2016 results presentation

Friday 24 February 2017

Forward-looking statements

Except for the historical information contained herein, the matters discussed in this statement include forward-looking statements. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing, anticipated costs savings and synergies and the execution of Pearson's strategy, are forward-looking statements. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will occur in future. They are based on numerous assumptions regarding Pearson's present and future business strategies and the environment in which it will operate in the future.

There are a number of factors which could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including a number of factors outside Pearson's control. These include international, national and local conditions, as well as competition. They also include other risks detailed from time to time in Pearson's publicly-filed documents and you are advised to read, in particular, the risk factors set out in Pearson's latest annual report and accounts, which can be found on its website (www.pearson.com/investors).

Any forward-looking statements speak only as of the date they are made, and Pearson gives no undertaking to update forward-looking statements to reflect any changes in its expectations with regard thereto or any changes to events, conditions or circumstances on which any such statement is based. Readers are cautioned not to place undue reliance on such forward-looking statements.

Financial summary

£m	2016	2015	*Headline growth*	*CER growth*	*Underlying growth*
Sales*	4,552	4,468	2%	(9)%	(8)%
Adjusted operating profit	635	723	(12)%	(27)%	(21)%
Adjusted EPS	58.8p	70.3p	(16)%		
Deferred revenue*	883	766	15%	(1)%	1%
Operating cash flow	663	435	52%		
Net debt	(1,092)	(654)	(67)%		
Dividend	52p	52p	0%		

* Continuing

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The headlines

- Full year revenues down 8% - a challenging year
- 2016 earnings in line with guidance; strong cash conversion
- Goodwill impairment - reflecting lower future profit expectations
- Restructuring delivered in full; competitive performance sustained
- 2017: encouraging start to another challenging year
- A more focused, digital company with scale and synergies
- Beyond 2017: building a stronger, more profitable – and more reliable – company

Structural trends in education

- **The economic value of an education is greater than ever**; yet the cost of an education is increasing, and public funding is under pressure
- **The process of getting an education remains inefficient**; translating education into employment is uneven and highly variable
- **Technology is revolutionising education**, creating opportunities to make learning more affordable, accessible, flexible, personal and effective
- The education market is continuously evolving; with **increasing focus on improving access and outcomes**

Structural changes in our markets

Opportunities

- Improve outcomes
- Expand addressable markets
- Discipline share growth
- Institutional selling
- Shift to subscription selling

Maximise

Risks

- New entrants (OER, MOOCs, edtech etc)
- Regulatory and policy challenges

Mitigate

Transitions

- Print decline
- Rental models
- Physical retail
- Lower ASPs in digital
- Investment in technology platforms, product and services

Manage

Our strategy

Content + Assessment = More effective teaching and personalized learning at scale

Powered by **services** and **technology**

2017 priorities

- Simplify our portfolio
- Control costs and increase efficiency
- Focus on our biggest opportunities
    - Digital courseware
    - Next generation assessment
    - Virtual learning and managed services

Financial Review and Outlook

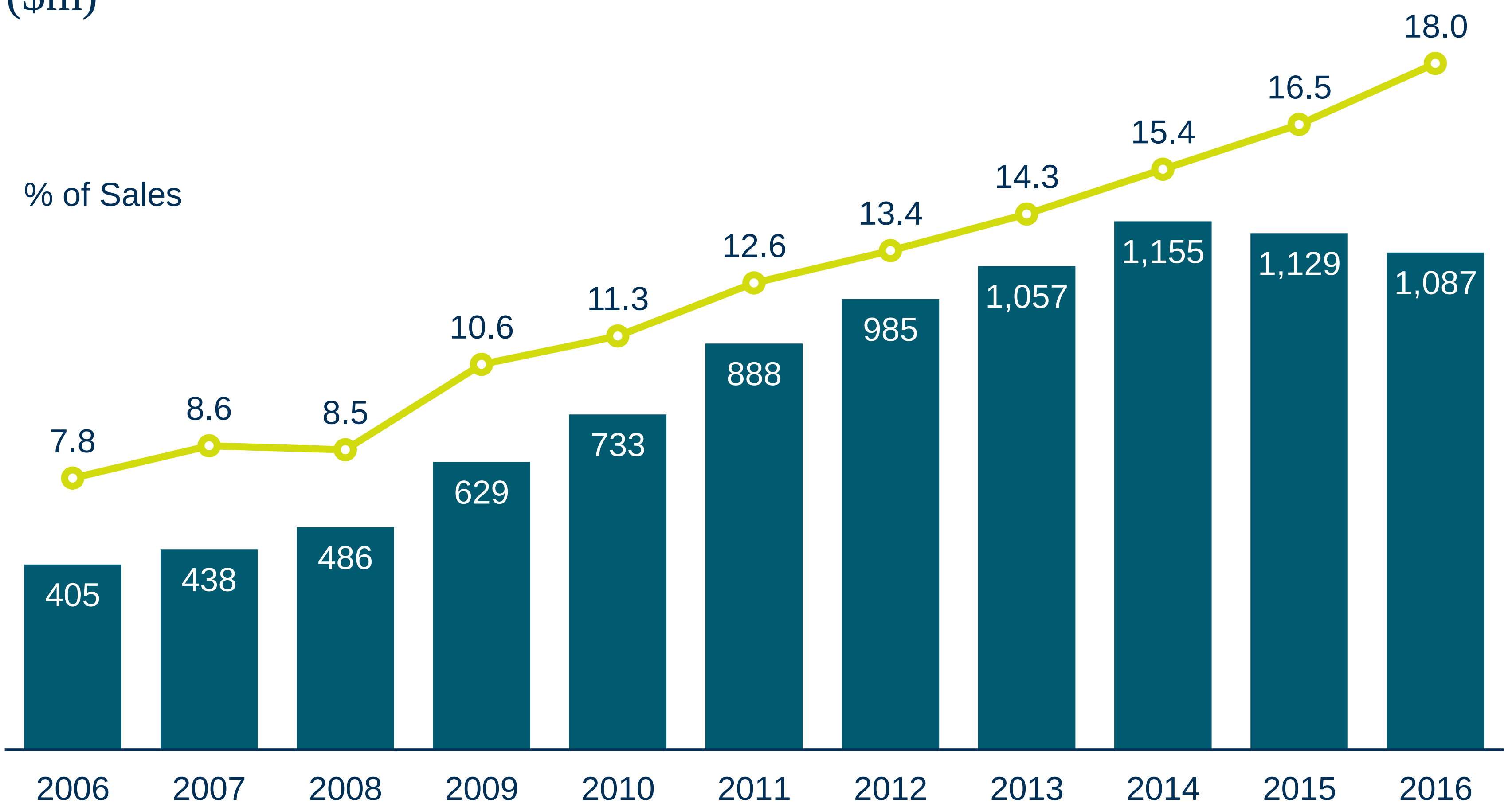
Sales

£m	2016	2015	*CER growth*	*Underlying growth*
North America	2,981	2,940*	(12)%	(10)%
Core	803	815	(7)%	(4)%
Growth	768	713	0%	(1)%
Continuing sales	4,552	4,468	(9)%	(8)%
FT Group	--	312	n/a	n/a
Total sales	**4,552**	4,780	(15)%	(8)%

* Includes £38m from PowerSchool

Deferred revenue*

($m)



*Continuing operations

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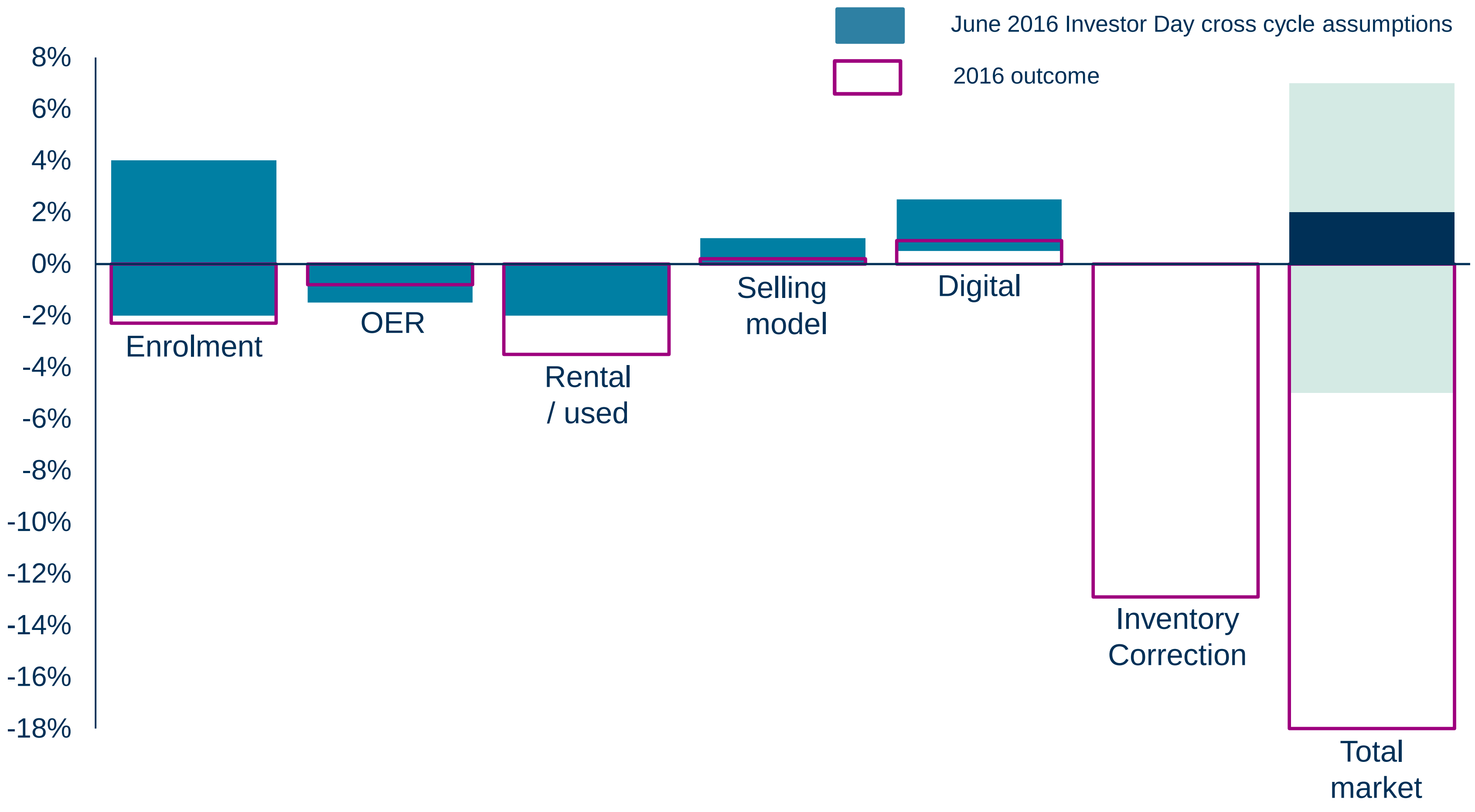
How 2016 compared in North American higher education courseware



