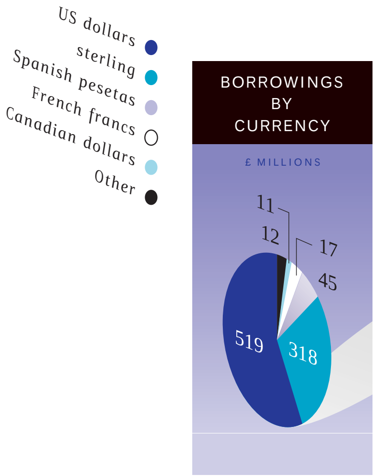
Borrowings We aim to manage the amount of net debt — total borrowings less cash and liquid funds — and the level of net interest cover in a manner which maintains our credit ratings at their appropriate levels. Current ratings from Standard & Poor's and Moody's are A and A2 respectively for long term debt and A1 and P1 respectively for short term debt.

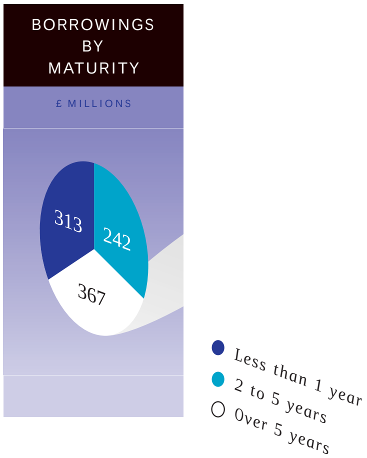
At the year end, total borrowings were £922m, with £519m in US dollar borrowings, £318m in sterling, and the rest in a number of other currencies.

A proportion of our overseas assets is hedged through foreign currency debt to reduce the extent to which changes in foreign exchange rates affect shareholders' funds. We may vary the level in a









particular currency for operational reasons if there is some other element of risk, but normally we hedge around 20% of capital employed, inclusive of any purchased goodwill, in each principal foreign currency.

We meet our long term financing requirements through sterling and US dollar debt issues in the capital markets. At 31 December 1997, approximately 51% of core borrowings were provided by non-bank sources; our target is between 25% and 75%, with a norm of 50%.

We aim for a diversity of debt maturity dates to avoid a concentration of refinancing risk in any short period. Our target is a weighted average maturity of our core gross borrowings of between three and eight years. At the end of 1997 it was 6.1 years.

Short term funding requirements are met through committed or uncommitted bank facilities and through the USA commercial paper programme. At 31 December 1997, committed bank facilities amounted to £476m, all of which had a maturity of over four years. The general guideline is that available undrawn committed bank facilities should be at least £200m.

Cash At 31 December 1997, we had £215m in total cash and liquid funds, with the largest currency being US dollars. We invest funds which are temporarily surplus to business requirements in a range of money market instruments, including AAA-rated asset-backed securities. We aim to maximise after-tax returns while preserving liquidity and managing counterparty risk. We ensure the portfolio is appropriately diversified by regularly reviewing limits for individual issuers and assets, taking published credit ratings, among other factors, into account. The finance director approves the limit.

Interest rate management Interest rate exposure is mainly in relation to sterling and the US dollar. We manage exposure within parameters agreed by the board, with the interest rate on at least one-third of core sterling and US dollar borrowings fixed or capped for around the next five years. We borrow on a fixed rate basis, but we also enter into interest rate swaps and forward rate agreements to modify the interest rate reset profile of our borrowing portfolio. At the year end, 37% of US dollar borrowings were fixed at a weighted average rate of 6.2% and 38% of sterling borrowings were fixed at a weighted average rate of 9.4%. In broad terms, a 1% rise in US dollar interest rates would increase the net interest charge by £4m, while a 1% rise in sterling interest rates would increase the net interest charge by £2m.

Foreign exchange Foreign currency transactional cash flows were normally hedged on the basis of rolling forecasts for periods of up to twelve months. In January 1998, we began to convert these cash flows at the relevant spot exchange rate, and we expect this new policy to be fully effective by the middle of 1998. Unremitted profits are not hedged under either policy. Cross-border trading flows and other recurring items, such as dividends, which give rise to transactional foreign exchange exposure in the UK amounted to the equivalent of approximately £95m in 1997.

Accounting policies The accounting policies of the Group are shown on pages 51 and 52. These policies have not changed and have been consistently applied during 1997. In 1998, we will adopt two new UK Accounting Standards — FRS 9 'Associates and Joint Ventures' and FRS 10 'Goodwill and Intangible Assets'. FRS 9, like its predecessor, requires the equity method to be used to account for associates but also requires additional disclosures. FRS 10 will mean a significant change to our accounts, as to the accounts of many UK companies. In summary, any purchased goodwill is now required to be shown as an asset on the balance sheet and amortised over its useful economic life, presumed to be not greater than 20 years unless shown to be otherwise. The charge is to be taken through the profit and loss account. Goodwill arising on all acquisitions made from 1998 onwards will be shown as an asset in the Pearson balance sheet and will be amortised accordingly. To show results from operating activities on comparable bases, we plan to exclude amounts charged to operating profit from the calculation of adjusted earnings.

Risk management In 1997 we combined our internal audit and risk management functions into a single Group control department, which has an independent reporting line to the Audit Committee and checks our effectiveness at managing risk. Through regular audits and reviews, it seeks to identify under-managed risks, and then works with the responsible line management to resolve any issues arising. The department also ensures that policies and procedures operating throughout the Group are suitably comprehensive and up-to-date. We will complete a comprehensive revision of central policies and procedures during 1998.

Following the major fraud at Penguin USA reported in last year's accounts, we undertook an extensive review of our operations to be sure that no other material unidentified exposure exists. We found no surprises.

Our most significant risks arise from our normal course of business. Our newspapers are highly dependent on advertising revenue, and therefore on the business cycles of our markets. This risk is spread well over Europe, and the global expansion of the FT's initiative will improve our resilience against potential future regional economic downturns.

All our major business systems are on track to be Year 2000 compliant by Christmas 1998, one year ahead of the critical date. For two years, Pearson has had a project team working with our businesses to plan their responses and audit their progress.

Our education business has to manage the US process of school book adoption whereby each state asks potential suppliers of education programmes to compete for adoption, which will secure sales for several years. AWL manages this risk by competing over all states, with a broad range of programmes, as well as by ensuring focused management support to each AWL programme seeking adoption.

Board of Directors

CHAIRMAN

SIR DENNIS STEVENSON chairman, aged 52, has been a non-executive director of Pearson since 1986 and succeeded Viscount Blakenham as chairman after the Annual General Meeting (AGM) in May 1997. He is also chairman of GPA Group plc, chairman of the Trustees of the Tate Gallery and a non-executive director of Manpower Inc. in the USA.

EXECUTIVE DIRECTORS

MARJORIE SCARDINO chief executive, aged 51, joined the Pearson board in January 1997. She trained and practiced as a lawyer, and published a weekly newspaper in the USA. In 1985 she joined The Economist Group as president of its North American operations and became its chief executive in 1993. She is also a non-executive director of W H Smith plc and of ConAgra Inc. in the USA.

DAVID BELL aged 51, became a director of Pearson in March 1996. He is chairman of the Financial Times Group with responsibility for the Group's information businesses, having previously been chief executive of the *Financial Times* since 1993. He is also a non-executive director of VITEC Group plc and chairman of the Millennium Bridge Trust.

GREG DYKE aged 50, has been chairman and chief executive of Pearson Television since 1995. He became an executive director of Pearson, responsible for the Group's television interests, in March 1996. He is currently chairman of Channel 5 Broadcasting and a non-executive director of Manchester United plc.

JOHN MAKINSON aged 43, joined the board and became finance director in 1996. Until that time he was managing director of the *Financial Times*, and prior to that he founded and managed the investor relations firm Makinson Cowell. He is also a non-executive director of George Weston Limited in Canada.

DAVID VEIT aged 59, will retire at the AGM this year. He joined Pearson in 1973 from Lazard Brothers, became a director in 1981 and president of Pearson Inc. in 1985. From March 1996 to the end of 1997, he was responsible for Pearson's entertainment businesses, excluding television.

NON-EXECUTIVE DIRECTORS

MICHEL DAVID-WEILL aged 65, is chairman of Lazard Partners, deputy chairman of Lazard Brothers, chairman of Lazard Frères, New York, and managing director of Lazard Frères, Paris. He joined the Pearson board in 1970.

GILL LEWIS+ aged 54, became a non-executive director of Pearson in 1992. She is a director and managing partner of the consumer practice of Heidrick & Struggles in Europe.

REUBEN MARK*+ aged 59, is chairman and chief executive of the Colgate Palmolive Company. He became a non-executive director of Pearson in 1988.

VERNON SANKEY* aged 48, is chief executive of Reckitt & Colman plc, which he joined in 1971. He became a non-executive director of Pearson in 1993.

DAVID VEREY* aged 47, joined Lazard Brothers in 1972 and became chairman in 1992. He was appointed an alternate director of Pearson in 1995 and became a non-executive director in 1996.

DIRECTORS WHO RETIRED DURING THE YEAR

SIR FRANK BARLOW aged 68, managing director until 31 December 1996. He retired from the board at the AGM on 2 May 1997, after 29 years with the Group, including eleven years on the Pearson board.

VISCOUNT BLAKENHAM aged 60, chairman until 2 May 1997, when he retired after 26 years on the board, first as an executive director, then chief executive and finally chairman.

MARK BURRELL aged 61, retired on 2 May 1997 after 20 years on the board.

PEHR GYLLENHAMMAR aged 62, retired as a director on 31 December 1997. He had been a non-executive director of Pearson since 1983.

SIR SIMON HORNBY aged 63, retired on 2 May 1997 after 19 years on the board.

**A member of the Audit Committee.* ■ *+A member of the Personnel Committee (previously the Remuneration Committee).*

Report of the Directors

The directors have pleasure in presenting their report to shareholders, together with the financial statements for the year to 31 December 1997 on pages 47 to 79. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given in the Business Review on pages 21 to 32 and on pages 3 to 20 of this Annual Report. Sales and profits of the different sectors and geographical markets are given on pages 53 and 54.

Results and dividend The profit for the financial year to 31 December 1997 was £38.3m (1996: £240.5m). The loss retained for the year was £74.1m (1996 profit: £137.8m) and has been transferred to reserves. A final dividend of 12.0p per share is proposed for the year to 31 December 1997. This, together with the interim dividend already paid, makes a total for the year of 19.5p (1996: 18.0p). The final dividend will be paid on 5 June 1998 to shareholders on the register at the close of business on 3 April 1998, the record date.

Significant acquisitions and disposals During the year, Pearson acquired All American Communications Inc. in the USA for a consideration of £246.5m and disposed of its 10% interest in Television Broadcasts Limited for £110.8m; its 44.1% interest in Troll Communications LLC for £45.5m; and Churchill Livingstone, the medical publisher, for £54.2m. In April 1997, Pearson exchanged its minority interests in UK Gold and UK Living, two satellite TV channels, for 8.8 million shares in Flextech plc. On 26 June 1997, 4 million of those shares were sold for £23.9m. Further disclosure of these transactions can be found in notes 23 and 24 to the accounts and in the Business Review on pages 21 to 32.

Transactions with related parties Details of transactions with related parties, which are reportable under FRS 8, are given in note 28 to the accounts on page 75.

Capital expenditure The analysis of capital expenditure and details of capital commitments are shown in note 10 to the accounts on page 60.

Post balance sheet events On 25 September 1997, Pearson announced a strategic alliance between its subsidiary, Recoletos Compania Editorial, SA (Recoletos) and Telefónica de España SA (Telefónica), the Spanish telecommunications group. Telefónica will pay Pts 23.1bn (£90m) to subscribe for a 20% stake in Recoletos, who will then invest Pts 11.54bn (£45m) of the proceeds to subscribe for a 10% stake in Antena 3, a commercial television channel in Spain. The transaction is expected to close on 16 March 1998.

On 9 February 1998, Pearson sold its 6.3% shareholding in Société Européenne des Satellites SA for £159.5m. The sale was made cum dividend and consequently £4.2m will be included in operating profit, leaving a profit of £132.2m before tax, estimated at around £25m.

On 2 March 1998, Pearson sold its specialist Law & Tax publishing businesses for £70m, giving rise to a profit of £61m before tax, estimated at £14m. Of the £70m consideration, £19.5m relates to the sale of the Federal Publications business which is conditional on Hart-Scott-Rodino clearance in the USA.

On 6 March 1998, Pearson announced that it is to sell Mindscape Inc., the consumer software publisher, for $150m (£91m) giving rise to an estimated loss on sale of £212m. This is also conditional on Hart-Scott-Rodino clearance in the USA.

Directors The directors who served throughout the year are shown on page 33 as well as in the Personnel Committee Report on pages 39 to 45, together with details of their interests in ordinary shares and options of Pearson plc. Four directors, David Bell, Michel David-Weill, John Makinson and Vernon Sankey, will retire by rotation at the AGM. All four, being eligible, will offer themselves for re-election. In addition, David Veit will retire at the end of the AGM and will not seek re-election. For details of directors' service contracts, see page 41. No director was materially interested in any contract of significance to the Company's business.

Nomination process for non-executive directors The nomination and appointment of non-executive directors is included in the items reserved for the full board.

The Audit Committee The committee is chaired by Vernon Sankey and made up entirely of non-executive directors, the other two members being Reuben Mark and David Verey. The committee provides the board with the means to appraise Pearson's financial management and reporting, and to assess the integrity of the Group's accounting procedures and financial controls. The Group's internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee. The committee itself reports to the full board of Pearson.

The Personnel Committee This committee (previously the Remuneration Committee) is chaired by Gill Lewis, who succeeded Sir Simon Hornby when he retired at the AGM on 2 May 1997. During 1997, the other members of the committee were Reuben Mark and Pehr Gyllenhammar, who was a member of the committee from May 1997 until he stepped down from the board on 31 December 1997. His successor has not yet been appointed. The committee meets regularly to decide, inter alia, the remuneration and benefits packages of the executive directors and advise on management succession and development.

Insurance of officers of the Company During the year to 31 December 1997, the Company continued to provide liability insurance for its officers.

Corporate governance The board has reviewed the Company's procedures in light of the Code of Best Practice published by the Committee on Financial Aspects of Corporate Governance. In the opinion of the directors, the Company fully complies with that Code and has done so throughout the year. The report of the auditors on corporate governance matters is set out on page 46.

Internal financial control The board of directors has overall responsibility for the Group's system of internal financial controls, which it exercises through an organisational structure with clearly defined levels of responsibility and authority, and appropriate reporting procedures. This structure includes an Audit Committee, comprising three non-executive directors. This committee, with the finance director, has reviewed the effectiveness of the internal financial control environment of the Group. The Audit Committee meets regularly and considers, inter alia, reports from internal and external auditors covering such matters.

The directors consider that the Group's system of internal financial controls is appropriately designed to provide reasonable but not absolute assurance against material misstatement or loss. The main elements of these internal controls are as follows:

FINANCIAL REPORTING There is a comprehensive budgeting system with an annual budget approved by the board of directors. Monthly financial information, including balance sheets, cash flow statements, trading results and indebtedness, are reported against the corresponding figures for the budget and the previous year, with corrective action taken by the directors as appropriate.

TREASURY MANAGEMENT The treasury department operates within board approved policies, and its procedures are reviewed biannually by the treasury committee, which currently consists of the finance director, one executive director and one non-executive director. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the finance director and quarterly reports are prepared for the treasury committee.

GROUP CONTROL AND INSURANCE The identification and mitigation of major business risks is the responsibility of operating management. The Group has merged the central responsibility for risk control with the internal audit department, which has operations located both in the UK and the USA. The Group control department reviews risks, systems and procedures in all major operating companies and reports regularly to the Audit Committee. Steps are taken to mitigate or eliminate these risks where possible. Insurance cover is provided either through Pearson's captive insurance subsidiary or externally depending on the scale of the risk in question.

OPERATING COMPANY SYSTEMS Each operating company maintains additional financial controls and procedures appropriate to its own business environment and carries out local treasury activities, in both cases conforming to overall standards and guidelines.

SELF ASSESSMENT Each year relevant senior executives and chief executives of operating units are required to confirm in writing compliance with appropriate standards of internal financial control in their respective areas.

Going concern Having reviewed the Group's liquid resources and borrowing facilities, and the 1998 and 1999 cash flow forecasts contained in the Group budget for 1998, the directors believe that the Group and the Company have adequate resources to continue as a going concern for the foreseeable future. For this reason, the financial statements have, as usual, been prepared on a going concern basis.

