Financial review

In 2019, underlying sales were flat and adjusted operating profit was up 6%

Coram Williams
Chief Financial Officer

Profit and loss statement

In 2019, sales decreased by £260m in headline terms to £3,869m (2018: £4,129m) with portfolio changes reducing sales by £347m and currency movements increasing revenue by £97m. Stripping out the impact of portfolio and currency movements, revenue was flat in underlying terms. Underlying revenue in North America declined 3%, Core was up 5% and Growth was up 4%.

The 2019 adjusted operating profit of £581m (2018: £546m) reflects a £130m year-on-year benefit from restructuring, £19m benefit from other operational factors, a benefit of £15m from currency movements, and a £25m benefit from the adoption of IFRS 16 Leases (see note 1b to the consolidated financial statements) offset by £37m of portfolio changes, £50m of inflation, and a £67m decrease from trading. Excluding the impact of currency movements and portfolio changes, underlying adjusted operating profit grew 6%.

Net interest payable was £41m, compared to £24m in 2018. The increase is due to the adoption of IFRS 16, which resulted in an additional £34m of net interest payable in 2019. After excluding the impact of IFRS 16, there was a reduction in net interest payable due to lower levels of net debt together with favourable movements in interest on tax and the absence of one-off costs from the redemption of bonds.

The effective tax rate on adjusted earnings in 2019 was a charge of 16.5% compared to a credit of 5.2% in 2018. The increase in tax rate reflects the lower level of one-off benefits in 2019 compared with 2018, including provision releases, due to the expiry of relevant statutes of limitation and the reassessment of historical positions.

Adjusted earnings per share of 57.8p (2018: 70.3p) reflects all the elements above.

Cash generation

Operating cash flow was £418m in 2019 (2018: £513m) with cash conversion at 72% (2018: 94%). This was impacted by the timing of the disposal of our US K12 Courseware business, a mismatch between cash and accrued incentive compensation and challenging trading in US Higher Education Courseware. These factors more than offset a modest benefit from the adoption of IFRS 16.

The equivalent statutory measure, net cash generated from operations, was £480m in 2019 compared to £547m in 2018, for the reasons noted above, as well as higher net restructuring payments of £111m. 2018 had £25m restructuring cash inflow due to proceeds from the rationalisation of our property portfolio.

Financial summary

Business performance

£ millions	2019	2018	Headline growth	CER growth	Underlying growth
Sales	**3,869**	4,129	(6)%	(9)%	0%
Adjusted operating profit	**581**	546	6%	4%	6%
Operating cash flow	**418**	513			
Adjusted earnings per share	**57.8p**	70.3p			
Dividend per share	**19.5p**	18.5p			
Net debt	**(1,016)**	(143)[1]			

Statutory results

£ millions	2019	2018	Headline growth	CER growth	Underlying growth
Sales	**3,869**	4,129	(6)%	(9)%	0%
Operating profit	**275**	553			
Profit for the year	**266**	590			
Cash generated from operations	**480**	547			
Basic earnings per share	**34.0p**	75.6p			

Throughout this section: a) Growth rates are stated on an underlying basis unless otherwise stated. Underlying growth rates exclude currency movements, portfolio changes and changes related to the adoption of IFRS 16. b) The 'business performance' measures are non-GAAP measures and reconciliations to the equivalent statutory heading under IFRS are included in the financial key performance indicators section on p201–204

1 Net debt pre-IFRS 16. Net debt adjusted for IFRS 16 in 2018 would have been £809m.

Financial review

Statutory results

Our statutory operating profit was £275m in 2019, compared to £553m in 2018. The decrease in 2019 is largely due to the decrease in gains on disposals, together with increased intangible and restructuring charges, which more than offset the increase in adjusted operating profit.

Capital allocation

Our capital allocation policy is to maintain a strong balance sheet and a solid investment grade rating, to continue to invest in the business and through acquisitions, to have a sustainable and progressive dividend policy, and to return surplus cash to our shareholders. Given the strength of the balance sheet and, with the simplification of our back office largely complete, this gives us more scope for inorganic investment.

Balance sheet

Net debt to adjusted EBITDA was 1.3x on a post-IFRS 16 basis. On a post-IFRS 16 basis, net debt rose from £809m in 2018 to £1,016m in 2019, reflecting lower operating free cash flow, dividends, additional capital invested in Penguin Random House, the acquisitions of Smart Sparrow and Lumerit Education and outflows from the disposal of the US K12 Courseware business.

In March 2019, the Group repurchased €55m of its remaining €500m Euro 1.875% notes due May 2021, to leave €195m outstanding. The Group also refinanced its revolving credit facility (RCF) in February 2019, extending the maturity to February 2024 and reducing the size to $1.19bn. Borrowings at 31 December 2019 included drawings on the Group's RCF of £230m (2018: £nil).

Pension plan

The overall surplus on UK pension plan of £571m at the end of 2018 has decreased to a surplus of £429m at the end of 2019. The decrease has arisen principally due to the unfavourable impact from changes in discount rate assumptions.

Dividend

In line with our policy, the Board is proposing a final dividend of 13.5p (2018: 13p), an increase of 4%, which results in an overall dividend of 19.5p (2018: 18.5p), up 5% on prior year, and subject to shareholder approval. This will be payable on 7 May 2020.

Share buyback

In January 2020, the Group commenced a £350m share buyback programme, in connection with the announcement in December 2019 of the sale of its remaining 25% interest in Penguin Random House. As of 3 March 2020, being the latest practicable date before the publication of this report, we have completed £105m of the share buyback so far.

Businesses held for sale

In December 2019, the Group announced the agreement to sell its remaining 25% interest in Penguin Random House to Bertelsmann, generating net proceeds of approximately $675m.

At the end of December, our share of the assets of Penguin Random House has been classified as held for sale on the balance sheet.

Businesses disposed of

Following the decision to sell the US K12 Courseware business, the assets and liabilities of that business were classified as held for sale on the balance sheet at the end of 2018. In March 2019, the Group completed the sale, resulting in a pre-tax profit on sale of £13m.

2020 outlook

In 2019, we delivered flat underlying revenue, achieved adjusted operating profit growth, made good progress on our simplification programme and laid the foundations for growth. Our guidance for 2020 is for adjusted operating profit between £410m and £490m and adjusted earnings per share of 38.0p to 47.0p. This reflects our portfolio excluding Penguin Random House, exchange rates as at 31 December 2019 and the following factors:

Inflation and other operational factors

Our 2020 guidance incorporates cost inflation of c.£30m which reflects a lower cost base and the benefits of our simplification drive, other operational factors of £45m predominantly due to the reinstatement of staff incentives, as well as continued investment in our strategic growth areas.

Trading

Trading is expected to impact profit between flat and £(80)m with the decline in US Higher Education Courseware offset by growth in the rest of the business.

Restructuring benefits

We expect incremental in-year benefits from the 2017–2019 restructuring programme of £60m in 2020.

Disposals

We expect a negative impact of £55m on adjusted operating profit, from portfolio changes, including £65m from the sale of Penguin Random House.

Interest and tax

We expect a 2020 net interest charge of c.£50m and a tax rate of c.21%, excluding Penguin Random House.

Currency

In 2019, Pearson generated approximately 62% of its sales in the US, 3% in Greater China, 5% in the Eurozone, 3% in Brazil, 3% in Canada, 4% in Australia, 2% in South Africa and 2% in India and our guidance is based on exchange rates at 31 December 2019.

We calculate that a 5c move in the US Dollar exchange rate to Sterling would impact adjusted EPS by around 2p to 2.5p.

Adjusted performance measures

The Group's adjusted performance measures are non-GAAP financial measures and are included as they are key financial measures used by management to evaluate performance and allocate resources to business segments. The measures also enable investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments over time by separating out those items of income and expenditure relating to acquisition and disposal transactions, major restructuring programmes and certain other items that are also not representative of underlying performance.

The Group's definition of adjusted performance measures may not be comparable to other similarly titled measures reported by other companies. A reconciliation of the adjusted measures to their corresponding statutory reported figures is shown in summary below and in more detail on p201–204

Adjusted operating profit

Adjusted operating profit includes the operating profit from the total business including the results of discontinued operations when relevant. There were no discontinued operations in either 2018 or 2019. A reconciliation of the statutory measure to the adjusted measure is shown below:

£ millions	2019	2018
Operating profit	275	553
Add back: cost of major restructuring	159	102
Add back: other net (gains) and losses	(16)	(230)
Add back: intangible charges	163	113
Add back: impact of GMP equalisation	–	8
Adjusted operating profit	581	546

In May 2017, we announced a restructuring programme, to run between 2017 and 2019, to drive significant cost savings. This programme began in the second half of 2017 and costs incurred relate to delivery of cost efficiencies in our Enabling Functions and US Higher Education Courseware business, together with further rationalisation of the property and supplier portfolio. The restructuring costs in 2019 relate predominantly to staff redundancies, whilst the restructuring costs in 2018 relate predominantly to staff redundancies and the net cost of property rationalisation, including the net impact of our consolidation of the property footprint in London.

