PEARSON TRADING UPDATE
18th December 2001
TRANSCRIPT OF MARJORIE SCARDINO'S COMMENTS

Thank you for joining us this morning. I'm here with John Makinson, Pearson's Finance Director, and I'd like to talk about some of the key points arising from our annual December trading update we've issued this morning, and then John and I will be happy to take questions.

This call is primarily for investors and analysts. I know there may be some press on the call – and you are very welcome to listen in– but if you have any questions, please call Luke Swanson in our London office.

The headline of this update is that in most respects our businesses are very much trading in line with the guidance we gave you when we had a similar call in October. To remind you, we said then that our earnings for 2001 would be hurt by 1) the advertising downturn; and 2) by fallout from the technology recession. We also said that it was likely that international markets would have an impact on our education results, as would our corporate training business, part of which was located in the world trade center.

These are still the negative factors in our performance, and in the last two months, they've worsened in a couple of areas:

1) The first is in television advertising. RTL announced its trading update on December 7, and at that time they said that television markets continue to deteriorate. Based on their estimates, RTL's contribution to our earnings will be some £10m lower than market expectations back in October.

2) The second is in three areas reported within our education business – international markets, technology spending and corporate training. These are three areas that we've been highlighting as trouble spots and which have worsened. In the two most important, we've taken firm action now, which puts us in a better position for next year. But that does mean

that the cost of those actions will reduce our education profits by some £35 million lower than expectations. A word on each one of these:

1) Firstly, the financial instability in some countries is by far the single biggest factor, as we have the largest international education business around the world. We said in October that we anticipated some unsteady international markets, and since then the economic picture of some places, especially in Latin America, has deteriorated. If you read the newspapers then you'll know that. We've tightened our credit terms, increased reserves for obsolescence and bad debt and restructured our operations to put this business in a much stronger position for 2002. But this action will reduce our profits this year.

2. Secondly, the sharp downturn in technology spending is less of a factor, but worth noting. We've already talked about the impact of this technology recession on our publishing program and indicated it could affect other areas. We now expect that our US School curriculum and enterprise software sales for the year will be pretty much flat on last year, which will have a modest impact on profits. Technology spending decisions are being postponed or delayed but they are not going away.

3. Finally, I believe you know that one of our corporate training businesses was in the WTC. While we had hoped to have insurance to cover some of the damage, we have now assumed that our claim won't be settled by the end of the year.

So these are the trouble spots, nothing really new from what we've told you except our action to change them. The core of our education business, however, has been having an excellent year.

Just a few specifics on that:

1) We are out-performing the market in the US Schools business.

Through the end of October, our sales in the schools business are up 9% on last year. According to sales reported to the Association of American Publishers by all the major publishers, the industry (taking out Pearson) is up about 8% on last year, so we're a tick ahead of the industry. And a new survey out this week in the trade press reports that Pearson has taken a larger share of new adoption dollars this year than anyone else. Of course, we've told you in the past that you have to look at the education business through the cycle, and we say the same thing now that we've had a good year.

We've lost a little share in elementary mathematics – which was inevitable as we slimmed down from selling two programs to one – but we are still a commanding #1 in the mathematics field. At the same time, we've really gained share in elementary reading, with the year's best-selling program, Scott Foresman reading.

We've also had an outstanding year in the secondary market – children 12-18 – that market is growing more quickly than the elementary market and it actually has more attractive economics than the elementary market.

2) Secondly, we expect to report another year of performance ahead of the market in College Publishing.

Again according to AAP data, through the end of October, our sales were up 5% and, the industry was up less than 3% not including Pearson. So it looks like, yet again, our college business, which is the industry's largest business, will gain market share.

3) Thirdly we're achieving double digit growth in testing & assessment.

Our school testing business, part of NCS, is also having a great year, with revenues up more than 15%. We've won a new 3-year, $100m plus contract with Florida - this is going to be formally announced in a few weeks. This follows recent contract wins that have been announced, in Virginia, Georgia and California (CAHSEE). With the new education bill expected to become law by Christmas, out of that bill the states will have an extra $400m a year in federal funding to spend on testing and assessment and we certainly expect to maintain our market share of that additional spending.