Year 2000 In line with other modern businesses, the Pearson Group relies heavily on information technology. Potential problems with dates arising in connection with the move into the next millennium are therefore being taken extremely seriously by all the Pearson companies. An extensive Group-wide programme has been put in place with the aim that, by December 1998, all computer systems, products using IT and facilities with microchips will be fully Year 2000 compliant and management will know of any problems with key suppliers and customers. While management believes that all companies within the Group will be compliant for the Year 2000, it must be recognised that, with a problem as large and complex as this, it is not possible to give any guarantees that no unforeseen problems will arise.

Supplier payment policy Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. It is Group policy that payments to suppliers are made in accordance with these terms, provided that the supplier is also complying with all relevant terms and conditions. Group trade creditors at 31 December 1997 were equivalent to 25 days of purchases during the year ended on that date. The Company does not have any significant trade creditors enabling it to produce creditor information for this purpose.

Employment The average number of Group employees in 1997 was 18,306, of whom some 8,395 were employed in the UK. The employment policies of the Group embody the principles of equal opportunity and are designed to meet the needs of operating companies and comply with local regulations in their areas of operation. The sole criterion for selection, training, development and promotion is the individual's suitability for the position of employment offered and his or her aptitudes and abilities.

TRAINING AND DEVELOPMENT The Group is committed to the continuous improvement of employee performance by developing skills and expertise through training and development. In addition to development opportunities offered by the Group, operating companies have their own programmes and courses to meet the needs of their employees and their business. Pearson also encourages employees to develop their careers by taking up opportunities in other parts of the Group.

EMPLOYEE PARTICIPATION The directors believe that the key to the success of Pearson lies in a truly motivated workforce. In September 1997, the board launched the "Change*gear*" initiative, which was aimed at giving employees the opportunity to share in the Company's prosperity and at raising the level of awareness of Pearson and the importance of results among employees throughout the Group. The elements of the initiative included a Group profit sharing plan and the Worldwide Save for Shares Plan.

WORLDWIDE SAVE FOR SHARES PLAN In 1997 Pearson decided to introduce the save for shares plan to the Group's employees worldwide, following shareholders' approval in 1992 of the worldwide establishment of plans parallel to the then 'Save As You Earn' Share Option Scheme. The worldwide plan will be adapted as necessary to meet local legal, regulatory and fiscal requirements. The first grant under the Worldwide Save for Shares Plan is planned for spring 1998.

The existing UK plan continues to attract a high level of interest and participation, and the most recent grant was taken up by over 1,500 employees with a cumulative total of more than 24.6 million options over ordinary shares having been granted, of which about 4.7 million were outstanding at the end of the year.

EUROPEAN EMPLOYEE FORUM In 1996, Pearson established a European Employee Forum with elected representatives from each of the Group's principal operating companies and from countries in Europe where the Group's operations are of significant scale. The Forum is intended to provide an arena for the exchange of relevant and appropriate information and to establish a constructive dialogue between management and employees on transnational issues which affect them. Two meetings of the Forum were held in 1997.

EMPLOYEE COMMUNICATIONS Employee communications continue to be developed through regular Group-wide communication from Marjorie Scardino; wide-ranging presentations to staff around the world in connection with the publication of Pearson's results or other important events; the distribution of *Pearson Now*, the employee magazine; the introduction of an intranet and the Report to Members of the UK Pension Plan. The various operating companies also have their own channels of communication such as briefing groups, videos, magazines and newsletters.

Shareholder communications Management is keen to develop, increase and improve communications with shareholders, large and small, institutional and private. This year's AGM will therefore include information about the Group's businesses, as well as 1997 results and general AGM business. In addition, Pearson has developed a comprehensive institutional investor communications programme.

Charitable donations In 1997, charitable donations in the UK amounted to £809,000 (1996: £568,000) and overseas to £458,000 (1996: £240,000). Approximately half of this was given by the Company to charities working on educational, literacy and youth projects. The other half was given by Pearson's businesses, many of which take active roles in supporting their local communities and industries. Specifically in 1997, a donation of £64,000 was made to the Princess of Wales Memorial Fund by Ladybird Books following the successful publication of a special tribute called 'Diana, Princess of Wales'. Many of the businesses already match the funds raised by their employees for charities and this is now being introduced as policy throughout the Group.

Political donations The board has reviewed its policy in this area and decided that it is no longer appropriate for Pearson to make party political donations. However, Pearson continues to support a number of independent research institutes across the political spectrum.

Sponsorship In 1997, Pearson sponsored its 17th major art exhibition, Seurat and the Bathers, at the National Gallery in London, which attracted nearly 250,000 visitors, including many Pearson employees and shareholders. In 1998, Pearson is sponsoring the Pearson Gallery of Living Words exhibition at the British Library, which opens to the public on 21 April 1998.

The Environment Pearson does not operate in industries where there is potential for serious industrial pollution. However, we recognise our responsibility to be aware of, and take steps to control and minimise, any damage our business may cause to the environment.

Share capital Details of share issues are given in note 21 to the accounts on page 68. At the AGM held on 2 May 1997, the Company was authorised, subject to certain conditions, to acquire up to 57.1 million of its ordinary shares by market purchase. This authority expires on the date of the forthcoming AGM. Although circumstances have not merited using it and there are no plans at present to do so, shareholders will be asked to renew this authority at the AGM on 1 May 1998.

At 16 March 1998, beneficial interests amounting to 3% or more of the issued ordinary share capital of the Company notified to the Company comprised:

	NUMBER OF SHARES	PERCENTAGE
Companies associated with Lazard Frères et Cie, Paris	48,129,727	8.34
Prudential Corporation plc	21,398,274	3.71

Share dividend alternative The Company operates a share dividend scheme under which a total of 1,673,515 new ordinary shares were issued in respect of the last two dividends in response to elections for shares instead of cash made by more than 5,000 shareholders on each occasion, improving the cash flow by approximately £12.4m and deferring approximately £3.1m of corporation tax. Details of the share dividend alternative for the final dividend for 1997 will be sent out to shareholders on 20 April 1998.

Close company status The Company is not a close company within the terms of the Income and Corporation Taxes Act 1988.

Annual General Meeting The notice convening the AGM to be held at 12 noon on Friday, 1 May 1998 at The Dorchester Hotel, Park Lane, London W1, is contained in the circular to shareholders dated 6 April 1998.

Registered auditors In accordance with section 384 of the Companies Act 1985 (the Act) resolutions proposing the reappointment of Price Waterhouse as auditors to the Company, at a level of remuneration to be agreed by the directors, will be put to the shareholders at the AGM.

Statement of directors' responsibilities Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group as at the end of the year and of the profit or loss of the Group for that period. The directors are also responsible for the maintenance of adequate accounting records in compliance with the Act, for safeguarding the assets of the Group, and for preventing and detecting fraud and other irregularities. In preparing the financial statements on pages 47 to 79 inclusive, the directors consider that appropriate accounting policies have been used and applied in a consistent manner, supported by reasonable and prudent judgements and estimates, and that all relevant accounting standards have been followed.

PAUL VICKERS
Secretary · 16 March 1998

Personnel Committee Report

Pearson's continued success depends critically on the efforts and success of its employees around the world. For this reason, the new Pearson management has introduced a package of incentives and rewards under the banner of "Change*gear*". This includes more geared bonus and share ownership plans for employees, strengthening the link between performance and reward and more closely aligning the interests of employees and shareholders.

The new approach includes giving all staff worldwide the opportunity to own Pearson shares through a savings contract linked to a share plan. From 1998, there will also be a Group profit sharing plan which will give employees the chance to receive an annual bonus linked to the Group's profitability.

In addition, the executive share option plan has been extended to almost 1,000 employees around the world. It is also management's belief that the Group's most senior executives should invest their own funds in Pearson shares, again strengthening the links between their own and shareholders' interests. The proposed Annual Bonus Share Matching Plan is designed to encourage them to do so.

The Personnel Committee (previously the Remuneration Committee) welcomes these initiatives, which clearly give all employees the opportunity to share the rewards as the Company succeeds and align employees' long term interests far more closely with those of shareholders.

The report of the committee sets out this philosophy in more detail, particularly as it applies to executive directors.

Composition and compliance The committee is chaired by Gill Lewis, who succeeded Sir Simon Hornby when he retired at the AGM on 2 May 1997. During 1997, the other members of the committee were Reuben Mark and Pehr Gyllenhammar, who was a member of the committee from May 1997 until he stepped down from the board on 31 December 1997. The board considers three members to be the ideal number, in line with the recommendations of the Greenbury Report. The committee currently has only two non-executive directors as members, but will fill the additional position once the board's complement of non-executive directors is increased as the result of a careful selection process the board is undertaking.

The London Stock Exchange has introduced a requirement that companies should comply with various best practice provisions in respect of the committee's operational framework and role. The committee has considered these provisions and believes that the Company has complied throughout the year with Section A on remuneration committees and confirms that it has given careful consideration to Section B in determining remuneration policy for executive directors and senior executives. Sections A and B are annexed to the Listing Rules of the Stock Exchange.

Role The committee decides the remuneration and benefits packages of the executive directors and approves those of the chief executives of the main operating subsidiaries. It recommends the chairman's remuneration to the board for its decision. In 1997, the board broadened the remit of the committee to include reviewing the Group's management development and succession plans and, in the first quarter of 1998, changed its name from Remuneration Committee to Personnel Committee to reflect this broader remit.

Worldwide Save for Shares Plan A UK 'Save As You Earn' share option plan is open to all eligible employees in the UK. The Company has already obtained shareholders' consent to introduce parallel plans around the world. In spring 1998, invitations will go out to employees worldwide to participate in the Worldwide Save for Shares Plan, allowing them to save for and receive Pearson shares. In that connection we are asking shareholders to approve a reduction in the qualifying period to take part in the plan from twelve months' service to six months.

Remuneration policy for executive directors The Company's remuneration policy aims to attract, retain and motivate high calibre senior executives through pay and other arrangements which are competitive and represent best practice. The committee aims to relate reward to performance and align the interests of directors and senior management with the interests of shareholders.

The main components are base salary, an annual bonus plan, long term incentives and pension benefits. The Company also provides company car and health care benefits in appropriate circumstances.

Base salary Base salaries are set at competitive levels within the range paid to directors and executives in similar positions in comparable companies.

Annual bonus The committee believes that outstanding performance should bring outstanding rewards. For 1997, the committee increased the maximum bonus the executive directors can earn to 75% of annual base salary as part of a phased increase to a maximum of 100% for 1998. Receiving the maximum will require achieving very challenging financial targets set by the committee. The targets for 1997 related to the Company's underlying sales growth, trading margin and cash generation. In the case of two executive directors, David Bell and Greg Dyke, part of their rewards also related to the performance of the Financial Times Group and Pearson Television respectively. The committee will continue to review the bonus plans and reserves the right to revise the bonus limits and targets again in the future. The committee may also award individual discretionary bonuses. Annual bonuses do not form part of pensionable earnings.

Annual Bonus Share Matching Plan Shareholders will be asked at the AGM on 1 May 1998 to consider and approve a share matching plan which permits executive directors and senior executives around the Group to take up to 50% of any after tax annual bonus in the form of Pearson shares which, if held for certain specified periods of time, will be matched by the Company on a gross basis. Further details are contained in the circular to shareholders dated 6 April 1998.

Long term incentives Long term incentive plans align the personal interests of directors and executives with those of shareholders. The committee's view is that if shareholders do well, then this should be reflected in the remuneration of senior executives. The committee reviews the operation of long term incentive plans on a regular basis, taking into account legislative and regulatory developments, particularly with regard to performance targets and evolving best practice.

Share option plans In the UK, the Company operates an executive share option plan comprising an Inland Revenue approved part and, following the change in legislation in 1996 which introduced an Inland Revenue limit of £30,000 for approved options, an "unapproved" part which enables the Company to grant options over and above the value of £30,000. All grants of share options are within the normal limit of four times earnings authorised by shareholders. Pearson also operates two US executive share option plans. Executive options are granted to eligible executives based on guidelines established by the committee on the total number of options which may be granted, the frequency of awards and the progression to a maximum award.

The current UK plan was introduced in 1988 and will have run its full ten-year course at the AGM in 1998. Thereafter, no more options may be granted under it. At the AGM on 1 May, shareholders will therefore be asked to consider and approve a replacement plan, which will have worldwide application, and thus replace the current US plans as well. The new plan takes account of changes in market practice and institutional share plan guidelines since the existing plans were introduced.

Incentive Share Plan The incentive share plan, first introduced in 1993, is designed to reward executives of the Group based on the performance of the Company over the medium to longer term.

Participants are conditionally awarded a certain number of Pearson shares which are held in an employee share trust for a specified period of not less than three years. The shares, together with the dividends, which are taken in the form of shares, can then be released depending upon the extent to which previously determined performance conditions are met. The current performance conditions used under the plan provide that the maximum release of shares is made if the total return to Pearson shareholders exceeds the equivalent average *FT-SE 100* figure by 25% over the period. The performance criteria are reviewed from time to time and may be revised by the committee to ensure that they remain sufficiently challenging and their achievement sufficiently rewarding for shareholders.

The three year performance period for the incentive share plan award made in 1995 ended on 31 December 1997, but since Pearson's total shareholder return was below that of the *FT-SE 100* over the period, no shares awarded in 1995 were released to participants.

Details of directors' awards under the plan are set out in tables 3 and 4 on page 44 of this report.

To the extent that the Company has provided funds to the trust for the purchase of shares, provision has been made in the accounts for the costs associated with the plan.

Service contracts All executive directors have agreements which can be terminated by the Company on twelve months' notice. However, as explained last year, the earliest expiry date of Marjorie Scardino's employment is 31 December 1999. In the event of Marjorie Scardino's contract being terminated early by the Company without cause during 1998, which is the second year of her contract, she would be entitled to liquidated damages equivalent to 15 months' base salary, benefits and a proportion of bonus, reducing to twelve months if her contract is terminated during the third year or later. For the other directors, if their contracts are terminated early by the Company without cause, those contracts provide for liquidated damages equivalent to twelve months' base salary, benefits and a proportion of bonus. During the period, no material changes were made to the service contracts of the executive directors.

Non-executive directors' remuneration Fees for non-executive directors are determined by the full board with regard to market practice and within the restrictions contained in the articles of association. Fees are reviewed annually with the help of outside advice. Non-executive directors receive no other pay or benefits (other than reimbursement for expenses incurred in connection with their directorship of the Company) and do not participate in the Company's share option or incentive share plans.

Since January 1995, non-executive directors have received an annual fee of £25,000 each. One overseas-based director is paid a supplement of £7,000 per annum. In June 1997, the Company decided to pay an additional fee of £5,000 per annum to each of the chairmen of the personnel and audit committees.

Retirement benefits The highest paid director, Marjorie Scardino, has pension arrangements comprising defined benefit and defined contribution arrangements in the USA. She participates in the funded, approved Pearson Inc. Pension Plan. This is a non-contributory final salary pension arrangement providing a lump sum convertible to a pension on retirement. The lump sum currently accrues at 6% of capped compensation. In addition, she participates in an unfunded, unapproved defined contribution arrangement, which provides a benefit on an annual notional company contribution of 25% of base salary. This plan is non-contributory. The Company also contributed $4,750 to the Pearson Inc. funded, approved, defined contribution (401k) arrangement.

David Bell, John Makinson and Greg Dyke are members of a defined benefit section of the Pearson Group Pension Plan (the Plan), with a member contribution rate of 5% of pensionable salary. David Bell is eligible for a pension from the Plan of two-thirds of final base salary at normal retirement date, due to his previous service with the Financial Times. It is anticipated that John Makinson will receive a pension of two-thirds of capped salary at normal retirement date (inclusive of benefits transferred from his previous pension scheme). Both John Makinson and Greg Dyke are subject to the pensions earnings cap introduced by the Finance Act 1989. John Makinson participates in the Company's FURBS (Funded Unapproved Retirement Benefits Scheme) arrangements, under which a contribution equivalent to 31.1% of his annual base salary is made by the Company to compensate him for pension benefits which cannot be provided from the Plan because of the pensions cap regulations. Greg Dyke receives a supplement of 50% of his annual base salary to compensate him for the loss of pension provision as a result of pensions cap regulations.