Operating profit

£m	2016	2015	*CER growth*	*Underlying growth*
North America	420	480*	(28)%	(28)%
Core	57	105	(51)%	(51)%
Growth	29	(3)	n/a	n/a
Penguin / PRH	129	90	23%	23%
Continuing operations	635	672	(21)%	(21)%
FT Group	--	51	n/a	n/a
Total	**635**	723	(27)%	(21)%

* Includes £9m from PowerSchool

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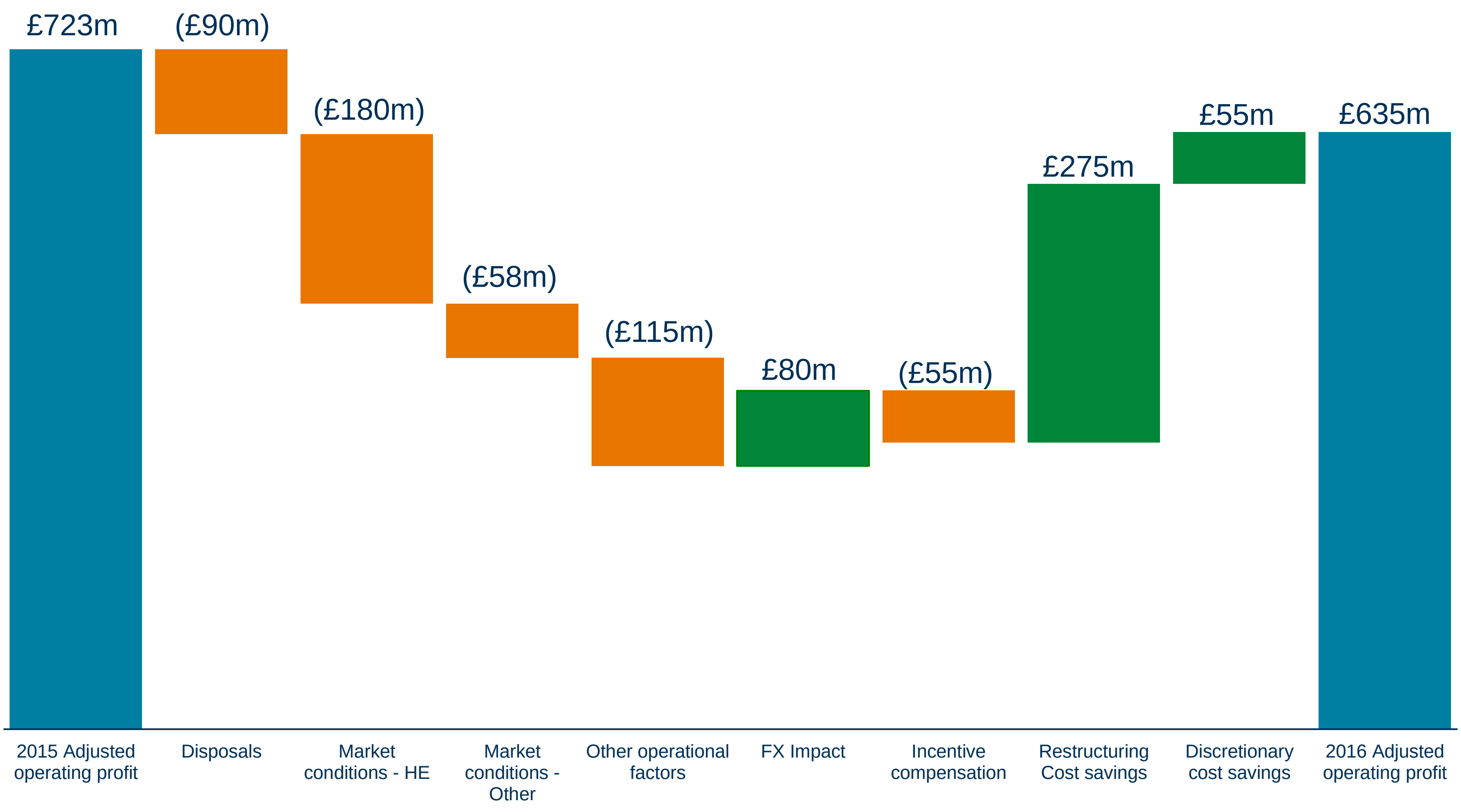
2016 bridge



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2016 restructuring program - delivered in full

- Single product organisation created
- Integration of North America assessment complete
- Reduced exposure to direct delivery
- Driving enabling function efficiency: Technology, Finance, HR
- Further rationalisation of property and procurement savings
- £425m of annualised cost savings, £25m more than planned at CER
- 4600 employees left Pearson

Adjusted EPS

£m	2016	2015	*Headline growth*
Operating profit	635	723	(12)%
Interest	(59)	(46)	
Taxation	(95)	(105)	
Tax rate	16.5%	15.5%	
Profit after tax	481	572	(16)%
Non controlling interest	(2)	--	
Adjusted earnings	479	572	
Shares in issue	814.8	813.3	
Adjusted EPS	**58.8p**	70.3p	(16)%

Total business

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Statutory P&L

£m	2016	2015
Adjusted Operating Profit	635	723
Operating Profit - discontinued operations	-	(51)
Operating Profit – continuing operations	635	672
Amortisation of intangibles	(221)	(240)
Other net gains and losses	(25)	13
Restructuring cost	(338)	-
Impairment	(2,548)	(849)
Operating loss	(2,497)	(404)
Interest	(59)	(46)
Other finance costs	(1)	17
Loss before tax	(2,557)	(433)
Taxation	222	81
Loss after tax	(2,335)	(352)
Discontinued operations	-	1,175
Loss / Profit for the year	(2,335)	823
Basic EPS (total)	**(286.8)p**	101.2p

Operating cash flow

£m	2016	2015	*var*
Adjusted Operating profit	635	723	(88)
Working capital	82	(226)	308
- of which pre-publication expenditure	(44)	(57)	13
- of which other working capital	126	(169)	295
Net capital expenditure	(247)	(241)	(6)
Depreciation	150	149	1
Share of operating results of associates	(142)	(110)	(32)
Dividends from associates and JVs	131	162	(31)
Exchange	43	22	21
Other movements	11	(44)	55
Operating cash flow	**663**	435	228
Cash conversion %	**104%**	60%	

