Pearson
Preliminary Results 2004

Marjorie Scardino
Chief Executive Officer

Thank you everybody for coming out; I hope you do not mind coming to our place. It is cheaper first of all, and it is better food I hope you think. I know you probably know who I am and I will introduce some of my colleagues later on, when we get to question time, so you can fire some questions at them.

I do want to acknowledge one of my colleagues; our Chairman, Dennis Stevenson, who is sitting here on the front row, quietly [indiscernible] like he usually does. I usually don't pay a blind bit of notice to Dennis if I can help it, but since we announced yesterday that Dennis is going to be stepping down, in case you missed the news report, I thought I ought to show him a bit of respect for once.

He's really got too old to be any use to us any more. He's entering his 60th year; that sounded really, really bad, and almost his 20th year at Penguin. So, we have all been talking for a while about this and decided this would be a good time to put him out to pasture. I just want you to know that he is here so that you can be formulating your very tough questions for him, for the end of the thing.

Getting down to business, we have got two big messages today. First we said last year at this time that we were going to make progress on all our main financial measures, and we did do that in 2004. Our earnings are up 5%, free cash flow up 50% and our return on invested capital has gone from 6.3% to 6.6% at constant currency. We always said that was going to be our hardest measure, and we are proud to have made progress, especially on that one.

The second message and probably the most important one today, is the intensity of our confidence that Pearson is going to increase our earnings strongly as expected in 2005 and for the next few years after that. We have some very concrete reasons for that, which we are going to spell out to you in the rest of the presentation. They really amount to three things.

First over the last seven years we have worked hard to build a strong company. It is centred on publishing and related services, it is made up of businesses that all have similar attributes, and they all are leaders in their field. Through the period of a downturn we worked very, very hard on this company. We have taken costs out, we have improved our efficiency and we have made improving efficiency a part of our everyday lives.

So we really think we are a strong and fit company, now we are confident we are entering a time when we are going to see the benefits of that work. The composition and efficiency of the business is aligning with our more buoyant markets, and that is going to give us accelerated growth for several years, and that is why we are able to predict our earnings are going to grow strongly and in line with expectations. That is also why our Board has voted to increase our dividend by 5% to

25.4p. That is the 13th straight year that we have raised our dividend above the level of inflation, and we are pretty proud of that record.
So, Rona is going to give you some details about what we did in 2004, and then I will come back and talk about 2005 and beyond.

Rona Fairhead

Chief Financial Officer

Thank you Marjorie, and good morning. Here are the financial highlights for 2004. Once again, our reported numbers are significantly affected by currency movements which reduced sales by £302m and operating profit by £51m in 2004.
In underlying terms, sales and operating profits for our continuing business, that is excluding Recoletos, were up 3% and 7% respectively, with growth in Education and the FT Group more than offsetting the difficult year in Penguin.
Adjusted earnings were up 5% and cash was well ahead and it would have been ahead even without the TSA payment which we received in full. Our operating cash conversion was 93% and our return on invested capital was 6.2% as reported, but that is up 0.3% to 6.6% at constant currency.
What I would like to do is take you through the performance of each of our businesses in 2004, starting with School.
In School sales were flat and profits were up 2%. As expected the breadth of our School business helped us grow profits in an unusually weak year for new US adoptions. We were number one in new state adoption business with 27% of the total market and 30% where we competed.
We also achieved good growth in our open territory and supplementary publishing businesses, benefiting both from the improving state budgets and the restructuring moves that we made in 2003. In the major new adoptions we were number one in Maths and number one in Texas Biology. This gives us confidence ahead of the expanded opportunities in 2005. As expected, sales were down a little with margins a couple of points lower as we continued to invest ahead of the big years that are coming.
Our US School Testing business grew sales in the mid single digits and picked up another $150m worth of new or follow-on contracts, including Tennessee, New Jersey, and California. Our digital learning business sales were slightly lower, but we saw a further profit improvement as we focused on a tighter portfolio of products and considerably reduced our cost base.
We had another strong year in international school markets, where we are starting to reap the fruits of some management changes which were made in 2003. We saw growth pretty much everywhere with gains in Canada, Hong Kong, Malaysia, South Africa, UK and mainland Europe, with particularly strong growth in testing and English language teaching.
Turning now to Higher Education, this business continued its stellar record. US sales were up 4%, which is more than 2 percentage points ahead of the rest of the industry. That is for the sixth straight year of above market growth. These consistent share gains are the result of our leadership in both technology and in customisation. Today 70% of our Education sales have an online component, and almost three million students, that is around 20% of the entire US population, are studying with one of our online programmes.
Our margins were down slightly as we continued to invest behind the rapid growth in career colleges publishing new programmes in subjects such as allied health, teacher education and graphic arts. Margins were also slightly affected by the slightly higher growth in our International

businesses, which grew 5%, but even in International margins improved as we benefited from the moves to make the best use of our international scale. For example we are sharing more technology now and more back office functions.

Now Professional; our Professional business showed good sales and profit growth. It really was a tale of three parts. Government Solutions had a great year with sales up 25% and profits well ahead as we started to see our 2003 contract wins build up. Profit growth was also helped by the absence of TSA close out costs, which we incurred in 2003.

We secured a further $500m of new contract wins in 2004 and we started 2005 by winning our largest ever contract, a ten-year $800m contract to handle student loans for the US Department of Education.

Sales were up in Professional Testing, but we operated at a small loss as we invested in our new testing centres; the backbone for our future growth. We successfully began our new contracts for on screen [driving] test in the UK, which can now operate in 150 secure centres across the country. Next year we expect to be around breakeven as we finish the development of our international centres for the worldwide $200m G-Mat contract. We expect to see a material uplift in profits in 2006 and then beyond.

Finally Technology Publishing; 2004 was the fourth successive year of market decline. Against this backdrop we continued to gain share, particularly in our graphics and in our [imprints] and to cut costs. We estimate that the technology recession has reduced sales by almost £80m, and we have responded by cutting over £50m from our cost base. We remain profitable, albeit with slightly lower margins, but we expect the market to pick up a little in 2005 with a better schedule of planned new software releases, so, a good year for our Education business.

Turning now to Penguin; this time last year we were saying that 2004 would be a tough year for comparables for Penguin, given the dollar weakness and its record best seller and financial performance in 2003; as the year wore on it got even tougher. In a moment I will cover what caused the profit drop, but it would be wrong not to recognise that this was another strong publishing year, with record best seller performances in the US, the UK and Australia.

We maintained our market share in all our main markets until, as you will see in a moment, we suffered a drop in the US in the fourth quarter. In the UK where we had distribution issues our front list performed well and sales were a little ahead. But as you know from our trading updates several factors hurt Penguin's margins, so I would like to take you through these in detail.

The largest single factor was the US dollar weakness. This represented £40m of decline or almost 40%. The second factor which we communicated to you at our interims was our investment in new channels and the bankruptcy of a UK distributor.

Third was UK distribution; throughout the year our priority has been to protect our long term relationships with customers and authors and our market position. To do this we incurred £9m of additional costs, including the cost of running two warehouses, shipping more books direct and providing additional marketing support. Operationally the improvement has been dramatic, we are on track with our automation plan and we expect to move Pearson Education into the facility in the second half.

The final factor was the unexpected market deterioration in the US in the second half, particularly in mass market where Penguin is strong. Mass market is the term for those best sellers; they are paperbacks with a sort of relatively low price point; usually retailing at $7.99.

