

## Pearson Preliminary Results 2002

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### Q&A SESSION

#### Marjorie Scardino - Chief Executive

I'm going to ask my colleagues to come up and join me on the stage. There's Peter Jovanovich, who runs Pearson Education, John Makinson, who runs Penguin and who is also the Chairman of IDC now, so very hard questions about IDC, please, for him. Rona, and Olivier Fleurot who runs the FT Group. I do ask that you wait until a microphone comes to you because we are webcasting this.

So, who's going to go first?

**Q:** Hello. Good morning. Could I just ask a couple of things? Could you quantify the losses associated with the Family Education Network, which I think you pushed into the core from the internet element of Education?

**Marjorie Scardino:** The losses in 2002?

**Q:** Am I right in thinking that they used to be in a separate internet line, but now they're in the core?

**Marjorie Scardino:** Yes, we integrated all of our internet businesses, and so obviously we would have integrated that into Education. Rona, do you want to answer that?

**Rona Fairhead:** Yes. The total internet losses for 2002 were £59m and £34m of that was in the FT, so the rest was in Education, that would include Family Education Network.

**Q:** And on the second part, the 15 per cent tax rate used within your return calculations. Could you just go through the sort of risks of that exceeding 15 per cent going forward, despite it being at that level over the last five years?

**Marjorie Scardino:** What we did, essentially, is that we looked back on five years. We have some quite significant NOLs (Net Operating Losses) against tax in the US, which is obviously typically a high tax rate regime. That comes from investments we've made, from acquisitions we've made. And if you look at our book, we have a big deferred tax asset sitting on our books, and that gives us a pretty high degree of confidence that, going forward, the tax level for the next three to four years should be at no more than 15 per cent.

**Q:** Just a quick question on the internet losses. Taking into account all the movements that you've made in the portfolio, do you still expect to be able to keep losses down to £20m for 2003?

**Marjorie Scardino:** Yes, go ahead Rona you're enjoying this.

**Rona Fairhead:** I think £20m will be the maximum loss we'll have, yes. Very much.

**Q:** I've just got a couple of questions. Could you just go through your expectations of working capital movements in 2003 and the planned increase in pre-pub' costs will go through ahead of the higher adoption schedules in 2005 and 2006 for this year and next? And then also could you parade down and give us a sense of the profits at International, and how they split between Schools, College and Professional?

**Marjorie Scardino:** I don't think Peter wants to talk about pre-pub' costs, so if you want to go ahead and do this Rona?

**Rona Fairhead:** In terms of the spend, if you look at the press release, we actually break out exactly what International would have been in 2002. So, it's very easy just to do the deduction from Schools, College and Professional, and just spread the international number through it.

**Q:** Not the profits though?

**Rona Fairhead:** No, what we've said is what we want to do is, going forward, we'll give you the breakdown on our three global businesses. So, we haven't given you the profits.

**Q:** Can you give us a sense of how profits are split?

**Rona Fairhead:** My sense is that we've given an awful lot more information than we've ever done before. The difficulty with our International businesses is it's all about trading terms and where you allocate costs. At one level, it's not hugely meaningful to decide how to allocate those costs. So, my

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sense would be just to assume that they are slightly lower margin businesses than we have in the US, which is a large market, but we're not going to give the further profit breakdown.

**Marjorie Scardino:** I think there are a couple of things you could also say. There are the two big parts; the Asian business, which is the School and the LTD business, and the Latin America business. A part of our agenda was to break even in Latin America, and we achieved that. And the Asian business does very well. Pre-pub' costs?

**Peter Jovanovich:** I think obviously 2002 was a very strong cash year, as far as Education is concerned. So the target that we've set, which was in the mid-80s is probably more appropriate going forward. Even though there's a surge coming in 2005-2006, I don't want to exaggerate its impact. Over the cycle, actually the spending stays relatively the same and so on. So for example, even in 2002, we had a lot of spending related to social studies, for example, which is still over 90 per cent cash conversion. So, I wouldn't model too much in terms of a big ramp up of spending in 2005 or 2006.