Free cash flow

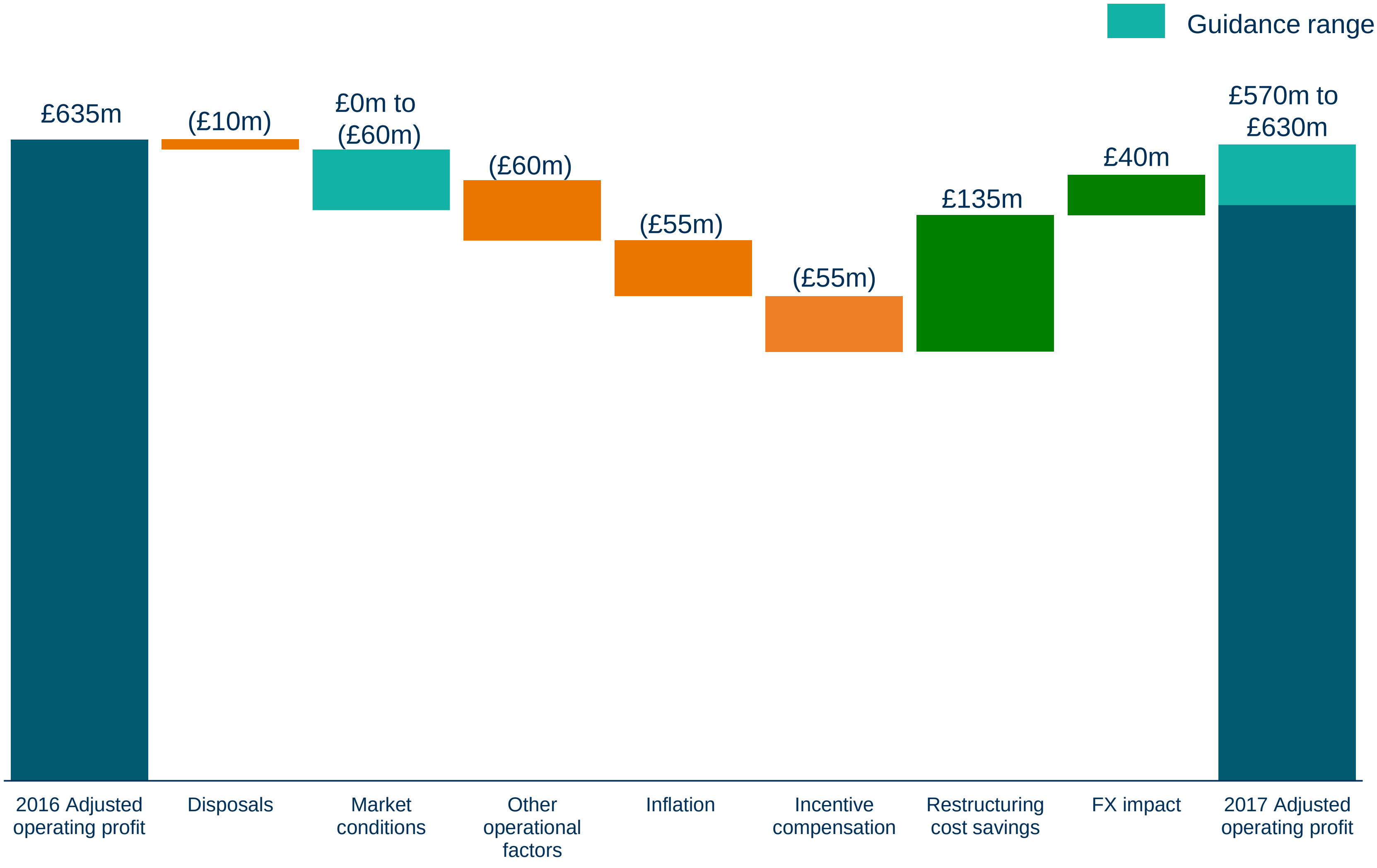
£m	2016	2015	*var*
Operating cash flow	663	435	228
Net interest paid	(51)	(51)	0
Operating tax paid	(63)	(129)	66
Operating free cash flow	**549**	255	294
Special pension contribution (net of tax)	(72)	-	(72)
Restructuring costs paid	(167)	-	(167)
Non operating tax paid	-	(103)	103
Free cash flow	**310**	152	158
Operating free cash flow / share	**67.4p**	31.4p	36.0p

Total business

Balance sheet

£m	2016	2015	Var
Goodwill / intangible assets	3,442	5,164	(1,722)
Tangible fixed assets	343	320	23
Associates & JVs	1,247	1,103	144
Pre-publication	1,024	841	183
Deferred revenue	(883)	(766)	(117)
Traditional working capital	561	644	(83)
Other net liabilities	(192)	(36)	(156)
Net trading assets	**5,542**	7,270	(1,728)
Shareholders' funds	4,344	6,414	(2,070)
Deferred tax	15	284	(269)
Pensions	(19)	(198)	179
Other provisions	106	112	(6)
Minorities	4	4	0
Net debt	1,092	654	438
Capital employed	**5,542**	7,270	(1,728)
Year end $/£	**1.23**	1.47	

2017 bridge



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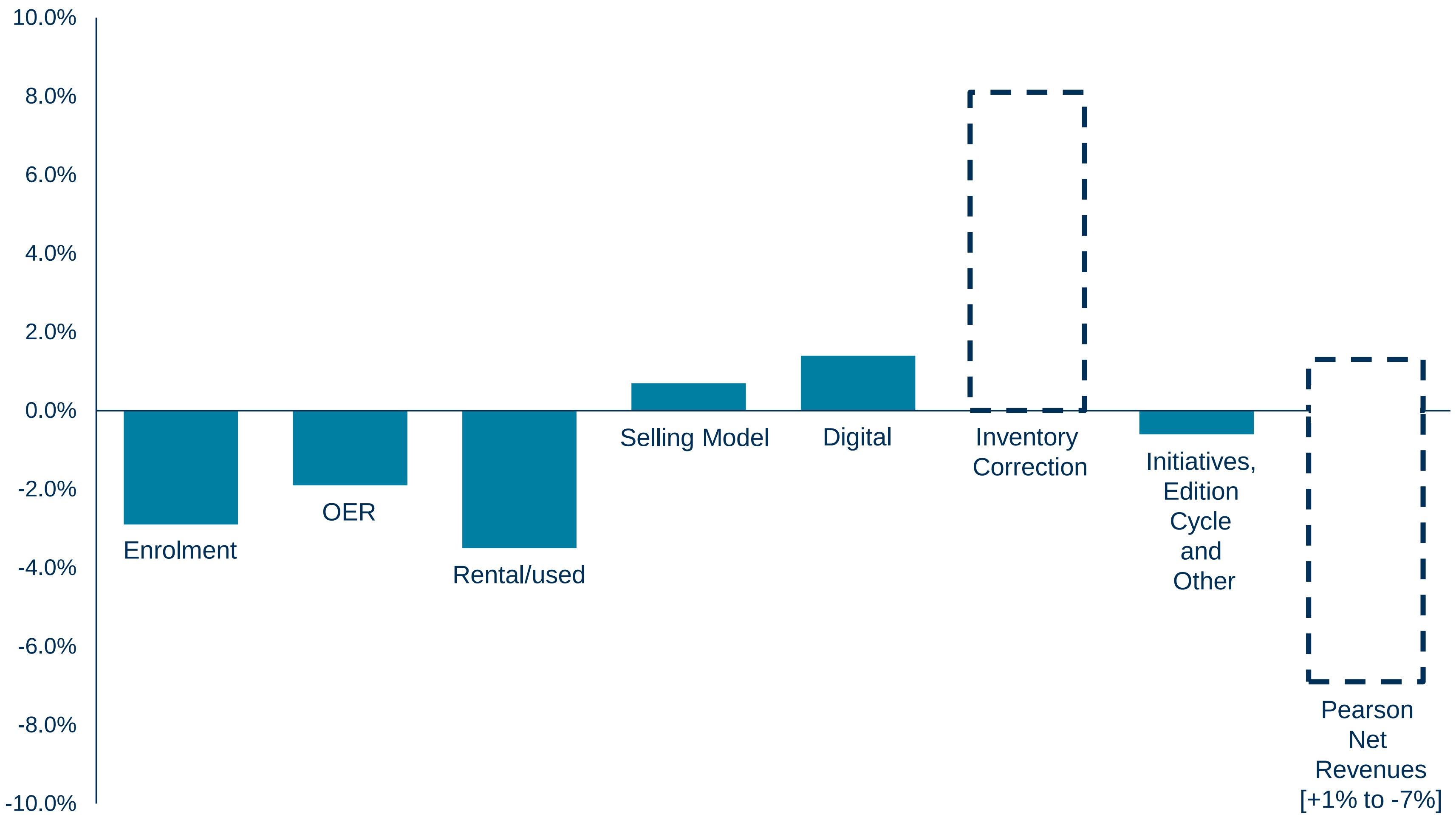
2017 higher education assumptions



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Other segments

Key assumptions

- UK Qualifications – stabilisation
- US Student Assessment – further top line pressures
- US K12 Courseware - ongoing pressures on participation rate due to CA
- Connections, OPM and Professional Certification - continue to grow
- China and Brazil - growth from new products and improvement in economy
- South Africa - some recovery

Cost control into 2017

- Continue to build scale and capability within our shared service centers that have over 900 employees across HR, Finance and Technology
- Simplify the organisation and technology estate through a further decomissioning of over 300 systems as single core platforms are implemented globally
- Contract with a smaller number of strategic global vendors to deliver higher performance and quality with lower prices and reduced risk
- Deliver ongoing process transformations including global procurement, supply chain and property portfolio
- Continually review through internal and external benchmarking the cost base and take additional corrective action if required

PRH update

- Integration of Penguin Random House complete
- Greater industry-wide stability on digital terms
- Issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann in the contractual window
- We will sell our stake or recapitalise the business and extract a dividend
- Proceeds used to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating. Currently BBB/Baa2 negative watch

PENGUIN RANDOM HOUSE

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Capital allocation

Organic investment

- Sustain c. £700m - £750m organic investment p.a.
- Investments aligned to strategy

M&A

- Very limited acquisition activity short term
- Disposals and actions to focus portfolio

- Benchmark against other returns of capital
- Focus on ROIC before and after disposal profits

Dividend

- 2016 final dividend in line with 2015
- 2017 to be rebased and communicated later in year

Credit rating

- Maintain solid investment grade credit rating
- Source of Internal financial discipline

Our priorities

2017 priorities

- Simplify our portfolio
- Control costs and increase efficiency
- Focus on our biggest opportunities
    - Digital courseware
    - Next generation assessment
    - Virtual learning and managed services