David Veit has both defined benefit and defined contribution arrangements in the USA. He participates in the funded, approved Pearson Inc. Pension Plan. He is additionally entitled to a pension supplement under his service agreement. In combination, these arrangements provide a level pension at age 60 of two-thirds of his final base salary. The actuarial equivalent of this pension will be paid as a joint and 100% survivor pension with a ten-year guarantee period. The Company also contributed $4,750 to the Pearson Inc. funded, approved, defined contribution (401k) arrangement.

As reported last year, the pension of Sir Frank Barlow was augmented at a cost of £253,333 with effect from his retirement date of 2 May 1997. The Company also contributed a total of £24,660 in matching the additional voluntary contributions (AVCs) made by three directors.

All the UK executive directors are also eligible for dependants' pensions and a lump sum payment on death in service.

Details of directors' pension arrangements are set out in table 2 opposite.

TABLE 1

Remuneration of the directors: Excluding contributions to pension funds and related benefits set out in table 2, directors' remuneration was as follows:

	1997					1996
ALL FIGURES ARE IN £ 000	SALARY/FEES	BONUS	OTHER	3-YEAR ISP	TOTAL	TOTAL
Chairman						
Sir Dennis Stevenson	203	—	—	—	203	25
Executive directors						
Marjorie Scardino	375	148	184	—	707	—
David Bell	230	64	9	—	303	201
Greg Dyke	240	118	13	—	371	295
John Makinson	250	87	14	—	351	252
David Veit	326	66	—	—	392	303
Sir Frank Barlow	130	—	6	—	136	397
Viscount Blakenham	107	—	5	—	112	329
Mark Burrell	71	—	6	—	77	225
Non-executive directors						
Michel David-Weill	25	—	—	—	25	25
Pehr Gyllenhammar	25	—	—	—	25	25
Sir Simon Hornby	8	—	—	—	8	25
Gill Lewis	28	—	—	—	28	25
Reuben Mark	32	—	—	—	32	32
Vernon Sankey	28	—	—	—	28	25
David Verey	25	—	—	—	25	17
Total	2,103	483	237	—	2,823	2,201
Total 1996	2,206*	173*	345*	—	—	2,724*

**Includes amounts to former directors*

NOTES: *Sir Dennis Stevenson became chairman on 2 May 1997, having been a non-executive director since 1986. Sir Frank Barlow, Viscount Blakenham, Mark Burrell and Sir Simon Hornby retired from the board on 2 May 1997. The chairman's total remuneration, amounted to £202,827. No pensions contributions were made on his behalf. Marjorie Scardino was the highest paid director in 1997. Her total remuneration, including pensions contributions, amounted to £825,115. Included in the above "other" emoluments for Marjorie Scardino were £32,000 in respect of housing costs and, as reported last year, a joining bonus of £130,000 in consideration of the loss of potential benefit with her previous employer. For 1997, in addition to the annual bonus earned, discretionary bonuses of £61,600 and £36,170 were awarded to Marjorie Scardino and John Makinson respectively. "Other" emoluments for the remaining directors comprised company car and health care benefits. A sum of $550,000 will be paid to David Veit as compensation for early termination of his contract on 1 May 1997.*

TABLE 2

Directors' pensions	AGE AT 31.12.97*	DIRECTORS' CONTRIBUTIONS OVER THE PERIOD £000 PA	INCREASE IN ACCRUED PENSION OVER THE PERIOD £000 PA	ACCRUED PENSION AT 31.12.97* £000 PA	PENSION AND RELATED BENEFITS COSTS TO THE COMPANY OVER THE PERIOD £000 PA
Marjorie Scardino	50	—	1.2	1.2	118.9
David Bell	51	11.5	9.8	107.3	—
Greg Dyke	50	4.1	1.6	3.9	131.2
John Makinson	43	4.1	2.2	9.5	281.3
David Veit	59	—	7.1	217.5	16.4
Sir Frank Barlow	67	—	—	250.1	261.6
Viscount Blakenham	59	—	—	248.9	8.2
Mark Burrell	60	—	—	167.4	8.2

**Or date of retirement, if earlier.*

NOTE 1: *The increase in accrued pension during the year excludes any increase for inflation. Accrued pension is that which would be paid annually on retirement at 62, the normal retirement age under the Pearson pension plans, based on service to 31 December 1997. Members of the UK plan have the option to buy AVCs. Neither the contributions nor the resulting benefits are included in the above table.*

NOTE 2: *Viscount Blakenham, Sir Frank Barlow and Mark Burrell all retired with effect from 2 May 1997. The figures shown for them in the accrued pension at 31 December 1997 represent their actual pension entitlement at their date of retirement. In their cases, no figure is shown in the increase in accrued pension over the period since it would not be meaningful. However, their accrued pensions at 31 December 1996 were 248.7, 250.1 and 166.3 respectively. The figure for David Veit's accrued pension was understated in the 1996 accounts.*

NOTE 3: *The column headed pensions and related benefits costs to the Company over the period comprises pension augmentations, Company additional voluntary contributions, payments to Funded Unapproved Retirement Benefit Schemes (FURBS) and pension and insurance supplements for UK benefits. For US benefits, this includes life assurance, group term life cover and contributions to the Pearson Inc. Pension Plan.*

NOTE 4: *Pension costs for John Makinson include arrears of payments in respect of his FURBS to March 1994 plus compensation for late payment. The annual cost in respect of 1997 was £77,750.*

Further information relating to directors' pensions:

EARLY RETIREMENT: *UK directors and other UK employees may retire before the normal retirement age of 62 and receive a pension provided they have obtained Company consent. In such cases, the pension entitlement will be scaled down to reflect the shorter service in accordance with normal actuarial practice. Early retirement reduction factors are also applied to the accrued pension if retirement occurs before age 60. The earliest any director can retire and receive a pension is at the age of 50. Of the two directors with pension provision in the USA, Marjorie Scardino has a normal retirement age of 65 but may retire with Company consent from age 55 with a reduced pension on a broadly equivalent actuarial basis. David Veit has a normal retirement age of 62, with early retirement reduction factors applied if retirement occurs before age 60.*

DEPENDANTS' PENSIONS: *If a UK director dies while in employment before normal retirement age, a spouse's pension of one- third of basic salary (capped for relevant directors) becomes payable. If an ex-director dies after leaving service but before retirement, a spouse's pension of 50% of the director's deferred pension becomes payable. If John Makinson or David Bell die in retirement, the spouse's pension is 60% of the director's pension. If one of the other directors in the UK pension plan dies in retirement, the spouse's pension is two-thirds of the director's pension. Children's pensions may also be payable to dependant children. Marjorie Scardino's US plan provides a spouse's pension on death-in-service from age 55 and death-in-retirement benefits broadly equivalent to 50% of the member's pension on early retirement.*

PENSION INCREASES: *John Makinson, David Bell and Greg Dyke are guaranteed post-retirement pension increases at the rate of 5% per annum or the Retail Price Index, if lower. Viscount Blakenham, Sir Frank Barlow and Mark Burrell are guaranteed post-retirement pension increases at the rate of 3% per annum. In all cases, the guaranteed increases relate to the non-Guaranteed Minimum Pension element of the pension. The Plan has a recent history of providing discretionary pension increases at the full Retail Price Index rate. The US plans provide no guaranteed post-retirement pension increases for Marjorie Scardino or David Veit.*

TABLE 3

Interests of directors were	31.12.97* Ordinary shares	1.1.97** Ordinary shares	31.12.97* Options – ordinary shares	1.1.97** Options – ordinary shares	31.12.97* Incentive share plans*** ordinary shares++	1.1.97** Incentive share plans*** ordinary shares++	Maximum number of shares in lieu of adjustment on Royal Doulton demerger
Sir Dennis Stevenson	68,606	38,000	—	—	62,500	61,875	—
Marjorie Scardino	10,101	—	—	—	64,432	62,850	—
Sir Frank Barlow	38,750	38,750	419,794	419,794	10,416	25,107	11,235
David Bell	12,997	9,303	58,163	111,156	24,757	6,790	628
Viscount Blakenham	141,968	138,214	413,700	417,454	8,328	31,926	12,908
(non beneficial)	129,040	129,040	—	—	—	—	—
Mark Burrell	791,674	791,674	283,339	283,339	5,551	15,222	9,841
(non beneficial)	65,040	65,040	—	—	—	—	—
Michel David-Weill+	48,129,727	48,129,727	—	—	—	—	—
Greg Dyke	—	—	139,100	106,900	—	6,790	—
Pehr Gyllenhammar	—	—	—	—	—	—	—
Sir Simon Hornby	4,000	4,000	—	—	—	—	—
Gill Lewis	—	—	—	—	—	—	—
John Makinson	3,000	1,000	169,784	103,784	—	—	—
Reuben Mark	7,600	7,600	—	—	—	—	—
Vernon Sankey	—	—	—	—	—	—	—
David Veit	357,091	253,602	141,891	245,380	23,661	31,892	—
David Verey	—	—	—	—	—	—	—

NOTES: *Executive directors of the Company, as possible beneficiaries, are also deemed to be interested in Pearson Employee Share Trustee Limited, the trustee of which held 328,940 Pearson ordinary shares of 25p each at 31 December 1997 and also at 16 March 1998, the latest practicable date prior to the printing of this report. There were no changes to the directors' interests shown above from 31 December 1997 to 16 March 1998 except that, on 16 March 1998, Marjorie Scardino and John Makinson each purchased 1,000 ordinary shares of 25p each in the Company taking their respective total holdings to 11,101 and 4,000 shares.* ■ **Or date of retirement, if earlier.* ■ ***Or date of appointment, if later.* ■ ****A full explanation of this plan is given on pages 40 and 41 of the Annual Report.* ■ *+Michel David-Weill's interests include 48,088,523 ordinary shares owned by companies associated with Lazard Frères et Cie, Paris.* ■ *++The number of shares shown represents the maximum number of shares, plus accumulated share dividend shares, comprised in the original award which may be transferred to the individual concerned.*

TABLE 4

Movements in directors' interests under the incentive share plan	Shares outstanding at 1.1.97*	Maximum conditional awards including share dividend on plan shares+	Number of shares vested and released	Number of shares lapsed	Market price on date of release	Number of shares outstanding at 31.12.97**
Sir Dennis Stevenson	—	62,500	—	—	—	62,500
Marjorie Scardino	—	64,432	—	—	—	64,432
Sir Frank Barlow	25,107	172	—	14,863	—	10,416
David Bell	6,790	24,927	—	6,960	—	24,757
Viscount Blakenham	31,926	275	—	23,873	—	8,328
Mark Burrell	15,222	91	—	9,762	—	5,551
Greg Dyke	6,790	170	—	6,960	—	—
John Makinson	—	—	—	—	—	—
David Veit	31,892	802	—	9,033	—	23,661

NOTES: **Or the date of appointment, if later.* ■ ***Or the date of retirement, if earlier.* ■ *+The award as stated is the maximum number of shares which may vest, subject to various performance conditions as described on pages 40 and 41 being fulfilled.*

TABLE 5

Movements in directors' interests in share options

		1.1.97*	Granted	Exercised	31.12.97*	Weighted average option price (p)	Gain on exercise (£)	Option price in respect of exercised options (p)	Market price (p)
Marjorie Scardino	A	—	—	—	—	—	—	—	—
	B	—	—	—	—	—	—	—	—
Total		—	—	—	—	—	—		
Sir Frank Barlow	A	419,794	—	—	419,794	396	—	—	—
	B	—	—	—	—	—	—	—	—
Total		419,794	—	—	419,794	396	—		
David Bell	A	53,574	—	1,250	—	—	5,119	299	708.5
		—	—	2,324	—	—	13,619	242	828
		—	—	50,000	—	—	64,500	635	764
	B	57,582	581	—	58,163	593	—	—	—
Total		111,156	581	53,574	58,163	593	83,238		
Viscount Blakenham	A	417,454	—	3,754	413,700	362	16,405	299	736
	B	—	—	—	—	—	—	—	—
Total		417,454	–	3,754	413,700	362	16,405		
Mark Burrell	A	280,000	—	—	280,000	338	—	—	—
	B	3,339	—	—	3,339	422	—	—	—
Total		283,339	—	—	283,339	339	—		
Greg Dyke	A	—	—	—	—	—	—	—	—
	B	106,900	32,200	—	139,100	617	—	—	—
Total		106,900	32,200	—	139,100	617	—		
John Makinson	A	—	—	—	—	—	—	—	—
	B	103,784	66,000	—	169,784	675	—	—	—
Total		103,784	66,000	—	169,784	675	—		
David Veit	A	186,280	—	103,489	82,791	334	432,584	318	736
	B	59,100	—	—	59,100	545	—	—	—
Total		245,380	—	103,489	141,891	422	432,584		

NOTES: *Or date of appointment, if later. **Or date of retirement, if earlier. Shares under option on 31 December 1997 are designated as: A) where the options are exercisable, and B) where the options are not yet exercisable ■ Total combined gain in the options for all directors during 1997 amounted to £532,227. The register of directors' interests (which is open to inspection during normal office hours) contains full details of directors' shareholdings and options to subscribe for shares. No options lapsed during the year. The market price on 31 December 1997 was 793.5p per share and the range during the year was 664.5p – 848p per share. Outstanding executive options become exercisable on the third anniversary of the grant and lapse if they remain unexercised after the tenth. SAYE options become exercisable on the third, fifth or seventh anniversary of the start of the contract and lapse if not exercised within six months after that anniversary.

Report of the Auditors on Corporate Governance Matters

To the Directors of Pearson plc In addition to our audit of the financial statements we have reviewed your statements in the Directors' Report on pages 35 and 36 concerning the Group's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and the adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non–compliance with Listing Rules 12.43(j) and 12.43(v), if not otherwise disclosed.

Basis of opinion We carried out our review having regard to guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not express any opinion on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor on the ability of the Group to continue in operational existence.

Opinion In our opinion, your statements on internal financial control and on going concern on pages 35 and 36 have provided the disclosures required by the Listing Rules referred to above and are consistent with the information which came to our attention as a result of our audit work on the financial statements.

In our opinion, based on enquiry of certain directors and officers of the Company and examination of relevant documents, your statement on page 35 appropriately reflects the Group's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

PRICE WATERHOUSE
Chartered Accountants
London · 16 March 1998

Report of the Auditors to the Members of Pearson plc

We have audited the financial statements on pages 47 to 79 (including the additional disclosures on pages 39 to 45 relating to the remuneration of the directors of Pearson plc specified for our review by the London Stock Exchange) which have been prepared under the historical cost convention, as modified by the revaluation of certain fixed assets and investments, and the accounting policies set out on pages 51 and 52.