As you can see, Penguin has built a strong position in this segment with an over-weighting of approximately 1.6 times the industry average. Here is what happened in that segment, you can see in the chart on the left that net sales were down 4% in the first half, but fell 13% in the second. That is quite a different picture to the industry overall, which was flattish over the course of the year. As you will see the other major adult segments which although suffering in the second half still showed good full year growth of 5%.

We also saw rising returns in the year that is a trend that has been creeping up for the industry for some time now. So, rather than hope for a fast recovery in the US mass market, we are treating this situation as if it was here to stay. We have developed a clear plan to respond and Marjorie will talk about what we are doing when she covers the 2005 outlook.

Turning now to the FT Group; for the first time in three years all parts of the FT Group were pulling in the right direction, resulting in a 69% profit improvement. At the FT itself we achieved the £20m of cost savings that we promised, and we saw the benefit of a 3% sales increase dropping through to profit; breaking even in the seasonally strong fourth quarter.

Advertising was up, albeit modestly at 2% for the first time in two years, and we saw particular strength in recruitment, online and luxury goods, where for example we increased the number of issues of how to spend it, and we saw our highest ever ad revenues in our Christmas edition.

Circulation revenues were also ahead. All our business newspapers benefited from this more stable advertising market, and the significant cost savings that we have made in recent years.

Les Echoes for example had another year of circulation growth, even as most of the other newspapers saw a decline. Les Echoes also increased its profits by 80%. In December FT Deutschland passed the 100,000 circulation milestone. We continue to benefit in the FT Group from the strong growth at Interactive Data Corporation (IDC), where sales were up 3% and profits up 9%. We maintained our 35% plus renewal rate and saw good growth in new products such as our fair value pricing, which is now being used by almost all major institutions.

After three years of successive margin rises, our margins fell slightly in 2004. However, Penguin's fall was largely offset by the improvement of the FT Group. We were particularly pleased that our Education margins were broadly level in a year of heavy investment.

Turning now to cash; cash improved dramatically with total free cash flow up £96m. We benefited from the receipt of the TSA receivable in December, but even without that we would have been ahead of last year. If we work from the bottom of the slide up you will see that our acquisition related integration costs are now minimal; finance charges remain low, with our cash tax still only 10% of our operating profit.

We have kept tight control on our capital expenditure and again have improved our working capital efficiency. As you are aware, we have been working extremely hard at improving working capital efficiency and we continue to see the benefits. Our average working capital to sales for our book business is lower for the third successive year at 32.3%. Again, we found savings elsewhere to invest in the R&D of our business; that is our pre-publication and our advances spend.

Our profit in cash management performance has allowed us to improve our ROIC at constant exchange rates from 6.3%. We expected this to be the toughest measure in which to show underlying progress this year, so we are obviously pleased with that result. In fact if we applied the actual tax - the cash tax paid rather than the 15% normalised, then our ROIC at constant exchange rates would be 7%.

Turning now to our balance sheet and the ratios; net debt improved £155m to £1.2b. This is before we deduct the proceeds from our two divestments in late 2004, CBS Market Watch where we have received just over $100m and Recoletos which should bring us net proceeds of around €550m.

We have used the favourable market conditions in 2004 to refinance our debt. We have renewed our five year syndicated revolver and have issued a dual tranche bond to replace the issues that matured in July and September on marginally more favourable terms. Our next major bond maturity will be in early 2007.

Our interest cover now stands at 6.6 times versus 6.1 times in 2003. Net debt to EBITDA has improved from 2.3 to 2.2 times and our debt to equity is 43%.
Before I finish I would like to just touch on two points, pensions and IFRS. Firstly pensions; as you know our main defined benefit scheme is in the UK. Last year we had our full actuarial valuation which identified a deficit of £137m that is an 89% [funding] level. We have agreed a contribution rate, details of which are in the appendices in your packs. The effect in 2004 was an increase of £5m up to £30m of cash contribution. Also in your packs we have included the details of the P&L charge under both UK GAAP and for disclosure purposes for FRS17.
Turning briefly to IFRS, we will be holding a full briefing on this subject during April when we will give you comparators for both 2003 and 2004, but I thought you would be interested in our main P&L adjustments for these years. Taking each in turn and bearing in mind that the numbers on these slides are indicative and they are unaudited.
Firstly goodwill; we will be adding back to profit the goodwill previously amortised under UK GAAP. This will lead to a positive adjustment of £264m and £224m for 2003 and 2004 respectively. Secondly purchased intangibles; these will need to be amortised over their estimated use, and this is likely to result in a charge of £5m to £10m.
Thirdly share based payments; restricted stock, options and save as you earn. We expect the charge here to be in the £15m to £25m range. Finally pensions; historically we have kept the P&L charge broadly in line with our cash, so the change here is likely to be very small.
Just finally touching on our financial priorities for 2005; we will essentially maintain the same financial priorities as 2004. Clearly earnings growth will be the most significant determinant of our success, but we will also continue to improve our working capital efficiency and generate even more cash. We expect our return on invested capital to move ahead, and of course it remains important to us to maintain our balance sheet strength, which gives us the flexibility to continue investing in organic growth and bolt-on acquisitions.
Thank you for listening, now I will hand you back to Marjorie.

Marjorie Scardino

Chief Executive Officer

Thank you Rona. I said at the start that we were really confident about 2005 and beyond. I would like to spend the next few minutes telling you what really supports our confidence in that.
The answer is really in three parts, as I said at the beginning. It is in the operational efficiencies we have already achieved; through our very aggressive integration and streamlining our businesses and those we still have yet to achieve. It is in the outlook for growth in our markets, which standing here today look very, very healthy indeed. It is in the strength of our products and services; we have been investing in those and they are really going to help us capture more than our fair share of that kind of market growth.
So, let me start with the operating efficiency; we have talked about this for the last couple of years, about our work to make Pearson a lot more operationally fit. That has been a real source of strength to us over that time. Over the past four years we have reduced costs by more than £360m net of the cost of doing that, £200m of that has been in our ad and technology businesses, those that have been affected by that big cyclical recession; those alone have reduced by £200m.