**Q:** Peter, the question I have for you firstly would be I notice your new adoption numbers are a little lighter than people expected. People think its about \$100m or so in adoption opportunities; you've had \$20m to \$30m. So I wonder if you'd be brave enough to venture what you think the market will do overall this year? Secondly, is there any more lumpiness in your Government Solutions business that we should worry about for 2004? Are there 2003 contracts that would come off in 2003? That would mean 2004 could be slightly down as well? And then for Rona, FT Knowledge, it's always made losses in the past. How have you gotten rid of some businesses? Will they be break-even, profitable on their own with what's remaining today?

**Peter Jovanovich:** My guess about the market for School business in the US is it'll be up somewhere around 0 to 3 per cent. We're more optimistic than that, as far as Pearson's results are concerned for a couple of reasons. First, we won most of the business in California in the testing side of the business. There were three major contracts up, we won two of the three. Our partners, by the way, in winning those businesses were two non-profit enterprises, Educational Testing Service and ACT. As far as stated option is concerned, Texas comes first and there's more news coming out of Texas right now, so we're on a firmer basis in terms of predictions there. And it's evident that we're doing quite well as far as Social Studies is concerned. This is important because, as Marjorie noted, we've been out of this market for a decade. So, it certainly wasn't assured that we would do extremely well. There's a lot of buzz in the industry right now as to how well we're doing and how other people are doing. So, curiously enough in this instance, if you call our competitors, they'd give you a pretty accurate prediction.

**Marjorie Scardino:** Yes, do that. Would you?

**Peter Jovanovich:** Seriously, we all know there are no secrets and everybody knows how everybody's doing. Florida is coming in a little later. We seem to be in good shape there and so on. But I think as far as Pearson's results are concerned, the big issue is Social Studies. Out of the market for a decade. How are we going to do? It looks, as well, the only other Social Studies adoption is in Indiana, and there too I think we're doing quite well. As far as lumpiness of the business is concerned, I think the big lump was TSA. The other contracts we won in 2002, they kick-in in 2003, are multi-year contracts. So, no, I don't foresee a decline in sales in 2004.

**Marjorie Scardino:** Rona do you want to speak about FT Knowledge?

**Rona Fairhead:** Yes. Essentially these businesses are close to break-even. So, if you're thinking of modelling, it could be small single-digit losses at most.

**Marjorie Scardino:** They're pretty small businesses as well.

**Q:** I've just got two questions, first on the education, then on the FT. Just to simplify what you've said if you can, because I didn't quite get it on the Professional Education side. It seems there are some pluses and minuses. If we start with the minuses. Could you quantify exactly what the fall-off in terms of revenue - and I'm assuming sort of double-digit 10 per centish margin from the contract business. You're losing £300m, but we know there's some coming though. So, what roughly is that effect offset by? You talked about the investment in Testing Centres, though you didn't quantify it. How much

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money would you have invested in that during the year, which we can consider recovered? So that was the first one.

**Marjorie Scardino:** Let's just take them one-by-one. Why don't I take the fall-off. As I said, it's a \$300m contract. We already had \$300m of contracts that'll start in 2003. We have a big roster otherwise and a lot we're going for. So, you can figure out if the average life of a contract is just under four years (actually it's more like 3.4 years). Then that's sort of how it's going to go in the Government Solutions business. I can't give you the precise number obviously. And then we had some more contracts that were already ongoing, but they won't be able to fill adequately, probably, that big spike for the TSA, \$300m in a one-year contract isn't something that happens every day. These are mostly multi-year contracts. Do you have anything else to say, Peter, on the cost of the Testing Centres?

**Peter Jovanovich:** It was nearly all expense in 2002. We only opened them in November. So, I would say the losses from the testing centres will fall by 50 per cent in 2003. Part of the problem with the Professional Business, is that it has got so many businesses in it. We have some Latin American Professional business. We have the Technology Publishing business, and so on and so forth. It would be a pretty complicated diagram if I tried to work it out for you. I think we've given you an awful lot of information. So, I don't think we're going to work on all the ins and outs, and so on and so forth. But maybe the easiest way to understand our enterprises is that we're going to be flattish in Professional. We'll have a strong School year and we'll have a strong College year in 2003. That's the best way to look at it.

**Marjorie Scardino:** Now, you had another part?

**Q:** The FT Newspaper, can you just clarify, I think what you're saying is basically the fixed cost level will be pretty stable. What you are going to get through on a full year basis you are going to reinvest. Does that mean, then, that you're really looking, all else being equal, at the business losing for the full year about £5m?

