

CEO's strategic overview ^S

“The long-term opportunity in education remains hugely significant.”



John Fallon
Chief executive

Dear shareholders,

2016 was a tough year for Pearson. We saw our biggest market – US higher education courseware – shrink again, as a result of three factors: declining college enrolments, changes in the buying patterns of students and a correction in inventory levels carried by distributors and bookstore chains.

In retrospect, we failed to see the accelerated level of disruption taking place in the US market. This disruption affected the whole sector, not just Pearson – but led to an 18% underlying decline in revenues for our largest business.

We announced in January 2017 that we would not achieve our previously set 2018 profit target, and will rebase our dividend from 2017 onwards.

We also announced a number of steps to accelerate our digital transition, protecting existing revenues and growing new ones, while managing the ongoing decline in print sales.

We will weather these challenges as well as, if not better than, our competitors. Digital now represents 50% of Pearson's higher education courseware revenues, and is growing steadily, even at a time when college enrolments are declining. By the end of this decade, the balance will be 75:25. Our digital higher education products are roughly twice as popular as those of our competitors.

As a natural consequence of our lower profits expectations, we have also taken a significant non-cash write-down of goodwill of £2,548m, as part of our annual impairment review. The goodwill relates to

our North American businesses, and in particular the 1998 acquisition of Simon & Schuster Education and the 2000 acquisition of NCS.

All this has been difficult for Pearson shareholders. However, we remain committed to returning the company to growth and to building a stronger, more durable business.

Pearson has demonstrated competitive spirit, resilience and progress on many fronts even in the tough conditions noted above. We performed well in our major markets and announced a number of new digital products and new partnerships to help reach more learners. We delivered our restructuring and cost savings programme in full and, thanks to careful cost management, hit our 2016 profit goal.

Three key trends in our markets ^S



Online education

To meet the demand for more flexible, digital and effective education, schools, colleges and universities are increasingly seeking partnership models which enable them to reach more learners, scale their teaching online and improve their productivity.



Personalised learning

Through the move to online education, rapid advances in technology are also enabling individual, adaptive learning to take place at scale. The rise of artificial intelligence and virtual reality in the classroom brings exciting new opportunities for learners, schools, colleges and educators, and will help increase student engagement and course completion and, ultimately, improve learning outcomes.



Employability

In a world where 500 million people are out of work but four in 10 employers are unable to find qualified candidates to fill open roles, the link between learning and earning is more crucial than ever before. Students are focused on gaining the skills they need to get better jobs and more rewarding careers, while re-skilling and up-skilling are taking place in the shifting digital economy.

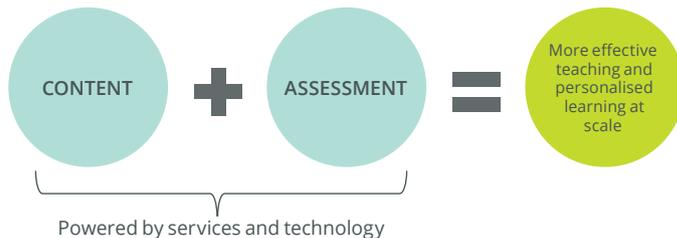
We are achieving important synergies across Pearson in terms of our product platforms and enabling technologies – helping to run the company more smoothly and efficiently.

We are creating an increasingly digital and services-based business. US student assessment contributed more in profit than a year ago despite a 22% underlying decline in revenues.

We have made our emerging market Growth businesses profitable again, with a more durable platform for future success. In our Core business – incorporating markets such as the UK, Australia and parts of continental Europe – we are managing a huge programme of change in UK qualifications, and setting the business up for future success. We are growing well in virtual schooling, online degrees for universities, and English language testing; all promising parts of our future.

This report highlights a number of ways we are drawing on the potential of technology to make meaningful improvements to learning, alongside our partners.

