Financial overview

Coram Williams
Chief financial officer

"In 2015, Pearson's sales decreased by £72m in headline terms to £4.5bn. Total adjusted operating profit rose £1m to £723m."

Sales (at CER)
–5%

Adjusted earnings per share
+5%

Operating cash flow
–33%

Dividend per share
+2%

Business performance

£ millions	2015	2014	Headline growth	CER growth	Underlying growth
Sales	4,468	4,540	(2)%	(5)%	(2)%
Adjusted operating profit	723	722	–	(3)%	(2)%
Adjusted earnings per share	70.3p	66.7p	5%		
Operating cash flow	435	649	(33)%		
Net debt	(654)	(1,639)	60%		

Statutory results

£ millions	2015	2014	Headline growth	CER growth	Underlying growth
Sales	4,468	4,540	(2)%		
Operating (loss)/profit	(404)	348			
(Loss)/profit before tax	(433)	255			
Profit for the year	823	470	75%		
Basic earnings per share	101.2p	58.1p	74%		
Cash generated from operations	518	704	(26)%		
Dividend per share	52p	51p	2%		

a) Growth rates are stated on a constant exchange rate (CER) basis unless otherwise stated. Where quoted, underlying growth rates exclude both currency movements and portfolio changes. Unless otherwise stated, sales exclude FT Group, while total adjusted operating profits include FT Group. Continuing operations exclude FT Group.

b) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in notes to the consolidated financial statements 2, 6, 7, 8 and 32, and the corporate and operating measures.

Profit and loss statement

In 2015, Pearson's sales decreased by £72m in headline terms to £4.5bn. Total adjusted operating profit rose £1m to £723m (2014: £722m).

Currency movements, primarily from the depreciation of sterling against the US dollar during the period, increased sales by £137m and operating profits by £22m.

At constant exchange rates (i.e. stripping out the impact of those currency movements), our sales fell by 5% primarily due to a change in revenue model at Connections Education which now records revenues charged at cost on a net basis; and adjusted operating profit fell by 3% due to revenue mix and an operating loss in our Growth segment.

The net effect of acquisitions, disposals and revenue model adjustments reduced sales by £129m and operating profits by £9m.

Stripping out the impact of portfolio changes and currency movements, revenues were down 2% in underlying terms while adjusted operating profit fell 2%.

Net interest payable in 2015 was £46m, compared to £64m in 2014. Our tax rate in 2015 was 15.5% compared to 17.9% in 2014. The decrease in both interest and tax was primarily due to agreement on historical tax positions and the release of associated accrued interest.

Adjusted earnings per share were 70.3p (2014: 66.7p).

Cash generation

Headline operating cash flow decreased by £214m to £435m as a result of challenging trading and disposals. Operating cash conversion fell from 90% in 2014 to 60% in 2015 due to: a mismatch between cash and accrued incentive compensation as a result of lower incentive compensation awards for 2015 when compared to 2014; capital expenditure greater than depreciation due to investments in our enabling function technology designed to lower administrative costs; an increase in US Higher Education textbook returns; and pension top-up payments as a result of a triennial valuation. These factors were partly offset by an increased dividend payment from Penguin Random House.

Return on invested capital

Our return on average invested capital was 5.8% (2014: 5.6%) primarily due to lower operating cash tax paid.

Statutory results

Our statutory results showed a profit for the year after tax of £823m, including gains on the disposal of the Financial Times Group, The Economist Group and PowerSchool of £1,214m and an impairment of goodwill and intangibles of £849m, primarily reflecting trading pressures in our Growth and North America businesses. Included within the net gain on disposal is a £70m balance sheet write down on the disposal of PowerSchool, related to the reduced market opportunity for software (such as Pearson System of Courses and Schoolnet) which was to be integrated with PowerSchool and the recognition that adoption of such software in US Schools is now unlikely to occur at the rate originally envisaged.

Balance sheet

Our net debt decreased to £654m (2014: £1,639m) primarily reflecting the disposals of the Financial Times, The Economist Group and PowerSchool and an increased dividend from Penguin Random House, offset by the strengthening of the US dollar relative to sterling, a higher group dividend and higher working capital. Pearson's net debt/EBITDA ratio decreased from 1.9x in 2014 to 0.8x in 2015 and our interest cover increased from 11.3x to 15.7x.

