PEARSON DECEMBER TRADING UPDATE 13 DECEMBER 2002

Conference call script

Good morning. Thanks for joining us today. I'm here with our CFO Rona Fairhead, and I'd like to go through the key points in the trading update we issued this morning, and then we'll be happy to answer your questions.

We have four headlines today:

1. First headline. We are going to deliver the strong earnings recovery we promised a year ago, even though this has been a much tougher year for business advertising than anybody predicted.

   We'll reach that level of earnings growth partly because we've moved our internet enterprises toward breakeven…but also because of the strength and resilience of our other core businesses that are not advertising supported.

2. Second headline. We're starting to produce the returns on our major investments
   - Simon & Schuster is now earning a good return, above our cost of capital.
   - NCS is well ahead of the targets we set at the time we acquired it.
   - Dorling Kindersley is back in profit, and back to its publishing best.
   - FT.com has reached breakeven and we're confident it will go on to make a good return on the investment we made in it.

3. Third headline. We're making good progress on managing our working capital and free cash flow. (I'll talk more about that later.)

4. Fourth headline. Looking ahead to next year, we expect another strong improvement in earnings, cash and returns, even though – I want to stress this – we're not planning on an advertising recovery.

I'd like to take a few minutes to look behind these headlines to the performance of each of our businesses in 2002. We have two weeks to go but we have reasonable confidence about what we have to tell you.

1. Starting with the FT Group:

We said at the half-year that, if advertising continued at current levels, the FT Group's full-year, pre-internet profits would be down some 10-15%. Actually, advertising revenue did not hold in the second half – it's down by some *8%* on the first half – so the full-year profit decline now looks like it will be in the 20% range (before the benefits of reduced internet losses).

Obviously, this has been a difficult couple of years in the newspaper business. But it's at this point that it's important to be clear about our philosophy towards the FT's operations.

As you know, business newspapers are cyclical, and we reap the great rewards in the good times. In times like we're in now, we think there are a few important rules about publishing great newspapers we must hold firmly to:

1) Never compromise the quality of the product.

We've done our best to protect our editorial integrity and spending, which I hope you see in the quality of our journalism. In coverage from the Middle East to China; from corporate reform in the US to public service planning in the UK, we have had some great stories this year and kept our nerve in some assaults on our independence and we think that's fundamental.

2) Maintain premium pricing if you have a premium product.

Over the last two years, we've continued to improve our yield on advertising. While volumes are down 46% from their 2000 peak, ad revenue will be down less than that, at 39%.

And, in fact, total revenue for the paper is down less still because our circulation revenue has held up better.

3) Manage the costs.

The cost base of the FT's total publishing operations, which are now completely integrated, is some 25% lower this year than it was in 2000 and that's been very important to how we run the company.

4) Know when to invest.

We eased off spending on growth in the last two years, but next year we'll make some modest increase in investment in our important regions, both to push our quality and to take competitive advantage.

The FT group is not made up of just the business newspapers, however. Overall, the FT Group's profits will be slightly up this year because of some of its other businesses:

a. IDC, which you know about, is continuing to grow its top line thanks to increased business and to the successful integration of acquisitions. It's also investing in some exciting new products which make us confident that it can keep up its consistent growth performance.

b. Recoletos, our Spanish business, is benefiting from the successful relaunch of its flagship sports newspaper *Marca*, and an aggressive cost reduction programme.

c. Losses are lower in the FT Group's internet businesses. As I mentioned at the beginning, FT.com has met its break-even target.

Moving on to book publishing – the vast bulk of Pearson's business:

2. Penguin is on track for double-digit profit growth

While our financial newspapers are suffering in the worst advertising downturn for 30 years, book publishing is proving pretty resilient. As you know, we ask a lot of Penguin in the second half, and though we still have a couple of big weeks of Christmas trading left, we're comfortable with the outlook we gave for Penguin at the half-year – that is, we're expecting double digit underlying profits growth.

