

Pearson's strategy: John Fallon, Chief executive



John Fallon, Chief executive of Pearson

By accelerating the transformation of Pearson we become more confident of our ability to seize that once in a generation opportunity – to become directly accountable for helping people make progress in their lives through learning.

Dear shareholders,

Last year, in my first letter to you as Pearson's chief executive, I wrote about the establishment of a clear Pearson education strategy and its accelerated implementation. That acceleration – the transformation of the company – is now well underway. Twelve months on, I am convinced that we started it not a moment too soon, and that the changes we need to make must go deeper, and happen faster, than I originally envisaged.

The global opportunity

The long-term opportunity in global education is greater than ever. Last year, the OECD reported that poor math and literacy skills limit access to better-paying and more-rewarding jobs. People who are strong in these skills are not just wealthier and live healthier lives, they are also more actively engaged in public life. Nelson Mandela was right: education really is the most powerful weapon with which to change the world.

As rapid advances in technology continue to disrupt the world of work, the economic value of education and skills will continue to increase. Governments spend trillions of dollars per year on education and training; and, each year, the still rapidly growing middle class invests more of its own increasing wealth in the education of themselves and their children. And yet, the world fails to meet the learning needs of far too many of our fellow citizens. One in five adults in today's world still lack the written communication skills they need to progress in life, 57 million children remain out of school, and many millions more are in education, but not really learning anything very much at all.

Pearson has a unique set of advantages with which to help meet this global demand for better education and skills, in part by applying technology to help tangibly improve learning outcomes. And, by being better able to meet some of the biggest challenges in global education, we can build a stronger, more profitable and faster growing company.

Pearson's strategy: John Fallon, Chief executive continued

The transformation of our company

To seize this opportunity, we need to accelerate our shift from mature to developing markets, from print to digital products and from education inputs to services with demonstrable learning outcomes. For much of the last decade, we've been implementing this strategy by reshaping the company portfolio through acquisitions and disposals – and we continued this work last year. We completed the Penguin Random House merger, securing both Penguin's commercial and creative future and the opportunity for significant economies of scale. We sold Mergermarket in February 2014, which has flourished under Pearson's ownership, but was not part of our strategy in global education. The sale proceeds helped us to finance the acquisition of Grupo Multi, the leading adult English language training company in Brazil. It fits very well with our strategy of investing more in faster growing economies and in digital and related services that can have a greater and more measurable impact on education around the world.

More urgently, the strategy now demands that we run the company in a fundamentally different way, too. Early last year, we started the biggest restructuring in the company's recent history, to tilt us towards our biggest growth opportunities, and by measuring everything we do in terms of impact in improving learning outcomes.

This is what we are doing:

1

Redirecting more of our operating expenses, and our organic investment, more quickly to our most promising opportunities

We need fewer people, and resources, deployed in the publishing, production and manufacturing of textbooks and their physical distribution, sales and marketing. We need less print-based testing capacity, as we consolidate our operations and move more towards online testing. By spending much less on these activities as demand falls (for example, US Higher Education textbook volumes have declined by more than 20% in four years), we can invest much more in our biggest growth opportunities (for example, MyLab digital registrations and our sales in emerging markets have both doubled over the same period).

WE ARE TRANSFORMING FASTER

Our revenues in emerging markets

\$1,302m

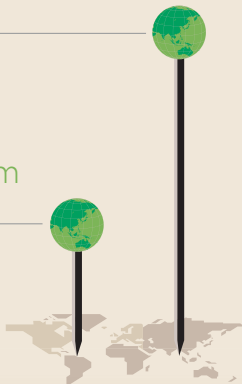
£819m

2013

\$471m

£235m

2007



Our revenues in digital products and services

\$4,727m

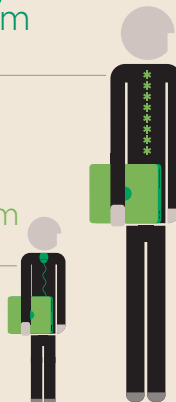
£3,020m

2013

\$2,253m

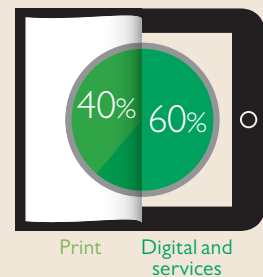
£1,125m

2007



Our revenues in print vs. digital products and services

2013 revenues



Print

Digital and services

2 Running Pearson as one globally connected company

Our operations are now entirely focused on our global education strategy in which we include the FT Group. We have appointed a new executive team to lead it. We'd outgrown our organisation and, as a collection of relatively stand-alone companies, we were duplicating investment and proliferating small-scale initiatives, limiting our ability to build global scale. We are now organising around a smaller number of global products and platforms, built around a single, world-class infrastructure and common systems and processes. This will help us to grow more quickly, as it frees up resources to invest in our digital transformation, and the new, more service-oriented, products that are vital to future growth.