Respective responsibilities of Directors and Auditors As described on page 38, the Company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 1997 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PRICE WATERHOUSE
Chartered Accountants and Registered Auditors
London · 16 March 1998

Consolidated Profit and Loss Account

For the year ended 31 December 1997

ALL FIGURES IN £ MILLIONS	1997 OPERATING ACTIVITIES	1997 OTHER ITEMS	1997 TOTAL	1996 OPERATING ACTIVITIES	1996 OTHER ITEMS	1996 TOTAL	NOTE
Sales							
Continuing operations	2,265.5	—	2,265.5	2,048.9	—	2,048.9	
Acquisitions	27.6	—	27.6	—	—	—	
	2,293.1	—	2,293.1	2,048.9	—	2,048.9	
Discontinued operations	—	—	—	137.1	—	137.1	
Total sales	2,293.1	—	2,293.1	2,186.0	—	2,186.0	2
Cost of sales	(1,114.2)	—	(1,114.2)	(1,064.1)	—	(1,064.1)	3
Gross profit	1,178.9	—	1,178.9	1,121.9	—	1,121.9	
Net operating expenses – normal	(863.1)	—	(863.1)	(853.3)	—	(853.3)	3
Net operating expenses – exceptional	(34.4)	—	(34.4)	(40.4)	(100.0)	(140.4)	3
Net income from partnerships and associated undertakings	41.8	—	41.8	53.1	—	53.1	11
Operating profit							
Continuing operations	320.9	—	320.9	247.6	(100.0)	147.6	
Acquisitions	2.3	—	2.3	—	—	—	
	323.2	—	323.2	247.6	(100.0)	147.6	
Discontinued operations	—	—	—	33.7	—	33.7	
Total operating profit	323.2	—	323.2	281.3	(100.0)	181.3	2
Continuing operations:							
Profit/(loss) on sale of fixed assets	—	23.0	23.0	—	(14.1)	(14.1)	4
Loss on sale of businesses and associates	—	(180.3)	(180.3)	—	(1.9)	(1.9)	5
Discontinued operations:							
Profit on sale of Westminster Press	—	—	—	—	231.3	231.3	5
Profit before interest	323.2	(157.3)	165.9	281.3	115.3	396.6	
Net interest payable	(37.3)	—	(37.3)	(29.5)	—	(29.5)	6
Loan stock redemption premium	—	—	—	—	(10.3)	(10.3)	6
Profit before taxation	285.9	(157.3)	128.6	251.8	105.0	356.8	
Taxation	(84.1)	(4.5)	(88.6)	(72.6)	(36.0)	(108.6)	7
Profit after taxation	201.8	(161.8)	40.0	179.2	69.0	248.2	
Equity minority interests	(1.7)	—	(1.7)	(7.7)	—	(7.7)	
Profit for the financial year	200.1	(161.8)	38.3	171 .5	69.0	240.5	
Dividends on equity shares	(112.4)	—	(112.4)	(102.7)	—	(102.7)	8
Profit/(loss) retained	87.7	(161.8)	(74.1)	68.8	69.0	137.8	22
Adjusted earnings/ total earnings per equity share	34.9p	(28.2p)	6.7p	30.6p	12.3p	42.9p	
Dividends per equity share	19.5p	—	19.5p	18.0p	—	18.0p	8
Average number of shares (millions)	573.1	573.1	573.1	560.8	560.8	560.8	

NOTE: *In order to show results from operating activities an adjusted earnings per equity share has been calculated which excludes profits/(losses) on the sale of fixed assets, businesses and associates (see notes 4 and 5), and in 1996, a loan stock redemption premium (see note 6) and the £100m exceptional charge for improper accounting at Penguin USA. The analysis of operating profit in 1996 between continuing and discontinued operations has been restated to reflect the allocation of central costs (see note 2).*

Consolidated Balance Sheet

As at 31 December 1997

ALL FIGURES IN £ MILLIONS	**1997**	1996	NOTE
Fixed assets			
Tangible assets	506.0	484.0	10
Investments:			
Partnerships and associated undertakings	197.9	182.6	11
Other	140.0	242.0	12
	843.9	908.6	
Current assets			
Stocks	379.3	360.7	13
Debtors	807.0	669.8	14
Investments	7.9	7.9	15
Cash and liquid resources	214.8	299.0	16
	1,409.0	1,337.4	
Creditors – amounts falling due within one year			
Short term borrowing	(313.1)	(174.2)	17
Other creditors	(918.4)	(919.8)	18
	(1,231.5)	(1,094.0)	
Net current assets	177.5	243.4	
Total assets less current liabilities	1,021.4	1,152.0	
Creditors – amounts falling due after more than one year			
Medium and long term borrowing	(608.8)	(555.2)	17
Other creditors	(44.8)	(15.1)	18
	(653.6)	(570.3)	
Provisions for liabilities and charges			
Deferred taxation	(37.2)	(30.3)	19
Other provisions for liabilities and charges	(174.6)	(159.1)	20
Net assets	156.0	392.3	
Capital and reserves			
Called up share capital	144.2	142.8	21
Share premium account	157.6	129.5	22
Revaluation reserve	3.1	5.4	22
Other reserves	1.2	1.2	22
Profit and loss account	(153.6)	109.7	22
Equity shareholders' funds	152.5	388.6	
Equity minority interests	3.5	3.7	
	156.0	392.3	

The Company balance sheet is shown in note 29.

The financial statements were approved by the board of directors on 16 March 1998 and signed on its behalf by

Sir Dennis Stevenson

John Makinson

Consolidated Statement of Cash Flows

For the year ended 31 December 1997

ALL FIGURES IN £ MILLIONS	1997	1996	NOTE
Net cash inflow from operating activities	244.2	291.2	25
Interest received	35.7	45.6	
Interest paid	(72.3)	(76.0)	
Dividends paid to minority interests	(0.5)	(6.1)	
Returns on investments and servicing of finance	(37.1)	(36.5)	
Taxation	(74.8)	(80.8)	
Purchase of tangible fixed assets	(110.3)	(89.8)	
Sale of tangible fixed assets	21.7	13.2	
Purchase of investments	(12.2)	(33.5)	
Sale of investments	147.6	53.7	
Capital expenditure and financial investment	46.8	(56.4)	
Purchase of subsidiary undertakings	(269.0)	(697.9)	
Net cash acquired with subsidiary undertakings	2.8	4.5	
Purchase of associated undertakings	(67.0)	(36.0)	
Sale of subsidiary undertakings	54.0	307.2	
Net cash disposed with subsidiary undertakings	(0.7)	(5.5)	
Sale of associated undertakings	46.2	—	
Acquisitions and disposals	(233.7)	(427.7)	23/24
Equity dividends paid	(106.5)	(96.0)	
Net cash outflow before management of liquid resources and financing	(161.1)	(406.2)	
Disposal of asset backed securities	89.4	204.1	
Liquid resources acquired	(123.3)	(65.1)	
Liquid resources disposed	123.2	212.4	
Management of liquid resources	89.3	351.4	25
Issue of equity share capital	27.2	14.1	
Loan stock redemption premium	—	(10.3)	
Capital element of finance lease rentals	(0.8)	(1.1)	
US medium term notes – repayable 1999	—	157.8	
Loan stock repaid	(67.6)	—	
Net movement in other borrowings	183.4	(138.9)	
Financing	142.2	21.6	
Increase/(decrease) in cash in the year	70.4	(33.2)	25

Statement of Total Recognised Gains and Losses

For the year ended 31 December 1997

ALL FIGURES IN £ MILLIONS	**1997**	1996
Profit for the financial year	38.3	240.5
Other net gains and losses recognised in reserves:		
Exchange translation effect on:		
Profit for the financial year	(3.5)	(0.4)
Foreign currency net assets	(17.1)	(35.5)
	(20.6)	(35.9)
Total recognised gains relating to the year	17.7	204.6

Note of Historical Cost Profits and Losses

For the year ended 31 December 1997

ALL FIGURES IN £ MILLIONS	**1997**	1996
Reported profit before taxation	128.6	356.8
Realisation of property revaluations	2.6	(1.2)
Historical cost profit on ordinary activities before taxation	131.2	355.6
Historical cost profit/(loss) retained after taxation, equity minority interests and dividends	(71.5)	136.6

Reconciliation of Movements in Equity Shareholders' Funds

For the year ended 31 December 1997

ALL FIGURES IN £ MILLIONS	**1997**	1996
Profit for the financial year	38.3	240.5
Dividends on equity shares	(112.4)	(102.7)
	(74.1)	137.8
Other net recognised losses relating to the year (see above)	(20.6)	(35.9)
Goodwill arising	(401.5)	(632.4)
Goodwill written back	232.9	1.4
Shares issued	27.2	84.5
Net movement for the year	(236.1)	(444.6)
Equity shareholders' funds at beginning of year	388.6	833.2
Equity shareholders' funds at end of year	152.5	388.6

Notes to the Accounts

1. ACCOUNTING POLICIES

Accounting policies have been consistently applied. 'Corporate expenses less other income', previously shown separately within the sector analysis, have been allocated to profit centres. Comparative figures in the profit and loss account and balance sheet have been restated to reflect the revised presentation of results (see note 2).

A) **Basis of accounting** The accounts are prepared under the historical cost convention, modified by the revaluation of certain land and buildings and investments, and in accordance with applicable accounting standards. A summary of the significant accounting policies is set out below.

B) **Basis of consolidation** The consolidated accounts include the accounts of all subsidiary undertakings made up to 31 December. Where companies have become or ceased to be subsidiary or associated undertakings during the year the Group profit includes profits for the period during which they were subsidiary or associated undertakings.

Goodwill, being either the net excess of the cost of shares in subsidiary undertakings, partnerships and associated undertakings over the value attributable to their net tangible assets on acquisition or the cost of other goodwill by purchase, is deducted from reserves in the year of acquisition. On disposal or closure, goodwill previously charged to reserves is written back and the profit or loss is adjusted accordingly.

The profit of the Group includes the Group's share of the profit of partnerships and associated undertakings, and the consolidated balance sheet includes the Group's interest in partnerships and associated undertakings at the book value of attributable net tangible assets. The figures included in the financial statements have been based on audited accounts, adjusted where necessary by reference to unaudited management accounts for the subsequent period to 31 December.

C) **Sales** Sales represent the amount of goods and services, net of valued added tax and other sales taxes, and excluding trade discounts, provided to external customers and associated undertakings.

D) **Foreign currencies** Profit and loss accounts in overseas currencies are translated into sterling at weighted average rates. Balance sheets are translated into sterling at the rates ruling at 31 December. Exchange differences arising on consolidation are taken directly to reserves. Other exchange differences are taken to the profit and loss account where they relate to trading transactions and directly to reserves where they relate to investments.

The principal overseas currencies for the Group are the US dollar and the Spanish peseta. The weighted average rates for the year against sterling were $1.63 and Pts 242.1 (1996: $1.58 and Pts 199.6) and the year end rates were $1.65 and Pts 250.8 (1996: $1.71 and Pts 222.6).

E) **Pension costs** The regular pension cost of the Group's defined benefit pension schemes is charged to the profit and loss account in order to apportion the cost of pensions over the service lives of employees in the schemes. Variations arising from a significant reduction in the number of employees are adjusted in the profit and loss account to the extent that the year's regular pension cost, reduced by other variations, exceeds contributions payable for that year. Other variations are apportioned over the expected service lives of current employees in the schemes.

1. ACCOUNTING POLICIES (CONT'D)

F) **Post-retirement benefits other than pensions** Post-retirement benefits other than pensions are accounted for on an accruals basis to recognise this obligation over the expected service lives of the employees concerned.

G) **Channel 5** The Group's share of certain Channel 5 initial costs is being amortised. These costs will be amortised by the end of the 10 year licence period. The Group's share of other profits and losses is being equity accounted.

H) **Tangible fixed assets** The cost or subsequent valuation of tangible fixed assets other than freehold land and investment properties is depreciated over estimated economic lives in equal annual amounts at the rates indicated in note 10.

I) **Leases** Finance lease rentals are capitalised at the total amount of rentals payable under the leasing agreement (excluding finance charges) and depreciated in accordance with policy H above. Finance charges are written off over the period of the lease in reducing amounts in relation to the written down carrying cost. Operating lease rentals are expensed as incurred.

J) **Fixed asset investments** Fixed asset investments are stated at cost less provisions for diminution in value, or as revalued by the directors.

K) **Stocks** Stocks and work in progress are valued at the lower of cost and net realisable value. Television programme production costs and direct costs incurred in the development of titles prior to their publication are included in stocks. These costs are amortised over their estimated economic lives.

L) **Deferred taxation** Deferred taxation is provided, using the liability method, at the expected applicable rates, on all timing differences between accounting and taxation treatments, including those arising from the revaluation of fixed assets, which are expected to reverse in the foreseeable future. Deferred taxation relief is accounted for in full on long-term timing differences in respect of provisions for unfunded retirement benefits.

M) **Capital instruments** Capital instruments are included at cost, adjusted for discount accretion or premium amortisation where the intention is to hold them to maturity. Interest receivable thereon and the premium or discount where relevant is taken to the profit and loss account so as to produce a constant rate of return over the period to the date of expected redemption.

Forward foreign exchange contracts and other off-balance sheet instruments are valued at the market prices prevailing at the balance sheet date. Borrowing is classified according to the maturity date of the respective individual holdings.

N) **Liquid resources** Liquid resources comprise short-term deposits of less than one year and investments which are readily realisable and held on a short-term basis.

O) **Retained profits of overseas subsidiary and associated undertakings** No provision is made for any additional taxation, less double taxation relief, which would arise on the remittance of profits retained.

2. A) ANALYSIS OF SALES AND OPERATING PROFIT

ALL FIGURES IN £ MILLIONS	1997 SALES	1997 OPERATING PROFIT BEFORE EXCEPTIONAL ITEMS	1997 OPERATING PROFIT AFTER EXCEPTIONAL ITEMS	1996 SALES	1996 OPERATING PROFIT BEFORE EXCEPTIONAL ITEMS	1996 OPERATING PROFIT AFTER EXCEPTIONAL ITEMS
Business sectors						
Information	676.3	121.0	107.0	691.6	99.6	88.2
Education	563.6	72.2	60.5	554.3	75.8	60.2
Entertainment	1,053.2	121.3	112.6	803.0	71.0	(41.6)
Investment Banking	—	43.1	43.1	—	40.8	40.8
Continuing operations	2,293.1	357.6	323.2	2,048.9	287.2	147.6
Discontinued operations	—	—	—	137.1	34.5	33.7
	2,293.1	357.6	323.2	2,186.0	321.7	181.3
Geographical markets supplied						
United Kingdom	660.5	92.5	76.7	601.4	92.3	82.3
Continental Europe	414.0	82.2	80.7	419.4	73.4	71.5
North America	987.3	152.3	135.9	798.3	96.6	(30.5)
Asia Pacific	183.9	24.0	23.3	185.2	20.6	20.0
Rest of World	47.4	6.6	6.6	44.6	4.3	4.3
Continuing operations	2,293.1	357.6	323.2	2,048.9	287.2	147.6
Discontinued operations	—	—	—	137.1	34.5	33.7
	2,293.1	357.6	323.2	2,186.0	321.7	181.3

NOTE: *Exceptional items comprise restructuring costs in both 1997 and 1996 (see below) and the £100m charge to profits in 1996 arising from improper accounting at Penguin USA.* ■ *Central costs have now been allocated to profit centres and investment profits credited to the appropriate profit centre. Profits from Cedar Fair, the main source of these investment profits, are included in the Entertainment sector. The final tranche of this investment was sold in 1996 for a profit of £16.3m. Reclassified figures for the years 1993 to 1996 are shown in the five year summary on page 80. Previously these items were included under the heading 'Corporate expenses less other income'. Central costs allocated to discontinued operations amounted to £1.6m in 1996.* ■ *Discontinued operations relate to the withdrawal of the Group from the UK regional newspaper business upon its disposal of Westminster Press in December 1996.* ■ *Analyses of the profits of partnerships and associated undertakings are shown in note 11.*

ALL FIGURES IN £ MILLIONS	1997	1996
Restructuring costs		
Post acquisition:		
All American Communications	4.2	—
HarperCollins Educational	—	15.0
Putnam Berkley	—	4.4
Other:		
Mindscape	3.7	5.4
Information	14.0	9.2
Addison Wesley Longman	11.7	0.6
Other	0.8	5.8
	34.4	40.4

NOTE: *Information restructuring was mainly in FT branded businesses, £10.0m in 1997 and in 1996, the Financial Times newspaper, £5.8m. Restructuring costs of £0.8m, included within other in 1996, relate to discontinued operations.*

2. A) ANALYSIS OF SALES AND OPERATING PROFIT (CONT'D)

ALL FIGURES IN £ MILLIONS	1997 TOTAL BY SOURCE	1997 INTER-REGIONAL	1997 SALES	1996 TOTAL BY SOURCE	1996 INTER-REGIONAL	1996 SALES
Geographical source of sales						
United Kingdom	888.6	(45.7)	842.9	822.7	(51.2)	771.5
Continental Europe	327.1	(7.5)	319.6	330.2	(9.0)	321.2
North America	998.1	(19.8)	978.3	820.8	(20.0)	800.8
Asia Pacific	146.0	(7.2)	138.8	149.0	(4.4)	144.6
Rest of World	13.5	—	13.5	10.9	(0.1)	10.8
Continuing operations	2,373.3	(80.2)	2,293.1	2,133.6	(84.7)	2,048.9

NOTE: *The table above analyses sales by the geographical region from which the products and services originate. Inter-regional sales are those made between the Group companies in different regions.*

2. B) ANALYSIS OF CAPITAL EMPLOYED

ALL FIGURES IN £ MILLIONS	1997 CAPITAL EMPLOYED	1996 CAPITAL EMPLOYED
Business sectors		
Information	97.5	134.7
Education	379.9	334.5
Entertainment	473.9	429.0
Investment Banking	123.6	113.9
Continuing operations	1,074.9	1,012.1
Geographical location		
United Kingdom	282.4	342.4
Continental Europe	114.3	106.6
North America	635.2	411.4
Asia Pacific	29.9	144.2
Rest of World	13.1	7.5
Continuing operations	1,074.9	1,012.1
Reconciliation of capital employed to net assets		
Capital employed	1,074.9	1,012.1
Less: deferred taxation	(37.2)	(30.3)
Less: other provisions	(174.6)	(159.1)
Less: net debt	(707.1)	(430.4)
Net assets	156.0	392.3