**Marjorie Scardino:** I didn't mean to, if I did. It's possible I did say that everything that we're going to get through we're going to invest. We've just had some incremental new identifications we've made, and we'll spend that. It's a very, very modest investment, so I don't think it'll rise to the level of it. But to predict the loss in the FT, I think it would probably be a mugs game at the moment. But we think it's under control, barring unforeseen circumstances.

**Q:** The MMS data suggests that your business was down in volume terms 30 per cent in January. You said it was 5 per cent to 10 per cent short of what you were expecting.

**Marjorie Scardino:** That was the revenue.

**Q:** Yes, volumes were down, according to MMS 30 per cent. So, I wonder if you could give us a little bit more detailed colour about that, whether that's true. Obviously, if it is, is it still likely that you would go ahead with investing in the UK?

**Marjorie Scardino:** As I said, the investment in the UK wouldn't even pay your coffee bill, probably. So, I wouldn't worry about that... but you wouldn't drink that much coffee, probably.

**John Makinson:** Yes. I think Marjorie mentioned the volume decline related to the second half of last year. I guess the MMS is a year-on-year variance. And January is usually a very, very low month. So, I think it's not typical. It's certainly not typical of what we saw in February and the bookings for March.

**Q:** Your business in Government Testing is obviously doing very well, but it doesn't really have too much to do with the core media businesses that you spent a lot of time and effort focusing down on. Does it really fit in well with what you're trying to achieve with Pearson? Or is it just like something that you got by chance, you picked up NCS?

**Marjorie Scardino:** It certainly was a part of NCS, definitely. It was a promising business. But the interesting thing about this business for us is that it does two things that are fundamental to our conception of what services we ought to be able to add to the kind of educational content we have. That is it does testing, and it does training. And it does large-scale data management, which we have

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to do for schools if we're going to achieve the vision that we've got for it. So, it really does use all of those fundamental skills that we've got. I don't know if Peter wants to expand on that?

**Peter Jovanovich:** There's a financial impact as well, which is that leverages off of the data centres and some of the core operations elsewhere in NCS. So, there would be diseconomies of scale if we sold the business.

**Q:** Who are the main competitors, and just a little about the dynamics of that business because I don't know it that well?

**Peter Jovanovich:** The main competitors have grown because everyone has figured out that the Federal Government is the one that's spending money. So, it's everyone from large companies such as Accenture to hundreds of companies you've never heard of. We seem to have a particular niche, in terms of our ability to handle both paper and online. And the reason why we're in this niche and why we have this capability, of course, is because of what's happening in testing is, it's moved from paper to online. So, we compete with a lot of online companies. We appear to be one of the few that can handle this transition. And because of the fact that the Federal Government is indeed the Federal Government, they're not in a position to say to the customers: "I'm sorry, if you want to hand in your form in paper we're not accepting it, you have to do it online". So, paper's going to survive a long time, and they're going to look to companies like Pearson because of that expertise in this particular market.

**Marjorie Scardino:** In fact the reason we got the TSA Contract, mostly, is because we have a particular technology called Quickscreen, where we could run through 150,000 people and test and certify 64,000 of them. That's something unique we've got that all these competitors don't have in the same degree.

**Q:** Thanks, could I ask a couple of questions? Firstly on NCS and the Schools Testing. Were you disappointed by that 3 per cent growth rate. Could you give us a sense of outlook in terms of the growth rate for 2003? And the second question is on IDC. You're very confident on this double-digit growth at IDC?

**Peter Jovanovich:** Testing actually has some cycles, just the way textbook adoption cycles do as well, by the way. So, there were actually fewer opportunities in 2001 that led to 2002. The states are now starting to gear up in order to meet the 2005-2006. So, what we're starting to see is a number of states having to essentially fill in grades. Remember, the law says you've got to grade grades 3 through 8, every grade in math and reading. There are a number of states actually that do just grade 3 and grade 8. So, what we're starting to see is this fill-in business, and so on and so forth. My expectation is that our Testing business will grow within the 5 per cent to 10 per cent range in 2003.

**Marjorie Scardino:** As I said, we renewed a lot of contracts and we got a lot of new state contracts. So, we upped our market share. You can't be unhappy about that. It's just that a lot of those revenues don't begin to come through until the test contract starts, which will be in this year. So we are happy. IDC?