3. In Pearson Education, there are several headlines:

a. It has been, as we predicted, a slower year for school education.

We have consistently made conservative predictions about the growth in the US school market and our US school business for this year, and this has proven correct:

i) We've said it would be a quieter adoption year in general, and an even quieter one for us. We were participating in only 65% of the adoptions, though it's important to note that in those we've participated in, we either increased or held our market share.

ii) Our testing business will be up a bit, and has won an array of important contracts such as California and the only national test of progress, the NAEP test.

iii) Our software business is down, mostly because one or two large contracts we hoped to close before the end of the year have been pushed into next year.

b. Our international business is strong in school and college, but still continuing to suffer from the downturn in technology markets which affected our US professional publishing business last year and continues to affect it this year.

c. The final point I'd make on education is that the remaining two parts of our education business will be real star performers this year:

i) Our college business is roaring ahead

For the full year, the US College publishing *market* will be up 8-10%. We expect to do better than that. This year, we are seeing the benefits of investment in our frontlist; in online applications, some sold with our College textbooks; in custom publishing, in which we're the leader; and in moving our older Addison Wesley Longman up to the level of performance of the standard-bearer, Prentice Hall – which we have done.

ii) NCS is beating all expectations

At the time of our half-year results, we predicted 15% revenue growth at NCS this year. It now looks like it will be at least 40%, with profits growing even faster than that.

NCS is ahead of the targets we set at the time we acquired it. Even though its software business has been slower to develop, its potential is greater, and we are still confident that it will help us deliver our vision of integrated learning.

Meanwhile, we're delighted that the Government Solutions business has helped bridge the timing gap. As the US government begins to outsource a large portion of the people-related tasks it performs, this is a great market. It can come in spikes, but recent multi-year contract wins have given us a steadier, more predictable and long lasting revenue flow.

iii) And we have one other big advantage this year:

We are the largest book publisher in the world and this year we've made even more headway on capitalising on that.

We've combined our consumer and educational publishing operations in Australia and Canada and we're moving ahead with the consolidation of our warehousing and distribution in the UK. We're also moving all our information systems onto the newest version of SAP - SAP

4.6 - which will bring us big benefits both in terms of customer services and our ability to manage working capital.

These moves will cost us about £50 million in total, but that investment, which is entirely expensed in our P&L, will be paid back in three years and give us advantages no other book publisher can match.

Finally, we are on target for our planned improvement in the use of working capital in the book businesses – where it matters the most. In those businesses, the working capital to sales ratio will improve by more than one percentage point – even though we have invested more in authors and programs.

In the group as a whole, we'll fall short of that 1% target simply because the FT is a net contributor of working capital and its fall in revenue hurts the average. Our user of working capital - and where we have applied our efforts - is the book businesses.

Looking ahead to 2003:

1) Overall, we expect another year of strong earnings growth.

2) We are planning on the basis that there will be no advertising recovery at our business papers, but we'll be making sure we're ready when the recovery does come by making some investments in growth.

3) We expect Penguin's markets to continue to be resilient. Once again, we see Penguin performing better than its peers through stronger publishing and further progress at DK. We'll also start to see the benefits of DK's creative collaboration with Pearson Education as we publish our new program for Texas social studies, which is the single biggest adoption opportunity in 2003.

4) In fact, a better adoption schedule overall will help the school publishing market return to growth – albeit modest growth – and we'll be going after a bigger slice of that market – about 85% of the available adoption dollars, versus about 65% this year. At the same time, our school testing and software businesses should start to benefit from the influx of new federal dollars into the market. We're expecting our college business to have another strong year; and though NCS faces some tough comparisons, we think it's in excellent shape to sustain the momentum it has built this year.

5) Finally, we'll also benefit from another steep reduction in the losses of our internet businesses, which we expect to be less than £20 million next year.

So, in total, we are planning for only modest underlying revenue growth next year. But, once again, we expect earnings cash and returns to continue to improve in 2003.

Thank you. We'll be happy to take your questions.