3. ANALYSIS OF CONSOLIDATED PROFIT AND LOSS ACCOUNT

ALL FIGURES IN £ MILLIONS	**1997** CONTINUING	1996 CONTINUING	1996 DISCONTINUED	1996 TOTAL
Cost of sales	(1,114.2)	(982.0)	(82.1)	(1,064.1)
Distribution costs	(125.9)	(114.3)	(12.5)	(126.8)
Administration and other expenses	(843.2)	(932.6)	(8.9)	(941.5)
Other operating income (see below)	71.6	72.9	1.7	74.6
Net operating expenses	(897.5)	(974.0)	(19.7)	(993.7)
Analysed as:				
Net operating expenses – normal	(863.1)	(834.4)	(18.9)	(853.3)
Net operating expenses – exceptional	(34.4)	(139.6)	(0.8)	(140.4)
Net operating expenses	(897.5)	(974.0)	(19.7)	(993.7)

NOTE: *The following amounts are included in the 1997 totals in respect of acquisitions: cost of sales £14.6m, net operating expenses £13.0m and income from partnerships and associated undertakings £2.3m. The exceptional expense of £34.4m is included in administration and other expenses in 1997 and comprises restructuring costs. The exceptional expense of £140.4m in 1996 is included in administration and other expenses and comprises restructuring costs of £40.4m and the £100m Penguin USA charge for improper accounting (see note 2).*

ALL FIGURES IN £ MILLIONS	**1997**	1996
Other operating income		
Income from other investments:		
Listed	2.1	2.9
Unlisted	12.9	8.5
BSBH loan stock interest	3.9	2.4
Other operating income (mainly royalties, rights and commission income)	52.7	60.8
	71.6	74.6
Profit before taxation is stated after charging:		
Depreciation	65.2	63.2
Operating lease rentals:		
Plant and machinery	12.2	16.5
Properties	35.5	32.7
Auditors' remuneration:		
Audit (Company £0.1m; 1996: £0.1m)	1.6	1.6
Non-audit – United Kingdom (Company £nil; 1996: £nil)	2.0	0.4
Non-audit – Other	0.3	0.2

NOTE: *In addition to the non-audit fees (United Kingdom)of £2.0m in 1997, consultancy fees of £8.1m have been incurred in respect of the Shared Services initiative. These fees have been capitalised.*

4. PROFIT/(LOSS) ON SALE OF FIXED ASSETS

ALL FIGURES IN £ MILLIONS	1997	1996
Continuing operations:		
Profit on sale of investment in Flextech plc (see note 12)	23.9	—
Profit on sale of investment in Television Broadcasts Limited (TVB) (see note 12)	4.1	—
Loss on fixed assets at East India Dock	—	(8.0)
Net loss on other investments and property interests	(5.0)	(6.1)
	23.0	(14.1)

5. PROFIT/(LOSS) ON SALE OF BUSINESSES AND ASSOCIATES

ALL FIGURES IN £ MILLIONS	1997	1996
Continuing operations:		
Provision against goodwill on sale of Mindscape Inc. (see below)	(212.0)	—
Profit on sale of Churchill Livingstone (see note 24)	30.4	—
Profit on sale of Troll Communications LLC (see note 11)	12.5	—
Net loss on sale of other businesses (see note 24)	(9.7)	(1.9)
Loss on sale of a business by an associate	(1.5)	—
	(180.3)	(1.9)
Discontinued operations:		
Profit on sale of Westminster Press (see note 24)	—	231.3

NOTE: *On 6 March 1998 Pearson entered into an agreement to sell Mindscape Inc. (see note 31). As a result of this agreement a provision of £212m has been recorded against the goodwill that arose on the acquisition of Mindscape Inc. to reflect its net realisable value.*

6. NET INTEREST PAYABLE

ALL FIGURES IN £ MILLIONS	1997	1996
Interest payable and similar charges:		
On borrowing repayable wholly within five years not by instalments	(32.3)	(18.4)
On borrowing repayable wholly or partly after five years	(44.4)	(52.2)
Partnerships and associated undertakings	—	(0.3)
Finance lease charges	(0.1)	(0.1)
Interest capitalised	—	0.2
	(76.8)	(70.8)
Interest receivable and similar income:		
On deposits and liquid funds	37.0	38.8
Amortisation of swap proceeds (see note 18)	2.5	2.5
Net interest payable	(37.3)	(29.5)
Interest cover	9 times	6 times

NOTE: *Interest cover is calculated by dividing net interest payable into operating profit.* ■ *A £10.3m premium was paid on the redemption of the £25m (13.625%) 2007 Unsecured Loan Stock in 1996.*

7. TAXATION

ALL FIGURES IN £ MILLIONS	1997	1996
Taxation on profit on ordinary activities		
United Kingdom:		
Corporation tax at 31.5% (1996: 33%)	37.2	46.8
Deferred taxation	10.9	(5.5)
BSkyB consortium relief	(0.2)	(8.8)
Double taxation relief	(0.5)	(2.2)
Partnerships and associated undertakings	4.7	10.2
Tax on franked investment income	—	0.2
Overseas:		
Overseas tax	29.4	25.3
Deferred taxation	2.0	41.2
Partnerships and associated undertakings	5.1	1.4
	88.6	108.6

ALL FIGURES IN PERCENTAGES	1997	1996
Tax rate reconciliation		
United Kingdom tax rate	31.5	33.0
Effect of BSkyB/BSBH income	—	(3.5)
Effect of utilisation of tax losses in the USA	(4.3)	—
Other items	2.2	(0.7)
Tax rate reflected in adjusted earnings	29.4	28.8
Effect of profits/(losses) excluded from adjusted earnings	39.5	1.6
Tax rate reflected in earnings	68.9	30.4

NOTE: *The 1997 tax rate has been affected by two significant factors:* A) *The Group has substantial tax losses in the USA which have not been recognised in the accounts and more than offset 1997 profits, so reducing the Group tax rate reflected in adjusted earnings.* B) *There is no tax payable on the profit arising on the disposal of TVB and the tax payable on the disposal of Flextech plc is reduced by capital losses brought forward. The provision against goodwill on the sale of Mindscape Inc. has had no impact on current year tax.* ■ *The 1996 tax rate was affected by three significant factors:* A) *The rate reflected in adjusted earnings was reduced by £8.8m of consortium relief recognised in the profit and loss account following renegotiation with the other partners in BSBH.* B) *There was no tax payable on the profit of £231.3m arising on the sale of Westminster Press.* C) *The Group had tax losses, arising in the USA, which had not been utilised or recognised in 1996 but were available to carry forward against taxable profits in future years. Accordingly the Group decided not to recognise tax relief on the £100m charge for improper accounting at Penguin USA and wrote off to profit deferred tax assets totalling £36.6m.*

8. DIVIDENDS

	1997		1996	
	PENCE PER SHARE	£M	PENCE PER SHARE	£M
Interim paid	7.5	43.1	6.9	39.4
Final proposed	12.0	69.3	11.1	63.3
Dividends for the year	19.5	112.4	18.0	102.7

9. EMPLOYEE INFORMATION

The details of the emoluments of the directors of Pearson plc are shown on pages 39 to 45 and form part of these audited financial statements.

ALL FIGURES IN £ MILLIONS	1997	1996
Staff costs		
Wages and salaries	453.7	454.1
Social security costs	46.7	47.5
Post-retirement costs	9.7	6.1
	510.1	507.7

	UK	USA	OTHER	TOTAL
Average number employed 1997				
Information	3,093	902	1,834	5,829
Education	818	2,498	1,279	4,595
Entertainment	4,360	2,192	1,113	7,665
Other	124	93	—	217
Continuing operations	8,395	5,685	4,226	18,306
Average number employed 1996				
Information	3,078	903	1,786	5,767
Education	823	2,352	1,348	4,523
Entertainment	4,272	1,607	1,080	6,959
Other	114	19	1	134
Continuing operations	8,287	4,881	4,215	17,383

NOTE: *In 1996 discontinued operations employed on average 2,564 in the United Kingdom (Information sector).* ■ *Discontinued operations total staff costs were nil (1996: £38.7m).*

9. EMPLOYEE INFORMATION (CONT'D)

ALL FIGURES IN £ MILLIONS	**1997**	1996
Post-retirement costs		
Defined benefit pension schemes		
United Kingdom Group plan: Regular pension cost	9.0	12.6
United Kingdom Group plan: Amortisation of surplus	(13.3)	(17.1)
Net pension credit	(4.3)	(4.5)
Other defined benefit pension schemes	5.8	5.0
Defined contribution pension schemes	6.3	4.4
Medical benefits	1.9	1.2
	9.7	6.1

Pension schemes The Group operates a number of pension schemes throughout the world. The major schemes are self-administered and the schemes' assets are held independently of the Group's finances. Pension costs are assessed in accordance with the advice of independent qualified actuaries. The principal schemes are primarily of the defined benefit type. There is also a closed defined benefit scheme in the UK, which now receives neither employers' nor members' contributions, and a number of non-UK defined contribution schemes.

The results of the most recent actuarial valuation, using the projected unit method of valuation, of the principal funded UK scheme, are shown in the table below. The principal assumptions used are also shown in the table below. The net assets of the UK Group plan at 31 December 1997 are included in the pension plan accounts at £952m (unaudited).

	UK GROUP PLAN
Assets at market value at latest full actuarial valuation on 1 January 1996*	£774m
Real return on investments per annum	4.8%
Real increase in earnings per annum	1.9%
Real increase in pensions in payment per annum	0%
Level of funding**	122%

NOTE: *Stated after a transfer of £2m to the scheme of a former subsidiary.* ■ ***Actuarial value of assets expressed as a percentage of the actuarial value of the liabilities.*

In view of these results, all employers' contributions remain suspended for the time being and the valuation surplus is being apportioned, in accordance with SSAP24, over the expected remaining service lives of the current employees, resulting in a credit to the profit and loss account of £4.3m (1996: £4.5m).

Following the changes announced in the UK Budget in July 1997, whereby pension schemes are no longer able to reclaim tax credits on UK dividends, the actuaries have carried out an informal review as at 1 January 1997 to assess the impact on the principal UK scheme. The impact is not material.

The total market value of the assets of the non UK defined benefit schemes (mainly in the USA), valued this year, was £48.0m (1996: £40.3m).

Other post-retirement benefits The principal assumptions affecting the provision for other post retirement benefits were: medical inflation rates of between 5.5% and 8.0% and a discount rate of 7.25%.

10. TANGIBLE FIXED ASSETS

ALL FIGURES IN £ MILLIONS	FREEHOLD AND LEASEHOLD PROPERTY	PLANT AND EQUIPMENT	ASSETS IN COURSE OF CONSTRUCTION	TOTAL
Cost or as valued				
At 31 December 1996	312.3	459.0	18.1	789.4
Exchange differences	(1.2)	(6.5)	(0.2)	(7.9)
Reclassifications	18.8	8.3	(28.5)	(1.4)
Permanent diminution in value	(1.6)	—	—	(1.6)
Owned by subsidiary undertakings acquired	0.5	4.0	—	4.5
Capital expenditure	7.0	59.9	47.1	114.0
Disposals	(15.0)	(33.7)	—	(48.7)
Owned by subsidiary undertakings disposed	(1.3)	(6.2)	—	(7.5)
At 31 December 1997	319.5	484.8	36.5	840.8
Depreciation				
At 31 December 1996	63.4	242.0	—	305.4
Exchange differences	—	(3.9)	—	(3.9)
Reclassifications	(1.4)	—	—	(1.4)
Provided in the year	11.4	53.8	—	65.2
Subsidiary undertakings acquired	0.1	2.1	—	2.2
Disposals	(2.1)	(26.9)	—	(29.0)
Owned by subsidiary undertakings disposed	(0.1)	(3.6)	—	(3.7)
At 31 December 1997	71.3	263.5	—	334.8
Net book value				
At 31 December 1996	248.9	217.0	18.1	484.0
At 31 December 1997	248.2	221.3	36.5	506.0

Freehold and leasehold property Net book value includes: freehold of £205.7m (1996: £221.0m), short leases of £39.6m (1996: £23.1m) and long leases of £2.9m (1996: £4.8m). On an original cost basis, cost would have been included at £324.5m, and accumulated depreciation at £65.4m. The net book value included at valuation is £5.0m (1996: £8.0m).

Permanent diminution in value Freehold and leasehold property includes £1.5m of assets held for resale. At 31 December 1997 the provision for permanent diminution in value amounted to £43.5m in cost and £2.9m in depreciation.

Depreciation Fixed assets are depreciated over their estimated economic lives in equal annual amounts. Generally, freeholds are depreciated at 1% to 5% per annum, leaseholds at 2% per annum, or over the period of the lease if shorter, and plant and equipment at various rates between 5% and 33% per annum. Land, amounting to £65.9m, is not depreciated.

Capital commitments The Group had capital commitments for fixed assets, including finance leases, amounting to £132.9m at 31 December 1997 (1996: £126.7m). This represented £31.4m already under contract and £101.5m authorised but not yet contracted.

Other notes The net book value of Group tangible fixed assets includes £1.0m in respect of assets held under finance leases. Depreciation on these assets charged in 1997 was £0.9m. The net book value of Group tangible fixed assets includes £3.2m (1996: £4.2m) in respect of capitalised interest. Assets in the course of construction includes £25.6m (1996: £nil) in respect of the Shared Services initiative which will become operational during 1998.

11. PARTNERSHIPS AND ASSOCIATED UNDERTAKINGS

ALL FIGURES IN £ MILLIONS	1997 VALUATIONS	1997 BOOK VALUES	1996 VALUATIONS	1996 BOOK VALUES
Partnership interests	200.0	123.6	200.0	113.9
Unlisted associated undertakings	129.9	(32.2)	122.6	3.9
Loans	95.3	106.5	64.8	64.8
	425.2	197.9	387.4	182.6

NOTE: *Principal associated undertakings are listed on page 79. The valuations of unlisted partnerships and associated undertakings are at directors' valuations as at 31 December 1997. If realised at these values there would be an estimated liability for taxation, at year end rates, of £58.6m. The Group had no capital commitments to subscribe for further capital and loan stock.*

ALL FIGURES IN £ MILLIONS	EQUITY	SHARE OF LOANS	RESERVES	TOTAL
Summary of movements				
At 31 December 1996	101.1	64.8	16.7	182.6
Exchange differences	(1.1)	0.8	(3.0)	(3.3)
Additions	3.5	63.5	—	67.0
Goodwill written back	—	11.2	1.0	12.2
Goodwill written off	(2.7)	(11.4)	(3.4)	(17.5)
Transfer from fixed asset investments	0.4	(0.2)	0.2	0.4
Disposals	(14.3)	(22.2)	2.8	(33.7)
Retained loss for the year	—	—	(10.0)	(10.0)
Write back of provision for diminution in value	0.2	—	—	0.2
At 31 December 1997	87.1	106.5	4.3	197.9

NOTE: *In February 1997 the Group acquired a 50% stake in Business Day and Financial Mail, acquiring assets of £1.0m for consideration of £12.4m.* ■ *In July 1997 the Group sold its 44.1% share in Troll Communications LLC for a profit of £12.5m.*

ALL FIGURES IN £ MILLIONS	1997 OPERATING PROFIT	1997 NET ASSETS	1996 OPERATING PROFIT	1996 NET ASSETS
Analysis of partnerships and associated undertakings				
Business sectors				
Information	15.9	(3.2)	10.9	(7.1)
Education	3.5	5.5	3.0	5.1
Entertainment	(20.7)	72.0	(1.6)	70.7
Investment Banking	43.1	123.6	40.8	113.9
	41.8	197.9	53.1	182.6
Geographical markets supplied and location of net assets				
United Kingdom	(0.9)	138.4	20.6	103.9
Continental Europe	9.3	33.9	12.9	38.1
North America	28.5	18.5	17.2	36.7
Rest of World	4.9	7.1	2.4	3.9
	41.8	197.9	53.1	182.6

11. PARTNERSHIPS AND ASSOCIATED UNDERTAKINGS (CONT'D)

ALL FIGURES IN £ MILLIONS	**1997**
Reconciliation to retained loss	
Net income from partnerships and associated undertakings	41.8
Loss on sale of a business by an associate	(1.5)
United Kingdom taxation	(4.7)
Overseas taxation	(5.1)
Distributions receivable in respect of the year from partnership interests	(28.2)
Dividends (including tax credits) from unlisted associated undertakings	(12.3)
Retained loss for the year	(10.0)