We have also integrated totally in some of our big markets; Pearson Ed and Penguin are now one company in Australia, in Canada and in India. In each place the profits are up strongly for the second successive year.
In much of the United States a number of our services have been combined, including warehousing and distribution, which I might add has been done flawlessly. In the UK we switched to our automated warehouse; that was not so flawless, we did have technology problems, which as Rona said have been completely corrected now. We have restored our distribution to normal levels and though we will have dual running costs during this year, until we move Pearson Ed in, which will be in the second half we will achieve the promised £20m of cost savings in 2006.
We will also then begin to enjoy what that organisation was built for, which is quality and speed of distribution at a cost that none of our other competitors can match. Behind the scenes driving all this operational change we have had a plan. It has been something we call the bigger picture. Our operational improvement programme; it has been going since 2002 and it now includes almost 200 projects which cover production and purchasing, most of our central functions, involves all of our businesses; is designed to improve both cost and quality and process and make the most of our scale. In total the bigger picture in its two years has made us cash savings of just over £50m, about £30m of that [indiscernible], and we expect £10m this year.
This programme and the culture of collaboration that we have got all around Pearson have made it possible for us to completely reorganise our back office services. It is now one consolidated across company function. I will introduce to you in a little while who [indiscernible]. It covers all of our business services that is the order to cash chain, technology, warehousing and distribution, purchasing, facilities, financial services, all areas like that are now being run together.
This slide shows you just how important that is to us. Over the past four years see we have taken a profit hit of about [£90m] [on] the weak dollar, added another £20m from portfolio changes. The technology recession knocked off a further £170m. We have absorbed about £300m of cost inflation; mostly in areas like salaries and health costs and pensions in particular. Had we stood still, had we not had the ability to achieve these efficiency savings, those pressures would have wiped out all our profits and then some.
Instead in the last four years we have produced £185m of organic profit growth, £360m of cost savings and so we have maintained profits in the face of those challenges. In the bargain we have put ourselves in shape to keep on doing this and to take advantage of improvements in our products and markets whilst we are doing it. Nowhere is that more important to us right now than in Penguin. That efficiency move will underline all the work we have got to do this year in Penguin and we do have some.
Rona told you about the pressures around the results in Penguin; so let me say a little bit more about how we are addressing those pressures; how we are approaching the challenges. They really centre in two major trends; in consumer books in the US. Although these trends may not persist we are looking ahead and planning that they will.
Weak sales in the mass market category; that is a relatively large part of the Penguin portfolio in the US, it depends on best selling authors who command very high advances. Secondly with the overall book market slowdown in the second half we saw retailers focus away from back list sales, and that is an area which is also substantially more profitable for most publishers and where Penguin is particularly strong too.
UK publishing does not have that large mass market category, or quite the same kind of channel pressures, but its business has some efficiency challenges, so we are addressing those as well.
So, what is our plan? Its cornerstone is that Penguin is now completely focused in their business on profits, on margins and on capital efficiency. To do that our detail programme falls into two parts,

costs and revenues obviously. So let me pick out some examples, because it is quite a detailed and comprehensive plan to go through bit by bit.

First the cost sections; we have had to make some tough moves in how Penguin is run in the last few weeks to make sure it is on a very solid footing if some of last years changes turn out to be secular. In the UK we streamlined management. We have settled in the new warehouse team, we have restructured the DK Creative Organisation and the sales force organisation; a lot of those announcements will be coming out today.

In the US we have also made some radical cost cuts. We have adopted a tough stance on working capital demands and a tough stance to our suppliers. Worldwide we focused on a much deeper integration with the rest of Pearson; the efficiency moves I was talking about. In particular these bite in the book business, and we are taking even more advantage of the [indiscernible] that those allow us. But cost measures are not really enough.

We have also had to approach the whole wide Penguin publishers and try to do that a bit differently in some areas. So in revenue actions we are rolling out in the mass market area a new paperback format to improve margins there. This premium paperback, which is the one you see on your right, is priced at $9.99 versus $7.99 for the very same book in a traditional mass market format. It may not seem like much to you, but if you see the two books you will see they are better paper, better print quality, more legibility, and this is a category that particularly appeals to the demographic class of people, around Dennis' age, so very important legibility.

We are also taking steps to wring a lot more revenue out of our backlist in a whole range of ways. Own brand publishing, which we are doing with some of our mass market retailers; using print on demand technology more to reduce inventory; integrating all of our travel imprints, this is the Rough Guides and the DK imprints mostly. Focusing ever more on direct sales channels; we began to invest in that last year and will carry on doing that. Not all of these are brand new, but they each have a sense of urgency.

Our third revenue action is that our imprint strategy is designed now to reduce our working capital to sales ratio that is its complete focus. We have created a new imprint strategy, nine specialised new imprints we have launched over the last couple of years to address specific market opportunities. For example, high quality non-fiction, business books, conservative political writing; these imprints are focused on the book, they are not focused on the author or a series by the author, they are focused on the book.

Today, out of the nine imprints we have generated sales of about $40m at a lower royalty advance cost than we might have paid for one author in that mass market category; so we are focused on that. All these actions, cost and revenue actions, are based, as I said, on Penguin's focus on margins and on working capital efficiency.

We are planning on that basis that the weak market conditions we saw in the second half of the last year are going to continue. We are spending, as you saw in your press release, about £5m on actions this year, on investment we would expect to recoup in the next 18 months, and that is going to leave us very well placed on both sides of the Atlantic.

Our aim is obviously, in addition to these actions, to take good advantage of what we see as a good sales market in the UK, and to capitalise on our US ability to produce best sellers that often end up defying the market as they have done in the past. That positive attitude, and I do think we have a very positive attitude towards Penguin, is based on our confidence in Penguin's unique [indiscernible] which I do not want to have overshadowed by these current challenges.

Penguin is publishing fantastic books. 2004 was our best year for best sellers, and our publishing schedule in 2005 is going to be just as strong. We have the best authors and the most loved brands in the business; we have the only really recognisable consumer brand in the industry.

We have been consistently more innovative than any other publishers. The books you see here on the left, great ideas, these are twenty books that we all know and we all think we have read, but we probably have not, running from the Confessions of St Augustine to Virginia Wolfe's A Rumour [indiscernible]. We made these up this past year selling for £3.99, we sold about two million books and they are going great.

These pocket Penguins are to celebrate Penguin's seventieth birthday, which happens this year. We gave some designer £70 to design covers for some well known books and those are going to be launched to celebrate that seventieth anniversary. Penguin is and it remains the world's best publisher. It has enjoyed the best margins in the industry and we are confident that with these actions we will recover that position over the next few years.

Meanwhile in the rest of our businesses, the other 80% or 85%, we have great confidence we are going to have accelerated growth this year, because of the combined strength of our improving markets and our products and services that are well in shape. That accelerated growth is coming from a few key sources, so I would like to just trip through those for a minute.

Our first source of growth is what I would call our main stays. For the past six years our Higher Education business and our Financial Data businesses have been growing at steadily rising contributions. For each of the past years those two companies together have contributed close to half of Penguin's profits. We see now another good year in Higher Education in 2005, college enrolments are up 2%, about 350,000 students a year added to the US college rolls. The proportion of the population going to college is rising. So, we expect that the Higher Ed market is going to grow at about the same rate it grew last year. As usual, as we have done for the past six years, we are going to grow faster.

The cost of college in the US is of public concern, but over the next few years we see some changes coming to play that play to our strengths, and will allow us to have more pricing power in that market. For instance, the Standards Movement is moving into Higher Education. You have heard us talk about the Standards Movement in Schools, the market is now moving in Higher Ed toward personalised learning, toward the use of technology, toward a focus of assessment; all completely aimed at figuring out whether students are learning what they need to learn. We have the clear leadership in all those areas; we have already begun to move them into college. Add that to our excellent ability to execute plans and innovations in this area, and our confidence in Higher Ed is certainly strong.

Meanwhile, in IDC our financial data and pricing business; it has managed to prosper even with the flat market you saw. So, they will be able to take really good advantage of a growing market, and they do have a growing market. The financial data industry is projected to return to growth this year with the rising good health, I know you are all happy about, at financial services and banking.

There are also two possibly less familiar businesses to you that I call maybe the new main stays, and add them to this category. They are also going to be improving our fortunes over the next couple of years. These are the US and International School Testing business and the Government and Professional Services business. We have talked before about the attractive financial characteristics of these businesses; they have predictable contract based revenues; very fast top line growth; low capital intensity, as well as the advantage that we have of being able to connect our publishing to the services that they deliver.

These businesses have shown tremendous growth over the last few years, 25% compound annual in the School Testing around the world and 29% in the Professional businesses. That growth is reliable because a large portion of it is contracted for ahead of time. So, going into this year School Testing already has 89% of its revenues in house and Government Services has 75%. So, they really are a highly reliable business.