These major restructuring costs are analysed below:

£ millions	2019	2018
Further efficiency improvements in Enabling Functions through back office change programmes in Human Resources, Finance and Technology	(94)	(48)
Adjusting the cost base in our US Higher Education Courseware business	(34)	(21)
Further rationalisation of property, vendor and supplier agreements	(29)	(21)
Associate restructuring	(2)	(12)
Total	(159)	(102)

Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are excluded from adjusted operating profit. This is because it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place, in order to understand the underlying trend in the performance of the Group. Other net gains included in operating profit of £16m in 2019 mainly relate to the profit on sale of the US K12 Courseware business. Other net gains of £230m in 2018 relate to the sale of the Wall Street English language teaching business (WSE), a gain of £207m, the disposal of our equity interest in UTEL, the online university partnership in Mexico, a gain of £19m, and various other smaller disposal items.

Charges relating to acquired intangibles and acquisitions are also excluded from adjusted operating profit when relevant, as these items reflect past acquisition activity and do not necessarily reflect the current year performance of the Group. Intangible amortisation and impairment charges in 2019 were £163m compared to a charge of £113m in 2018, as although acquisition activity has reduced in recent years, there was an additional £65m impairment charge in 2019 relating to acquired intangibles in the Brazil business, following a reassessment of the relative risk in that market (see also note 11 to the financial statements).

In 2018, the impact of adjustments arising from clarification of guaranteed minimum pension (GMP) equalisation legislation in the UK were excluded from adjusted operating profit, as outlined below in the section on post-retirement benefits.

Underlying growth rates

Sales decreased on a headline basis by £260m, or 6%, from £4,129m in 2018 to £3,869m in 2019, and adjusted operating profit increased by £35m, or 6%, from £546m in 2018 to £581m in 2019. The headline basis simply compares the reported results for 2019 with those for 2018. We also present sales and adjusted operating profit on an underlying basis, which exclude the effects of exchange, the effect of portfolio changes arising from acquisitions and disposals, and the impact of adopting new accounting standards that are not retrospectively applied. Our portfolio change is calculated by taking account of the contribution from acquisitions and by excluding sales and profits made by businesses disposed in either 2018 or 2019. Portfolio changes mainly relate to the sale of our US K12 Courseware business in 2019 and the sale of our WSE language teaching business in the first half of 2018. Acquisition contribution was not significant in either 2018 or 2019.

In 2019, our underlying basis excludes the impact on adjusted operating profit of IFRS 16 'Leases'. This new standard was adopted on 1 January 2019 but the comparative figures for 2018 have not been restated. The impact in 2019 was to increase adjusted operating profit by £25m.

On an underlying basis, sales were flat in 2019, compared to 2018, and adjusted operating profit increased by 6%. Currency movements increased sales by £97m and adjusted operating profit by £15m. Portfolio changes decreased sales by £347m, and together with the impact of IFRS 16 (as noted above), decreased adjusted operating profit by £12m.

Adjusted earnings per share

Adjusted earnings includes adjusted operating profit and adjusted finance and tax charges. A reconciliation to the statutory profit is shown below:

£ millions	2019	2018
Profit for the year	266	590
Non-controlling interest	(2)	(2)
Add back: cost of major restructuring	159	102
Add back: other net gains	(16)	(230)
Add back: intangible charges	163	113
Add back: other net finance costs	2	31
Add back: impact of GMP equalisation	–	8
Tax benefit relating to items added back	(123)	(65)
Adjusted earnings	449	547
Weighted average number of shares (millions)	777.0	778.1
Adjusted earnings per share	57.8p	70.3p

Financial review

Net finance costs classified as other net finance costs or income are excluded in the calculation of adjusted earnings.

Finance income relating to retirement benefits are excluded, as management believe the presentation does not reflect the economic substance of the underlying assets and liabilities. Finance costs relating to acquisition transactions are also excluded as these relate to future earnouts or acquisition expenses and are not part of the underlying financing.

Foreign exchange and other gains and losses are also excluded as they represent short-term fluctuations in market value and are subject to significant volatility. Other gains and losses may not be realised in due course, as it is normally the intention to hold the related instruments to maturity.

In 2019, the total of these items excluded from adjusted earnings was a charge of £2m compared to a charge of £31m in 2018. Finance income relating to retirement benefits increased from £11m in 2018 to £13m in 2019, reflecting the comparative funding position of the plans at the beginning of each year. The remainder of the decrease was largely driven by a reduction in foreign exchange losses on unhedged cash and cash equivalents in 2019 compared to 2018.

The adjusted income tax charge excludes the tax benefit or charge on items that are excluded from the profit or loss before tax. In addition, the tax benefit from tax deductible goodwill and intangibles is added to the adjusted income tax charge, as this benefit more accurately aligns the adjusted tax charge with the expected rate of cash tax payments.

Operating cash flow

Operating cash flow is presented in order to align the cash flows with corresponding adjusted operating profit measures. A reconciliation to operating cash flow from net cash generated from operations, the equivalent statutory measure, is shown below:

£ millions	2019	2018
Net cash generated from operations	**480**	547
Dividends from joint ventures and associates	**64**	67
Capital expenditure on property, plant, equipment and software (including leased assets)	**(257)**	(204)
Proceeds from sale of property plant, equipment and software (including disposal of leased assets)	**18**	128
Investment income	**2**	–
Add back: costs paid/(proceeds from) major restructuring projects	**111**	(25)
Operating cash flow	**418**	513

Operating cash flow decreased on a headline basis by £95m from £513m in 2018, to £418m in 2019. The decrease results from increased investment in pre-publication assets and other increases in net working capital, including the impact of reduced staff incentives and the absence of a contribution from the US K12 Courseware business, following its disposal in the first half of the year. These factors more than offset a positive impact from the adoption of IFRS 16.

Restructuring cash inflow of £25m in 2018 included proceeds from the sale of property primarily associated with the rationalisation of the property footprint in London and in 2019 restructuring cash outflow was £111m. The restructuring payments made in 2019, together with the impact of the adoption of IFRS 16 (see section below 'Adoption of new accounting standards in 2019') largely explain the reduction in provisions and other liabilities on the balance sheet when comparing 2019 and 2018.

Other financial information

Net finance costs

£ millions	2019	2018
Net interest payable	**(41)**	(24)
Finance income in respect of retirement benefits	**13**	11
Other net finance costs	**(15)**	(42)
Net finance costs	**(43)**	(55)

Net interest payable in 2019 was £41m, compared to £24m in 2018. The increase is due to the adoption of IFRS 16, which resulted in an additional £34m of net interest payable in 2019. After excluding the impact of IFRS 16, there was a reduction in net interest payable due to lower levels of average net debt, together with favourable movements in interest on tax, and the absence of one-off costs relating to the redemption of bonds.

As detailed in the adjusted earnings per share section, finance income in respect of retirement benefits, and other net finance costs are excluded from adjusted earnings.

Capital risk

The Group's objectives when managing capital are:

- to maintain a strong balance sheet and a solid investment grade rating;
- to continue to invest in the business organically and through acquisitions;
- to have a sustainable and progressive dividend policy; and
- to return surplus cash to our shareholders where appropriate.

The Group is currently rated BBB (negative outlook) with Standard and Poor's and Baa2 (stable outlook) with Moody's.

Net debt

The net debt position of the Group is set out below.

£ millions	2019	2018
Cash and cash equivalents	**437**	568
Investment in finance leases	**196**	–
Derivative financial instruments	**15**	9
Bank loans and overdrafts	**(3)**	(43)
Revolving credit facility	**(230)**	–
Bonds	**(593)**	(672)
Lease liabilities	**(838)**	(5)
Net debt	**(1,016)**	(143)

The Group's net debt increased from £143m at the end of 2018, to £1,016m at the end of 2019. The adoption of IFRS 16 added £666m of debt on transition, with the remainder of the increase principally due to treasury share purchases, additional capital invested in Penguin Random House and outflows from the US K12 Courseware business disposal transaction, which outweighed the normal cash inflow from operations after taking account of interest, tax and dividend payments.

Liquidity and funding

The Group had a strong liquidity position at 31 December 2019, with over £400m of cash and a significant proportion undrawn on its Revolving Credit Facility due in 2024 of $1.19bn (at 31 December 2018, the Group had cash of over £500m and was undrawn on the Revolving Credit Facility).

Taxation

The effective tax rate on adjusted earnings in 2019 was a charge of 16.5%, compared to an effective rate credit of 5.2% in 2018. The increase is mainly due to: the lower level of one-off benefits present in 2019 compared to 2018, including the release of provisions due to the expiry of relevant statutes of limitation; the reassessment of historical positions, as well as a one-off benefit from a reassessment of the tax treatment of certain items of income and expenses.

The reported tax charge on a statutory basis in 2019 was a credit of £34m (14.7%), compared to a credit of £92m (18.5%) in 2018. The statutory tax credit in 2019 was primarily due to US tax losses generated on the disposal of the US K12 Courseware business.