Interests in Lazard Partners Limited Partnership and the three Lazard Houses

ALL FIGURES IN £ MILLIONS	**1997** NET ASSETS	1996 NET ASSETS
A summary of the aggregate net tangible assets at 31 December is as follows:		
Total assets	9,369	8,013
Total liabilities	(8,972)	(7,632)
Net tangible assets	397	381
Attributable to Pearson	124	114

NOTE: *Pearson's indirect general partnership interest in Lazard Frères et Cie and Maison Lazard et Cie held directly and indirectly through Lazard Partners Limited Partnership is an unlimited liability interest. Pearson holds these partnership interests through a subsidiary undertaking registered in England, with no other material assets. The aggregate liabilities of these partnerships included above are £930m (1996: £831m). Pearson also holds direct interests in Lazard Frères & Co, a New York Limited Liability Company.*

	COUNTRY OF INCORPORATION OR REGISTRATION	BENEFICIAL INTEREST PER CENT	CLASS OF SHARE	SHARE CAPITAL MILLIONS
Interests in the Lazard Houses				
Lazard Partners Limited Partnership (which, with direct interests in the USA and French partnerships gives the following interests in the Lazard Houses):	USA	50.0		Partnership
Lazard Brothers & Co, Ltd	England	29.2	Ord £1	25.3
Lazard Brothers & Co, Ltd	England	80.0	Def £1	5.0
Lazard Brothers & Co, Ltd	England	50.0	Sw Fr 1	0.4
Lazard Frères & Co, 'LLC'	USA	11.9		LLC*
Lazard Frères et Cie/Maison Lazard et Cie	France	9.4		Partnership

NOTE: *The beneficial percentages held for the investment banking partnership interests are interests in partnership profits.* ■ **Limited Liability Company.*

11. PARTNERSHIPS AND ASSOCIATED UNDERTAKINGS (CONT'D)

With effect from 1 January 1996, Lazard Frères & Co, 'LLC', Lazard Frères et Cie, Maison Lazard et Cie and Lazard Brothers & Co, Limited (together known as the three Lazard Houses) created a new system of interhouse profit sharing through the establishment of the Three Houses Pooling Partnership (the 'Pool') which became a limited partner of Lazard Partners Limited Partnership. As a result, the members, directors or partners in a particular Lazard House receive an interest in the profits of the other Lazard Houses in exchange for part of their existing profit entitlement in their own House. Pearson received additional income in 1997 (the 'Pearson Adjustment') to reflect the reduction in its profit entitlements from its direct holding in Lazard Frères & Co, 'LLC', Lazard Frères et Cie and Maison Lazard et Cie and accordingly did not receive any income through the Pool. The share of net distributable profits of Lazard Partners Limited Partnership (after the Pool's profit share and the Pearson Adjustment) is divided in accordance with the respective capital interests of the original partners (Pearson plc – 50%).

Interest in The Economist Newspaper Ltd The net liabilities of The Economist Newspaper Ltd as at 31 March 1997 were £24.8m (1996: net liabilities £33.3m); profit before taxation amounted to £26.7m (1996: £24.0m).

12. OTHER FIXED ASSET INVESTMENTS

ALL FIGURES IN £ MILLIONS	1997 VALUATIONS	1997 BOOK VALUES	1996 VALUATIONS	1996 BOOK VALUES
Listed	1.3	1.2	111.8	100.2
Unlisted	463.5	138.8	355.0	141.8
	464.8	140.0	466.8	242.0

NOTE: *During the year the Group's 10% shareholding in Television Broadcasts Limited (TVB) was sold for £110.8m. The sale was made cum dividend and consequently £2.1m (1996: £2.8m) has been included in operating profit and a profit on disposal of £4.1m recorded. During the year the Group exchanged its minority equity interests in UK Gold and UK Living, two satellite channels, for 8.8 million shares in Flextech plc. The Group sold 4 million of these shares giving a profit on disposal, before tax, of £23.9m. At 31 December 1997 the Group holds 4.8 million shares in Flextech plc. Subsequent to the year end the Group's 6.3% shareholding in Société Européenne des Satellites was sold for £159.5m (see note 31). If all investments were realised at valuation there would be an estimated liability for taxation, at year end rates, of £78.3m.*

ALL FIGURES IN £ MILLIONS	BSBH	TVB	OTHER	TOTAL
Summary of movements				
At 31 December 1996	93.7	99.0	49.3	242.0
Exchange differences	—	5.6	0.5	6.1
Additions	—	—	11.2	11.2
Transfer to partnerships and associated undertakings	—	—	(0.4)	(0.4)
Transfer to current asset investments	—	—	(0.1)	(0.1)
Disposals	(3.4)	(104.6)	(9.6)	(117.6)
Provisions for permanent diminution in value	—	—	(1.2)	(1.2)
Book value at 31 December 1997	90.3	—	49.7	140.0
Valuation at 31 December 1997	255.0	—	209.8	464.8

13. STOCKS

ALL FIGURES IN £ MILLIONS	1997	1996
Raw materials	22.5	22.3
Work in progress	88.7	79.6
Finished goods	268.1	258.8
	379.3	360.7

NOTE: *The replacement cost of stocks and work in progress is not materially different from book value.*

14. DEBTORS

ALL FIGURES IN £ MILLIONS	1997	1996
Amounts falling due within one year		
Trade debtors	557.7	382.3
Partnerships and associated undertakings	16.6	14.1
Other debtors	138.7	179.8
Prepayments and accrued income	56.3	53.5
	769.3	629.7
Amounts falling due after one year		
Other debtors	17.4	23.8
Prepayments and accrued income	3.0	0.4
Advance corporation tax recoverable	17.3	15.9
	37.7	40.1
	807.0	669.8

NOTE: *The Pearson Employee Share Trust holds 326,784 (1996: 149,933) Pearson plc ordinary shares with a market value of £2.6m at 31 December 1997 (1996: £1.1m) inclusive of accumulated scrip dividend shares. Amounts included within other debtors for own shares are £1.6m (1996: £0.6m).*

15. CURRENT ASSET INVESTMENTS

	1997		1996	
ALL FIGURES IN £ MILLIONS	VALUATIONS	BOOK VALUES	VALUATIONS	BOOK VALUES
Listed abroad	0.1	0.1	—	—
Unlisted	7.8	7.8	7.9	7.9
	7.9	7.9	7.9	7.9

NOTE: *Listed investment valuations are at middle market quotation and unlisted investments are at directors' valuations. If all investments were realised at valuation there would be no liability for taxation.*

ALL FIGURES IN £ MILLIONS	
Summary of movements	
At 31 December 1996	7.9
Exchange differences	0.3
Additions	0.4
Transfer from fixed asset investments	0.1
Disposals	(2.0)
Write back of provision against net realisable value	1.2
At 31 December 1997	7.9

16. CASH AND LIQUID RESOURCES

	1997		1996	
ALL FIGURES IN £ MILLIONS	GROUP	COMPANY	GROUP	COMPANY
Cash, bank current accounts and overnight deposits	143.7	0.6	138.8	24.5
Certificates of deposit and commercial paper	43.8	—	6.0	—
United Kingdom government securities	—	—	1.0	—
Listed sterling asset backed floating rate notes	—	—	45.9	15.3
Listed US dollar asset backed floating rate notes	—	—	42.1	42.1
Term bank deposits	27.3	14.0	51.2	1.4
Other	—	—	14.0	14.0
	214.8	14.6	299.0	97.3
Listed securities, dealt on recognised Stock Exchanges, included above:				
Cost	—	—	89.0	57.4
Market value	—	—	89.0	57.4

17. BORROWINGS

	1997		1996	
ALL FIGURES IN £ MILLIONS	GROUP	COMPANY	GROUP	COMPANY
Borrowing summary (by maturity)				
Short term				
Loans or instalments due within one year	7.9	—	8.5	3.0
Bank loans, overdrafts and commercial paper	305.2	295.2	165.7	167.3
Total due within one year	313.1	295.2	174.2	170.3
Medium and long term				
Loans or instalments thereof repayable:				
From one to two years	0.2	—	7.8	—
From two to five years	242.3	140.9	6.3	4.8
After five years not by instalments	366.3	100.0	541.1	184.3
Total due after more than one year	608.8	240.9	555.2	189.1
Total borrowings	921.9	536.1	729.4	359.4

NOTE: *In the absence of enforceable contracts from the relevant lenders to refinance current advances as they fall due, at 31 December 1997 £140.8m (1996: £84.3m) of debt currently classified from two to five years would be repayable within one year.*

	1997	1996
ALL FIGURES IN £ MILLIONS	GROUP	GROUP
Borrowing summary (by currency)		
US dollars	518.5	379.3
Sterling	317.5	210.2
Spanish pesetas	44.9	33.7
French francs	16.6	19.1
Canadian dollars	10.9	16.5
Hong Kong dollars	0.3	56.1
Other currencies	13.2	14.5
	921.9	729.4

17. BORROWINGS (CONT'D)

ALL FIGURES IN £ MILLIONS	1997 GROUP	1997 COMPANY	1996 GROUP	1996 COMPANY
Borrowing summary (by instrument)				
Secured				
Bank loans and overdrafts	0.3	—	0.1	—
Unsecured				
10.5% Euro-sterling Bonds 2008	100.0	100.0	100.0	100.0
9.5% Euro-sterling Bonds 2004	117.3	—	113.2	—
10.75% Euro-sterling Bonds 2002	100.0	—	100.0	—
Other unsecured borrowings	7.9	0.1	8.5	3.0
Unsecured bank loans and overdrafts, commercial paper and medium term notes	596.4	436.0	407.6	256.4
Total borrowings	921.9	536.1	729.4	359.4

Forward foreign exchange contracts Foreign currency transactional cash flows are hedged using forward foreign exchange contracts. At 31 December 1997, the UK Group had contracted to exchange the equivalent of £66m and the estimated mark-to-market gain on these contracts at 31 December 1997 was £0.7m.

Interest rate hedging transactions	NOTIONAL PRINCIPAL £M	WEIGHTED AVERAGE RATE %	MARK-TO -MARKET VALUE £M
Swaps in force at 31 December 1997			
US dollars: converting fixed debt to floating	152	7.23	11
US dollars: converting floating debt to fixed	152	5.99	—
Sterling: converting fixed debt to floating	120	6.74	5
Sterling: converting floating debt to fixed	40	7.16	—
Converting fixed sterling debt to floating US dollars	117	10.41	19
			35

NOTE: *All of the total mark-to-market gain on the above transactions of £35m arises from transactions that hedge debt issues for their entire lives. There is a mark-to-market loss on those issues of £55m included in the footnote below.*

The following shows the amount of these contracts which are in force at the end of each year.

ALL FIGURES IN £ MILLIONS	1997	1998	1999	2000
US dollars: converting fixed debt to floating	152	152	152	152
US dollars: converting floating debt to fixed	152	152	167	130
Sterling: converting fixed debt to floating	120	120	120	120
Sterling: converting floating debt to fixed	40	40	40	—
Converting fixed sterling debt to floating US dollars	117	117	117	117

17. BORROWINGS (CONT'D)

As a result of the above transactions, the interest rate exposure of the borrowings of the Group at 31 December 1997 was as follows:

ALL FIGURES IN £ MILLIONS	TOTAL GROSS BORROWING	FIXED RATE	FLOATING RATE
Sterling	317	120	197
US dollars	519	160	359
Other currencies	86	—	86
	922	280	642

NOTE: *Of this total, £466m relates to long-term borrowings with a maturity of over four years. The current value of this debt at 31 December 1997, considering only the movements in risk-free interest rates, is £521m. The difference between the current and book values of these borrowings is partially offset by the mark-to-market gain on the related swaps detailed on page 66.*

18. OTHER CREDITORS

ALL FIGURES IN £ MILLIONS	**1997**	1996
Amounts falling due within one year		
Trade creditors	272.9	288.2
Taxation	224.9	232.3
Social security and other taxes	26.5	26.7
Other creditors	41.7	72.4
Accruals and deferred income	282.2	230.5
Obligations under finance leases	0.4	0.8
Payments received on account	0.4	5.1
Dividends	69.4	63.8
	918.4	919.8
Amounts falling due after one year		
Trade creditors	19.4	—
Other creditors	5.5	3.2
Accruals and deferred income	19.6	11.3
Obligations under finance leases (due within one to two years)	0.3	0.6
	44.8	15.1

NOTE: *Accruals and deferred income includes £10.1m (1996: £12.6m) relating to the unamortised profit arising out of the unwinding of a sterling interest rate swap in 1994. The swap was arranged in 1992 in connection with the issue of £100m 10.75% Eurosterling Bonds 2002. The profit is being amortised over the remaining life of the Bonds. £7.7m is due after one year. None of the amount falls due after five years.*

19. DEFERRED TAXATION

ALL FIGURES IN £ MILLIONS	
Summary of movements	
At 31 December 1996	30.3
Exchange differences	(1.5)
Subsidiary undertakings acquired/disposed	0.7
Net charge for the year	12.9
Transfer to current taxation	(5.2)
At 31 December 1997	37.2

19. DEFERRED TAXATION (CONT'D)

ALL FIGURES IN £ MILLIONS	**1997**	1996
Deferred taxation derives from		
Capital allowances	25.3	21.6
Revalued assets	—	1.1
Other timing differences	11.9	7.6
	37.2	30.3
Deferred taxation not provided		
Relating to revalued assets and timing differences	6.7	7.2
Relating to gains subject to rollover relief	17.8	18.9
	24.5	26.1

20. OTHER PROVISIONS FOR LIABILITIES AND CHARGES

ALL FIGURES IN £ MILLIONS	POST-RETIREMENT	OTHER	TOTAL
At 31 December 1996	35.1	124.0	159.1
Exchange differences	0.5	1.2	1.7
Subsidiary undertakings acquired/disposed	—	6.7	6.7
Deferred consideration arising on acquisitions	—	18.7	18.7
Transfers	1.0	—	1.0
Released	(4.3)	(2.8)	(7.1)
Provided	14.0	23.5	37.5
Utilised	(12.3)	(30.7)	(43.0)
At 31 December 1997	34.0	140.6	174.6

NOTE: *Post-retirement provisions are in respect of pensions, £18.7m and post-retirement medical benefits, £15.3m. Other provisions are mainly in respect of future costs relating to the purchase of subsidiary and associated undertakings £52.1m, litigation £7.7m, reorganisations and redundancies £40.6m, disposals and closures £2.8m, and lease commitments £31.7m. Amounts utilised include £9.9m, and amounts released £1.7m, in respect of provisions relating to subsidiary undertakings acquired.*

21. SHARE CAPITAL

	NUMBER (000'S)	£M
Authorised		
Ordinary shares of 25p each	838,000	209.5
At 31 December 1997	838,000	209.5
Called up and allotted		
Ordinary shares of 25p each fully paid 31 December 1996	571,001	142.8
Issued under share option and employee share schemes	4,098	1.0
Issued under scrip dividend scheme	1,673	0.4
At 31 December 1997	576,772	144.2

NOTE: *The ordinary shares referred to above, as defined in the memorandum and articles of association of the Company, are equivalent to equity shares as defined by FRS 4. The consideration received in respect of shares issued during the year was £27.2m (1996: £84.5m). Options granted under certain of the Company's employee share option schemes were adjusted following the demerger of Royal Doulton plc. In the case of those 'Save As You Earn' and Executive share options which were not adjustable, compensation is to take the form of additional Pearson shares distributed from an employee share trust when the options are exercised. If all these options are exercised the maximum amount of equity shares to be issued is estimated at 50,328 under the 'Save As You Earn' scheme and 46,508 under the Executive schemes.*

21. SHARE CAPITAL (CONT'D)

Options outstanding at 31 December 1997	WHEN GRANTED	NUMBER OF SHARES (000'S)	ORIGINAL SUBSCRIPTION PRICE (PENCE)	EXERCISE PERIOD
'Save As You Earn' share option schemes	1990	116	265	1995 - 1998
	1991	200	299	1996 - 1999
	1992	1,111	242	1997 - 2000
	1994	742	509	1999 - 2002
	1995	958	436	2000 - 2003
	1996	847	578	2001 - 2004
	1997	728	593	2000 - 2005
		4,702		
Executive share option schemes	1988	31	342	1991 - 1998
	1989	180	341 - 376	1992 - 1999
	1990	450	307 - 334	1993 - 2000
	1991	94	364 - 377	1994 - 2001
	1992	445	327 - 379	1995 - 2002
	1993	133	396 - 410	1996 - 2003
	1994	1,200	629 - 635	1997 - 2004
	1995	1,418	545 - 606	1998 - 2005
	1996	1,626	654 - 682	1999 - 2006
	1997	3,049	744 - 757	2000 - 2007
		8,626		

NOTE: *The subscription prices have been rounded down to the nearest whole penny.*

22. RESERVES

ALL FIGURES IN £ MILLIONS	SHARE PREMIUM ACCOUNT	REVALUATION RESERVE	OTHER RESERVES	PROFIT AND LOSS ACCOUNT	TOTAL
Summary of movements					
At 31 December 1996	129.5	5.4	1.2	109.7	245.8
Exchange differences	—	0.3	—	(20.9)	(20.6)
Premium on issue of 5.8m equity shares	28.1	—	—	(2.3)	25.8
Goodwill arising (see note 23)	—	—	—	(401.5)	(401.5)
Goodwill written back (see note 24)	—	—	—	232.9	232.9
Realisation of revaluation reserve	—	(2.6)	—	2.6	—
Profit retained for the year	—	—	—	(74.1)	(74.1)
At 31 December 1997	157.6	3.1	1.2	(153.6)	8.3
Analysed as:					
Partnerships and associated undertakings	—	0.2	1.2	2.9	4.3
Group excluding partnerships and associated undertakings	157.6	2.9	—	(156.5)	4.0

NOTE: *The cumulative net goodwill written off is £2,161.9m.* ■ *During 1997 Pearson plc received £17.3m on the issue of shares in respect of the exercise of options awarded under various share option plans. Employees paid £15.0m to the Group for the issue of these shares and the balance of £2.3m comprised contributions to the qualifying employee share ownership trust (QUEST) from subsidiary undertakings.*

23. ACQUISITIONS

In November 1997 the Group acquired All American Communications (Entertainment sector). All acquisitions have been consolidated applying acquisition accounting principles.