In 2005 they will benefit once more from new contracts. Just as an example, this month we will mark the first ever SA questions on the SAT college entrance exam in the US, and we will be doing that in fact worldwide where students take it. We will be continuing to add similarly innovative contracts at a rapid rate.

The third source of our confidence for growth is, I am happy to say for the first time in about three years, our business newspapers; there you see them all pushed together. Though our ad sales have been stable for a year now, the business advertising market is still slightly erratic; growth will continue we think though. Most advertising associations now predict that business ads are going to rise about 4% financial ads about 5% this year, we certainly hope they are right.

The Financial Times and our wider network of national business papers are in very good shape to take a major role in our growth because of that [which] they have over their new revenues, about 80% becomes [indiscernible] really does help underpin that.

There are reasons we think the FT is going to be an engine for our growth. The first is that the FT does provide the best most international business news in analysis in print and on the web. It is the only paper to have a global 24 hour integrated news operation. That, plus the network of business newspapers that give us local market knowledge, gives us an editorial breadth and quality that is completely seamless, print to web.

We have a new publishing system that will be finished this year that is going to complete that paper to web integration, and it is going to reduce our costs and enable us to feed our data and analysis to lots of different categories of paying users; we do emphasise paying users these days.

The second reason our paper is going to grow is the international breadth of its audience of senior people in business in finance and politics; that audience is just increasing. Readership studies around the world confirm that. The paper's broad reach means that it is much less exposed to any downturn in any one market. So, as a for instance, last year we saw US business advertising down in the double digits and the US for the FT was down in the same amount, but worldwide the FT's advertising was up 3% last year. So that mix of markets helps us keep even.

As the readership quality grows the FT is going to attract an ever larger number of blue chip advertisers because of that audience. These advertisers are willing to pay premium rates to reach these notoriously hard to reach people. This chart really describes that audience that advertisers pay for. It shows how our expansion around the world and on line has improved the audience quality, if we had only one region, and say that was the UK, you can see why our offering would not be nearly so excited as it is today.

The FT now has more paying readers in print and on line than at any point in its history. Our newspaper circulation revenues were ahead last year, even while our circulation numbers were a little bit lower. That is our focus.

We can give that broad audience and that advertiser community much better choices. Our integrated print and on line model gives us lower cost; their offer is broader. About 50% of our ad sales are now part of a combined print and on line package. To that we have added services; we have something that now is ominously called behavioural targeting, which means we can aim advertising at people who read a certain kind of article, whether it is an IBM ad at people who read technology articles or whatever. We are adding to that faster archive searches and a range of other web tools that we think will be appealing to advertisers.

Of course, as I said at the beginning cuts of the last four years and the scale of our global network and FT's ability to integrate in Pearson's cost efficiencies mean that costs for the entire FT Group are £160m lower. The FT and its publications are in the very best of health to turn most of every new revenue dollar or euro or pound into profit, at least about 80% of it.

The fourth source of our confidence for 2005 and beyond is our US Schools business. This is the first of several good years for the US School market, so what is causing that? First, state budgets in the United States. The total state budget gap was about $235b three years ago, and now it is less than $0.5b.

Most states are reporting that all three of their major tax categories, personal income, sales and corporate income are running ahead of their projections. Federal programmes are also underpinning our confidence; George Bush's re-election, his appointment of one of his very closest aides and one of our friends as the Education Secretary has renewed the momentum behind Education Reforms. The Federal Government has maintained its No Child Left Behind funding and added a stronger focus on secondary schools.

School Testing is also strong; we expect to grow in double digits in School Testing. It is now mandatory in America in Grades III to VIII and once in high school. The Bush Education Department has suggested mandatory testing for three more grades and added about $250m to support that, so that can only be a good trend for us, since we have 40% of the testing market.

Then there is growth in the sales opportunity; open territories picked up strongly at the end of last year. They are going to continue to form a significant part of the market. New adoptions we still expect, as you see here, an 80% increase in opportunities this year. This is the first of several strong years, not only because of adoptions, but because of the residual sales.

It is really easy to over-examine this adoption calendar, and I think all of us do it, and we always talk about it, because it is a lot more transparent and detailed than a lot of business sales opportunities. But, it is important to remember that for Pearson it is less than 10% of our total School business. It is however, one concrete indication of overall market growth that we are going to see for the next three years, so here is a little more detail about it.

Let me show you how it will unroll for Pearson. In 2005 the 80% increase will show us participating in 75% of that market. In 2006 it will be a lower market offset for the industry by good growth in supplemental, in testing in open territories in those residual sales from the very strong 2005 calendar. We will also benefit from a sharp participation rate increase, so we will go to above 90% participation in 2006 as we said, and therefore we will expect our total School business to grow again in 2006 after 2005. In 2007 there will be another 20% improvement in the new adoption market, and again our participation rate will be over 90%, so we will expect growth again.

As for margins in that business, we expect our Basel margins to increase back to the 18% range that we see as normal. We told you it would fall a percent or two this past year, and it did. In 2005 it will be rising again, and it will rise through this adoption cycle, 2005/2006/2007 as we get further away from having to have made those big investments in the programmes.

The opportunities are also spread over a very wide range of subjects. We have been investing in some important new programmes that we believe are going to help us take share in some of these new areas. So, for instance, a new elementary reading programme written by the leaders of the US Federal Government's Reading Research Centres set up under No Child Left Behind; a new elementary science programme, a new secondary literature programme with original writing from 50 Penguin authors which takes it far beyond any normal just collection of literature.

In secondary social studies our first digital print integrated Basel programme. All of the content in this programme is going to be available on line, it is for California. We have created the programme with half the pre-publication spend that a print version would have taken, and there will be no free [with] orders in this kind of programme. So, we think it is quite exciting and quite a bold adventure for us.

All of these programmes are going to benefit from the things that have been our hallmarks, embedded informative testing so that the teachers can monitor progress against eight standards.

Prescribe assistance; prescribe intervention if needed, all aimed at helping learning and all at using the skills that we have got uniquely to do that. So, with all these opportunities our US School business will have strong sales, steadily increasing margins over the next three years.

We have also said that the breadth of our Education business is one of our strengths, and that is true again this year. As the fifth source of our confidence is International Education.

We always talk a lot about the US, but it accounts for only 5% of the world's school enrolments and less than a quarter of college enrolments. PWC produces a media report that estimates that the worldwide market for education books is worth more than $100m and growing at 5%. Our education businesses range over the major markets and we are leaders in most of them; Hong Kong, South Africa, Australia, Canada; we have a wide variety of businesses as well as you see here, on the right, touching every part of the education process.

This next graph shows you why these statistics are more important to us than they are to any other education company. It shows the sales generated by us internationally and our major competitors outside the United States. We are now three times the size of our nearest competitor in International Education, our sales are $1.2b. Over the past two years we have worked really hard on these businesses; we have made a lot of operating savings, we have taken some of those savings straight to profits; we have reinvested some in new programmes. We have also extended our leadership in technology, in customisation and testing in these markets, and we have begun to use our scale also to do what none of the other publishers can do, and that is to create some truly global products.

Here is an example of one, it is called English Adventure. It is for primary English language teaching. This is a market that is growing about 8% to 10% in many countries, particularly European countries like Italy, Poland and Spain, which have begun teaching English in kindergarten now. This is a global programme, we did it with Disney; we made it so that it can be tailored to local markets; it is going to be published in 52 countries. Ultimately our competitors just cannot match this kind of thing; they are mostly national and they do not have enough markets to spread this kind of investment over.