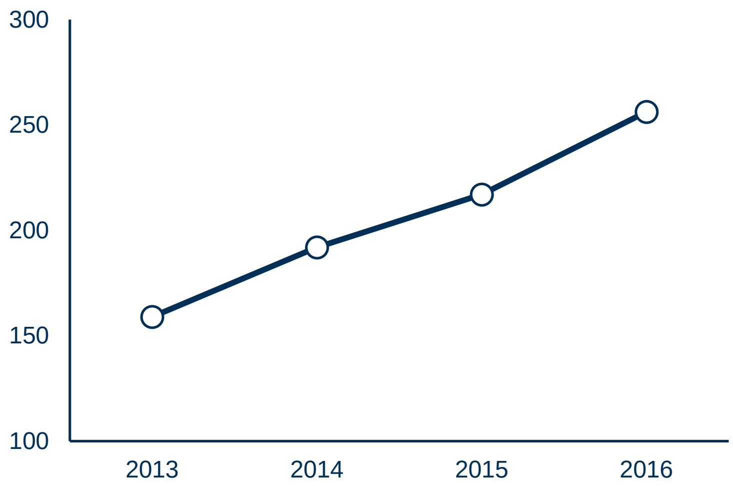
Digital courseware: US higher education

- 68 million course enrolments, we have 35% share of usage but 20% share of value
- In 2016 HE Courseware revenue 50% digital ; 50% print
- Accelerate digital and direct to consumer and institution

Grow direct to consumer

In 2016 18% of sales were direct to consumer

Direct to consumer gross sales $m



Accelerate digital

- 11 million registrations for digital products, our share of digital greater than competitors
- Integrated digital to grow share in new disciplines
- Adding adaptive personalized features across the portfolio
- 148 Digital Direct Access deals signed

Maximise value of text

- Reduce digital rental prices
- Create print rental partner model

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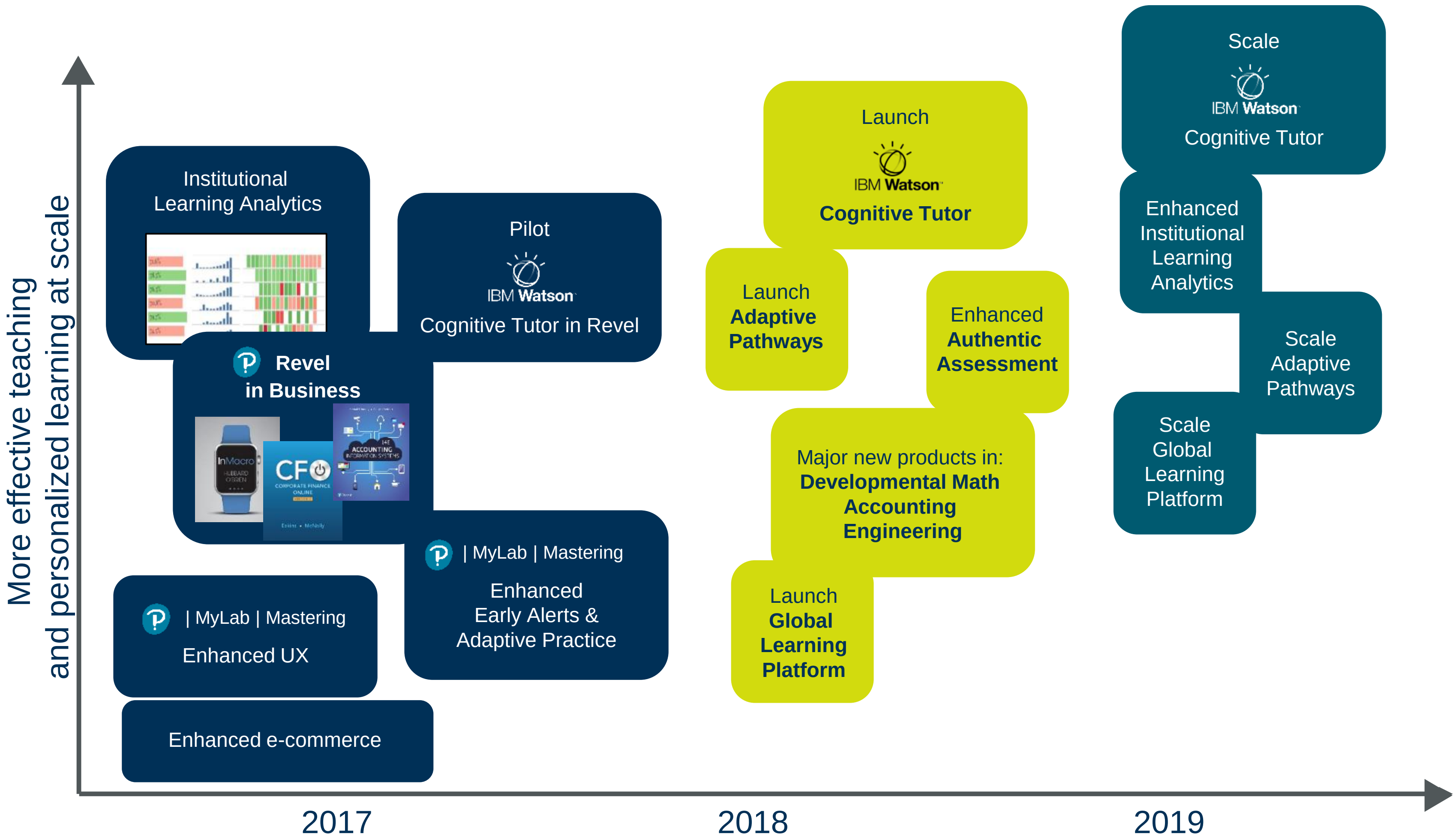
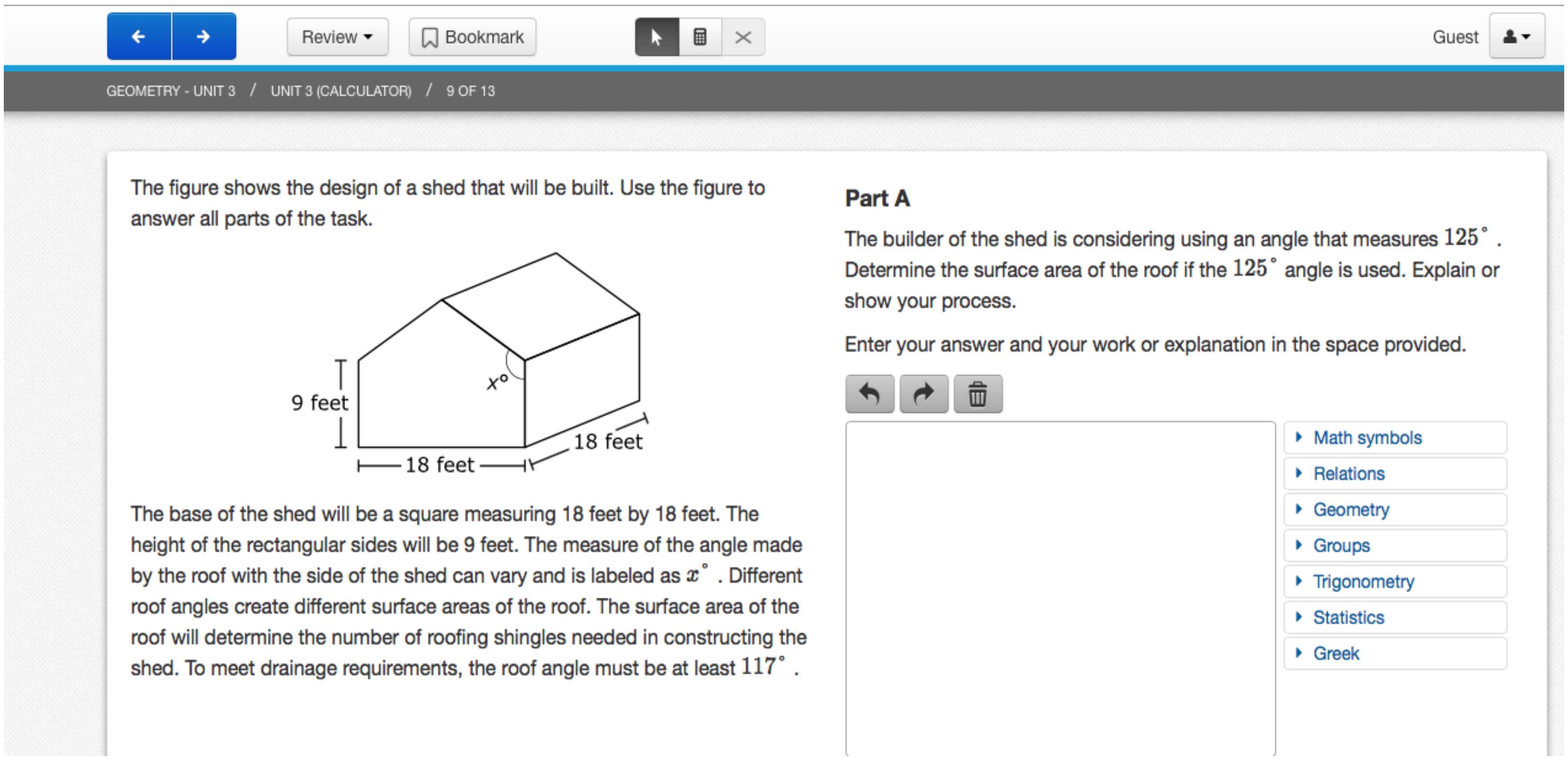
Grow digital– our product/feature pipeline

A product pipeline that promotes learning



Assessment: a smaller, more digital, higher margin business

Fewer, better, smarter tests



OPM

Leveraging our global scale and domain knowledge

Manchester Metropolitan University

KING'S College LONDON

MARYVILLE UNIVERSITY

MONASH University

How we’ll measure our progress

Financial

- Delivering our guidance for 2017
- Overall improvement in operating profit, EPS & ROIC