Operating tax paid in 2019 was £9m. This was impacted by a refund received in the US relating to historical periods together, with no US tax being paid in relation to 2019 as a result of the tax loss on the sale of our US K12 Courseware business. Non-operating tax paid of £21m in 2019 relates to tax paid to the Chinese tax authorities, following the disposal of WSE during 2018, and New York state and city taxes paid in the US as a result of a settlement with the tax authorities relating to past disposals. Deferred tax liabilities reduced from £136m in 2018 to £48m in 2019, mainly due to the generation of tax losses in the US as noted above. Deferred tax assets and current tax liabilities remained relatively consistent year on year. There are contingent liabilities in relation to tax as outlined in note 34 to the financial statements.

The Group adopted IFRIC 23 'Uncertainty over Income Tax Treatments' on 1 January 2019, resulting in a reduction of £5m in provisions for uncertain tax positions. The cumulative effect of applying this adjustment has been applied to retained earnings at 1 January. The impact of adopting IFRIC 23 on the income statement for 2019 was not material.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £115m in 2019 compares to a gain in 2018 of £90m. The loss in 2019 mainly arises from the weakness of the US dollar compared to sterling. A significant proportion of the Group's operations are based in the US and the US dollar weakened in 2019 from an opening rate of £1:$1.27 to a closing rate at the end of 2019 of £1:$1.32. At the end of 2018 the US dollar had strengthened from an opening rate of £1:$1.35 to a closing rate of £1:$1.27 and this movement was the main reason for the gain in 2018.

Also included in other comprehensive income in 2019 is an actuarial loss of £149m in relation to retirement benefit obligations of the Group and our share of the retirement benefit obligations of Penguin Random House. The loss arises from the unfavourable impact of changes in the assumptions used to value the liabilities in the plans and in particular movements in the discount rate. The value of assets was also impacted following the UK plan's purchase of insurance buy-in policies in the first half of 2019. The loss in 2019 compares to an actuarial gain in 2018 of £25m.

Post-retirement benefits

Pearson operates a variety of pension and post-retirement plans. Our UK Group pension plan has by far the largest defined benefit section. We have some smaller defined benefit sections in the US and Canada but, outside the UK, most of our companies operate defined contribution plans.

The charge to profit in respect of worldwide pensions and retirement benefits amounted to £56m in 2019 (2018: £56m) of which a charge of £69m (2018: £67m) was reported in adjusted operating profit and income of £13m (2018: £11m) was reported against other net finance costs. The small increase in the operating charge in 2019 is largely explained by the absence of material past service items, which in 2018 included a credit of £11m relating to changes in the US post-retirement medical plan, and a charge of £8m relating to guaranteed minimum pension (GMP) equalisation.

The overall surplus on UK Group pension plans of £571m at the end of 2018 has decreased to a surplus of £429m at the end of 2019. The decrease has arisen principally due to the actuarial loss noted above in the other comprehensive income section. In total, our worldwide net position in respect of pensions and other post-retirement benefits decreased from a net asset of £471m, at the end of 2018, to a net asset of £337m at the end of 2019.

Adoption of new accounting standards in 2019

The adoption of IFRS 16 'Leases' has impacted both the income statement, as described above, and has had an impact on certain lines in the balance sheet. The lease liability (classified as financial liabilities – borrowings) brought onto the balance sheet at transition was £881m, with the corresponding right-of-use asset (classified within property, plant and equipment) valued at £424m. In addition, certain subleases have been reclassified as finance leases resulting in an additional lease receivable (classified as other receivables) of £215m being brought on balance sheet. The net impact on the balance sheet is a reduction of net assets of £83m, after taking into account existing liabilities relating to onerous lease provisions (reducing provisions for other liabilities and charges by £101m), lease incentives, prepayments, adjustments to tax and the net impact on associates. The full impact of the adoption of this standard is outlined in note 1b to the consolidated financial statements.

Financial review

The impact of adopting IFRIC 23 'Uncertainty over Income Tax Treatments' had a small impact on the current tax balance but has not materially impacted the income statement (see note 1c to the consolidated financial statements).

The impact of adopting Amendments to IFRS 9 and IFRS 7 has not had a material impact on the financial statements (see note 1d to the consolidated financial statements).

Dividends

The dividend accounted for in our 2019 financial statements totalling £147m represents the final dividend in respect of 2018 (13.0p) and the interim dividend for 2019 (6.0p). We are proposing a final dividend for 2019 of 13.5p bringing the total paid and payable in respect of 2019 to 19.5p. This final 2019 dividend, which was approved by the Board in February 2020, is subject to approval at the forthcoming AGM and will be charged against 2020 profits. For 2019, the dividend is covered 3.0 times by adjusted earnings.

Businesses held for sale

Following the decision to sell the US K12 Courseware business, the assets and liabilities of that business were classified as held for sale on the balance sheet at the end of 2018. In March 2019, the Group completed the sale of its US K12 Courseware business, resulting in a pre-tax profit on sale of £13m. Total gross proceeds were £200m including £180m of deferred proceeds, which include the fair value of an unconditional vendor note for $225m, an entitlement to 20% of future cash flows to equity holders, and 20% of net proceeds in the event of a subsequent sale.

The cash outflow in the year relating to the disposal of subsidiaries was £101m, mainly reflecting the deferral of proceeds for the US K12 Courseware business and the seasonal level of cash reflecting deferred revenue in the business at the disposal date.

Tax on the disposal of the US K12 Courseware business is estimated to be a benefit of £51m. The benefit arises as the transaction gives rise to a loss for tax purposes mainly due to the differing treatment of deferred revenue disposed in the tax computation. In addition to the tax on the US K12 Courseware business there were £17m of tax credits relating to adjustments following settlement of tax relating to prior year disposals.

In December 2019, the Group announced the sale of its remaining 25% interest in Penguin Random House. At the end of December, our share of the assets of Penguin Random House has been classified as held for sale on the balance sheet.

Acquisitions and disposals

During 2019, the Group made some small acquisitions for total consideration of £40m. There were no significant acquisitions in 2018.

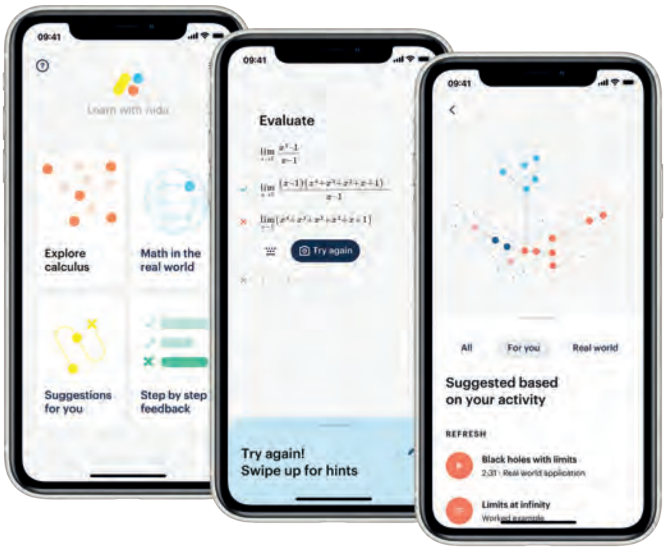
The main disposal in 2019 was the US K12 Courseware business as noted above. In 2018, the Group disposed of the Wall Street English language teaching business (WSE), realising a gain of £207m, and the equity interest in UTEL, the online university partnership in Mexico, realising a gain of £19m. Various other smaller disposal items resulted in a net gain of £4m in 2018.

Related party transactions

Transactions with related parties are shown in note 36 of the consolidated financial statements.

Post balance sheet events

In January 2020, the Group commenced a £350m share buyback programme in connection with the announcement in December 2019 of the sale of its remaining 25% interest in Penguin Random House.

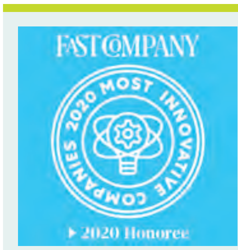


Aida is a first in education. By using multiple types of AI to tutor students, we can teach them how to learn calculus and apply it in the real world.

Milena Marinova,
SVP-AI Products & Solutions

CASE STUDY AIDA

Aida – the world's first AI-inspired calculus app



In 2020, Pearson has been named in the prestigious **Fast Company's Most Innovative Companies List**.

The biggest economic revolution of our time is unfolding around us: the talent economy. Technology, AI and automation are shoving all of us off a one-track career.

The future of work is moving faster than any of us. The talent economy is the new patchwork of dream jobs, gigs, freelancing, and any other way we earn a living from what makes us unique. In this new talent-driven world, we'll never catch up or leap ahead unless we redesign how people learn. Everything about our future hinges on this redesign of learning.

It's no longer enough to sit in a classroom and soak in knowledge. Learning has to happen wherever you are, whenever you need it and across your lifetime – tuned to the skills for the job you do today and the job you don't even know about yet.

Educators and schools always decided when and how people learned. Now, people are telling us how they want it done, personalised like the other content and products we all consume in a digital world.

But this is a bigger deal than the next film someone watches or an online purchase. If we want to get to the new internet, or the answer to climate change, we need more data analysts, engineers, doctors and scientists.