So, with this global approach and our scale, and the growth in these international markets we really do believe that our International Education operations are going to grow sales in the high single digits, and their profits are going to grow significantly faster than that.

So, that is a snapshot of what we think are the highlights in Pearson, not just for this year, but for a few years going forward. We really are proud of the Pearson that we have built, both our businesses and our operating [indiscernible], and our way of doing things, and we are now more than ready to see all this change; pay back our shareholders for all their trust and commitment as we have tried to build the company. We are confident that it will, both in 2005 and in the years beyond, and we thank you for your confidence as well.

So, thank you for listening. Let me introduce a few of my colleagues who will be happy to help answer your questions. We have got one person missing this morning, and that is Peter Jovanovich who would have been here, but as most of you know he tried very hard to overcome his lung transplant and begin to work again, but it just was not possible. So, he has had to leave working, and we all miss him, but one of his great legacies is that he has left behind some fantastic people who know how to run education companies.

So we have got Will Ethridge who runs our Higher Ed and International business; Steve Dowling who runs our School business and this guy, stand up George, this tall guy with the strange hair is the CFO of Pearson Ed, and I want to give him special attention, because he is Pearson's new Head of Operations. So, he is the one responsible for bringing all of our operations together

[indiscernible]; getting all these cost efficiencies. He is a maniac about this, and he has done a great job in Pearson Ed and we are really happy to have him.
So these three people plus Olivier Fleurot and John Makinson are all going to come up as well as Rona, and help try to answer your questions.

Question and Answer Session

Paul Sullivan

Just a few questions if I may. Firstly could you just talk about the margins in Government Solutions that we can expect in 2006? Also you talked about breakeven in the Professional business in 2005 and then major uplift in 2006. Can you just quantify that a little bit more?

Secondly at Penguin, of the £9m warehouse costs that you took for, how much of those could reoccur in 2005? Is that on top of the £5m [restructuring] you are going to take this year?

Marjorie Scardino

Let me talk to you about the Government Solutions margin, and I will let Rona talk about Professional and John can talk about the Penguin warehouse costs.
The Professional margins will be on or about the 10% range. The big new education contract, like all [new] contracts, has a sort of [inaudible] margin, be a bit lower at the beginning as they make the investments that they need to make, but as all of you know, other than capital investments, which are very low in Pearson, we take all those to operating income, so those will be expensed in the year. Then those margins will rise, but they are around about 10%.

Paul Sullivan

In 2006 [indiscernible]?

Marjorie Scardino

[indiscernible] get pretty close to there; it depends on the mix of contracts and what we add to that mix. Do you want to talk about Professional Book Rona?

Rona Fairhead

In terms of Professional, this is a growth business at the moment. Last year we said it was a $100m business that sort of size, it grew 30%. So, it will be around $130m of sales. Breakeven we say next year because we have invested in the US, we have invested in the UK this year and we will have some small investments for our International business [as we pursue] that contract.
What we have said, is that we are not giving a specific margin for 2006, but we definitely think this business should be in the 15% margins over the long term. I would imagine it would be moving up towards that in 2006.

Marjorie Scardino

You have to remember; our Professional business also we report our technology publishing in that, and that will be, as you saw, sort of rising, but it will be a flat margin, so that would probably drive it down.
Then the warehousing costs - one-off costs?

John Makinson

Most of that £9m will go away in 2005, but we have got the dual running of both the warehouses, as you know, until the second half of this year when we are expecting Pearson Education to move in. We have also got some continuing investment by Penguin in marketing really and in channel support, in order to make sure that we have fully restored the service levels that we had before April 2004. So, you could assume that there will be some small number of millions of, if you like, additional costs that we will continue to incur in 2005, but it will not be of the same level, obviously, as in 2004.
That £5m you were asking about is quite separate from the warehousing that is distributor between the UK and the US on quite a number of the initiatives that Marjorie was talking about, and is a separate item.

Marjorie Scardino

And is expense [indiscernible].

Colin [Turner], Lehman Brothers

A couple of things; first of all, on the Higher Ed margin it has come down a little bit, and in the statement it says that you are expecting it to be broadly flat this year, I guess that is investment. My question is in the out years do you expect that investment to stay there further out, or do you think the margin could start to move up again in this revenue in 2006/2007?
The other question was on -- you talked about the low cash tax rate. I just wondered how sustainable that is over the next two or three years?

Rona Fairhead

Well we think that low cash tax; certainly below 15% is sustainable for the next few years. We have still significant NOLs in the US stemming back to the Mindscape acquisition. So, we are comfortable, and we give you our ROIC as you know on a normalised basis, the 15%, but actually in some ways that penalises us because our actual cash tax performance has been better than 15% for all of the years in which we have done that ratio that way. But, we still think that 15% at least in the next three or four years is maintainable.

Will Ethridge

In Higher Ed we have very strong margin, over 20%. We are investing primarily right now in a clear sales force. We think it is a good time, that is the where a lot of the market is going and we do [think this will] go up in the out years.

Marjorie Scardino

You also have to remember that in that Higher Ed we have International Higher Ed. International Higher Ed is at a lower margin than the US obviously, and we are investing in that as well, so that will drive down the margins a bit, but they are the highest in the industry.

Simon [Mays-Smith], CSFB

Two quick questions; one is one book plate spend. Could you give us some idea of what happened to book plate, both cash and non-cash in 2003, and how the profile is looking given the big adoption year this year and going forward; both cash and non-cash? Maybe you want to weave into that what happens to your book plate if you do go on line; some more details [inaudible] savings, cash savings from going online?
The second question is, a lot of the US newspaper publishers have been investing in online reach recently. Do you think the FT will have to make a similar investment?

Marjorie Scardino

A lot of the US newspapers? Do you mean like the New York Times $400m investment in about.com?

Simon Mays-Smith

Yes, and Market Watch for Dow Jones.

Marjorie Scardino

Do you want to try that Olivier? Are you going to invest in a big search?

Olivier Fleurot

We have increased the reach of FT.com a lot in the last two or three years. We now have 3.5 million unit users. We also have invested in a Chinese website for instance, called [Jonweng] in Mandarin and it is now the first international website in China.
I think if you compare -- the New York Times is clearly a general interest newspaper. We are targeting our efforts and it is the same strategy in print as on line.

Will Ethridge

By book plate I take you mean what we would call plant expense - the fixed [indiscernible]. It is up slightly this year. Over a period of say three or four years it will even out, it is up slightly this year ahead of the big years that are coming.
We amortise on an accelerated basis, 40/30/20/10, except for our reading which we amortise on a straight line [full] year. So, you see the effects of it feeding through the income statement in various ways. But, on a cash basis it is up a little bit, and it has some ups and downs, but not huge swings.

Simon [Mays-Smith]

What was your [amortisation in 2005 versus 2004]?

Marjorie Scardino

We said that our margins in the School business would continue to rise. Our Basel and supplemental margin continue to rise in the ‘05/06/07 rate as we move away from having had a couple of points lower margins in ’04 up to 18 in ’05 because of that plant investment.

Will Ethridge

It is up slightly this year, but not -- and our margins are up.