ALL FIGURES IN £ MILLIONS	1997 ALL AMERICAN COMMUNICATIONS	1997 OTHER	1997 TOTAL	1996 TOTAL
Acquisition analysis of subsidiary undertakings and businesses				
Tangible fixed assets	1.6	0.7	2.3	18.0
Investments	—	—	—	30.2
Stocks	47.3	(11.1)	36.2	111.5
Debtors	63.1	1.0	64.1	91.3
Creditors	(77.2)	(2.6)	(79.8)	(106.2)
Provisions	(3.9)	—	(3.9)	(32.6)
Deferred taxation	—	(0.2)	(0.2)	0.3
Equity minority interests	—	0.8	0.8	20.3
Net (borrowing)/cash acquired	(102.2)	(15.0)	(117.2)	4.5
Net assets/(liabilities) acquired at fair value	(71.3)	(26.4)	(97.7)	137.3
Fair value of consideration:				
Cash	(230.9)	(20.8)	(251.7)	(685.7)
Deferred cash consideration	(15.6)	(3.1)	(18.7)	(12.9)
Shares issued	—	—	—	(70.4)
Costs accrued	—	(0.1)	(0.1)	(1.2)
Net prior year adjustments	—	(15.8)	(15.8)	1.1
Total consideration	(246.5)	(39.8)	(286.3)	(769.1)
Goodwill arising	317.8	66.2	384.0	631.8

ALL FIGURES IN £ MILLIONS	1997 ALL AMERICAN COMMUNICATIONS	1997 OTHER	1997 TOTAL
Acquisition goodwill and fair values			
Acquisition cost	246.5	39.8	286.3
Book value of net liabilities acquired	(31.5)	(16.4)	(47.9)
Fair value adjustments	(39.8)	(10.0)	(49.8)
Fair value to the Group	(71.3)	(26.4)	(97.7)
Goodwill arising written off to reserves	317.8	66.2	384.0

NOTE: *Other fair value adjustments comprise the revaluation of assets acquired in HarperCollins Educational in 1996 (see page 71), adjustments to tax £4.2m and other sundry adjustments of £0.6m. Subsidiaries and businesses acquired recorded £10.8m in asset write-downs in the twelve months prior to acquisition.*

23. ACQUISITIONS (CONT'D)

ALL FIGURES IN £ MILLIONS	FAIR VALUE 31 DECEMBER 1996	REVALUATIONS AND OTHER ADJUSTMENTS	FAIR VALUE 31 DECEMBER 1997	NOTE
HarperCollins Educational				
Tangible fixed assets	6.0	—	6.0	
Stocks	86.4	(11.7)	74.7	A
Debtors	12.4	(3.1)	9.3	B
Creditors	(29.4)	—	(29.4)	
Provisions	(27.3)	—	(27.3)	
Net assets acquired	48.1	(14.8)	33.3	

NOTE: *HarperCollins Educational was acquired in April 1996 and provisional fair value adjustments were made in the 1996 accounts. Final fair value adjustments have been made in 1997.*

Final fair value adjustments

Revaluations and other adjustments:

A) Stocks have been written down by £4.1m and pre-publication expenditure by £7.6m following the establishment of more accurate estimates of their net realisable values.

B) The reserve against debtors has been increased by £3.1m to reflect debts which could not be collected.

ALL FIGURES IN £ MILLIONS	BOOK VALUE	ACCOUNTING POLICY ALIGNMENT	REVALUATIONS AND OTHER ADJUSTMENTS	FAIR VALUE	NOTE
All American Communications					
Tangible fixed assets	1.6	—	—	1.6	
Stocks	82.3	(5.7)	(29.3)	47.3	A
Debtors	60.5	—	2.6	63.1	B
Creditors	(76.7)	—	(0.5)	(77.2)	C
Provisions	(3.9)	—	—	(3.9)	
Net debt acquired	(95.3)	—	(6.9)	(102.2)	D
Net liabilities acquired	(31.5)	(5.7)	(34.1)	(71.3)	

NOTE: *All American Communications was acquired at the end of 1997 and as such all fair value adjustments made are provisional.*

Provisional fair value adjustments

Accounting policy alignment:

A) Programme stocks have been reduced by £5.7m to eliminate capitalised interest and overheads in line with existing Pearson accounting policy.

Revaluations and other adjustments:

A) Programme stocks have been reduced by £29.3m to reflect their net realisable value.

B) Certain receivables have been revalued by £2.6m to reflect their net realisable value.

C) Additional accruals have been made for sundry liabilities identified at the time of purchase.

D) At the time of purchase there was US$100m of loan stock at an interest rate materially in excess of market rates. The loan was redeemed immediately following the purchase and the premium payable was provided for as a fair value adjustment.

23. ACQUISITIONS (CONT'D)

ALL FIGURES IN £ MILLIONS	COST	NET ASSETS/ (LIABILITIES) ACQUIRED	GOODWILL
Total goodwill arising on acquisitions			
Subsidiary undertakings and businesses (see page 70)	286.3	(97.7)	384.0
Associated undertakings	67.0	52.9	14.1
Acquisitions by associated undertakings	—	(3.4)	3.4
	353.3	(48.2)	401.5

ALL FIGURES IN £ MILLIONS	**1997**	1996
Cash flow from acquisitions		
Cash – current year acquisitions (see page 70)	251.7	685.7
Deferred payments for prior year acquisitions and other items	17.3	12.2
Net cash outflow	269.0	697.9

NOTE: *Contributions to the cash flow from acquisitions in 1997 are as follows: net cash inflow from operating activities £1.1m, returns on investments and servicing of finance £(0.8)m, taxation £nil, and investing activities £nil.*

24. DISPOSALS

ALL FIGURES IN £ MILLIONS	**1997** CHURCHILL LIVINGSTONE	**1997** OTHER	**1997** TOTAL	1996 TOTAL
Disposal analysis of subsidiary undertakings and businesses				
Tangible fixed assets	(0.8)	(3.0)	(3.8)	(54.1)
Goodwill written back	(3.5)	(5.2)	(8.7)	(1.4)
Stocks	(11.4)	(1.1)	(12.5)	(1.9)
Debtors	(6.1)	(8.4)	(14.5)	(24.9)
Creditors and taxation	(1.9)	5.1	3.2	7.4
Provisions	0.1	(2.9)	(2.8)	1.0
Deferred taxation	(0.4)	(0.1)	(0.5)	6.5
Equity minority interest	—	0.4	0.4	—
Net cash	0.2	(0.9)	(0.7)	(5.5)
Net assets disposed of	(23.8)	(16.1)	(39.9)	(72.9)
Proceeds received	57.3	4.1	61.4	305.8
Deferred consideration	—	4.1	4.1	—
Costs	(3.1)	(1.0)	(4.1)	(3.5)
Net prior year adjustments	—	(0.8)	(0.8)	—
Profit/(loss) on sale	30.4	(9.7)	20.7	229.4

24. DISPOSALS (CONT'D)

ALL FIGURES IN £ MILLIONS	1997
Total goodwill written back on disposal	
In respect of Mindscape Inc. (see note 5)	212.0
On disposal of subsidiary undertakings	8.7
On disposal of associated undertakings	11.2
On disposal by associated undertakings	1.0
	232.9

ALL FIGURES IN £ MILLIONS	1997	1996
Cash flow from disposals		
Cash – current year disposals (see page 72)	61.4	305.8
Costs paid	(2.8)	(3.5)
Deferred receipts and payments from prior year disposals and other amounts	(4.6)	4.9
Net cash inflow	54.0	307.2

NOTE: *Contributions to the cash flow from disposals in 1997 are as follows: net cash inflow from operating activities £1.4m, returns on investments and servicing of finance £(0.9)m, taxation £nil and capital expenditure and financial investment £nil.*

25. NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS

	1997	1996		
ALL FIGURES IN £ MILLIONS	TOTAL	CONTINUING	DISCONTINUED	TOTAL
A) Reconciliation of operating profit to net cash inflow from operating activities				
Operating profit	323.2	147.6	33.7	181.3
Depreciation charges	65.2	56.8	6.4	63.2
Share of profit of partnerships and associated undertakings	(41.8)	(53.1)	—	(53.1)
Dividends from partnerships and associated undertakings	39.5	33.5	—	33.5
Decrease in stocks	4.8	4.6	1.9	6.5
(Increase)/decrease in debtors	(138.6)	21.8	(1.0)	20.8
(Decrease)/increase in creditors	(4.3)	59.9	1.0	60.9
(Decrease)/increase in operating provisions	(3.5)	1.6	(3.5)	(1.9)
Exchange adjustments	(5.9)	(7.7)	—	(7.7)
Other	5.6	(10.6)	(1.7)	(12.3)
Net cash inflow from operating activities*	244.2	254.4	36.8	291.2
Purchase of fixed assets and finance leases	(111.1)	(85.9)	(5.0)	(90.9)
Sale of operating tangible fixed assets	14.1	6.5	0.4	6.9
Other	11.6	10.0	1.8	11.8
Operating cash flow	158.8	185.0	34.0	219.0

NOTE: **Net cash inflow for 1997 includes a £9.4m outflow relating to exceptional items charged in 1997 and a £11.4m outflow relating to exceptional items charged in prior years.*

25. NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (CONT'D)

ALL FIGURES IN £ MILLIONS	CASH AT BANK AND IN HAND	OVER-DRAFTS	SUB-TOTAL	CURRENT ASSET INVESTMENTS	DEBT DUE WITHIN ONE YEAR	DEBT DUE AFTER ONE YEAR	TOTAL
B) Analysis of net debt							
At 31 December 1996	138.8	(68.6)	70.2	160.2	(105.6)	(555.2)	(430.4)
Exchange differences	(8.1)	(11.3)	(19.4)	0.2	(0.9)	(1.9)	(22.0)
Acquired with subsidiary*	—	—	—	—	(53.6)	(66.4)	(120.0)
Transfers	—	—	—	—	(7.9)	7.9	—
Net cash flow	13.0	57.4	70.4	(89.3)	(122.6)	6.8	(134.7)
At 31 December 1997	143.7	(22.5)	121.2	71.1	(290.6)	(608.8)	(707.1)
At 31 December 1995	155.5	(50.7)	104.8	516.5	(210.3)	(474.4)	(63.4)
Exchange differences	(8.2)	6.8	(1.4)	(4.9)	19.6	23.2	36.5
Net cash flow	(8.5)	(24.7)	(33.2)	(351.4)	85.1	(104.0)	(403.5)
At 31 December 1996	138.8	(68.6)	70.2	160.2	(105.6)	(555.2)	(430.4)

NOTE: **Excluding cash and overdrafts.*

ALL FIGURES IN £ MILLIONS	**1997**	1996
C) Reconciliation of net cash flow to movement in net debt		
Decrease/(increase) in net debt from net cash flow	70.4	(33.2)
(Increase) in net debt from management of liquid resources	(89.3)	(351.4)
(Increase) in net debt from other borrowings	(115.8)	(18.9)
Acquired with subsidiary	(120.0)	—
Exchange differences	(22.0)	36.5
Movement in net debt in the year	(276.7)	(367.0)
Net debt at beginning of year	(430.4)	(63.4)
Net debt at end of year	(707.1)	(430.4)

D) **Tax paid** includes £3.5m of credits (1996: £30.1m) relating to items excluded from operating profit.

26. COMMITMENTS UNDER LEASES

At 31 December 1997, the Group had commitments under leases other than finance leases, to make payments in 1998 as follows:

ALL FIGURES IN £ MILLIONS	LAND AND BUILDINGS	OTHER
For leases expiring:		
In 1998	4.9	1.0
Between 1999 and 2002	11.6	5.5
Thereafter	24.6	9.2
	41.1	15.7

27. CONTINGENT LIABILITIES

There are contingent Group and Company liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiary undertakings and in respect of guarantees in relation to subsidiary and associated undertakings. In addition there are contingent liabilities of the Group in respect of legal claims and general partnership interests (see note 11). None of these claims is expected to result in a material gain or loss to the Group.

28. RELATED PARTIES

Partnerships and associated undertakings Loans and equity advanced to associated undertakings during the year and at the balance sheet date are shown in note 11. Amounts falling due from partnerships and associated undertakings are set out in note 14. Dividends receivable from partnerships and associated undertakings are set out in note 11. Details of individually significant transactions are shown below.

Troll Communications LLC During the year the Group sold its 44.1% interest in the equity of Troll Communications LLC. £1.5m in interest income on the subordinated debt and £0.8m dividend income on the preferred stock were earned in the period. As at 31 December 1997 no interest was outstanding (1996: £3.6m) and no dividend was outstanding (1996: £2.1m).

Port Aventura SA The Group has a 40% interest in the equity of Port Aventura SA. Management fees of £2.0m were earned during the year of which £0.8m (1996: £1.0m) was outstanding at the year end.

Channel 5 Television Group Ltd The Group has a 24% economic interest in the equity of Channel 5 Television Group Ltd. During the year £47.3m of loans were advanced.

During the year the Group provided £22.6m of programming to Channel 5 Broadcasting Ltd, a wholly owned subsidiary of Channel 5 Television Group Ltd, and undertook transmission to the value of £2.1m for Channel 5 Engineering Services Ltd, a subsidiary of Channel 5 Television Group Ltd. At 31 December 1997 £6.3m was outstanding (1996: £nil).

European Channel Management Ltd The Group has a 45% interest in European Channel Management Ltd. During the year the Group paid £1.0m for £3.9m of tax losses.

UK TV The Group has a 20% interest in UK TV. During the year the Group provided programmes and services to the value of £2.7m of which £0.1m was outstanding at the year end (1996: £nil).

Grundy associated undertakings During the year the Group received £3.7m for management fees, format rights and royalties from a number of associated undertakings of Grundy Worldwide Ltd, of which £0.1m (1996: £0.4m) was outstanding at the year end. No individual transactions were material to the Group.

Lazard Partnership Details of the ownership structure and profit sharing arrangements are set out in note 11.

The Group periodically places funds on deposit with the Lazard Houses. The investments are made on an arm's length basis and no transactions are individually material in the context of the Group treasury transactions. The Group also uses the Lazard Houses to provide professional advice. Fees for such services for the year to 31 December 1997 totalled £3.6m.

Other Transactions with directors and officers of the company are set out on page 35 of the Directors' Report.