Our strategy can be expressed as an equation:



Pearson’s strategy – 100% focused on education

The long-term opportunity in education remains significant. Around the world, 500 million young people and adults are out of work, yet 40% of employers are unable to find qualified candidates to fill open positions.¹ The social and economic changes being wrought by technology, ageing populations and globalisation will only increase the value of high-quality education. Much of our work relates to meeting these new needs – whether through our vocational qualifications and apprenticeship programmes in the UK, or offering workforce development partnerships to some of America’s largest employers.

Pearson serves the needs of millions of students and teachers by combining world-class educational content and assessment with the promise of new technologies and cutting-edge new educational services.

In 2016, Pearson continued to invest significantly in research and expertise for education products. Our **courseware** – educational materials, in print, blended and digital formats – now combines the very best content with learning design and technology to create great user experiences and better learning outcomes. Our MyLabs software now adapts to prompt college students with hints about what to study next, and gives early alerts to teachers when their students are in danger of falling behind.

1. *The Economist*, April 2013.

How our strategy creates value ^S

Our goal is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, powered by services and technology.

Short-term priorities

- › Simplify our portfolio
- › Control costs
- › Invest in the biggest opportunities in education

Strategic growth drivers

- Develop digital & services**
See p14-15 →
- Build market presence**
See p16-17 →
- Deliver measurable outcomes**
See p18-19 →

Our constant goals

- Our strategy will deliver growth by:
- › building a sustainable business;
 - › being a trusted partner; and
 - › reaching more learners; to create long-term value.

CEO's strategic overview S

Our **qualifications and assessment** services are cutting edge. We help to measure progress and analyse insights about the achievements and abilities of learners all over the world. In 2016, we ran 23.6 million online tests in the US alone – and helped teachers create millions more of their own short, formative assessments, to check student progress and learning.

Our **digital teaching and learning services** combine these capabilities and focus on extending educational access and improving outcomes – through virtual schools and online degree programmes, we are creating digital products that are more reliable and enjoyable for the students that use them. These will in turn create new opportunities to grow.

The process of making, selling and servicing our products means that we are in daily contact with more educators than any other commercial organisation in the world. We understand the realities of running schools and universities, and teaching students of all ages and backgrounds. That understanding means Pearson is well placed to assist schools and universities in their transition from analogue to predominantly digital learning.

Personalised learning in action

Our products are increasingly driven by the concept of personalised learning, and our goal is to help educators reach every student in a way that meets their individual needs. New technologies are enabling Pearson to make personalised learning a reality for millions of students and teachers: **analytics**, which provide decision-making insights to teachers and students; **adaptive capabilities**, that intelligently adjust to the needs of each student based on their knowledge, skills, attributes or behaviours; and **implementation services**, that support educators to successfully integrate digital tools into their teaching.

Millions of students already experience adaptive learning every day with our products, but we have major plans to step up these capabilities. In October 2016, we announced a partnership with IBM to integrate their advanced cognitive computing capabilities into Pearson's products. Together, we plan to provide college students with a virtual tutor, powered by artificial intelligence techniques to help increase engagement, provide educators with better tools and ultimately help drive completion rates. We will be piloting the product in colleges across America in 2017 – and over time we see the potential to reach millions of students around the world with better, more engaging teaching.

The digital opportunity

The colleges and universities with whom we work still teach primarily face to face, in physical buildings, which limits their own scale and reach – but this is starting to change. Technology now enables them to reach far more students, with teaching and learning happening virtually, online, as well as in the physical classroom.

We are partnering with universities on three continents with services including course and programme design and development, student recruitment and retention, and related platforms and technologies. These services help our partners reach more students, ensure more of those students are successful in their studies, and help those partners run their operations more effectively.

We already have more than 40 of these partnerships in the US and Australia. In 2016, we began our first online degree partnership in the UK with King's College London, helping to create online master's degrees in Psychology and Law. We expect to announce further partnerships with leading universities in 2017.