Ten years from now the US will have half a million more IT jobs. In 15 years, 5G will create almost 22m jobs globally. Think about that.

We can't even find workers for the 2.4m unfilled STEM jobs we have now and we'll have to find more.

And, there's a major, unseen barrier standing in the way. Calculus.

Almost all STEM fields require it and almost one-third of students drop or fail it. Just imagine a world where we could plug that leak in the STEM pipeline.

We have.

Meet Aida. The world's first AI-enabled mobile calculus tutor. Aida is a first in education. By using multiple types of AI to tutor students, we can teach them how to learn calculus and apply it in the real world. Aida gives feedback tailored to everyone. Aida is designed based on evidence of the most effective ways to teach and learn calculus. It's a highly personalised learning approach for a highly personalised world.

It's not the only answer to the STEM shortage. But Aida is a new way to teach people how to learn, and ultimately how to adapt to this new economy. It's about redesigning learning to create the economists, doctors, designers, coders and the new jobs we haven't even dreamed up yet for the future of everything.

This is an example of how we are designing products to have an impact on key learning outcomes in STEM and promoting education to advance the UN SDGs as part of our 2030 Sustainability Strategy.

Learn more about Efficacy on p27
Learn more about Sustainability on p16

Operating performance review

North America

Market summary

Our largest market includes all 50 US states and Canada.

Sales

£2,534m

Adjusted operating profit

£361m

SUSTAINABILITY IN ACTION

Accelerated Pathways

Accelerated Pathways partners with employers to implement educational benefits programmes that provide our clients' employees with lifelong learning opportunities. These solutions may include foundational education skills (including reading, writing, English, core job and work skills), pathway to a GED, college advising, accredited courses, degrees and industry or trade certifications. It drives our sustainability objective to advance equity by addressing many of the unique challenges adult learners without educational opportunities face. Programmes are online and optimised for mobile delivery, so employees can learn anytime, anywhere. A mix of funding sources can reduce or remove the cost barrier for participation.

In 2019, Accelerated Pathways grew both through new clients, including Manpower, and the acquisition of Lumerit Education, an ed-tech company that helps address the issues of college degree completion and affordability. Preliminary results from new client programmes include an average reduction of 89% for high-turnover roles, saving clients in recruitment and replacement costs, as well as increased employee engagement and confidence.

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue declined 3% in underlying terms, primarily due to US Higher Education Courseware declining 12%, and Student Assessment, which declined slightly. Offsetting that, we saw good growth in Virtual Schools, OPM and Professional Certification (VUE) revenue. Headline revenue decreased due to disposals, partly offset by FX gains.

Adjusted operating profit declined 3% in underlying terms, due to the impact of lower sales, inflation and other operating factors partially offset by restructuring savings. Headline profit was flat on last year, with the impacts on adjusted operating profit offset by the benefits of FX and IFRS 16 adoption.

Courseware

In US Higher Education Courseware, a revenue decline of 12%, with print declining close to 30%, was partially offset by modest growth in digital. In 2019, the weaker performance was driven by a number of factors:

- Unbundling of premium-priced print and digital products for digital-only formats. Sales of bundle units declined 45% during 2019.
- Campus bookstores buying less physical inventory due to changing student behaviour, with over 50% of learners now preferring an eBook to a physical text. This trend led to eBook growth of 18% during 2019.
- Modest adoption share loss caused by the delivery issues due to the implementation of the new ERP system in H2 2018 as well as the reorganisation of our sales force.

We are focused on regaining share over time as we build traction from the rollout of our next wave of digital products on the Pearson Learning Platform, which launched in September. 60% of all Revel fall subscriptions will migrate onto the Pearson Learning Platform by the end of the year enhancing the faculty and student experience.

We are also launching a direct-to-learner Pearson eText in 2020, with enhanced features.

US Higher Education Courseware digital registrations, including eBooks, declined 2%. Good registration growth in Revel, up 9%, was offset by continued market pressure in Developmental Mathematics and the planned retirement and deprioritisation of long-tail products.

We continue to make good progress with Inclusive Access signing 162 new institutions in 2019, taking the total not-for-profit and public institutions served to 779. Including 80 longer-standing contracts with for-profit colleges, we now have direct relationships with over 850 institutions.

In 2019, we served 1.8m Inclusive Access enrolments up from 1.4m in 2018, making up 9% of 2019 US Higher Education Courseware revenue, up 19% on 2018 on a like-for-like basis, excluding the 80 for-profit colleges.

Assessment

In US Student Assessment, underlying revenue declined slightly in 2019 with continued contraction in revenue associated with PARCC and ACT-Aspire multi-state contracts and contract losses, which were partially offset by new contract wins.

During 2019, Pearson won new contracts or signed renewals in several key incumbent states including Kentucky, Maryland, Colorado and New Jersey, as well as the federal NCES contract for delivering the National Assessment of Educational Progress (NAEP). Pearson also won back the testing contract in the state of Tennessee.

Automated scoring continues to be a competitive strength for Pearson. In 2019, we scored 39m responses with AI, up 8% from 2018.

In Professional Certification (VUE), global test volume rose 8% to c.16.5m. Revenue in North America was up a high single-digit percentage, mostly driven by the IT sector with increased demand for cloud technology certifications through Microsoft and Amazon, and volume growth in an education contract launched at the end of 2018, which is now operating at its full run rate.

We signed over 40 new contracts in 2019, including the Project Management Institute (PMI) and our renewal rate on existing contracts continues to be over 95%.

In Clinical Assessment, underlying revenue declined as demand for new product only partially offset normal declines in products in the later stages of their lifecycle.

Services

School Services (Virtual Schools) grew revenue 6% and served 76,000 Full Time Equivalent (FTE) students through 42 continuing full-time virtual partner schools in 28 states, up 5% on last year.

Six new full-time, online, state-wide partner schools opened in the 2019–20 school year in the states of Oregon, Washington, Tennessee, Minnesota and California, while a contract was exited in North Carolina.

Higher Education Services (including OPM and Learning Studio) grew revenue 4%, due to growth in OPM, partially offset by a small drag from Learning Studio revenue, a learning management system, which was fully retired in 2019.

In OPM, revenue grew 9%, with growth in course registrations of 5% and new programmes launched more than offsetting programmes terminated. Our overall active programme count grew to 347 from 325 in 2018.

During 2019, we continued to optimise our portfolio and reduce the number of partners to 25 from 35. This will allow us to shift towards enterprise models where we have a number of programmes with a single partner and can benefit from economies of scale in marketing and recruitment. We are also working to integrate more content and assessment services into our partnerships.

Core

Market summary

Our international business in established and mature education markets.

Sales

£838m

Adjusted operating profit

£92m

SUSTAINABILITY IN ACTION

BTEC

BTEC qualifications support progression to higher or further education, apprenticeships or directly into employment. Across England as a whole, 44% of white working-class students who make it to higher education have at least one BTEC. 48% of black British students accepted to higher education have at least one vocational qualification.

We are committed to increasing the number of BTEC registrations outside the UK, particularly in markets where vocational education is developing. In 2018, the Group had 33,403 registrations outside of the UK, which increased to 43,906 registrations in 2019 (an increase of 31%).

BTEC also helps to build skills for a sustainable future. Sustainability is embedded within 31% of BTEC qualifications across sectors, including engineering, logistics, construction, health, health and social care, science and IT.

We recently launched our first sustainability-backed loan, linking to our progress in increasing access to quality vocational education to learners in international markets.

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue was up 5% in underlying terms and 4% in headline terms, with growth in Student Assessment and Qualifications, including the delivery of a new digital assessment contract in Egypt, PTE Academic, OPM and Professional Certification (VUE), all partially offset by declines in Courseware.

Adjusted operating profit increased 58% in underlying terms and 61% in headline terms due to trading growth and restructuring savings.

Courseware

Courseware revenue declined moderately. Declines in School Courseware in the UK and Australia offset growth in Italy. In Higher Education Courseware, revenue declines in the UK and Europe more than offset growth in Australia.

Assessment

In Student Assessment and Qualifications, revenue grew strongly, due to price and volume increases for A levels and GCSEs and the delivery of a new digital assessment contract in Egypt. This was partially offset by continued market declines in Apprenticeships.

We successfully delivered the National Curriculum Test (NCT) for 2019, marking 3.8m scripts, up slightly from 2018. The NCT will be delivered by another provider in 2020.

In Professional Certification (VUE), revenue was up due to good growth in the DVSA test in the UK, additional exam series added to the ICAEW contract and good growth in the MOI (French driving test) which launched in late 2017.

Clinical Assessment sales declined primarily in France and the Netherlands due to an absence of new major product introductions.

PTE Academic saw continued strong growth in test volumes in Australia and New Zealand, up 14% from 2018. This was driven by its use to support visa applications to the Australian Department of Home Affairs, as well as good growth in New Zealand. We recently announced the win of the UK Secure English Language Test (SELT) contract with the UK Home Office, which we expect to drive future growth.