Operational

- Progress on cost reduction
- Delivery of key simplification programmes and global platforms

Competitive performance

- Market share performance in key businesses
- Increase share of value: expand addressable market

Talent and retention

- Retain key talent
- Drive a high performance culture

Purpose and impact

- Delivery of efficacy goals
- Improved brand awareness and favourability

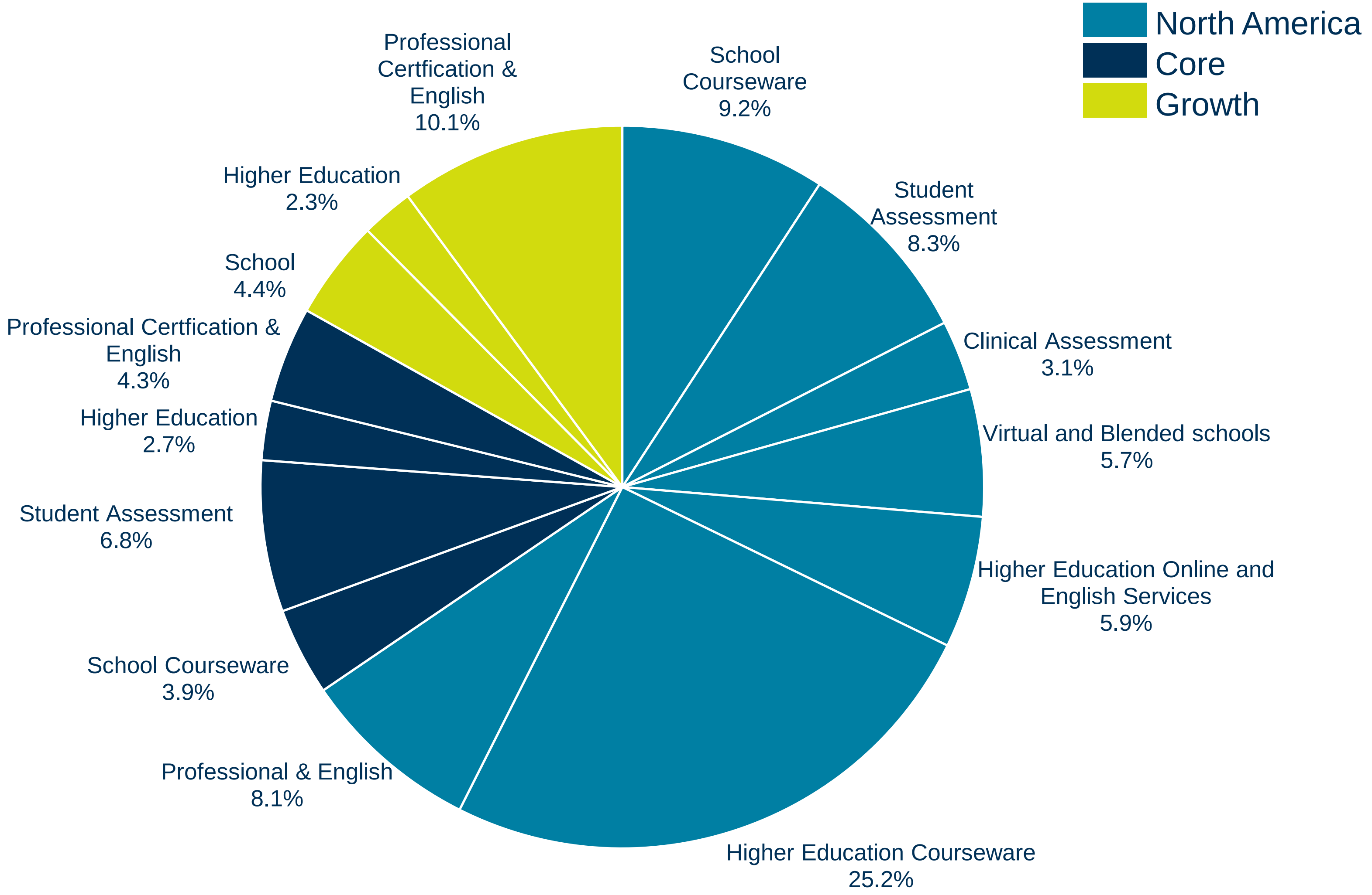
Building a more sustainable, digital company

- Fewer bigger opportunities
- Continued focus on tight cost management
- A simpler business
- Delivering better outcomes for learners
- A stronger, more sustainable, more digital business

Q&A

Appendices

2016 revenue split by geography



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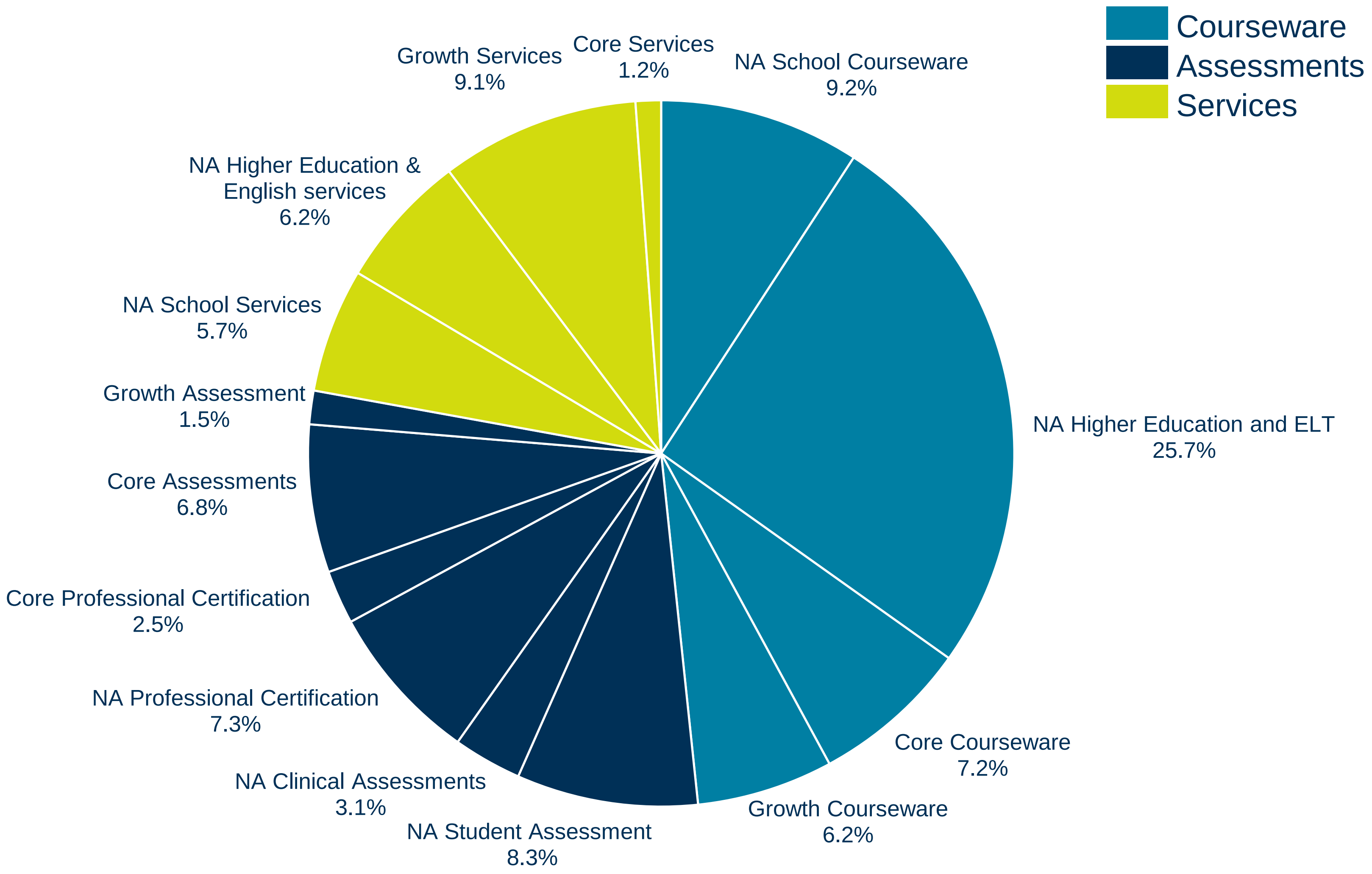
2016 revenue split by product line



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North America – Sales detail

£m	2016	2015	Underlying growth
K12 Courseware	418	406	(10)%
HE & English Courseware	1,168	1,229	(17)%
Courseware	**1,586**	**1,635**	**(16)%**
School Assessment	378	420	(22)%
Clinical	143	126	(1)%
Professional Certification	333	269	7%
Assessment	**854**	**815**	**(9)%**
School Services	259	209	8%
HE Services	269	223	5%
English Services	13	18	(8)%
Powerschool	0	40	na
Services	**541**	**490**	**6%**
Total	**2,981**	**2,940**	**(10)%**