**Q:** In IDC, what's happening to your customer profile?

**John Makinson:** Well they're confident, mostly because the business is fairly predictable. As you know, a very high proportion of the business is on an annual renewable contract cycle. And while those contracts are phased through the year, there is a seasonal bias towards a calendar year-end. So, as you begin the year, you have a pretty high proportion of your revenue effectively locked in for the forthcoming 12 months. What we have done is make some, I think, fairly cautious assumptions about renewal rates for 2003, relative to the 95 per cent figure that Marjorie was quoting earlier, and also made some fairly conservative assumptions about take-up rates on new products, particularly the Fair Value Pricing product. But having done that, we still come out feeling reasonably optimistic. The main reason for the optimism is that, although we are clearly subject to the same pressures as Reuters and Bloomberg and others, a lot of the products within Interactive Data are regulatory pricing. And so there are issues about competitive offers in the market, but these aren't prices that mutual funds, for example, can do without. There is a regulatory obligation for them to provide future prices.

**Q:** Just a couple of questions on College, if I can. Thompson have made some quite confident comments about their ability to effectively recapture some share in 2003 through revitalising the old

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Harcourt titles. What's your view on that? Secondly, in terms of the 2003 market growth in Colleges, do you just want to give us a feel for sort of volume against price within that?

**Peter Jovanovich:** I cannot really speak to their confidence on how they are going to do.

**Marjorie Scardino:** What about the old Harcourt titles?

**Peter Jovanovich:** The old Harcourt titles. I do think they're going to be helped by the fact that one of their officers was just appointed to be Chairman of the Council of Economic Advisors. But knowing academia's view of George Bush, maybe that won't help in any case. So, I can't speak to that. I'd say that I think the market will be up in the 5 per cent to 7 per cent range, and I think we'll gain share in that market. And the other question?

**Q:** Volume against pricing?

**Peter Jovanovich:** Volume against pricing. Interestingly enough, this is the first time actually that, I think it's one of the reasons why it was such a strong year, that the ratio - at least our pricing was pretty modest; it was about a 3 per cent increase, something like that. So, most of it was unit, and we did it primarily for an awful lot of combination of products together and so on. So I was particularly pleased, not just with the 14 per cent - we all were pleased with the 14 per cent increase - but that so much of it was driven by unit increases. And the second point that Marjorie made, which I think is very, very important, is that, in fact, we actually improved our performance against used books. And that's probably the first time in a quarter of a century? So, that's part of what drove our business.

**Q:** I've got a couple of questions on the Education side. On the College business, could you confirm that the 14 per cent is as measured by AAP (Association of American Publishers)? Secondly, more a longer-term issue with the College market is that a lot of the cuts by states are in the College area. Do you expect that in the longer-term it'll have an impact on the increase in used book sales in that business? And maybe a follow-up question on the K12 business. We had one bad year in K12. Next year's probably going to be flat. What is the long-term outlook for this industry with increased pressure on state budgets?

**Peter Jovanovich:** Actually, in terms of our data, we do use AAP, but there's something else called Management Practice. And Management Practice is a non-profit group that is essentially sustained by the six major college publishers. We all submit our data to Management Practice, and the reports that come out of Management Practice, Thomson relies on them, McGraw Hill relies on them, etc. etc. They tend to be the most accurate and they're in greater detail, and so on. All publishers got together about a decade ago and said we need better data than AAP, and so on. So that's Management Practice. So, if you speak to McGraw Hill and Thomson, they use the Management Practice data, and so on. So, those numbers are driven by Management Practice. Your second question was?

**Q:** The longer-term outlook in College.

**Peter Jovanovich:** The longer-term outlook in college. Obviously, after the huge year that the industry had, and the spectacular year that Pearson had, I don't think that this year, 2003, is going to be as strong. Yes, I do think there's some cutback in the number of courses given in community colleges and there are other issues as well, and so on. But the long-term trend is that it's still a very strong business in the 6 per cent to 8 per cent range, something like that. I just don't see American parents thinking that a college education is going to be any less valuable than it is today. And your third question was?