Services

In Higher Education Services (OPM), revenue growth was driven by course enrolment growth in the UK. During the year, we also announced new OPM partnerships in Australia with the University of Adelaide and University of Wollongong.

Operating performance review

Growth

Market summary

Emerging and developing economies with investment priorities in Brazil, India, South Africa, Hispano-America, China and the Middle East.

Sales

£497m

Adjusted operating profit

£63m

SUSTAINABILITY IN ACTION

China

We have taken action to assist learners as the COVID-19 epidemic has taken hold in China. As schools across China have been closed down to prevent the further spread of the illness, Pearson has made dozens of online products and courses available for free to students unable to attend school.

Both students and teachers have welcomed these resources. For example, there were over 60,000 applicants to International Connections Academy and almost 200,000 people are using free AI learning resources on the Longman English Plus WeChat Platform, known as 'Longman Xiaoying.'

Read more about Pearson's Sustainability Strategy on p16

Advance equity in learning

Build skills for sustainable futures

Revenue grew 4% in underlying terms due to strong growth in China and good growth in Brazil and the Middle East, partially offset by declines in South Africa. Headline revenue declined due to disposals.

Adjusted operating profit increased 24% in underlying terms, reflecting higher revenue together with the benefits of restructuring. In headline terms, adjusted operating profit increased 7% with the impact of disposals more than offset by trading and restructuring savings.

Courseware

Courseware revenue was flat in underlying terms, with growth in English Language Courseware in China and School Courseware in the Middle East and Hispano America, offset by declines in Higher Education Courseware in South Africa following a change in government funding.

Assessment

Professional Certification (VUE) revenue grew well due to a large ICT infrastructure certification contract, and a number of new smaller contract launches in China.

PTE Academic saw strong growth in revenue with test volumes up 25% in India and China.

Services

In English Services, underlying revenue grew slightly in our English Language School franchise in Brazil due to new product launches.

In School Services, underlying revenue grew slightly due to price increases and new product launches in our sistemas in Brazil.

In Higher Education Services, enrolments grew 3% at the Pearson Institute of Higher Education (formerly CTI), however revenue declined modestly due to changes in mix.

Penguin Random House

Penguin Random House

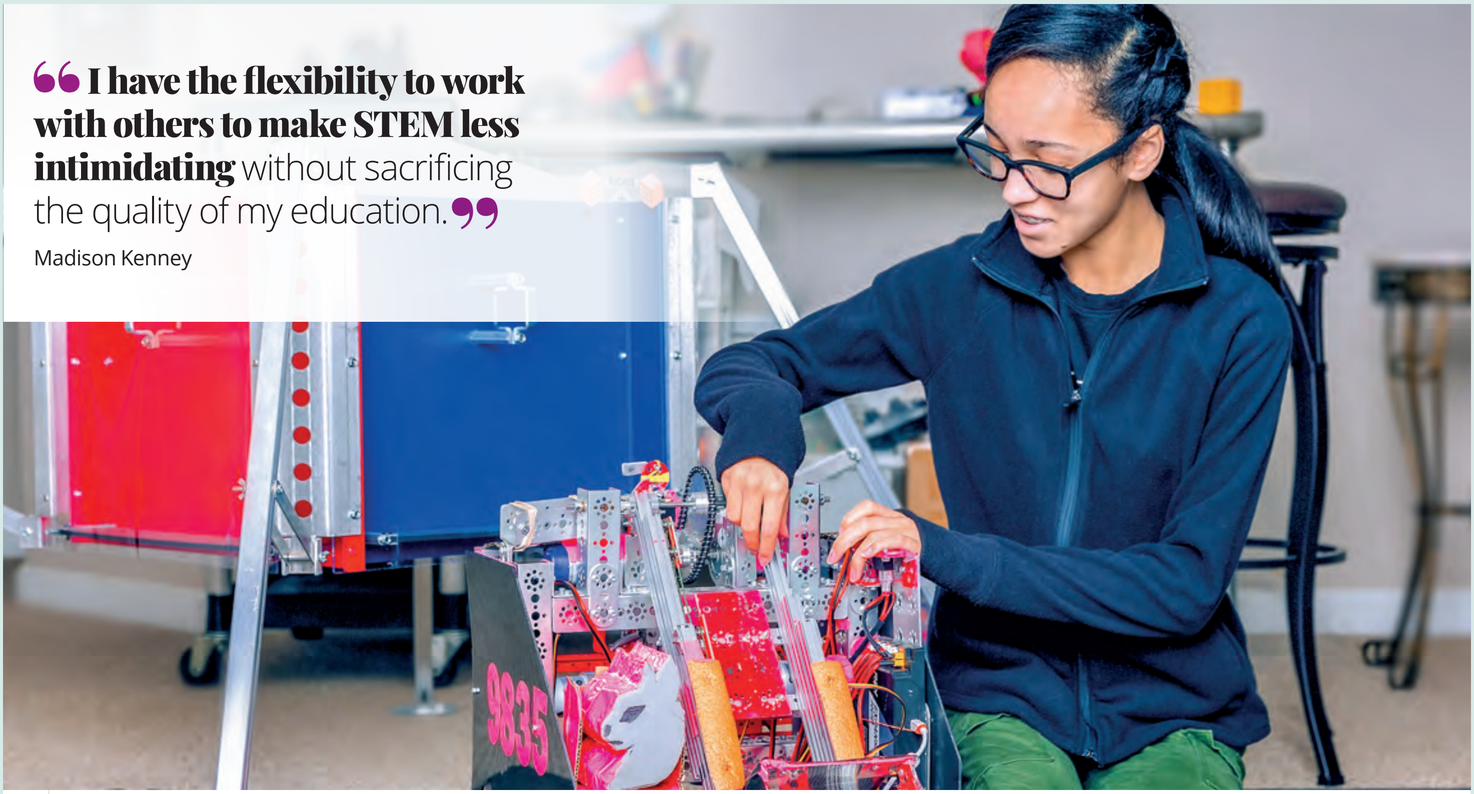
Adjusted operating profit

£65m

Pearson owns 25% of Penguin Random House, the first truly global consumer book publishing company.

Penguin Random House performed solidly with underlying revenue growth from a rise in audio sales, stable print sales, and the industry's top bestsellers, including *Where the Crawdads Sing* by Delia Owen, *Becoming* by Michelle Obama, and bestselling books by Margaret Atwood, Tara Westover, Lee Child, Jamie Oliver, Jeff Kinney, and Dr. Seuss.

We announced the sale of the remaining 25% in Penguin Random House on 18 December 2019. The transaction is expected to close in H1 2020.



I have the flexibility to work with others to make STEM less intimidating without sacrificing the quality of my education.

Madison Kenney

CASE STUDY VIRTUAL SCHOOLS

Online school provides opportunity for young students to pursue passions and achieve their dreams

Read the 2018 efficacy report: www.pearson.com/corporate/efficacy-and-research/reports/connections-academy.html

Madison Kenney has a passion for STEM and wants to share that enthusiasm with other young female students. STEM is often intimidating and Madison has made it her mission to work with female students to make STEM more approachable. To allow Madison to spend more time on this mission, her mother enrolled her in Connections Academy, Pearson's Virtual Schools programme for students in K12.

"I was first introduced to robotics at a Girl Scout Expo and immediately knew that this is what I wanted to do," says Madison. "Attending Connections Academy gives me the flexibility to work with others to make STEM less intimidating without sacrificing the quality of my education."

Madison keeps a busy schedule coaching FIRST Lego League and Seaperch, and has earned several awards for STEM excellence, including the Prudential Spirit of Community Award and the President's Volunteer Service Award, among others.

Madison is also a full-time, dual-enrolled student at Kennesaw State University, and hopes to pursue a career as a mechatronics engineer for NASA. Madison says, "Online learning helped prepare me for college as it has made me an independent and motivated learner."

Efficacy research shows that Connections Academy students like Madison can receive the same quality of education as that offered at their local public school, while simultaneously taking advantage of the benefits offered to them by virtual schools.

Pearson and Virtual Schools

Pearson delivers K12 online education to schools and students across the US and internationally. Solutions include the accredited Connections Academy, an online school programme which is delivered via full-time, online public schools. This is an option for families seeking personalised learning and a high-quality alternative to the traditional classroom. A global online private school, International Connections Academy, is also available.

This is an example of how we are designing products to have an impact on key learning outcomes and promoting education to advance the UN SDGs as part of our 2030 Sustainability Strategy. We will release a new Efficacy Report on Virtual Schools later in 2020.

Learn more about Efficacy on p27
Learn more about Sustainability on p16

Organisational risk management

Our risk management process is used to identify and mitigate our exposures and, where possible, turn risks into business opportunities.

The focus of our risk management process, which we call 'organisational risk management', is on identifying, analysing, managing and mitigating risks, with our goal to support Pearson in meeting its strategic and operational objectives.

Our risk approach aligns to international standards (e.g. COSO and ISO 31000) and aids our continued compliance with the Financial Reporting Council's (FRC) UK Corporate Governance Code guidance on risk management, also enabling us to adapt to any required changes in approach.