Unidentified participant

A couple of questions on the Financial Times if I may. First of all can you give us some colour on where the advertising growth that you are seeing now, where that is, the category and geography? Also I notice you didn’t talk that much about cost reductions at the FT Newspaper. Is that -- did I -- am I getting that right, or is there more coming in terms of cost reductions? And also what are you doing on the circulation -- continued circulation in the U.K? What can we expect to try and mitigate and turn that around?

Unidentified company representative

[Indiscernible] as you know we don’t do predictions. We saw a good increase last year for the first time in 4 years. Year to date it’s about the same trend but it is still very last minute bookings. So it is very difficult to predict what is going to happen in Q2 or Q3.

Unidentified participant

Is it still reached in the in the U.S. and is the pattern --

Unidentified company representative

Actually we have a very good start to the year in the U.S., compared to what you have heard from 1 or 2 other newspapers.
On costs, I mean, on costs we have done a lot to complete the company. We had 5 or 6 different companies and we have 1 now. We are continuously looking a how to -- how we can maximise or -- well, optimize the cost base and this is going on and it will go on, I was going to say forever, but that is what we do.
What was the third point?

Unidentified participant

Can we expect anything -- efforts to turn around the U.K. circulation trend?

Unidentified company representative

Yes well overall, we -- our strategy is clearly to be a global business newspaper and to focus on the quality of the circulation. You may have noticed that the yield, we are working on yields. We increased the revenue per copy and we increased the revenue per advertising page. That’s what we did last year, that’s what to do this year.

Marjorie Scardino

But just to emphasize what I said before, we have more paying readers and users than at any time in the FT's history right now. So we really are focused on the quality of those. Focused on readers across the piece, as long as we consider them to be appropriate. So just because our newsstand buyers are down in the U.K., and we don't like that, it's not a big deal. Okay.
At the back.

[Jonathan Barratt]

Good morning, Jonathan Barratt from Williams Debroe. Could you just talk about Penguin's inventory levels? Whether or not they have gone up through '04? What you have got there at the moment, whether you are going to have to write off any stock? And whether or not you are going to have to manage your returns terms any differently going into '05 and '06?

Marjorie Scardino

John, do you want to do that?

John Makinson

Yes. On inventory, yes we have seen some increase in inventory simply because the returns levels have been high. If you get more returns back then you are going to see some increase in your finished inventory. The actual -- the new inventory if you like is not being managed-up so we are holding that down. The issue for us in terms of how we deal with that inventory, and it's an issue for the rest of the industry, is what the balance is between the remainder stock and the stock that goes to pulp. And one of the ways I think we are going to address the challenges of this channel, and particularly the used book channel which is becoming more of a feature in the U.S., is to try to increase the yield that we achieve on the remainder stock.
So, in other words, rather than taking this back into the warehouse and then just selling it on at very low prices into remainder channels, see if we can use some of these direct sales that Marjorie was using and websites and display marketing channels in order to achieve a somewhat higher yield than publicists would have done historically before that.
The real issue though, which I think is where you are going with the question. Is what we can do in order to bear down on those return levels and improve the quality of the supply chain structure, particularly with the mass market retailers, the big merchants. And we are doing that very actively. From this month we are examining the supplier relationships with all of those channels to see whether we are able to reduce the level of supply. And in some cases that is going to mean that we will eliminate the supply of certain categories of books to certain channels and to certain customers where our customer profitability and analysis shows that we are getting inadequate return. So we will be very much more forensic about that supply issue than we have been historically.

Jonathan Barratt

Does that mean that we should be taking something out of our revenue line for those eliminations going forward?

John Makinson

Well we are not -- I don't think we are being quite that specific in our guidance but you did hear from Marjorie that the focus for 2005 is going to be on how we allocate and employ our capital and what the margin is on our sales. So you could conclude from that certainly, that there will be sales that we would have earned in 2004 that we won't earn in 2005, because we don't think those sales will generate sufficient margin, yes.

Jonathan Barratt

Sorry, just to clarify. What was the actual change in value of the inventories?

John Makinson

I don't think we've -- we've given an inventory number for the Group and that was in Rona's analysis, but we don't break the inventory level down between Penguin and Pearson Education. But if you are asking was there a big increase in inventory at Penguin? No there wasn't at all.

Jonathan Barratt

Thank you.

Marjorie Scardino

Yes.

Charles Peacock

Thanks, good morning. It's Charles Peacock from Seymour Pearce. I have 3 questions, if I may? Firstly, just on the mass market within Penguin. Can you explain a bit more as to why you think there is weakness there? Is it because the second-hand book market is taking hold and why you think this may be structural rather than simply a cyclical issue?
Secondly, just on the £5m spend, what your savings -- what savings you are expecting from that? And then on the professional business, what's been happening with revenues of scanners and the outlook there -- the scanning business?

Marjorie Scardino

I think I'll take scanners and you can take the big topic. Scanners as you know is a fantastic business but is relatively level. So it doesn't grow a lot it's very, very profitable but it doesn't -- it doesn't have the kind of margins that a school business would have. But it's a very nice business and it keeps us supplied with competitive advantage in the [indiscernible] business.

Charles Peacock

Could I just perhaps follow up on that because looking in the guidance that you gave to the overall professional business of mid-single digit for '05? You have got the acceleration in the second half of the Government Solutions in '04 -- of the Government Solutions and Professional Assessment as the new contracts came on. Technology publishings are expected to improve somewhat, so you have got a change from about 12% growth underlying in '04 to mid-single digits in '05. What --

Marjorie Scardino

The Technology publishing is just -- is not going to be very much improvement. I don't think -

Rona Fairhead

I think the breakdown is roughly, the professional side will be quite significant growth but, as I said before, the Professional Testing certification is $130m. So it is one of the smaller ones. Government Solutions has had a big pick-up in 2004 when they had a 25% pick-up and so that growth will level off. But again it will come again in 2006 and 2007 as the new contract load build up again. And then in our Professional Technology publishing we have said that they'll be up but they'll be up slightly and we have to take in the context of down in the last 4 years.

And then finally as Marjorie said, the remainder is broadly flat, so net/net it results in about double digits but high single digits as we said to you.

Marjorie Scardino

Okay so scanners what --

John Makinson

Yes, mass markets. Well starting with the £5m budget. What we said is that we would expect that investment to pay back in about 18 months. So, so you can draw conclusion from that I think.

The mass market picture is obviously a pretty complicated one. The first thing I would say is that it is very volatile. The mass market category was actually up in 2003, down 2004. Our own mass market sales, through October of last year, were almost level on the year ago -- sorry up actually, and off 25% in the second -- in the final 2 months of the year.

The AAP data shows mass market category down 33% in December on December 2003, 17% down in November on November 2003. So that's to say this is a market that does have in it quite a lot of inbuilt volatility. And that is because of these mass market products that are on whole supplied by big wholesalers whose return patterns vary a lot month by month. So you really have to take a trend line and the trend is clearly that, if you take trade paperback like the Penguin classic and compare that with the mass market paperback, the airport blockbuster, there is a shift from mass market into trade.

That is partly, I think, because the consumer is trading up. My personal proposition is that when you go into Walmart or you go into Borders and [Bonds and Mabel] and you see the quality today of a packaged DVD or a packed CD and how much the design and presentation of that product has improved in the last 10 years compared with the traditional mass market paperback. I am not talking about our mass market paperback here but it has not moved on 10 years. It is still heavily embossed, a lot of gold leaf used, the same design values, quite hard to read. The consumer is, I think, less patient with that product and that is why we have moved the mass market product into this new premium paperback format. We are not going to move everything in there but half a dozen of our key authors in the fall of this year, will be presented in that format.