**Q:** The long-term outlook indicator of the K12 market?

**Peter Jovanovich:** Long term, I think the recession bit in the fourth quarter of 2002, for example, the postponement of that major software sale we had; it was directly a consequence that. Also, things kind of freeze. I think those will be affected on 2003 as well. That's why I think the rebound, which is 0 per cent to 3 per cent plus, would have been stronger under different circumstances, and there may even be some lingering effects in 2004. On the other hand, this NCLB issue is just enormous. Essentially, George Bush has federalised the educational enterprise in the United States. I'll give you a good example. New York City is in a budget crisis. I'm sure you're aware of that. Nevertheless, during this budget crisis, they announced they are going to go out and spend \$30m on new math books. Now we're particularly pleased; we are going to get about \$12m out of that. So, if

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Mr Bloomberg, who is facing a \$4bn budget crisis, can still go out and say "I'm going to buy new math books for every child Grade K through 12," something's going on. Now, what's going on is the fact that testing is increasing and, therefore, they've got to show results.

**Q:** Thank you. Two quick ones. One, have we seen the last of the back office integration charges? And two, your overall comment that revenues in Education might fall. That's obviously in reported terms. That's a reflection of currency, rather than anything else? Just to be absolutely clear.

**Marjorie Scardino:** I didn't hear the first part of that.

**Q:** Your comment that overall Education divisional revenue would be slightly down. Presumably that's a comment about reported terms rather than underlying?

**Marjorie Scardino:** Yes. What was your first one now?

**Q:** Back office.

**Marjorie Scardino:** About the back office. We did say we had \$30m, and we'd have another \$20m this year. And then we'll begin to see the results come through.

**Q:** A couple of questions. Firstly, just on the FT circulation and your attempts to correct decline. You comment that a lot of the fall had come through in the UK, but it looks like, more recently, there has been a bit of a decline in circulation in the US. I just wonder if you could comment about some of your attempts to push up that editorial content in the US, and perhaps how much that would cost you? The second was just on the sale of Forum. I think you said the loss on your sales from Forum Group was £40m. I think if you bought that in 2000, and just remind us, was that for about £60m? Just wondering if having bought it at the top of the cycle, are you confident that you're now not selling it at the bottom of the cycle? And just lastly, there was also the comment you made about Technology Publishing changing somewhat. Was that a reference that this is perhaps, despite your number one position there, an industry that you don't regard as being attractive going forward?

**Olivier Fleurot:** In the US, we are clearly, on the editorial side, refining the relevance of the US edition. As far as the circulation is concerned, we had - if you compare the first half of this year with a year ago - we started at a lower level, but we're going up again. Our plan is to have a slightly higher average circulation in the US this year.

**Marjorie Scardino:** Are you changing editorial content to make that happen? Is that going to cost you money?

**Olivier Fleurot:** No, we don't have big plans. It's more refining the content. We don't have big plans in terms of new supplements in the US. At this stage, we're working on the quality of our circulation, investing in more direct marketing. But apart from working on an ongoing basis - we have a very high exposure in the US media. Our journalists appear very often on radio and on TV, and we're working on that to make sure that the visibility is even higher.

**Marjorie Scardino:** That's free because their ego's like that. So, you don't have to give them a pay rise if they can get them on television. That's our strategy!

**Olivier Fleurot:** I didn't say that!

**Marjorie Scardino:** Rona, do you want to say a word about the Forum sale.

**Rona Fairhead:** Yes, the FTK, I mean, clearly it's not a great story. But this £40m is essentially the goodwill that we have written off and, therefore, it's essentially a non-cash charge. The option was do we continue to run a business that doesn't fit within the rest of Pearson and potentially see further losses or further cash drain. We decided that this was the right thing to do. The businesses that we've kept are good businesses, and I think they will be boosted by integration into the FT Group and into our Government's Solutions business.

**Marjorie Scardino:** Peter, do you want to talk about the future of Technology Publishing?

**Peter Jovanovich:** These are extraordinary times. As you know, we're the world's largest. Fundamentally, our writers and our readers are the same people. They're people who work for technology companies, which is not a good thing. We're the largest in the world. We've never seen a technology recession like this. It started in the fourth quarter of 2000. The Technology Publishing

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business has had downturns. Even busts before, they always lasted somewhere around a year, 18 months. We're now two and a half years into this. But given we have a number one market position, we do the best we can to cut costs, and so on. What will happen is that eventually the industry will revive, God willing. And they will come out with new products that will get people excited, and so on. We're in the ideas business; that's what we're doing. Right now, other than Linux, there's not a heck of a lot out there that's terribly exciting. So, it's a number one position. I think we do the best we can in these circumstances. But like everyone else, whether it's investing in technology companies or publishing for the people you work for, then this has obviously been a difficult period.