Dividend

The Board is proposing a flat final dividend of 34p, which results in a 2% increase in the overall 2015 dividend to 52p, subject to shareholder approval.

Financial overview continued

2016 outlook

In 2016, we expect to report adjusted operating profit before restructuring costs of between £580m and £620m. This reflects the impact of: the in-year benefits from restructuring offset by the loss of operating profit from disposals made in 2015, ongoing challenging conditions in our largest markets, the reinstatement of the employee incentive pool and other operational factors (including dual running costs as we rationalise our technology infrastructure, cost inflation and increased pre-publication amortisation relating to new product launches).

We expect adjusted earnings per share to be between 50p and 55p, after a normalised interest charge of approximately £60m and a tax rate of approximately 19%. In 2016, we are excluding the one-off cost of our major restructuring from adjusted operating profit and earnings per share to better reflect the underlying earnings potential of the business. Operating profit after restructuring charges is expected to be in the £260m to £300m range. This guidance is based on our current portfolio of businesses and exchange rates on 31 December 2015.

The major factors behind this guidance are as follows:

Trading conditions

While we expect to achieve continued good growth in areas such as virtual schools and online programme management, we anticipate trading conditions to remain challenging in our major markets in 2016.

North America

In North America, our largest market, we anticipate US college enrolments will be flat given forecast modest improvements in US employment; a smaller adoption market in K-12 learning services and lower participation rate partially offset by growth in open territories driven by new products; reduced testing revenues in North America reflecting State and National Assessment contract losses worth approximately £100m announced in 2015; and growth in clinical assessments and professional certification.

Core

In our Core markets (which include the UK, Italy and Australia), we expect declines in vocational course registrations in UK schools, ongoing pressure in our various learning services businesses, partially offset by growth in managed services in Australia and the UK. At VUE, we will cease to deliver the contract to administer the UK Driving Theory test for the DVSA in September 2016.

Growth

In our Growth markets (which include Brazil, China, India and South Africa), we expect continued pressure in South Africa on government spending on textbooks and lower enrolments in CTI, macro-economic pressures in emerging markets, specifically China and Brazil, offset by growth from new products such as our Wall Street English new student experience.

Penguin Random House

In Penguin Random House, we anticipate that additional benefits from the ongoing integration of the business will be broadly offset by reduced demand for ebooks, following industry-wide changes in terms in 2015.

Portfolio changes

We completed the sale of PowerSchool on 31 July 2015 for £222m; the sale of the Financial Times on 30 November 2015 for £858m; and substantially completed the sale of our 50% stake in The Economist Group on 16 October 2015 for £469m. In addition we disposed of Fronter and a number of print textbook lists in the US. Total disposals contributed approximately £90m to 2015 operating profit which will not recur in 2016.

Other operational factors

Dual running costs from technology implementations, increased investment amortisation from new product launches and cost inflation will increase costs by approximately £90m in 2016 when compared to 2015.

Incentive compensation

Group incentive compensation was zero in 2015 reflecting the weakness of performance versus budget. The incentive pool will be reinstated to £110m in 2016 to ensure our workforce is incentivised to sustain its strong competitive performance and to implement a significant programme of change within the company.

Restructuring

Building on the work we have done over the last three years, we are taking further action to simplify our business, reduce our costs and position Pearson for growth in our major markets. We will: create a single courseware product organisation; integrate our North America assessment operations; reduce our exposure to large scale direct delivery and focus on more scalable online, virtual, and blended services; implement major efficiency improvements across all our enabling functions - technology, finance, HR; and rationalise our property portfolio and renegotiate and consolidate major supplier agreements.

To implement this programme, we will incur costs of approximately £320m in 2016 and expect to generate annualised savings of approximately £350m, with approximately £250m of savings in 2016 and a further £100m of savings in 2017. We have already implemented a number of significant associated actions since announcing the programme in January.

Currency movements

In 2015, Pearson generated approximately 63% of its sales in the US, 6% in Greater China, 5% in the Eurozone, 3% in Brazil, 2% in Canada, 2% in Australia, 2% in South Africa and 1% in India and our guidance is based on exchange rates at 31 December 2015.

Interest and tax

We expect our interest charge to be approximately £60m, with lower average net debt levels offset by the absence of released accrued interest payments following agreement on historical tax positions. We expect a tax rate of approximately 19% on our total profit before tax (which includes the post-tax contribution from Penguin Random House).

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