Core – Sales detail

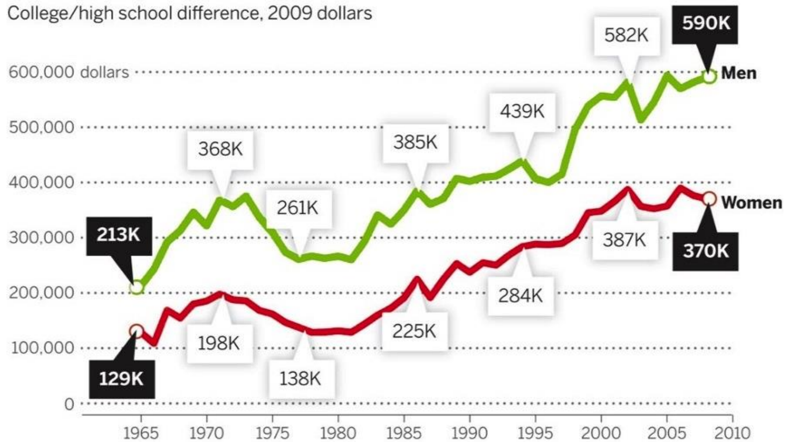
£m	2016	2015	Underlying growth
School Courseware	173	178	(5)%
HE Courseware	92	94	(10)%
English Courseware	65	65	(9)%
Courseware	**330**	**337**	**(7)%**
School & HE Assessment	268	296	(10)%
Clinical	40	32	9%
Pearson Test of English	22	8	138%
Professional Certification	90	87	(1)%
Assessment	**420**	**423**	**(4)%**
School Services	6	1	▲
HE Services	29	26	12%
English Services	18	28	7%
Services	**53**	**55**	**22%**
Total	**803**	**815**	**(4)%**

Growth – Sales detail

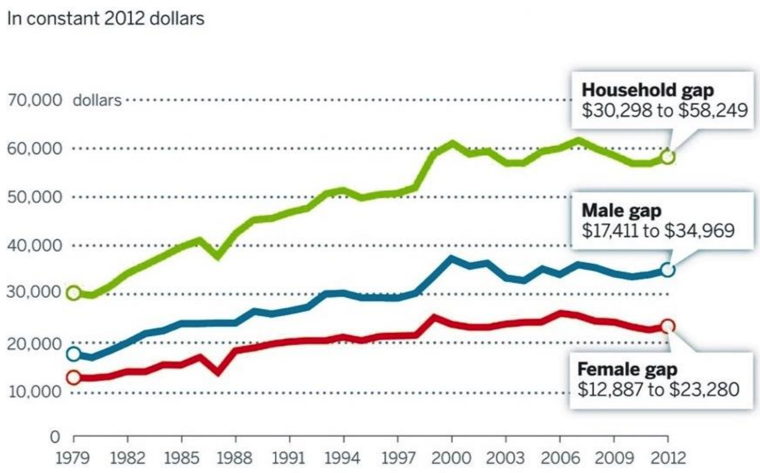
£m	2016	2015	Underlying growth
School Courseware	127	112	9%
HE Courseware	60	57	0%
English Courseware	97	84	11%
Courseware	**284**	**253**	**8%**
School & HE Assessment	21	20	0%
Pearson Test of English	11	6	50%
Professional Certification	38	31	6%
Assessment	**70**	**57**	**9%**
School Services	54	47	2%
HE Services	46	70	(37)%
English Services	314	286	(2)%
Services	**414**	**403**	**(8)%**
Total	**768**	**713**	**(1)%**

The economic value of an education has never been higher

Present discounted value of college relative to high school degree net of tuition, 1965 – 2008