**Marjorie Scardino:** I think also what we're referring to is that part of our Technology business, in fact the part that is 'Teach Yourself XML', the kind of graphics publishing and sort of personal computing is doing pretty well. So, we just need to adjust our list and make sure we're catering for that market.

**Q:** Concerning the Professional Education business and the Testing Centres, you mentioned that they effectively came on in November last year, and yet you're expecting a fall in the costs by 50 per cent. I just wonder whether you could expand a little bit on the profile of costs there? And the second question was just on the Enterprise Software business within US Schools and how you expect that to develop over the next couple of years, and what's happening from the competition?

**Peter Jovanovich:** Well, our costs at Testing Centres are the same whether or not there's someone in them or not. So, as we've fitted them out all over the United States, we didn't have anybody going through them. So, now that the nurses have started and now the pathologists have started going through them, and so on, that's why the loss is diminished.

**Marjorie Scardino:** Enterprise Software.

**Peter Jovanovich:** Enterprise Software face actually the same circumstances that Enterprise Software faced in corporate America. Superintendents froze, in the beginning of last year thinking, do I want to invest in a major new system, and so on and so forth. And I think there has been a delay in terms of purchasing. On the other hand, because there are reporting requirements at NCLB, they are going to have to change the systems that they invested in, in order to meet those needs. The competition is all over the place. There are large companies, small companies and so on. We tend, I think, to focus on some level of educational content within our products because I think that's our core advantage. So, for example, in Concert we already offer about 40,000 test items. That's not something that you can get from IBM or Accenture, for example.

**Q:** You gave us figures just for the swing in the adoption cycle for 2002 and 2003. And I'm wondering if you can give us a feel for, as we build in total for 2005 and 2006, what you'd expect the adoption swing is going to be? Just a sense because I know what you'll say, it's not budgeted yet.

**Peter Jovanovich:** 2004 will be flattish, and then 2005 and 2006 will be the Mother of all adoption years.

**Q:** Two questions. The first one, your return on invested capital and what you think a reasonable target might be. And in perspective, if you return to your peak level of operating profit, which was in 2000 when FT was doing pretty well, you've had a return on capital of about 8.4 per cent, which would kind of suggest that you'd need to get significantly beyond your 2000 levels before you were returning a decent return on capital. And the second one is on Education. As one goes through these statements, they're beginning to come up with the phrase, we're not necessarily improving our education budget this year, but if you look at our spend per pupil since an arbitrary date like 1995, and say our spending has increased by X per cent annually for the last five or six years. Are you a little bit worried that the spend per pupil, which has been the big driver of schools growth, is actually beginning to lose its political momentum even while the Federal attention to schools is there?

**Marjorie Scardino:** Good question. Rona, do you want to take that ROIC?

**Rona Fairhead:** I think if you look at the ROIC, as you said, there are two levers that we'll be pulling. One is the operating profit and the other one is the operating assets. And clearly we'll manage the operating assets pretty hard, but it'll be on the operating profits that we'll really move the dial. And in terms of the operating profits, it will be dependent a little bit on how the ad recession returns in business newspapers. Yet we are confident that the rest of our business, if you think about the growth that's been created in the Penguin business, the growth that underlies our education profit,

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then those two alone will make a significant further improvement in our return on invested capital. If you said, our WACC is somewhere in the just under 8 per cent, say 7.8 per cent, I mean you'll probably all have calculated it yourselves, but around that sort of level, we are targeted firstly to get beyond it and then move it further on. We're saying that in terms of the speed at which we do that will be somewhat dependent on the advertising recession. But we're pretty confident that we have quality businesses in Penguin, in our Education businesses and in the non-business advertising related part of the FT, that we should start to see some quite significant operating profit uplift.

**Q:** The number I was giving you, that would take you back to the period when the FT was at its full profitability. So, we've added back to the advertising downturn. And in fact we've put it at arguably an unrealistic peak in 2000, using the 686 number, which brings you just over your cost of capital.