And it is very early days but you saw Marjorie's slide being that [Monett Walters] in $9.99 and the previous Monett Walters at $7.99. We have sold in Borders 40% more units of that new $9.99 book than we did of the old $7.99 book. It's not to say that we'll sell 40% more units everywhere but - but at a higher priced one that's obviously much more than 40% more value and very much more than 40% more profit because the gross margin of a $9.99 book is a lot higher.

So our hope is that we can persuade consumers, and we have done consumer research on this, to trade up into this new format. But, I am sorry that's a long answer I'm afraid.

Marjorie Scardino

Yes, sorry you're next. I'm so sorry. Do you mind if he goes ahead and then I promise--

Paul Gooden

Hi, it's Paul Gooden from ABN Amro. 2 questions, first of all the interest line. In the press release the guidance is for interest being slightly lower in '05 compared to '04. Which is perhaps a little surprising given the cash in from MarketWatch and Recoletos. Can I just confirm is that guidance taking into account the cash from Recoletos or is that benefit on top?
And my second question is just on the balance sheet. You'll finish the year with net debt to EBITDA closer to 1 than 2. Given those disposals what are the priorities in terms of spending that cash and if it is on acquisitions what are the priorities? Thank you.

Marjorie Scardino

Do you want to take this?

Rona Fairhead

In terms of the interest, the reason that we think it has risen slightly though it does take into account the proceeds of those two divestments. But what we had, we benefited last year from, you will have seen, an interest refund from the litigation that was settled in France after a 12 year period on [Satalatour] in fact, which has improved our interest line by £9m in the last quarter and then that brought it down.
So what the effects are, is the -- if you go back up to say where it was at 80, you have an improved level of net debt, which obviously will bring the interest charge down but we are also trying to put -- looking at what people are expecting for the full year average interest rate, taking that into account and saying the broad effect of those 2 will bring it to slightly lower than this year, as guidance.

Marjorie Scardino

As far as the cash, first of all we don't have the Recoletos cash yet, so we're not spending it. But our attitude has been, as you see from our dividend policy, that we think shareholders like best a reliable return through dividends. And we have done that for 13 years and we think it's a good record; it's a pretty high yield stock at this point, so we will carry on doing that.
In the acquisition way, we are really focused on the bolt-on kind of acquisitions that fill in a hole or something like that. We have largely got the Company that we like so we'll be looking at trying to spend money on organic growth and money on maybe those small bolt-ins and big dividends and then see where we are from there.
Next. All right, sorry.

[Chris Collet]

It's Chris Collet from Goldman Sachs. Just 2 quick questions. 1 was just on the cost savings program from 2003, the £20m worth of savings. Has that been pushed out from 2005 to 2006 and if so does that apply both for the Penguin part of the cost savings and the Pearson Education? From memory they were split 2-thirds/1-third?
And second just on the college growth. Obviously continuing to grow well above the market. You have talked in the past about the market growing 4 to 6%. It seems to have come down; do you think that this lower rate of growth will continue in the future?

Marjorie Scardino

I'll let Will answer the college growth. Right Will.

Unidentified company representative

We think actually the markets in transition right now and actually gives us great opportunities. Fundamentally our business is very healthy, involvement is strong, demand is strong. I think if you are selling just traditional text it may be a little tougher place to be, but if you are not, providing more value as we are I think it is a very great place to be. So we have used our growth going back to our previous guidance but right now in our transition period we are taking advantage of the trends of the market. Especially on our custom, online learning and assessment, so we are quite bullish long-term about the market.

Marjorie Scardino

You wanted to talk about the cost saving and also we didn't cover your gradings questions, so maybe Rona you want to say a work about that.

Rona Fairhead

Let's just touch on the balance sheet. Obviously one of the other things that we have to take into account, in terms of the cash that we have to invest is also our ratings as we have said, they are long-term ratings. We are into the [DAA1] [indiscernible].
If I go to the operations and say at this point that we did say that there would be specific integration that we would save £20m a year. We think we will have some of that in 2005, but the full £20m will be in 2006. And I think there is probably proportionately a little bit more in Pearson Education and Penguin this year because one of the integrations obviously that is behind that program is the Rugby warehouse that is just chinking away into 2005.
But I think the important thing is that you look at the overall context of the cost savings that we have made around Pearson. It is much more than just that £20m integration that we have talked to you about. And I think that what we have tried to do today is to give you an understanding of where the cost savings have come, where cost drivers are in terms of our cost base and give you confidence that we have the ability to make further efficiency savings through what George is doing on the bigger picture and across or businesses.

Monica Scandino

I think that's our emphasis. That £20m the conduit was about our warehousing project and [indiscernible] but that's the least of what we have been able to accomplish and expect.

Mark Brody

Thanks, it's Mark Brody at Deutsche. I have got a couple of questions. The first 2 basically long-term margin aspirations. Marjorie you have said in the past that you think the FT should be able to make a 15% margin. I think at mid-cycle point, do you still think that is a reasonable aspiration?

Monica Scandino

I think that's the least they should do.

Mark Brody

And then the second one was, I think Marjorie you said that you believe Penguin can get back to its historic margin leadership. Just to be clear, you think in a few years' time you can get back to making 11, 12% margins in that business?

Monica Scandino

We absolutely do. It is hard to predict. We would love to really say it's going to be on this day and here's exactly how much cost savings we are going to make. But I think the revenue side of that equation is important to us and we can't exactly predict that. But we certainly believe that Penguin ought to perform that way, partly because it's focused on margins. Partly because it matters to Penguin. They have always been a high margin player and as John gets the U.K. side and DK up to the U.S. margins and U.S. re-coverage I believe that.
John do you want to --

John Makinson

I have trouble deciding on that particular day that Marjorie mentioned, but I think that's a reasonable aspiration for us and will be chasing up, absolutely.

Mark Brody

And the final one was John, just to understand the FX impact in Penguin. If the dollar move last year cost you £14m, looking at where rates are this year you are looking at about another -- looking at where FX rates are today you are looking at about another £7m impact in '05, or is the relative FX structure changed?

Rona Fairhead

I think it will be a little bit less than that because the U.S. sales are smaller as a percentage of the total so there has been -- there will be a reduction to that number.

Monica Scandino

Yes, hi.

Unidentified participant

Good morning, it's [indiscernible] at Citigroup. Sticking with Penguin and another way of looking at margins. Could you talk about what happened to author royalties at the moment, both for the market and for you specifically and what you are paying?
May be on a broader question, have you moved from cost cutting to looking at growth. Could you talk about where you might look to invest more and what opportunities you see to invest more? Specifically I suppose what you could do in the international education business that you are now highlighting?
And then finally, Rona, actually shared interest with the return on invested capital. Do you want to tell us on constant currency when you think that might approach your cost of capital?

Marjorie Scardino

If we did that we would be a profits forecaster. Why don't you talk about Investment International?

Unidentified company representative

If you know about 2 years ago we aligned our international group with our U.S. higher education group. There are a couple of benefits that came out of that. 1 is we got a lot of cost savings and margin improvement. But more importantly, we were able to take a lot of the practices and

strategies that we're doing in the U.S. and take them to other markets. And we think that is going to drive a good revenue growth.
We have a very strong ELT business. Again we have taken some of this savings and invested them more in the product we sell. An example of it the English Adventure product which has delivered a very strong list of books coming out. And then in school publishing we look country by country and as Marjory noted, in many countries we have strong growth. So we have a nice portfolio, we have great global reach and we are really focussing on ELT, higher ed. and .in selected countries school publishing.