Executive team

We are managed by a board of directors and I, as chief executive, am responsible to the board and lead through an executive team.

-  **Coram Williams** Chief financial officer
-  **Michael Barber** Chief education advisor stepping down in March 2017
-  **Tim Bozik** President, global product
-  **Rod Bristow** President, core markets
-  **Kevin Capitani** President, North America
-  **Giovanni Giovannelli** President, growth markets

-  **Albert Hitchcock** Chief technology and operations officer
-  **Kate James** Chief corporate affairs and global marketing officer
-  **Bjarne Tellmann** General counsel and chief legal officer joined executive in 2017
-  **Bob Whelan** President, assessments
-  **Melinda Wolfe** Chief human resources officer

For more on our governance structure, see p63 

Our priorities for 2017

Pearson needs to achieve a number of important goals in 2017 to fuel our return to sustainable growth.

Our competitive performance has been strong even in the face of market challenges – you can read more about this on p38-43. In 2017, we will be focused on [holding or gaining share in all our major markets](#) – from seeking improvements in US higher education to building on the rapid growth we have achieved with virtual schools, online degrees, professional testing and the Pearson Test of English.

Having made Pearson a more focused business and lowered operating costs significantly over the past three years, we will also continue to [make Pearson simpler, more efficient and effective](#). We will further rationalise our platforms and tools, supply chain process and property portfolio; improve our efficacy and the speed with which we launch new product features; and ensure our digital and marketing capabilities are optimised and effective. These investments in stronger simpler platforms and in better learning outcomes should all contribute to better user experiences for the millions of teachers and students we serve. You can read more on our approach to sustainability on p20-27 and our efficacy reporting commitments on p18-19.

Our employees bring diverse talents to Pearson, and learning and social impact matter for our staff as much as those we serve. In 2017, we will continue to identify and retain the best talent across Pearson, building a talent pipeline for key roles and promoting employee programmes that contribute to career development. We are also intent on [building Pearson's culture and our brand](#), which we relaunched in 2016, to position Pearson as a force for good with all the stakeholders with whom we work – recognising the value of our core business as much as our important partnerships through Project Literacy and with Save the Children, Unicef and others. You can read more about this on p20.

The achievement of these core aims will help us to [meet our financial targets](#): achieving our 2017 budget, investing in Pearson's growth, maintaining our financial strength through a period of change and volatility, and improving returns to shareholders.

The year ahead

2016 was a challenging year for Pearson. We have been hit hard by pressures in US higher education, which will continue into 2017 and 2018. We are acting quickly to build a more sustainable, digital business less exposed to volatility.

Across Pearson we have strong businesses delivering steady profits in educational content and assessment. We have others which are growing fast from a smaller base, meeting new needs as education itself evolves.

We are creating a more digital, services-led company that can maximise opportunities – and mitigate threats – by making education more accessible, affordable and effective for far more people. We are making Pearson a more efficient company, with digital services that support a new generation of personalised learning and which create subscription-style business models for us to renew and repeat sales.

This is challenging, but exciting work. Pearson will continue to focus on fewer, larger opportunities, to manage our cost base tightly and to make Pearson a simpler, more efficient company. Over time, we will deliver a more sustainable, more profitable business, delivering better educational outcomes for learners.

Thank you for your support of Pearson.



John Fallon
Chief executive

Penguin Random House

Penguin has been an important part of Pearson for many years, and our decision in 2012 to combine it with Random House, creating the world's largest consumer publisher has been vindicated by its continued creative and commercial success.

Our recent announcement of our intention to exit our 47% stake of the combined business reflects an intention that we will now focus entirely on our education strategy.

Should Bertelsmann choose to buy Pearson's stake we will reinvest the proceeds to maintain a strong balance sheet, invest in our business and return excess capital to you, our shareholders, while retaining a solid investment grade credit rating.



Learn more about
our Strategy in action
on the following
18 pages.