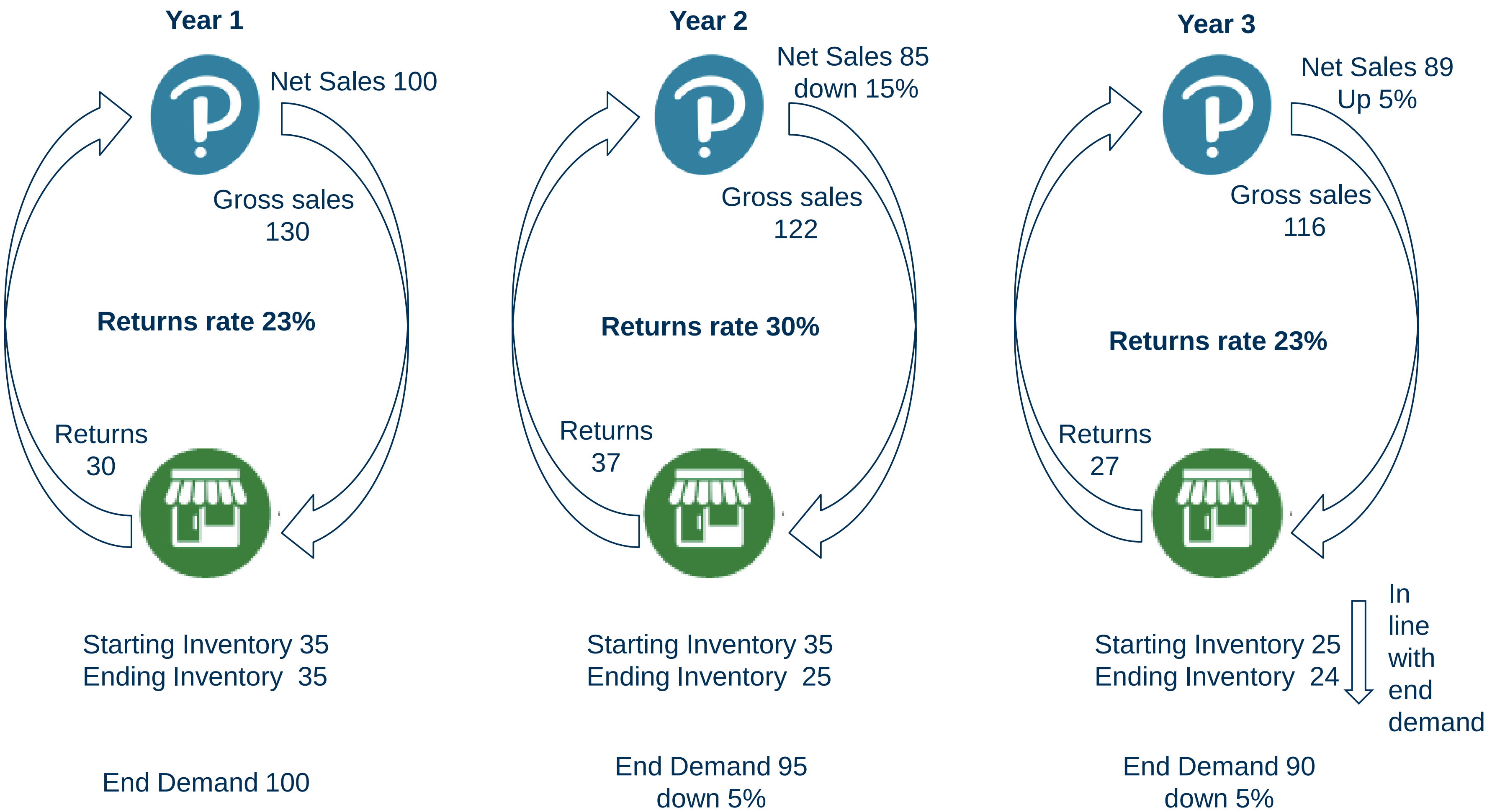


College / high school median annual earnings gap 1979 – 2012

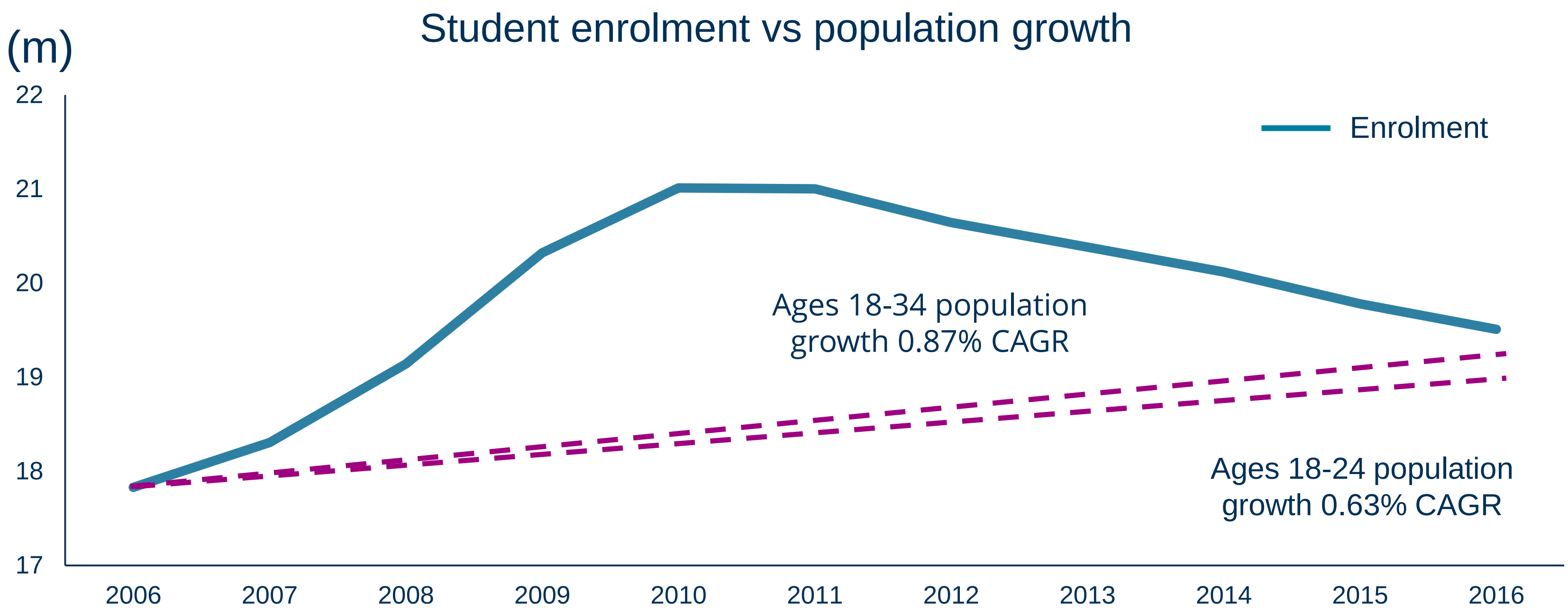


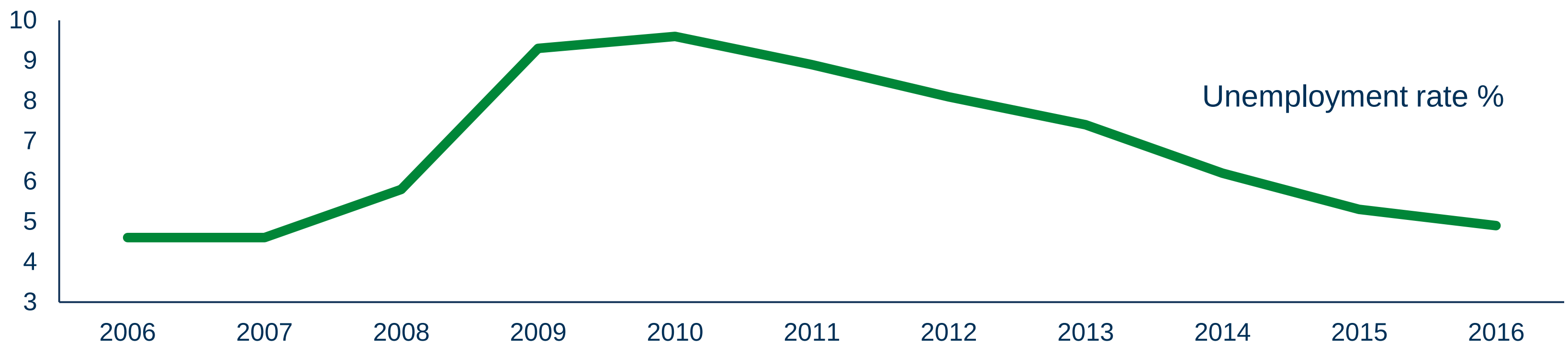
Source: adapted from Skills, education, and the rise of earnings inequality among the “other 99 percent” David H. Autor

How an inventory correction might work



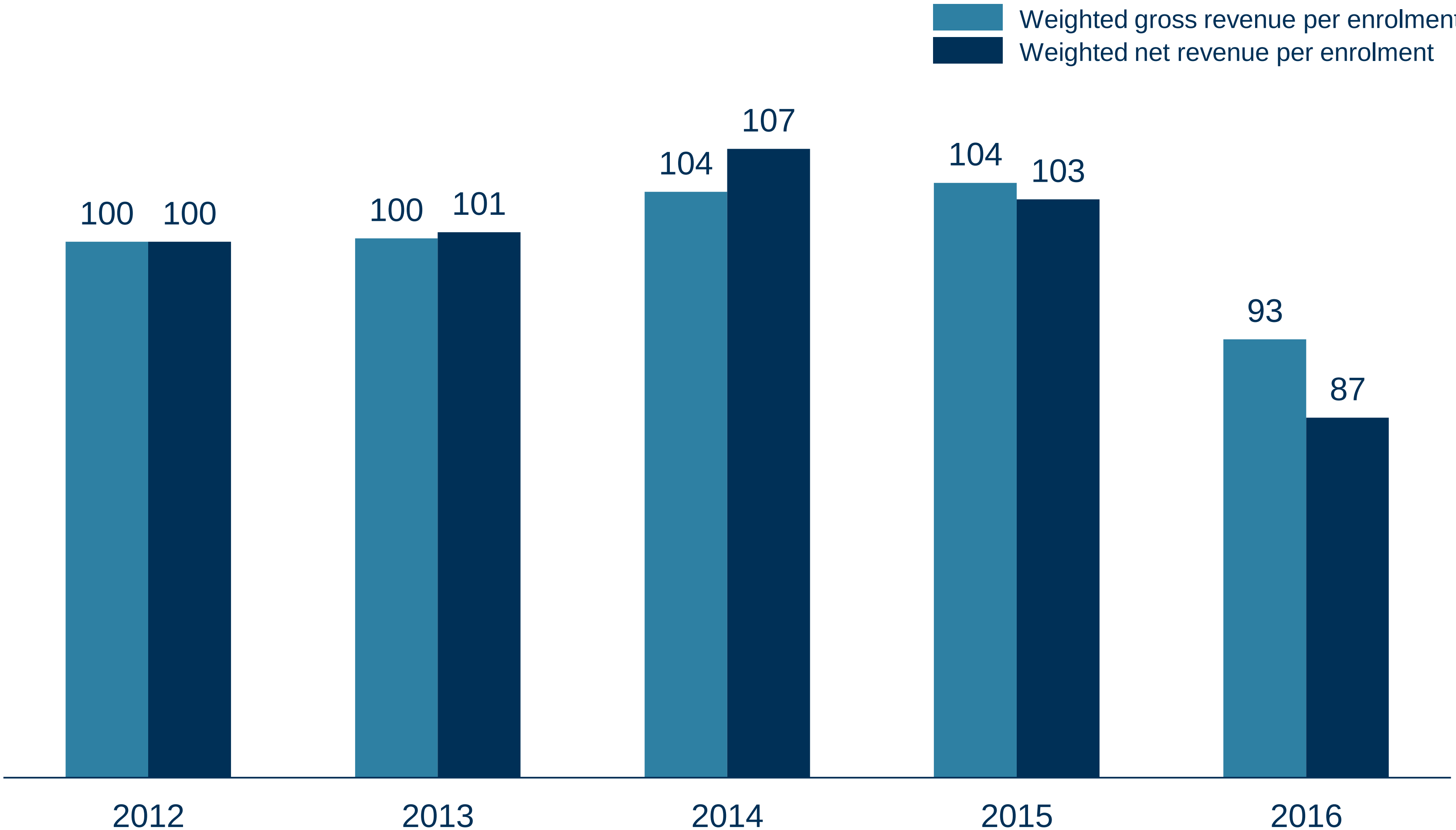
Enrolment





Source: National Student Clearing House, NCES, US Bureau of Labor Statistics

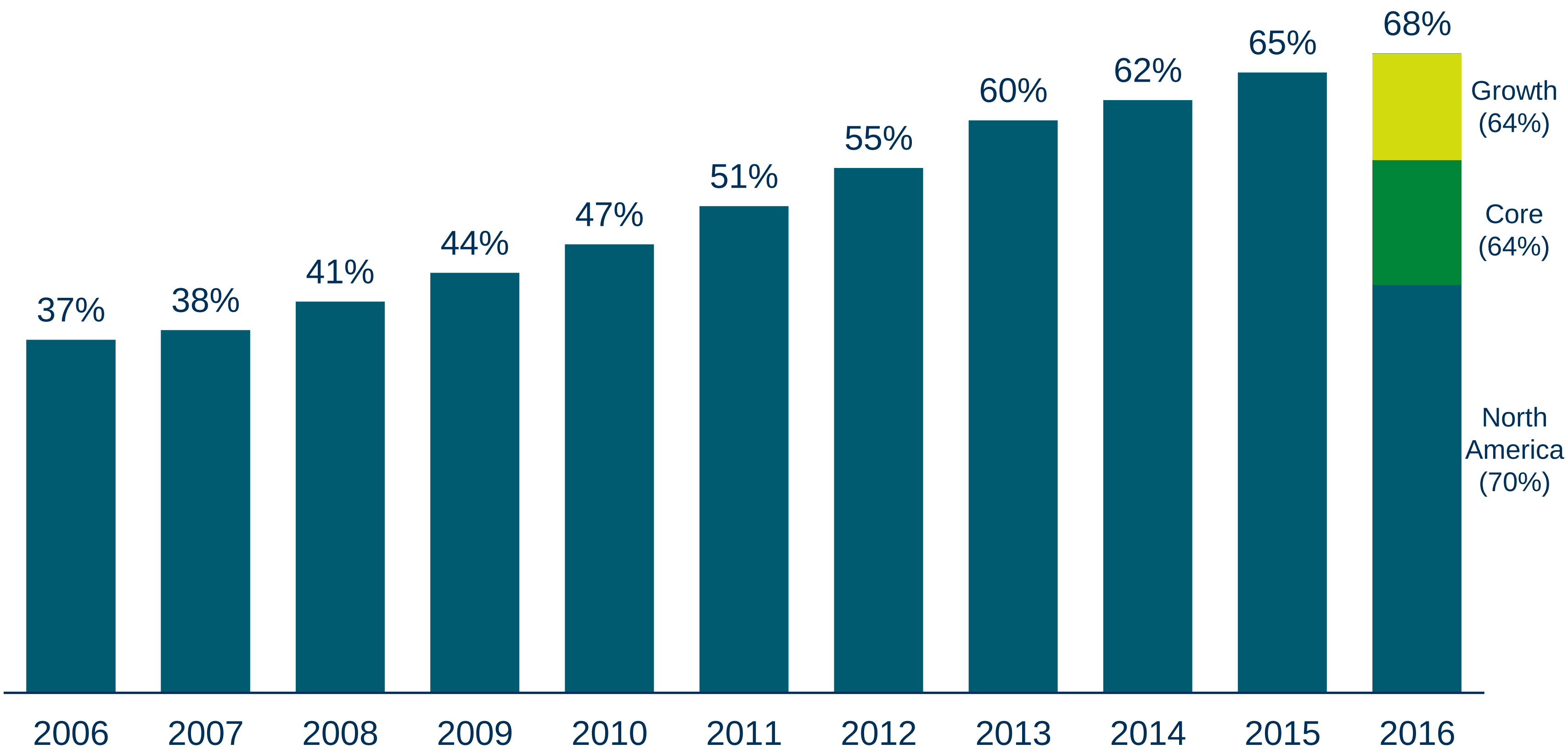
Higher education courseware ARPE analysis



Source: Management Practice Inc.

