

# CEO's strategic overview

Technology is radically changing the way we live, work, and learn, and we are only in the early stages of what is possible.



John Fallon  
Chief Executive

Dear Shareholders,

## A year of progress

We are making good progress, financially, operationally and strategically. Underlying adjusted operating profit increased by 8% last year, with a healthy 94% of that profit converted into cash. We outperformed on our cost savings plan and are now on track to achieve more than £330m in annualised cost savings by the end of this year. We strengthened our balance sheet even further, allowing us to invest more than ever in the digital transformation of our company. The demand for dynamic, evidence-based, outcome led, digital first education products and services is growing all the time. So we are investing in the digital platforms, products and services that help people make progress in their lives through learning – and it is starting to pay off. Our digital and digitally-enabled revenues now account for 62%<sup>1</sup> of our sales and we expect them to grow steadily over time.

## A strategy for future, sustainable growth

There is, however, a lot still to do. On the measure that is the best indicator of our company's long-term success – sustainable and profitable growth in like for like sales – we are not yet where we need to be. Underlying sales were down by a further one percent last year. What is encouraging, though, is that we expect revenues to stabilise this year – an important step in the Pearson recovery – before starting to grow again in 2020 and future years.

That growth will be driven by our compelling vision of Pearson's future, a clear understanding of the capabilities – the competitive edge – that will get us there, and what we need to be focusing on today to secure that future.

Pearson is the world's learning company. Our purpose is to empower people to progress in their lives through learning, enabling them to acquire the knowledge and skills to thrive in an ever-changing and increasingly connected world. As the link between education and employment becomes both more important and explicit, we aim to be at the heart of a wider ecosystem of partners, shaping the future of learning.

We will be able to play that role because of the world-class capabilities we bring to bear, and the ways in which we combine them to achieve better learning outcomes. We will get there by focusing on the three things that are starting to change the growth dynamic of Pearson:

- › One, we are leading the digital transformation of our courseware and assessment businesses. These businesses make up 65% of our sales today. Their collective sales fell by 4% underlying last year as we are at a point in the technological disruption of these businesses where the impact of the decline in analogue sales (from textbooks and paper and pen testing) is still greater than the benefit of growing digital uptake. We are now close to a tipping point in these businesses, however, where the momentum shifts. As these businesses become increasingly digital first, the rate of decline will gradually lessen before revenues stabilise and, in time, grow again.
- › Two, we are investing more in our businesses in structurally growing markets. These businesses, all fully digital or digitally-enabled, make up 35% of our sales today and grew 7% underlying last year. As we invest more, these businesses will grow more quickly and, as they become a bigger part of Pearson, they help the company as a whole to start to grow again.

- › And three, making Pearson simpler and more efficient. This does not just cut costs. It also provides an important platform for future growth because it enables us to reallocate investment to our growth areas more quickly, innovate at scale, and build a more direct, longer-term relationship with the tens of millions of learners who use Pearson products each year.

## A digital first approach

The increasingly digital nature of our courseware and assessment businesses can be seen in the work we do with American schools and universities. Digital now accounts for 56% of all tests we administer in US schools and 55% of our US Higher Education Courseware revenue.

This digital first approach is driving our product innovation and investment. Our Global Learning Platform (GLP) will accelerate our ability to develop, test, and deliver highly personalised experiences across all of our products and services, eventually becoming a platform for growth for the whole company.

Revel, our first fully integrated digital courseware product, increased subscribers by over 40% last year. New Revel titles, with enhanced assignment options and sophisticated data analytics, will be the first products to launch commercially later this year on the GLP.

We will also launch our first Artificial Intelligence (AI) powered maths tutor, as a mobile app marketed directly to Calculus students around the world, providing step by step feedback instantaneously on hand written attempts to solve a problem.

<sup>1</sup> Excluding WSE and US K12 Courseware. Underlying growth rates exclude currency movement portfolio changes and accounting changes.

We will partner with universities on our first AI powered essay marker, that will adapt to the personal style of any professor. And we expect to bring a new adaptive maths product, which we are currently piloting, to commercial launch early next year.

This growing, innovative product pipeline signals we are now ready to shift our higher education product portfolio to a digital first model, with frequent releases of content, features and updates no longer tied to an edition cycle.

Print resources will be available, but as rental or an “add on” service. This means better customer choice with simple, affordable and convenient access to the courseware that enables students to be successful – and all giving better insights for instructors to enable better outcomes. A digital first, subscription-based business is also, of course, a much more stable one.

Increased investment in our structural growth opportunities is also paying off. Online Program Management, (OPM) our business helping universities scale online, increased underlying sales 10% last year, with global course registrations growing 14%. We signed a new OPM contract with leading European business school ESSEC in France – the fourth global market we have entered in OPM – allowing students to study AI and big data in an online masters format.

Our virtual schools business, Connections Academy, grew underlying revenue by 8%. Professional Certification grew underlying revenue by 4% with over 70 new contracts signed during the year.

The Pearson Test of English Academic, our homegrown test of English aptitude, increased test volumes by 30% in part driven by the extension of the Australian immigration office contract for a further two years. This has opened up additional opportunities with governments and educational institutions that we are currently exploring. The Pearson Test of English is also a good example of how, as we become a simpler and more efficient company, we are also able to operate much more globally, sharing innovation more quickly with customers all over the world.

## Key achievements in 2018

### Adjusted operating profit<sup>1</sup>

£546m

Achieved 2018 adjusted operating profit in the upper half of our guidance range.

<sup>1</sup> See p46–47 for an explanation of this alternative performance measure and p222–225 for full reconciliation of the numbers to the equivalent statutory measure.