The risk reporting process is carried out biannually and reviewed by the Audit Committee and the Board. During the year, the Audit Committee and Board conduct deep dives into selected principal risks.

Principal risks and uncertainties

In 2019, the Board of Directors undertook a robust assessment of the current principal and emerging risks facing Pearson, in accordance with provision 28 of the 2018 UK Corporate Governance Code.

Listed in the table and shown on the adjacent risk map are the most significant risks that may affect Pearson's future. A longer list of business area and company-wide risks is monitored and reviewed internally throughout the year. The most material risks are those which have a higher probability and significant impact on strategy, reputation or operations, or a financial impact greater than £50m, and are classed as our principal risks.

Brexit

The UK exited the EU on 31 January 2020. Given the prolonged negotiation process during 2019, we continued our mitigation planning, led by a Steering Committee chaired by the CFO. We worked to identify and mitigate any potential impact on our principal risks, including supply chain and operations (covered in the customer experience risk), tax and data privacy, treasury, workforce mobility and more. By virtue of that analysis and mitigation planning, we continue to believe that Brexit will not have a material adverse impact on Pearson as a whole; and we have plans in place to ensure we continue with business as usual.

Coronavirus (COVID-19)

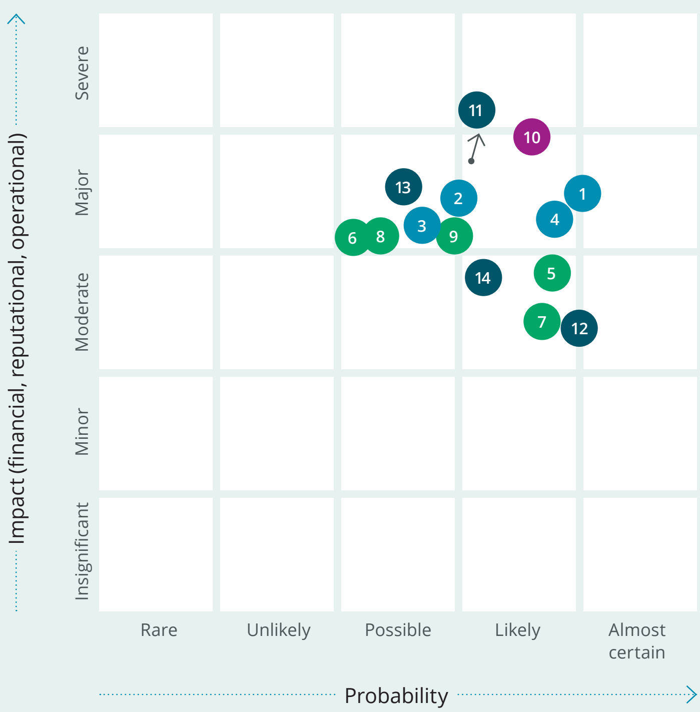
At the time of publication of our annual report, the COVID-19 outbreak in China and globally is an emerging risk that is being closely monitored on a day-by-day basis. Our primary focus is on ensuring the safety and well-being of our employees, customers and learners. We have invoked our business resilience plans to help support our customers and maintain our business operations. At this time, we do not believe that COVID-19 will have a material adverse impact on Pearson's financial results. We are actively continuing to monitor the situation.

Mitigation and controls

Throughout all 14 principal risks, Pearson adopts mitigation activities in the form of internal controls, as part of regular internal meetings and external consultations. These include reporting to the Board, reporting to Pearson's Executive management team, and monitoring compliance with Pearson policies, international regulations and standards.

The following principal risks also relate to the material issues considered in the Sustainability section of this report on p16: products and services, testing failure, political and regulatory, information security and data privacy, customer experience, and safety and security.

Principal risks: status and 2019 change



Net risk

Probability and impact are based on residual risk, i.e. after taking into account controls already in place and assumed to be operating effectively.

Indicates change in 2019

For more information see principal risks and uncertainties tables on the following pages.

Risks are categorised into four main areas:

			Executive responsibility
Strategy and change	Relating to the goals that are aligned with and support our strategy. This category is the most likely to contain 'opportunity' risks which are likely to have a higher risk appetite.	1 **Business transformation and change**	Chief Executive
		2 **Products and services**	President – North American Courseware & Global Product
		3 **Talent**	Chief Human Resources Officer
		4 **Political and regulatory risk**	Chief Corporate Affairs Officer Chief Strategy Officer
Operational	Involving people, systems and processes.	5 **Testing failure**	President – Global Assessment President UK & Global Online Learning
		6 **Safety, safeguarding and corporate security**	Chief Financial Officer Chief Human Resources Officer
		7 **Customer experience**	President – North American Courseware & Global Product Chief Technology and Operations Officer
		8 **Business resilience**	Chief Financial Officer General Counsel
		9 **Data**	President – North American Courseware & Global Product Chief Technology and Operations Officer
Financial	Involving financial planning, investments, budgeting, potential losses of and exposures to Pearson's assets.	10 **Tax**	Chief Financial Officer
Legal and compliance	Relating to the adherence to applicable laws and regulations. Risks in this category typically have a very low risk appetite	11 **Information security and data privacy**	Chief Technology and Operations Officer General Counsel
		12 **Intellectual property**	General Counsel
		13 **Compliance**	General Counsel
		14 **Competition law**	General Counsel

Principal risks and uncertainties

Strategy and change

Risk description	2019 activity	2020 plans
1 Business transformation and change		
The accelerated pace and scope of our transformation initiatives increase our risk to execution timelines and to the business's adoption of change.	› During 2019, planned headcount reductions were completed, allowing the delivery of annualised savings as expected of the programme. › A range of additional transformation initiatives were successfully completed, with further ones identified for completion in H1 2020. See the Audit Committee update on business transformation on p74 for more details.	› Deliver the Business Value Realisation (BVR) Plan, that will continue to further stabilise operations, resources and existing governance models. › Continue to review and make recommendations on further optimisation programme opportunities. › Create a key performance indicator (KPI) scorecard to reflect stabilisation activities. › Progress rest of world phase of TEP.
2 Products and services		
Failure to successfully invest, develop and deliver innovative, market-leading global products and services that will have the biggest impact on learners and drive growth.	› Product innovation: we made progress across key markets in implementing product portfolio management to ensure our products are aligned to our strategy to achieve target revenue and profitability. We also made significant progress understanding the competitive and structural threats, especially to our US Higher Education Courseware business, and made progress mitigating these. › Product and investment portfolio: we improved visibility into how our products and services contribute to Pearson's overall growth, and are using that as an input for the future investment allocation process. We continued to build our employability capabilities and further clarified our investment priorities. › Competition: market share competition remained high, especially due to pricing pressure from low cost competitors, including, in US Higher Education Courseware, open educational resources (OER). The proposed Cengage & McGraw Hill merger, if it proceeds, will consolidate our two largest competitors in this market. The impact of this remains unknown. However, we believe we have the right strategy in place with our Inclusive Access (IA) programme to tackle affordability and keep ahead of the consumer trend to digital.	› Build on the 2019 launch of the Pearson Learning Platform (PLP): 60% of all Revel fall subscriptions on PLP by the end of the year; over 100 MyLab and Mastering titles on PLP in 2021. › Launch a new Pearson eText, with an expanded catalogue and enhanced features that differentiate it from a conventional third-party eReader. › Continue efforts to embed the product lifecycle framework into our decision-making processes. › Use the results of the US Higher Education Courseware baseline survey we did in 2019 to inform and design new ways of working. › Improve our ability to horizon scan the market and customer behaviours, which will provide improved trend analysis and agility to respond to trends.

Strategy and change

Risk description	2019 activity	2020 plans
3 Talent		
Failure to attract and retain the talent we need and to create the conditions in which our people can perform to the best of their ability.	**People development** › We continued with the development of our VP and Director levels, with the *Lead to Succeed* programme, which aims to support succession planning. › We refreshed our *Manager Fundamentals* training across the company, with tools and resources that are shared with line managers each month. › We continued targeted learning with our internal learning and development platform, Pearson U, with career development workshops. **Diversity & Inclusion (D&I)** › We conducted D&I assessments and dashboard reviews with Executive team members and their leadership teams. › We continued mentoring programmes for female talent, with Board members mentoring SVP women and Executive team members mentoring VP women. **Employee engagement** › Internal teams with global employees were created to address company-wide issues (e.g. silo-busting, performance management, employee learning). › An Employee Engagement Network was created with cross-functional, top talent employees to provide an employee voice for strategic input at Pearson. › We completed research, gathered insights, delivered messaging workshops for the Employee Value Proposition which aims to improve recruiting outcomes and increase talent retention. › We launched the *Pearson Proud* campaign intended to empower employees as Pearson advocates. **Structure and approach** › Created the SVP-Learning position reporting to the Chief Human Resources Officer (CHRO) which is responsible for scaling Pearson products to all employees. › Centralised HR centres of expertise that make up our employee experience under a newly created SVP-Employee Experience role. › Refreshed performance management tool for employees with quarterly check-ins that focus on feedback, development and to improve performance outcomes.	› Work with each Pearson Executive team member and their teams to make progress on the 2019 actions from the 2018 Organisational Health Index, to improve decision-making and role clarity, as well as driving innovation and learning. › Roll out the 'new employee value proposition' programme. › Reskill/upskill employees as teams restructure and new roles are created. Assess and refine the HR global strategy. › Continue with the work under way on our recruitment marketing platform. This will help Pearson to attract and convert passive candidates to become employees and build our brand in the technology sector. › Look to update Pearson's remuneration philosophy to align with our five-year strategy and provide flexibility to adapt remuneration policies for business and talent needs as we continue to build on our digital transformation.