29. COMPANY BALANCE SHEET AS AT 31 DECEMBER 1997

ALL FIGURES IN £ MILLIONS	**1997**	1996	NOTE
Fixed assets			
Investments:			
Subsidiary undertakings	1,962.8	1,798.4	
	1,962.8	1,798.4	
Current assets			
Debtors:			
Advance corporation tax recoverable	17.3	15.9	
Subsidiary undertakings – due within one year	686.6	696.9	
Subsidiary undertakings – due after one year	535.0	521.6	
Other debtors	6.6	6.8	
Prepayments and accrued income	7.4	5.6	
Investments	0.1	0.7	
Cash and liquid resources	14.6	97.3	16
	1,267.6	1,344.8	
Creditors – amounts falling due within one year			
Short term borrowing	(295.2)	(170.3)	17
Subsidiary undertakings	(930.7)	(958.7)	
Taxation	(10.8)	(23.1)	
Other creditors	(0.4)	(0.2)	
Accruals and deferred income	(11.3)	(11.0)	
Dividends	(69.3)	(63.3)	
	(1,317.7)	(1,226.6)	
Net current (liabilities)/assets	(50.1)	118.2	
Total assets less current liabilities	1,912.7	1,916.6	
Creditors – amounts falling due after more than one year			
Medium and long term borrowing	(240.9)	(189.1)	17
Subsidiary undertakings	(225.0)	(225.0)	
Accruals and deferred income	(7.7)	(10.2)	
Provisions for liabilities and charges			
Deferred taxation	(0.4)	(0.6)	
Other provisions for liabilities and charges	(1.9)	(10.5)	
	(475.9)	(435.4)	
Net assets	1,436.8	1,481.2	
Capital and reserves			
Called up share capital	144.2	142.8	21
Share premium account	157.6	129.5	
Special reserve	397.2	397.2	
Other reserves	50.1	50.1	
Profit and loss account	687.7	761.6	
Equity shareholders' funds	1,436.8	1,481.2	30

The financial statements were approved by the board of directors on 16 March 1998 and signed on its behalf by

Sir Dennis Stevenson

John Makinson

30. NOTES TO THE COMPANY BALANCE SHEET

ALL FIGURES IN £ MILLIONS	1997	1996
Tangible fixed assets (leasehold property)		
Cost	0.6	0.6
Depreciation	(0.6)	(0.6)
Net book value	—	—

NOTE: *There were no capital commitments for fixed assets at 31 December 1997.*

ALL FIGURES IN £ MILLIONS	
Investment in subsidiary undertakings	
At 31 December 1996	1,798.4
Acquisition from subsidiary undertaking	20.4
Disposals to subsidiary undertaking	(51.9)
Subscription for additional share capital in subsidiary undertaking	210.0
Revaluations	(14.1)
At 31 December 1997	1,962.8

NOTE: *Shares are stated at cost less provisions for diminution in value or directors' 1969 valuations.*

ALL FIGURES IN £ MILLIONS	
Deferred taxation	
At 31 December 1996	(0.6)
Released in the year	0.2
At 31 December 1997	(0.4)

NOTE: *Deferred taxation derives from other timing differences.*

Current investments The investments are unlisted and valued by the directors at book value. If realised at valuation there would be no liability for taxation on disposal.

Accruals and deferred income Accruals and deferred income includes £10.1m (1996: £12.6m) relating to the unamortised profit arising out of the unwinding of a sterling interest rate swap in 1994. The swap was arranged in 1992 in connection with the issue of £100m 10.75% Euro-sterling Bonds 2002. The profit is being amortised over the remaining life of the Bonds. £7.7m is due after one year. None of the amount falls due after five years.

30. NOTES TO THE COMPANY BALANCE SHEET (CONT'D)

ALL FIGURES IN £ MILLIONS	SHARE PREMIUM ACCOUNT	SPECIAL RESERVE	OTHER RESERVES	PROFIT AND LOSS ACCOUNT	TOTAL
Reserves					
Summary of movements					
At 31 December 1996	129.5	397.2	50.1	761.6	1,338.4
Exchange differences net of related tax	—	—	—	(12.2)	(12.2)
Premium on issue of 5.8m equity shares	28.1	—	—	—	28.1
Profit for the financial year	—	—	—	50.7	50.7
Dividends	—	—	—	(112.4)	(112.4)
At 31 December 1997	157.6	397.2	50.1	687.7	1,292.6

NOTE: *The special reserve represents the cumulative effect of cancellation of the Company's share premium account. As permitted by Section 230(4) of the Companies Act 1985, only the Group's profit and loss account has been presented.*

31. POST BALANCE SHEET EVENTS

Recoletos and Telefónica On 25 September 1997 Pearson announced a strategic alliance between Recoletos and Telefónica de España SA, the Spanish telecommunications group. Telefónica will pay Pts23.1bn (£90m) to subscribe for a 20% stake in Recoletos, who will then invest Pts11.54bn (£45m) of the proceeds to subscribe for a 10% stake in Antena 3, a commercial television channel in Spain. The transaction is expected to close on 16 March 1998.

Société Européenne des Satellites SA (S.E.S.) On 9 February 1998 Pearson sold its 6.3% shareholding in S.E.S. for £159.5m. The sale was made cum dividend and consequently £4.2m will be included in operating profit leaving a profit of £132.2m before tax estimated at around £25m.

Law & Tax publishing businesses On 2 March 1998 Pearson sold its specialist Law & Tax publishing businesses for £70m giving rise to a profit of £61m, before tax estimated at £14m. Of the £70m consideration, £19.5m relates to the sale of the Federal Publications business which is conditional on Hart-Scott-Rodino clearance in the USA.

Mindscape Inc. On 6 March 1998 Pearson announced that it is to sell Mindscape Inc., the consumer software publisher, for $150m (£91m) in cash and stock, giving rise to an estimated loss on sale of £212m (see note 5). This is also conditional on Hart-Scott-Rodino clearance in the USA.

Principal Subsidiary and Associated Undertakings

Subsidiary undertakings

The principal operating subsidiary undertakings are listed below. They operate mainly in the countries of incorporation or registration, the investments are in equity share capital and they are all 100% owned unless stated otherwise.

	Country of incorporation or registration
Information	
Financial Times Group Ltd*	England
Interactive Data Corporation	USA
Les Echos SA	France
Recoletos Compañiá Editorial SA (94.3%)	Spain
Pearson Professional Ltd	England
Education	
Addison Wesley Publishing Co Inc.	USA
Addison Wesley Longman Ltd	England
HarperCollins Educational Publishers	USA
Entertainment	
Penguin Putnam Inc.	USA
The Penguin Publishing Co Ltd	England
Mindscape Inc.	USA
Future Publishing Ltd	England
Pearson Television Limited*	England
Grundy Worldwide Limited	Australia
Thames Television Ltd	England
All American Communications	USA
The Tussauds Group Ltd*	England

NOTE: **Direct investment of Pearson plc.*

Associated undertakings

	Country of incorporation or registration	Beneficial interest %	Class of share	Share capital £m	Accounting year end
Information					
The Economist Newspaper Ltd	England	50	Ord 5p	1.1	March
		100	'B' 5p	0.1	
		Nil	'A' 5p		
		Nil	Trust 5p	—	
Entertainment					
Port Aventura SA	Spain	40	Pts 10,000	52.8	December
Channel 5 Television Group Ltd	England	24	Ord 1p	—	December
			Def 1p	—	
			Pref 1p	—	

The principal partnerships are shown on page 62.

Five Year Summary

	1993	1994	1995	1996	**1997**
ALL FIGURES IN £ MILLIONS					
Sales					
Continuing operations	1,193.8	1,413.3	1,687.1	2,048.9	2,293.1
Discontinued operations	676.3	136.8	143.3	137.1	—
	1,870.1	1,550.1	1,830.4	2,186.0	2,293.1
Profits *					
Information	28.9	54.7	67.6	88.2	107.0
Education	53.6	43.8	22.9	60.2	60.5
Entertainment	66.5	128.7	108.5	(41.6)	112.6
Investment Banking	36.4	30.2	39.9	40.8	43.1
Continuing operations	185.4	257.4	238.9	147.6	323.2
Discontinued operations	30.7	15.0	20.7	33.7	—
Operating profit	216.1	272.4	259.6	181.3	323.2
Profit/(loss) on sale of fixed assets	4.4	26.4	123.4	(14.1)	23.0
Profit/(loss) on sale of businesses	(68.4)	15.2	6.0	229.4	(180.3)
Provision on investment in BSkyB	71.4	—	—	—	—
Profit before interest	223.5	314.0	389.0	396.6	165.9
Net interest payable	(14.9)	(16.2)	(23.9)	(29.5)	(37.3)
Loan stock redemption premium	—	—	—	(10.3)	—
Profit before taxation	208.6	297.8	365.1	356.8	128.6
Taxation	(60.3)	(74.3)	(92.8)	(108.6)	(88.6)
Profit after taxation	148.3	223.5	272.3	248.2	40.0
Equity minority interests	(0.3)	(0.6)	(11.3)	(7.7)	(1.7)
Profit for the financial year	148.0	222.9	261.0	240.5	38.3
Earnings per equity share	27.0p	40.4p	47.1p	42.9p	6.7p
Adjusted earnings per equity share **	27.9p	34.1p	28.8p	30.6p	34.9p
Dividends per equity share	13.0p	15.0p	16.5p	18.0p	19.5p

NOTE: *'Corporate expenses less other income' have been allocated to profit centres and, accordingly, prior year figures have been restated (see note 2). ■ **Adjusted in accordance with page 47.

Five Year Summary

	1993	1994	1995	1996	**1997**
ALL FIGURES IN £ MILLIONS					
Capital employed					
Net assets	1,000.1	1,051.9	855.4	392.3	156.0
Deferred tax and other provisions	67.6	233.8	134.4	189.4	211.8
Net debt	1.3	146.4	63.4	430.4	707.1
	1,069.0	1,432.1	1,053.2	1,012.1	1,074.9
Cumulative goodwill written off	700.2	1,042.5	1,437.8	1,896.4	2,161.9
Gearing					
Debt/equity	N/A	14%	7%	110%	453%
Debt/adjusted equity (including goodwill)	N/A	7%	3%	19%	31%
Interest cover	15 times	17 times	11 times	6 times	9 times
Share statistics					
Equity shares – weighted average	547.6m	551.6m	554.4m	560.8m	573.1m
Share price – year end	608p	555p	624p	750p	791p
Share price – high	614p	725p	684p	760p	849p
Share price – low	356p	554p	543p	601p	665p
Average number employed					
Continuing operations	11,823	13,562	16,008	17,383	18,306
Discontinued operations	15,453	3,653	3,414	2,564	—
	27,276	17,215	19,422	19,947	18,306

Shareholder Information

Payment of dividends to mandated accounts Where shareholders have given instruction for payment to be made direct into a bank or building society, this is done through the Bankers Automated Clearing Systems (BACS), with the associated tax voucher showing the tax credit attributable to the dividend payment sent direct to the shareholder at the address shown on our register. If you wish the tax voucher to be sent to another address, please inform our Registrar, Lloyds Bank plc, Lloyds Bank Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 01903 502 541.

UK tax on capital gains At 31 March 1982, the base date for capital gains tax, the value of each of the Company's ordinary shares (adjusted for the one for one capitalisation issues in May 1985 and June 1992), was 62p. The market quotations of Pearson plc ordinary shares and Royal Doulton plc ordinary shares on the first day of dealing in Royal Doulton shares, following the demerger in 1993, as calculated in accordance with s.272(3) of the Taxation of Chargeable Gains Act 1992 and as derived from The Stock Exchange Daily Official List on 2 December 1993 were:

Pearson plc ordinary shares of 25p	592p
Royal Doulton plc ordinary shares of £1	203.5p

Personal Equity Plans (PEPs) Pearson operates a Corporate PEP and a Single Company PEP. Both are open to existing and prospective shareholders in Pearson. For further information, please ring the Halifax helpline on Freephone 0800 371769.

Low cost share dealing facility A postal facility, which provides a simple, low cost way of buying and selling Pearson shares, is available through the Company's stockbrokers, Cazenove & Co, 12 Tokenhouse Yard, London EC2R 7AN. Telephone 0171 588 2828.

Information about the Pearson share price The current price of Pearson ordinary shares can be obtained from Financial Times CityLine on telephone 0836 433620. Calls are charged at 40p per minute cheap rate and 50p per minute at all other times, inclusive of VAT.

American Depository Receipts (ADRs) Pearson introduced a sponsored Level One ADR programme in March 1995. Each ADR represents one ordinary share. The programme is administered by the Bank of New York, ADR Department, 101 Barclay Street, New York, NY 10286, telephone 1-800-524-4458. However, as holders of ADRs are not registered shareholders, they do not automatically have the right to receive the Pearson report and accounts or other communications nor are they able to attend or vote at the Annual General Meeting.

Advisors AUDITORS Price Waterhouse ▪ BANKERS Midland Bank plc, National Westminster Bank Plc ▪ BROKER Cazenove & Co ▪ FINANCIAL ADVISORS Lazard Brothers & Co, Limited, J. Henry Schroder & Co Limited ▪ SOLICITORS Freshfields, Herbert Smith

FINANCIAL CALENDAR FOR 1998		
Ex-dividend date	MONDAY	30 MARCH
Record date	FRIDAY	3 APRIL
Despatch of share dividend information	MONDAY	20 APRIL
Annual General Meeting	FRIDAY	1 MAY
Last date for share dividend election	TUESDAY	12 MAY
Share entitlement under share dividend posted	THURSDAY	4 JUNE
Payment date for dividend	FRIDAY	5 JUNE
Interim results	MONDAY	3 AUGUST
Interim dividend		OCTOBER

Principal Offices

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Major Subsidiaries

Financial Times Group	Number One, Southwark Bridge, London SE1 9HL TEL 0171 873 3000 FAX 0171 407 5495 E-MAIL firstname.lastname@ft.com	*information*
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Addison Wesley Longman Inc.	One Jacob Way Reading, Massachusetts 01867-3999, USA TEL 001-781-944-3700 FAX 001-781-944-9338 E-MAIL firstname.lastname@awl.com	*education*
Addison Wesley Longman Ltd	Edinburgh Gate, Harlow, Essex CM20 2JE TEL 01279 623623 FAX 01279 431059 E-MAIL firstname.lastname@awl.co.uk	
The Penguin Group	375 Hudson Street New York City, NY 10014, USA TEL 001-212-366 2000 FAX 001 212-366-2666 E-MAIL initiallastname@penguin.com	*entertainment*
The Tussauds Group Limited	Maple House, 149 Tottenham Court Road, London W1P 0DX TEL 0171 312 1131 FAX 0171 465 0864 E-MAIL firstname.lastname@tussauds.com	
Pearson Television Limited	1 Stephen Street, London W1P 1PJ TEL 0171 691 6000 FAX 0171 691 6100 E-MAIL firstname.lastname@pearsontv.com	
Pearson New Entertainment Limited	Kingsgate House, 536 Kings Road, London SW10 0TE TEL 0171 331 3920 FAX 0171 331 3929 E-MAIL initiallastname@pne.co.uk	
Lazard Brothers & Co, Limited	21 Moorfields, London EC2P 2HT TEL 0171 588 2721 FAX 0171 628 2485	*associates*
The Economist Group Limited	25 St James's Street, London SW1A 1HG TEL 0171 830 7000 FAX 0171 839 2968	

Accounting policies 51, 52
Acquisitions 70, 71, 72
Adjusted earnings per share 47
Auditors
    Remuneration 55
    Report to members 46
Balance sheets
    Company 76
    Group 48
Borrowings 65, 66, 67
Capital commitments 60
Capital employed 54
Capital expenditure 60
Cash flow 49, 73, 74
Cash and liquid resources 65
Contingent liabilities 75
Creditors, other 67
Debtors 64
Deferred taxation 67, 68
Depreciation 55, 60
Disposals 72, 73
Dividends 47, 58
Earnings per share 47
Employee information 58, 59
Fair value 70, 71
Forward exchange 66
Five year summary 80, 81
Fixed assets, tangible 60
Geographical analysis 53, 54, 58, 61
Goodwill 70, 72, 73
Historical cost profits and losses 50
Interest 56
Interest rate hedging 66, 67
Investments 63, 64
Leases 55, 74
Net cash inflow from
    operating activities 73
Net debt 74
Other operating income 55
Partnerships and
    associated undertakings 61, 62, 63
Pensions 58, 59
Post balance sheet events 78
Post-retirement costs 58, 59
Principal subsidiary undertakings 79
Profit and loss account 47
Provisions 68
Recognised gains and losses 50
Related parties 75
Reserves 69
Sales 47, 53, 54
Sector analysis 53, 54, 58, 61
Share capital and options 68, 69
Shareholders' funds 48, 50
Stocks 64
Taxation 57, 67, 68
Treasury information 65, 66, 67

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