Marjorie Scardino

I think undoubtedly Pearson's focus obviously we are investing internationally and also in the FT. Asia is a big, big ground for us to grow and we have been out there, what 18 months, 2 years and I think our audience is now bigger than our closest competitor a well-known newspaper, so we are doing pretty well and will continue to invest internationally in the FT as well.
As so we are on to royalties.

John Makinson

Well, talking about cash spending on royalties first and then maybe just a second on the P&L. We have been bearing down on that issue, particularly in the U.S. over the last couple of years, because it hasn't escaped anybodies attention that those best selling franchise authors, as a group, have been selling in somewhat lower unit numbers across the industry in the last 2 years, than they were in the preceding 2 to 3 years.
So as contracts have come up for renewal there has been, at least in our own case, some downward pressure on renewal rates and the total royalty advance that we put out in penguin in 2004, for example, was a lower dollar number than in 2003. It takes a while for that effect to work through to the P&L because of the way in which we account for the royalties as you know. But the trend is definitely downwards and one of the key measures that we are going to be looking at, in this very bottom line focused world we are in, is the royalty advanced sales relationship, so that we are continuing to reduce that.
I might just say also in terms of what are we investing in? One thing we have announced this morning is that we are putting together our travel businesses. The Rough Guide to Travel business and the DK Eyewitness Travel Guide business, which is a very profitable and fast growing business within DK. And we think putting those businesses together, allowing them to move onto new electronic platforms and some PDA formats and so on, is a big opportunity for growth within Penguin for the future. So we will have more to say on that I am sure in time.

Monica Scandino

Yes, [indiscernible].

Alex Drury

Thanks, yes it's [Alex Drury] from Chevreux. Just taking that 10% school margin last year, as a starting point.

Monica Scandino

What 10% school margin was that?

Alex Drury

Your school margin last year. [Indiscernible].

Monica Scandino

No, we said it was a couple of -- we say 18 is the sort of normalized margin, we were a point or 2 lower than that last year and now we will be moving back up.

Alex Drury

But it's just to get a feel for the mix effects within your reported school segment, which I think was about £1b of revenue from the press release. Historically, you have software testing and some other odds and sods in there. I just wanted to know basically what are the variances on the non-base or business going forward.

Monica Scandino

Right.

Alex Drury

Just so I can do a like-for-like review.

Monica Scandino

The testing business [indiscernible] said ought to be about a 15% margin business. The digital businesses are coming along, they are beginning to make some substantial profits and they ought to be in the 10 to 15% range, somewhere. International schools will run, what Steve? Around about -- sorry wrong -- yes about 10, about 10 as we being to invest in them. And part of our international school is our U.K. testing business Edexcel, which is around about that level.
What have I left out? Okay, Martin yes.

Unidentified company representative

Just also, vis-à-vis Reed. If you look at what Read has in there school business, it is actually broader than what we have on our school business. A couple of points, 1 they put their professional testing in there, our professional testing is in our professional group. Those margins tend to be quite high.
Their supplemental business is probably twice the size of ours. Supplemental margins tend to be higher. So I think if you're trying to do an apples-for-apples comparison you need to tick off each business. If you line up the Basil business, I would contend our Basil margins are probably higher than their Basil margins. But you have -- it's an apples and oranges comparison a bit so I think you just need to be careful when you look at it.

Monica Scandino

And you need to remember that international school numbers is highly variable because depending on what the markets are in South Africa, margin will obviously be lower than the U.K. margin etc. So that's -- may be you should think an 8 - 10% margin.

Alex Drury

Just a very quick follow-up. Just on IBC it never gets talked about. They seem to be probably most the reliable side of the FT Group. I just wondered, a huge minority outstanding, what is the long-term strategy for the IBC side of the FT Group.

Monica Scandino

Well, obviously that's part of the strategic considerations we make and obviously you wouldn't expect me to talk about those here. But it is a great performing company. They announced their results on Thursday and you will have seen what we said and the predictions that we make and it's a very big company. We are proud of owning it.
Who hasn't talked? Patrick.

Patrick

The first 1 you say in Recoletos you sold MarketWatch. It used to be 1 of your mantras that you would sell business that you thought were worth more to others. So, do you think there are any other there particularly in respect of the FT, given as you say the amount of money people are paying for things like [debt.com].
Secondly the Chairman is retiring, is it the Pearson policy that executives also retire at the age of 60?

Monica Scandino

No, because I'm not near 60. No it's a Dennis policy that in his 60th year not everything works as well as it used to and he wants to [indiscernible].

Patrick

So January 25, 2007 won't be the date.

Monica Scandino

No. It's not.
On the, what was your question about Recoletos and the FT? Would I like to sell the FT; could that possible be your question? I'm sure it's not, I'm sure it's not.
Obviously, MarketWatch was worth more to others than to us, because look at the amazing multiple that was paid for it by Dow Jones and we wish them well will it. And Recoletos not only did we get a very, very, very excellent price but you will have noticed that Recoletos had a strategy of its own. It was a fully formed media company and we are not in television and in radio and in the kinds of general interest and sports papers they were in. So that was the strategic move that carried with it a very high price so that was what motivated us to do that.
We are never finished; we are always looking at everything all the time. That is all I wanted to say about it.

Alex Drury

Are you looking at a very excellent price for the FT?

Monica Scandino

I don't know. You have already asked a question. Anybody else have 1. Okay you get the last question.

Unidentified participant

Thanks for that. Just wanted to ask a couple of quick follow ups on Penguin. Just coming back to the royalties issue. If you have been squeezing you -- the royalties are you starting to lose some more authors at all? Have you seen anything there? And secondly, are you actually moving away from the mass market because of this royalties issue? Is that why you are shooting for these other costs etc and more niche titles?

John Makinson

On the mass market you -- I don't know if you remember the slide Rona put up about the bias of Penguin towards mass market. You will also have seen that we are roughly in line with the market in terms of our adult hardback publishing. So the overage, if you like, in relation to the market is mostly from straight to paperback authors who don't pass through hardcover. Some of those are well know names, Nora Roberts for example and we would never want to lose publishers, a lot straight to paperback. Some of that publishing is very genre based, like science-fiction, or romance, or westerns, or thrillers, that aren't very author dependent. And some of those categories are the categories that we are reviewing very actively, which are less author dependent categories. On the authors' side, we are scrutinizing as we go through this year and will continue to do so next year, more rigorously perhaps than any publisher has done in the past, the investment criteria that we absolutely need. And it is not just margin criteria it is also internal rate of return criteria to green-light a new author contract.
We have lost 1 or 2 authors over the past 12 months. On that basis they wouldn't be household names here. What's more significant I think is they are authors we could easily have bought that we did not buy over the 12 months by applying that criteria. I wouldn't be surprised if in the next 12 months you see did some names that you might recognize that we wouldn't be moving forward with. But we will negotiate those as they come up 1 by 1 and will see where we get to.

Unidentified participant

Thank you.

Marjorie Scandino

Thank you all very much I hope you leave here - we have had a lot of questions about Penguin and I hope you understand what is going on. I'll think they'll leave a stronger company. I hope you leave with the kind of confidence that we have got for the next few years. So thank you very much for coming.
[end]