Principal risks and uncertainties

Strategy and change

Risk description	2019 activity	2020 plans
4 Political and regulatory risk		
Changes in governments, policy and/or regulations have the potential to impact business models and/or decisions across all markets.	In our two biggest markets, the UK and the US, progress in 2019 was as follows: › In the UK, we continued to build Pearson's position as a leader, expert and innovator in general qualifications, technical/vocational education and assessment. › In the US, we positioned Pearson as an innovator in the education and workforce space, among both parties, in state capitals, on Capitol Hill and with the Trump administration. › We maintained fair market access through national and state partnerships, as well as direct lobbying. › With the bipartisan National Governors Association, we shaped the Chair's workforce initiative which was shared with all governors, informing state policies. › We continued to monitor trade actions and sanctions that could impact business goals.	The Government relations team will continue to monitor and advise on: › Online learning legal and regulatory challenges. › Instructional material market risks that arise when Governments mandate the use of state-produced instructional materials and/or content (China, Hong Kong, South Africa and India). › Implications of being a US/UK company in the current global geopolitical environment.

Operational

Risk description	2019 activity	2020 plans
5 Testing failure		
Failure to deliver tests and assessments (e.g. for Pearson UK, Schools and VUE) and other related contractual requirements because of operational or technology issues, resulting in negative publicity impacting our brand and reputation.	› In 2019, there was a GCE (A level) Maths security breach which was managed as a significant incident. We have since reviewed, analysed and strengthened our security options, in conjunction with other awarding bodies. › A complete review, with improvements was delivered to our test fraud investigations processes, in partnership with our key UK clients. › Development was completed for an improved process enabling more secure access to live test materials for centres, rather than manual provision via email or secure file transfer. › An improved VQ system monitoring was introduced and we reduced the frequency and volume of unconfirmed bookings (i.e. test provision failure). › All School Assessment customer-facing products were successfully migrated to the cloud, resulting in greater scalability, reliability, efficiency and security.	› Utilise technology, moving systems to more stable and secure platforms in the cloud. Work continues to ensure that any technology changes are fully factored into all of Pearson's business continuity activities and adjustments are made to relevant certifications and regulatory frameworks. › Work with our security technology teams to further develop systems and partnerships towards fraud detection analytic models, AI and machine learning analysis. › Ensure assurance will continue to extend ISO activity across products and geographies. We will also further mature our business continuity measures by improving integration of Disaster Recovery (DR) and Business Continuity (BC) activities. Additional certifications are under way to further strengthen our security and technology resilience. › Ensure that our service plans will continue to develop a technology-based solution to reduce or eliminate manual Test Publishing Quality Assurance (TPQA) processes.

Operational

Risk description	2019 activity	2020 plans
6 Safety, safeguarding and corporate security		
A variety of risks that can cause harm to our people, assets and reputation continue to evolve as our company does. While some risk has reduced due to outsourcing and divestiture, the diverse nature of our people's activities require continued focus, resource and improvement to reduce the potential for harm.	**Health & Safety and wellbeing** › In 2019, two serious and separate incidents occurred, at the same Pearson printing facility. Both highlighted the continued need by staff and managers at a local/regional level for focus and improvement. › Continued to implement all outstanding audit actions, meeting or exceeding targets for follow-up action closure. › Mental health awareness has been included in high impact events sessions and was extensively rolled out in APAC, as part of the *R U OK?* Campaign. › We continued to monitor implementation of our Health & Safety Statement, which sets out our commitment to protecting the health, safety and welfare of all our employees and anyone else who comes into contact with our operations around the world, including our learners, customers and other partners. We also migrated from BS OHSAS 18001 to the new ISO 45001 standard covering Pearson Management Services in our UK Head Office.	**Health & Safety and wellbeing:** › Continue to further develop the analysis of occupational health data to ensure proactive and reactive intervention strategies are aligned for the promotion of employee wellbeing. › Implement a global solution to report, escalate, investigate and action Health & Safety incidents (including near misses). › Continue to focus on risk controls in high-risk activities while improving local oversight of relevant risks in lower-risk environments (emergency planning, ergonomics, stress and wellbeing). › Deliver wellbeing and mental health awareness and training across North America.
	Safeguarding › There were stronger engagements across relevant Pearson business lines and fresh development of safeguarding policies in PIHE in South Africa and Pearson College London. › Productive conversations and future knowledge was developed with the UK's Internet Commissioner. › An advisory review was undertaken with our businesses in Brazil, which will continue to support safeguarding practice in the franchise businesses, and consider how we integrate safeguarding in our future product offerings. › At Pearson College London, we published policies that offer advice and guidance on sexual harassment, self harm and suicide.	**Safeguarding** › Continue to develop best practice and policy in regard to online safeguarding/harm. › Continue discussions with external consultants towards ensuring compliance with best practice and developing legislation. › Work towards the global implementation of the programme and effective support for learners. › Continue to develop our incident reporting, analysis and assurance plans. › Integrate diversity into our safeguarding practices.
	Corporate security There was one catastrophic incident involving Dieter Kowalski, a Pearson IT manager, who sadly lost his life while on business travel to Colombo, Sri Lanka. Dieter was a victim of the Easter Sunday terror attacks. › Travel security continues to grow in support of more travellers and new countries and cities and is no longer limited solely to higher-risk locations. › Security reviews for higher-risk locations were conducted in new locations. › High impact events (HIE) awareness continued across key locations.	**Corporate security** › Continue to identify key risks when selecting properties across the globe, and particularly for higher-risk locations. › Work towards 'secure by design' in our new/refurbished offices. › Deliver further high impact events (HIE) awareness. › Work with those markets which do not have a dedicated travel provider, thus reducing risk and improving our response capabilities. › Continue to develop our current intelligence and information third-party relationships for better sharing of the risk horizon across Pearson.

Principal risks and uncertainties

Operational

Risk description	2019 activity	2020 plans
7 Customer experience		
Failure of either our current, (or future) operations, supply chain or customer support to deliver an acceptable service level at any point in the end-to-end journey; or to accelerate Pearson's lifelong learner strategy and transformation of our higher education business (direct to consumer business model and online presence).	› In 2019, our UK back to school period went well, with improved fulfilment rates and all Service Level Agreements (SLAs) being met. In addition, our helpline call volumes were down. › We continued to see improvements in forecast accuracy in the UK with the deployment and adoption of new systems. › We successfully implemented our Brexit contingency plans with our existing channel partner, providing warehousing and logistics services to UK-based customers. › In North America, we improved capabilities within the team and implemented improved processes. Warehouse fulfilment rates exceeded the SLA. › Our US Customer Experience team launched a modern digital experience for learners in the US and Canada. The new Pearson website provides the first global experience that merges content and commerce. › Customer Support teams continued to make progress in product improvement, self-help strategy and assisted support improvements. › Our focus remained on the performance and stability of all product platforms.	**Customer experience** › Onboard additional portfolios to redefine the user experience – e.g. ITPro, Pearson eText; which will rollout in our UK higher education market. › Work with customer service teams to establish a 24/7 support model for learners. › Enable new commercial models e.g. Buy Now Pay Over Time. › Expand the Voice of Customer (VOC) programme for BVR initiatives. **Customer service and support** › Continue with core platform deployment across all lines of business to enable modern support experiences. › Continue to work with technology on business cases for increased efficiencies. › Continue partnering with business owners to introduce more differentiated services to drive loyalty and growth.
8 Business resilience		
Failure to plan for, recover, test or prevent incidents involving any of our products, customers and our businesses' locations. Incident management and technology disaster recovery plans may vary in ability/ comprehensiveness across the Group.	› Direct and prolonged incident management support to key office locations following the Easter Sunday attack in Sri Lanka. › Resiliency visits made to workforces, landlords and critical suppliers in the US, South Africa, India and the Philippines, to assure local coordinated incident and business continuity readiness, including media management. Incident response teams created where none existed in critical areas. › Work continued on the delivery of a Facility Manager bundled service in North America. › Improved capabilities to respond to incidents across Pearson globally. › Continue to drive the risk message as prevention rather than reaction, towards a change focused on agile resilience.	› Continue with global process owners to embed business continuity planning within their processes. › Respond appropriately to major incidents. Resilience resources will continue to develop local, high-quality teams and plans. › Ensure critical vendors have mature response plans which are annually resilience-assured. › Continue to invest time in all critical vendors to ensure KPIs can be met during a range of disruptions. › As of February 2020, the COVID-19 outbreak in China is a new emerging risk to the wider economy across mainland China, Hong Kong, and a growing number of countries around the world. We have invoked our business resilience plans to help ensure the safety and well-being of our staff while enhancing our ability to support our customers and maintain our business operations.