3 Publicly committing to efficacy and improving learning outcomes

We will judge ourselves – and invite others to judge us – not by the products that we make but by their impact on learners. This changes how we decide which companies to acquire, where and how we invest, which products we get behind and which

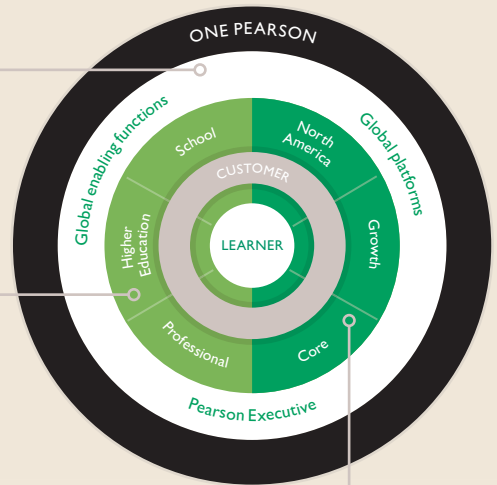
we retire. It changes how we recruit, train and reward each and every person in this company. It will change how we develop new products, unleashing, I believe, a new wave of innovation and creativity across the company. It will be difficult to pull off; and it will take time. That's why we specifically talk about the 'path to efficacy' that we are on. And it is why we have committed to providing audited learning outcomes data for all our products and services by 2018. But, as detailed elsewhere in this report, we are making some specific, and measurable, efficacy commitments for this year.

4 We are putting the learner at the heart of everything we do

We are putting the learner at the heart of everything we do. Our commitment to efficacy recognises the fact that, whilst our customer is often a teacher, an institution, an education authority, a parent, or a company; the real beneficiary of our work – and of our customers' work – is always the learner. Our purpose as a company – and, ultimately, the true measure of our success – is whether we really do help to equip more people with the education and skills they need to progress in their lives.

WORKING AS ONE PEARSON

- Global functions**
Partner with geographies and lines of business; operate as integrated global functions to achieve scale economies.
- Lines of Business**
Responsible for global strategy, investment priorities, product strategy and product portfolio for respective learner 'age and stage'.
- Geographies**
Responsible for customer relationships, sales and marketing, and delivery of education products in their markets.



Pearson's strategy: John Fallon, Chief executive continued

A necessary transition

This is changing the way that every person in the company works. At times, it is proving difficult and disruptive. In the short term, it is made more painful, but all the more necessary, by the fact that we are battling against a number of cyclical, policy-related, structural and operational headwinds. These led to a sharp decline in earnings and free cash flow last year and will continue to make life difficult for us in 2014:

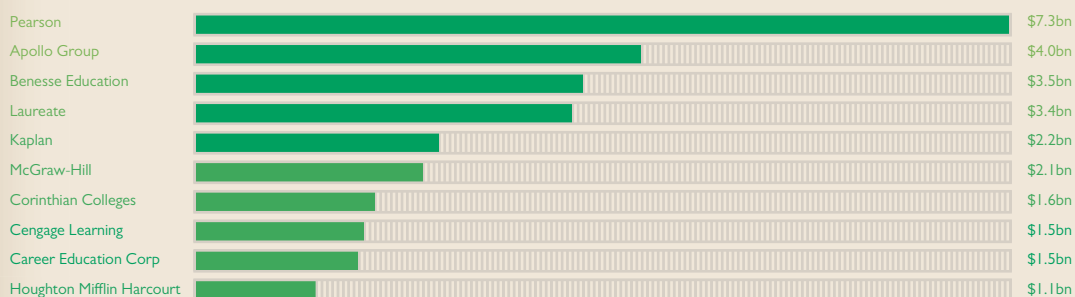
- › The creation of Penguin Random House is a major portfolio change, which creates economic value for Pearson, but the move to associate accounting reduces our reported operating profit in 2013 and 2014.
- › Our US college business, our biggest and most profitable activity, is highly counter-cyclical, as enrolments grow strongly during a recession, when jobs are harder to come by, and then fall back in the early years of economic recovery.
- › Our two big assessment and qualifications businesses, in the US and the UK, are seeing demand fall in the short term due to changes in government policy, which will open up new, and bigger, opportunities as these changes are implemented.

The transformation of our company is fundamental to get ahead of the significant structural changes taking place in education – chiefly the digital shift, in which Pearson is playing a leading role. It means that we are now in a much more intensive phase of investment at the same time as we are financing the one-off costs of the biggest restructuring in Pearson's recent history. We are investing much more, both in building the technology and related infrastructure, and in the next generation of products and services, that are vital to making the most of that global education opportunity.

We make this investment with confidence as we continue to grow strongly in emerging markets and with our digital and service-related products. In future years, investing in these new growth areas will be financed by cutting back in the print-led related areas I outlined earlier. But, first, we face significant one-off costs, both in 2013 and again in 2014, to achieve this.

UNIQUE MARKET POSITION

2012 Education revenues



An ever more purposeful, and faster growing, company

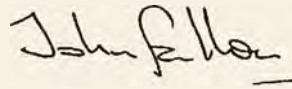
We have a lot of work ahead of us, but when I write again in 12 months we will have completed our second year of significant restructuring and reorganisation. We will be reaping the rewards of significant investment, and we will start to see the benefits of a more favourable trading environment as those headwinds, over time, begin to ease and the operational risks recede.

By accelerating the transformation of Pearson, we are ensuring that we shorten this transitional period – and that we get the company growing in a more profitable and sustainable manner, as quickly as we can. As we do so, we open up, for Pearson, bigger growth opportunities, a larger addressable market and a greater impact on learning outcomes.

We become more confident of our ability to seize that once-in-a-generation opportunity – to become directly accountable for helping people make progress in their lives through learning. We see the chance for Pearson to be the stand-out company in education, which is now emerging as one of the new global growth industries.

I thank all my colleagues for all their hard work and commitment, including all our former colleagues, who have served the company with such distinction. I'm sorry to see many good colleagues leave the company as a result of our restructuring and I wish them every success in their future careers. I also thank all our shareholders for their support and patience through this short, sharp transition.

I'm determined to ensure that it is rewarded, as soon as possible, by building a leaner, more cash generative and faster growing business – and one ever more equipped to tackle some of the biggest and most intractable problems in global education.



John Fallon Chief executive