Pearson's digital & services revenues

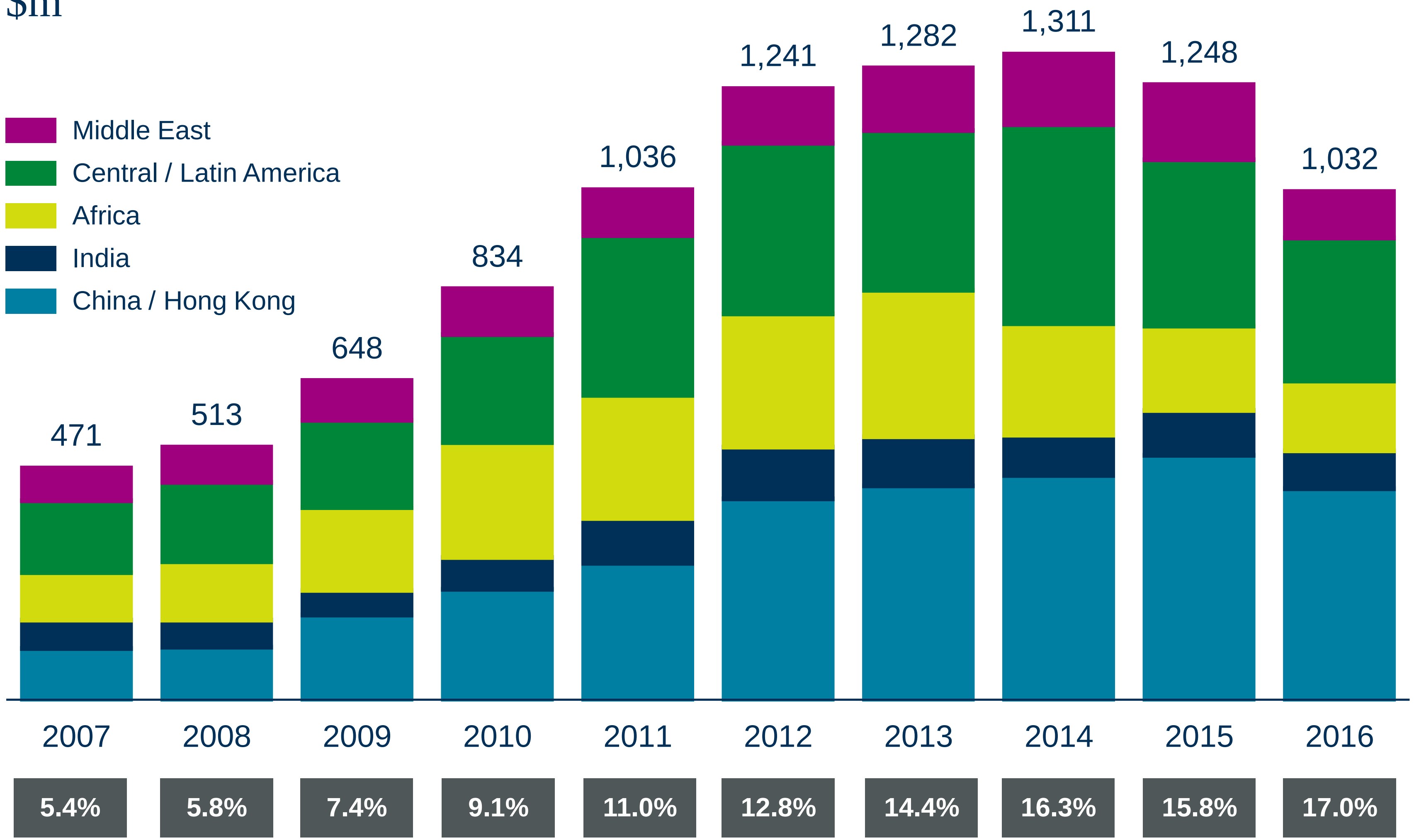
% of sales



Excludes Penguin and Mergermarket

Pearson's emerging markets revenues

$m



% of Pearson revenues

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Focus products - key performance indicators

Assessment, registration and student volume growth

School	2016	2015
Accuplacer	8,545,000	8,100,000
BTEC (calendar year registrations)	1,012,000	1,197,000
Connections Education (Full Time Equivalent students)	73,000	68,700
Edexcel GCSE/A level (papers marked)	5,429,000	5,467,000
Pearson sistemas (students)	407,000	449,000
Q-Interactive (sub-tests administered)	2,400,000	1,316,000
State and National Paper (papers marked)	21,922,000	32,700,000
State and National TestNav (tests administered)	23,638,000	26,400,000
UK National Curriculum Test (papers marked)	3,437,000	3,989,000
Higher education		
CTI/MGI (students)	8,500	11,300
MyLab/Mastering (user registrations)	13,200,000	13,000,000
Pearson Online Services (registrations)	315,000	265,000
UTEL Mexico (students)	14,500	12,600
English & Professional Certification		
Global Education (new student registrations)	64,000	85,000
MyEnglishLab and other ELT courseware (registrations)	861,000	739,000
Vue (tests administered)	14,910,000	14,200,000
Wall Street English (students)*	182,800	181,700

* Excluding disposals

Return on Invested Capital

£m	2016	2015
Adjusted Operating Profit	635	723
Less: operating tax paid	(63)	(129)
Return	**572**	**594**
Total Invested Capital	11,464	10,317
ROIC	**5.0%**	**5.8%**

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Debt level: credit rating agency view

£bn	2016	2015
Net debt	1.1	0.7
Lease liabilities	1.2	1.2
Total	**2.3**	1.9

Reconciliation: statutory to adjusted earnings 2016

£m	Statutory	Restructuring	Acquisition costs	Other net gains and losses	Intangible charges	Other net finance costs	Tax amortisation benefit	Adjusted earnings
Operating profit	**(2,497)**	**338**	**-**	**25**	**2,769**	**-**	**-**	**635**
Net finance costs	(60)	-	-	-	-	1	-	(59)
Profit before tax	**(2,557)**	**338**	**-**	**25**	**2,769**	**1**	**-**	**576**
Income tax	222	(84)	-	(14)	(255)	-	36	(95)
Profit after tax	**(2,335)**	**254**	**-**	**11**	**2,514**	**1**	**36**	**481**
Discontinued operations	-	-	-	-	-	-	-	-
Profit for the year	**(2,335)**	**254**	**-**	**11**	**2,514**	**1**	**36**	**481**
Minority interest	(2)	-	-	-	-	-	-	(2)
Earnings	**(2,337)**	**254**	**-**	**11**	**2,514**	**1**	**36**	**479**

Reconciliation: statutory to adjusted earnings 2015

£m	Statutory	Discontinued operations	Acquisition costs	Other net gains and losses	Intangible charges	Other net finance costs	Tax amortisation benefit	Adjusted earnings
Operating profit	**(404)**	**51**	**-**	**(13)**	**1,089**	**-**	**-**	**723**
Net finance costs	(29)	-	-	-	-	(17)	-	(46)
Profit before tax	**(433)**	**51**	**-**	**(13)**	**1,089**	**(17)**	**-**	**677**
Income tax	81	(9)	-	40	(257)	7	33	(105)
Profit after tax	**(352)**	**42**	**-**	**27**	**832**	**(10)**	**33**	**572**
Discontinued operations	1,175	(42)	-	(1,135)	2	-	-	-
Profit for the year	**823**	**-**	**-**	**(1,108)**	**834**	**(10)**	**33**	**572**
Minority interest	-	-	-	-	-	-	-	-
Earnings	**823**	**-**	**-**	**(1,108)**	**834**	**(10)**	**33**	**572**

Reconciliation: pre-publication costs

£m	2016	2015
Opening balance	841	820
Exchange	130	19
New spend capitalised	395	347
Acquisitions/disposals/transfers (net)	8	(64)
Amortisation	(325)	(281)
Restructuring charge	(25)	-
Closing balance	1,024	841

Reconciliation: year end net debt

£m	2016	2015
Non current assets		
Derivative financial instruments	171	78
Current assets		
Derivative financial instruments	-	32
Marketable securities	10	28
Cash and cash equivalents	1,459	1,703
Non current liabilities		
Borrowings	(2,424)	(2,048)
Derivative financial instruments	(264)	(136)
Current liabilities		
Borrowings	(44)	(282)
Derivative financial instruments	-	(29)
Net debt	**(1,092)**	(654)

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Retirement benefit obligations

£m	2016	2015
Income statement		
Operating charge		
Defined benefit schemes	16	24
Defined contribution schemes	67	74
Post retirement medical benefit schemes	(2)	-
	81	98
Interest	(11)	(4)
Total	70	94
Balance sheet		
UK pension scheme asset	158	337
Other pension scheme liabilities	(47)	(40)
Post retirement medical benefit liability	(77)	(76)
Other pension accruals	(15)	(23)
Total	**19**	198

ALWAYS LEARNING