4) Other NCS businesses are also doing very well.

And in government solutions and data management, the NCS businesses are performing in line with expectations. The recent $75m e-learning contract we've won with the US Navy is a good example of new business that we can get through our ability with NCS to bring together software, testing & assessment and content in one integrated package. No other education company can do that.

Just to dwell on this NCS part of our education business for a moment - the only area where we’re not achieving our plan in NCS is in the school software market - and that’s due to the state of that market.

As budgets have tightened, we have seen US school districts delay major new technology investments, as we’ve been predicting they might and just as corporations have held back on those kind of major systems decisions. For example, our assessment of the pipeline for new enterprise software project tenders by schools is about 30% lower than last year.

This same caution over large technology investments is also having some effect on online-curriculum software products, too. That area is going to be flat this year as well. But this is a problem in the marketplace. We have held our market share this year in systems as well as in curriculum software.

This software softness does mean that in 2001, we won't get the sales growth from NCS we had planned. This year, stripping out the benefit of last year’s decennial US census contract and acquisitions, NCS revenues will be up some about 5%-6% on last year.

However, we still expect a big increase in profits this year. On a standalone basis, we expect the profits contribution from NCS will be some 25% higher than last year.

Both systems and software are exciting growth markets and important to the future of customizing education for each child. We are confident that our business is a good one, but it may not rebound until 2003. When it does, we will have market-leading products to capitalize on it. The development in ASP format of NCS4School, our new integrated curriculum and schools management program, is going very well and receiving a lot of market attention and we are on track for commercial release in spring 2002.

Looking elsewhere within Pearson, the FT Group and Penguin are trading in line with our October update.

1) You'll remember that, for the month of September, FT advertising revenues were down 40% on the same month last year, making this the sharpest advertising downturn that anyone at the FT can remember. We have seen similar declines in our other business papers.

Since then, things haven't got any worse, or any better. We said then that FT Group profits for 2001 could be some 40% lower than in 2000 and we are trading in line with that guidance.

2) At Penguin, we talked in July, and again in October, about industry-wide softness in backlist sales and a sharp decline in sales, particularly of our travel guides after September. That continues to be a problem, but we've had another great year on the bestseller lists and therefore we are tracking our predictions in that business too.

So that is how 2001 is turning out. Before closing, let me say a few words about how we see our markets are shaping up for next year.

We are not, as we said, planning on any early recovery in advertising. We will face some very tough comparisons in the first half of next year because of our good first quarter this year.

But overall for the year we will be helped by all the work we've done this year to reduce costs across all our business newspapers. For example, the costs base of the FT is going to be 16% lower than it was at the start of this year. And, with circulation still going up, we will be able to increase advertising rates next year.

For Penguin, we think the consumer publishing market is proving resilient, though we don't expect softness in backlist sales to pick up any time soon. Two big things are going to help Penguin next year:

- Firstly, a very strong publishing schedule - with new titles from Tom Clancy and Patricia Cornwell among others.

- Secondly, Dorling Kindersley will return to profitability, following a lot of restructuring and integration work we've done this year.

In Education, we are expecting another good year in our biggest business, the College business, and in testing.

We think it is going to be a quieter year in the school publishing market as we have already talked about. We will get some help from increased federal spending but '02 is a weaker adoption year and state tax receipts are definitely going to be lower. So we are planning for a slight fall in US School spending next year followed by good growth in '03 - and we've got the cost structure of our school business in shape accordingly.

We are also planning that the markets that have proved so sluggish in 01 – technology publishing, Latin America, corporate training –are not going to improve next year. So, as I said, we've been reducing costs right across these businesses fairly aggressively.

And, of course, we've taken aggressive steps to integrate FT.com and Learning Network within our major businesses and the result of that will be reduced costs and increased revenues, cutting losses by some 80 million next year.

So, overall, we are not planning, given the environment, for more than modest revenue growth next year. But with costs in all our businesses significantly lower than in 2001, we are in a very good position to deliver a sharp recovery in earnings next year and to continue to hold the market leading positions that we have sustained in all our businesses this year.

Thank you. We'll be happy to try to answer your questions.