**Rona Fairhead:** But what about the rest of the operating profit improvement from the rest of the business? I mean, that's what I'm saying, is that you're focussing exclusively on the FT, and you're saying, can you get from zero back to the £100m of profit that you lost. And what we're saying is, we're not saying, standing here today to say that we are expecting to get back to that 2000 peak any time soon. But what we are saying is that the operating profits from the rest of the business, the growth is strong and that is where we'll see it. And if we get help from the advertising recession, then that's even better.

**Peter Jovanovich:** The way to understand per-pupil spending is simply this: look for the testing. A great example is going on right now in Texas. I mean the market was terrorised by a couple of articles coming out of Texas. Texas was going to cut its spending, and so on and so forth. And those reports went out and everything else. And yet the Department of Education in Texas said, if we have to cut spending, we will not cut spending on any textbook purchases or products on subjects for which there will be a test. I mean that's it. So, if there's more testing, more books and more software get purchased. You've got to remember that school revenues and budgets etc., boomed in the 1980s, and we didn't see actually as much of an increase in purchase of textbooks. The answer was it was actually during a period of anti-testing. Remember the whole authentic testing movement – tests are bad for children etc. So, when only 1.5 per cent of the schools' spend - and this is sort of a poor man's Johnny Cochrane - but what gets tested, gets taught, gets bought. Okay?

**Q:** Persisting a bit with the testing thing. In future is the, are the states where you win the adoptions in publishing going to be the states in which you're successful with your testing-type products? Secondly, with testing, have you saddled yourself with a high fixed cost base in what's going to be a lumpy business? And thirdly, you seem very confident that spending on schoolbooks etc., is nowhere near the issue that people have made it out to be, but you do seem to be implying that there'll be state budget pressures somewhere in the educational business. I don't know how hypothecated the state education budget is, whether you have to spend so much on teachers, so much on school buildings, so much on textbooks etc., etc. But perhaps you could give some reassurance on that?

**Peter Jovanovich:** Yeah. Categorical funding. Obviously, there's a budgetary impact, otherwise the industry would be up more than 0 per cent to 3 per cent in 2003. So, I'm not wildly optimistic. In normal circumstances, we'd be talking about 3 per cent or so better than what we have seen. Yes, it's having an impact, but nevertheless I do see an increase.

**Marjorie Scardino:** Are we going to be successful in testing in states where we're successful in adoptions?

**Peter Jovanovich:** No, there's absolutely no relation. Believe it or not, there's much talk about an all-industry Chinese Walls. The one that's really truly a Chinese Wall is in testing and textbooks. We don't fiddle at all, there are state laws, I can go to jail or close to it, by mixing my testing and my textbook business. So no, there's no leveraging, there's no synergy, there's no talking. There's not even any winking about talking, unlike some other industries which some of you may be familiar with.

As to the question of having a large cost base, I think Pearson, the reason why we're doing well in our testing business is the fact that NCS had a very large installed base and a business. And we've got a million square feet in Iowa City. We've got testing centres in 14 states just related to school testing. I think that's what's giving us our advantage at the moment. I think the cost-base issue probably will be greater for a company like Thomas Lee, which just bought Houghton Mifflin, where they've got, I think, maybe just two state contracts, where they've got to build out a million square feet of testing space,

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they've got to buy all these scanners, and so on and so forth etc., etc. I think the cost base for us works as an advantage, it doesn't work as a disadvantage.

**Q:** Perhaps I should have asked the reverse question. Are you actually excluded from having testing centres in adoption states?

**Peter Jovanovich:** No we're not excluded; we're just extremely careful. But, so we have the Texas contract, for example, we're the prime testing vendor in the state of Texas. We have a few sub-contractors who work for us etc., etc. And at the same time, we're going to have very good results in Texas. What we're very careful to do is ensure that the two sides do not talk to each other. Now where there is some level of synergy is more related to the data business, which is the state of Texas and the state of New Jersey or Washington where we have a contract, for example. It's also saying, all right, you're doing all this testing for us, now we need to manipulate this data in order to figure out how to comply with Federal requirements etc., etc. Where we do see states moving in saying, you've got the testing business for us, can you help us now, since you create all this data for us? Help us manipulate it, use it, in order to improve instruction. That's where the synergy is. But no, there's actually none between testing and textbooks. It's testing and software. That's how it works.

**Marjorie Scardino:** Any other questions? We've satisfied all your questions? Thank you all very, very much for coming, as usual, if you have specific questions we'll try to help any way we can. Thank you very much.