### Strong balance sheet, low net debt

£143m

Net debt down from £432m in 2017 as we continue to strengthen our balance sheet, enabling us to navigate a large transformation.

### Continuing organic investment

£700m+

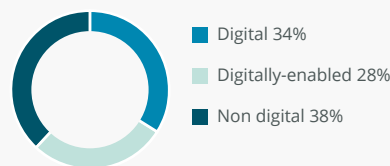
Continued investment in fastest growing businesses in order to build a pipeline to grow revenue over the next few years.

### Simplification programme ahead of plan

£130m

In year cost savings for 2018 running ahead of our plan enabling further investment back into the business. Total annualised cost savings now expected to be £330m+.

### Pearson's digital revenue 2018 Percent of sales<sup>2</sup>



<sup>2</sup> Excludes WSE and US K12 Courseware.

## CEO's strategic overview

A wider trend in lifelong learning is the growing demand for employer certified and applied, career relevant education. Our leadership in BTEC and apprenticeship programmes is an interesting opportunity to grow internationally – and we are working on some promising initiatives in Thailand, Vietnam and China.

It is by focusing on these three priorities – leading the digital transformation of our courseware and assessment businesses; investing more in our structurally growing businesses; and making Pearson simpler and more efficient – that we will set Pearson growing again. As we accelerate our move to digital, Pearson also becomes more sustainably profitable and scalable, with a more reliable and predictable revenue and cash profile.

### Our commitment to efficacy and impact

Underpinning all of this work is our commitment to efficacy, to achieving the very best learning outcomes. Last year, we became the first education company in the world to publish externally audited and independently reviewed reports about the efficacy of our products. This year, we are releasing our second series of reports. These reports give us confidence that our existing products can be used to impact on outcomes that matter to our customers and learners. Our public commitment to efficacy is also influencing others in the sector to now take up similar work. What is most exciting, though, is how we are applying what we are learning to the next generation of digital first products and services that we are launching this year. We are able to explicitly connect the outcomes that matter most to our customers: evidence-based content, assessment, and technology, all designed to be implemented in ways that maximise the impact on learning. This enables us to shape the future of learning so educators, learners, employers – and shareholders – all get the best possible return for the investments we make.

### Promoting talent and diversity through a time of great change

Making an impact matters to the highly motivated and talented colleagues who, inspired by our mission and purpose, are committed to driving the company through what is, by any definition, a major transformation. Many new and talented employees are joining Pearson, but we also continue to say goodbye to some long-standing friends and colleagues. As we align our cost base, and bring everything we do in line with the future direction of the company, the scale and pace of change can be disruptive and difficult for many colleagues. This makes it all the more important that we are very focused on the overall health of the organisation, and in fostering a culture that enables people to learn, to grow, and to be able to innovate, through these times of change.

To do that, we are focusing on developing talent at all levels, and we remain firmly committed to improving diversity and inclusion across the company. For example, as required by UK legislation, we now publish an annual gender pay report covering our UK employees, which reveals a median pay gap, in favour of men, of 14%. The only way to close this gap is to have more women in more senior positions in the company, and we are taking concerted actions that we believe will help us to achieve this over time. As a global company, we think it is important to hold ourselves to account on that basis, so we are planning to publish a company-wide gender pay report next year.

We continue to make progress. We are proud to be recognised on Forbes Best Employers for Diversity in 2019 and Bloomberg's Gender Equality Index. We are also proud of the progress and the external recognition of our sustainability work. In January 2019, we were named as one of the Global 100 Most Sustainable Corporations in the World, which ranks large companies on their performance of reducing carbon and waste, their gender diversity among leadership, revenues derived from clean products and overall sustainability.

### A simpler portfolio

We have now reached an agreement to sell our US K12 Courseware business to Nexus Capital Management. School publishing in America has been an important part of Pearson for many years, and what it does matters to teachers and students across the country. We are pleased to have found new owners who are committed to its future, and we wish it every success. The sale frees us up to focus on the digital first strategy that will drive our future growth. Through our assessment, virtual schools, advanced placement and career education businesses, we will still serve schools across America and we will now be better placed to focus on the areas in which we can help students to be successful in their studies and future careers.

### Looking ahead

Last year, Viscount Blakenham, Pearson's former Chairman and CEO, and the last member of the Pearson family to lead the company, sadly passed away. Michael was widely regarded for his staunch defence of editorial independence and freedom of speech, his commitment to international growth and expansion, and his personal embodiment of Pearson's values.

In terms of its focus and operations, Pearson is now quite different from the company he stepped down from 23 years ago. What has not changed is our commitment to taking a long-term view, and creating sustainable value for our shareholders by providing important services to our customers in entrepreneurial and innovative ways.

Accelerating the move to more accessible, more affordable and better learning is as important as anything that this company has taken on in its 175 year history. We are confident that our strategy will deliver long-term sustainable growth, and we expect to make further progress in 2019.

Thank you for your ongoing support.



**John Fallon**  
Chief Executive

## Executive team



John Fallon Chief Executive



Coram Williams Chief Financial Officer



Albert Hitchcock Chief Technology  
& Operations Officer



Anna Vikström Persson  
Chief Human Resources Officer



Bob Whelan President Pearson Assessments



Bjarne Tellmann General Counsel  
& Chief Legal Officer



Deirdre Latour Chief Corporate Affairs Officer



Giovanni Giovannelli  
President Growth Markets



Jonathan Chocqueel-Mangan  
Chief Strategy Officer



Kevin Capitani President North America



Rod Bristow President UK & Core Markets



Tim Bozik President Global Product