Operational

Risk description	2019 activity	2020 plans
9 Data		
Inability to utilise our data to achieve market intelligence and increase productivity and efficiency, while managing market risk impacts arising from customer concerns around use of student data, may significantly affect management of our core operations and achievement of our strategy objectives.	› Defined our data governance and toolset. › Our data orchestration programme saw a solution director assigned to commence scoping work and future structures. › Initiated four work streams: – data privacy – data governance – data catalogue – data KPIs › Initiated product, customer, supplier and employee governance work streams.	› Introduce a governance operating model to become operational with an initial focus on the customer and product, followed by employees and suppliers. › Introduce a data maturity model enabling continuous improvements to be made as we progress with Pearson's digital transformation.

Financial

Risk description	2019 activity	2020 plans
10 Tax		
Legislative change caused by the OECD Base Erosion and Profit Shifting initiative, the UK exit from the EU, or other domestic governments' initiatives, including in response to the European Commission State Aid decision regarding the UK CFC exemption, results in a significant change to the effective tax rate, cash tax payments, double taxation and/or negative reputational impact.	› State Aid – the Group appealed against the Commission's decision and continues to work through the implications of the decision with support from external advisers. › Reputational risk – the third annual tax report has been published. Pearson has signed up to the B-Team tax principles and is actively participating in the B-Team tax working group. › Legislative changes – the Group continued to assess and monitor proposed changes in the international tax framework, including proposals to address the tax challenges arising from the digitalisation of the economy.	› State Aid risk – the specific next steps depend on the response from HMRC and any update on the EC legal case, and are likely to include the requirement for a payment on account. However, we will continue to confer with external advisors to protect the Group's position. › Tax legislation – work continues to mitigate the impacts of changes in the international tax environment and to monitor the ongoing OECD work.

Principal risks and uncertainties

Legal and compliance

Risk description	2019 activity	2020 plans
11 Information security and data privacy		
We have from time to time experienced, and may continue to experience in the future, security breaches of our systems despite our best efforts to prevent them. We also risk failure to comply with data privacy regulations and standards. The above could result in damage to the customer experience, our reputation, and a breach of regulations and financial loss.	**Information security** › For our people, refreshed security awareness training and policies were launched to ensure all employees understand their responsibilities for securing information. › We enhanced account access controls through Multi Factor Authentication and Privilege User Management. › Pearson continued to evolve our security controls to enable IT simplification and other transformation programmes.	**Information security** › Our people will have access to role-based security training and resources to further influence our security culture. › We will complete roll-out of enhanced laptop and mobile security controls, to track best practices. › Information Security resources, tooling and practices will continue to be embedded in our learning, enterprise and infrastructure platforms to ensure comprehensive security by design. › We will enhance our ability to detect and respond to potential security incidents through development of automated security tools in our Security Operations Centre.
	Data privacy › In 2019, we put plans in place to ensure that we were appropriately prepared for the California Consumer Privacy Act, including updates to privacy notices, execution of relevant vendor terms, implementation of processes to respond to user right requests and extensive training and guidance. › Held privacy summits with key product and tech teams focused on embedding privacy by design. › Notified affected customers of unauthorised access to school and university AIMSweb 1.0 accounts. See www.pearson.com/news-and-research/announcements/2019/07/pearson-customer-notification.html	**Data privacy** › Globally assess new laws and regulations coming into force and prepare for their implementation. › Expand scope of processes to address new user/data subject right requirements in additional jurisdictions. › Work with product teams to review and update retention schedules. › Continue to engage with relevant teams to drive privacy by design in product development.
12 Intellectual property		
Failure to adequately manage, procure, protect and/or enforce intellectual property rights (including trademarks, patents, trade secrets and copyright) in our brands, content and technology may impair the value of our core assets, or reduce profits.	› Continued to reduce our multiple brand identities, streamline and strengthen Pearson's brand and patent key strategic technology assets (PLP, Aida, etc). › Expanded internal governance and best practices to ensure effective rights management and mitigation of infringement risks across IP. › Targeted IP enforcement against key third party infringers of Pearson copyright (piracy), brands and patents.	› Continue 2019 activities with focus on improving IP practices and governance across growth geographies and reorganised product groups. › Monitor increasing risks posed by local legislation and global treaties aimed at reducing copyright protection of educational content and partner with local associations to resist these policy shifts.

Legal and compliance

Risk description	2019 activity	2020 plans
13 Compliance		
Failure to effectively manage risks associated with compliance (principally ABC and sanctions risk), including failure to vet third parties, resulting in reputational harm, Anti-Bribery and Corruption (ABC) liability, or sanctions violations.	› Completed the rollout of a third-party due diligence programme globally and over 32,000 third parties have undergone ABC and sanctions due diligence. › Created and launched a learning course for third-party due diligence in the UK, US and Canada. This will be rolled out to the rest of the world in 2020. › Our annual Code of Conduct rollout achieved 100% completion in record time, and we implemented a global conflict of interest policy as part of that launch. › We launched our *SpeakUp* campaign in certain key markets, and incorporated it into the Code of Conduct. As a result, reports into the PearsonEthics.com portal have increased by 69%.	› Focus on sanctions compliance best practice in 2020 in light of the 2019 US Department of Treasury guidance. › Continue ABC risk assessments to monitor implementations of our ABC and sanctions compliance programme policies and procedures, as well as to identify areas of continuous improvement. › Evaluate a prospective interactive Code of Conduct, for potential launch in 2021. › Finalise any legacy third-party due diligence efforts.
14 Competition law		
Failure to comply with antitrust and competition legislation could result in costly legal proceedings and fines of up to 10% of global revenue; other financial consequences such as class actions, damages, void contracts; and could adversely impact our reputation.	› Continued holding training and refresher sessions for our employees. › Formed a working group in the Lawyers Network, dedicated to performing an in-depth assessment on Pearson employees involved in industry association groups. › Set up a working group to assess on resale price maintenance risk in all countries where Pearson is active, to match the recent trend of enforcers to target this type of infringement. › Launched eLearning modules on information-exchange risk.	› Develop our approach to industry associations and information-exchange, which will include work on specific training and monitoring levels of awareness. › Continue efforts on resale price maintenance with the working group to assess risk and issue recommendations. › Raise awareness via the efforts of our Antitrust Lawyers Network. › Convey and encourage compliance measures to all teams, as part of our antitrust compliance programme, as recognised by enforcers.

Principal risks and uncertainties

Risk assessment of prospects and viability

This section should be read together with the full viability statement on p107

Pearson's principal risks and our ability to manage them as outlined in this section are linked to our viability as a company. These risks have therefore been taken into account when preparing the viability statement.

The Board assessed the prospects of the company over a three-year period, longer than the minimum 12 months for the annual going concern review. The three-year period corresponds with Pearson's strategic planning process and represents the time over which the company can reasonably predict market dynamics and the likely impact of additions to the product portfolio.

The Board discusses the company's three year plan on an annual basis taking account of a range of factors including market conditions, the principal risks to the Group above, product and capital investment levels as well as available funding. Pearson's strategic model and businesses are discussed in more detail on p10–13

The key assumptions which underpin our three-year plan to December 2022 are as follows:

- there are further declines in enrolments and other downwards pressure in the US Higher Education Courseware market.
- OPM grows, driven by global enrolment in undergraduate and postgraduate online courses.
- Virtual Schools grows, driven by increased enrolments in new and existing schools.
- other growth businesses, including Professional Certification (VUE) and English show good growth.
- the remaining Pearson business shows modest growth.
- our 2017-2019 cost efficiency programme is completed and additional cost savings are achieved in 2020.
- our investment in the product technology platform accelerates the shift to digital and enhances courseware service capabilities.
- investment continues in our growth businesses and the Pearson Brand in order to drive growth.
- our stake in Penguin Random House is sold and no additional share of profits are recorded.

In assessing the company's viability for the three years to December 2022, the Board analysed a variety of downside scenarios, including a scenario where the company is impacted by all principal risks from 2020. The primary modelling overlaid a 'severe but plausible' downside scenario onto the base case three-year plan for the Group, focusing on the impact of the following assumptions and key risks:

- the benefits of our 2017–2019 cost efficiency programme are not sustainable;
- further declines in US Higher Education Courseware, with digital growth failing to take hold;
- failure to accelerate our digital transformation in the wider Pearson Group;
- our growth businesses including OPM and Virtual Schools do not deliver despite increased investment; and
- the Group is required to make significant cash tax payments in respect of a negative ruling on UK CFC exemption (EU State Aid). Other contingencies are not expected to crystallise in the period to December 2022.

The Board also stress-tested the impact on our liquidity of all the principal risks occurring together. Although this is not regarded as a plausible scenario, the test showed that the company would still have liquid resources subject to a limited number of management actions.

The Board's confirmation of Pearson's viability for the three years to 2022, based on this assessment, is included alongside the going concern statement on p107