Our performance: 2012 financial overview

Watch an interview with Robin Freestone, Chief financial officer of Pearson.

ar2012.pearson.com

In 2012, Pearson increased sales by 4% in headline terms to £6.1bn generating a total adjusted operating profit of £936m (2011: £942m).

The headline growth rates were reduced by currency movements and helped by acquisitions. Currency movements reduced sales by £27m and operating profits by £11m. This was the result of non-dollar currency depreciation relative to sterling. At constant exchange rates (i.e. stripping out the impact of those currency movements), our sales and adjusted operating profit grew 5% and 1% respectively.

Acquisitions, primarily in our education company, contributed £318m to sales and £39m to operating profits. This includes integration costs and investments related to our newly-acquired companies, which we expense. The disposal of our 50% stake in FTSE International in 2011 reduced operating profits by £20m.

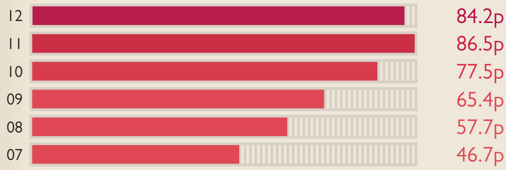
Our underlying revenue and adjusted operating profit (i.e. stripping out the impact of both portfolio changes and currency movements) declined by 1% and 2% respectively.

Our tax rate in 2012 was 23.1% compared to 22.4% in 2011 reflecting movements in tax settlements with revenue authorities in each year.

Adjusted earnings per share were 84.2p (2011: 86.5p).

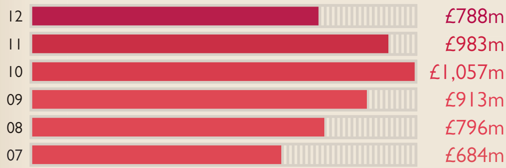
KEY FINANCIAL GOALS

Adjusted earnings per share Pence

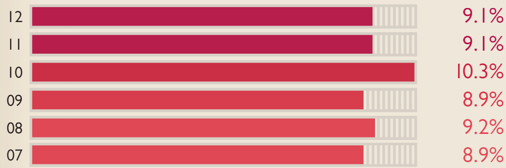


Average annual growth (headline) 13%.

Operating cash flow £m



Return on invested capital %



Average capital/actual cash tax

Cash generation

Headline operating cash flow declined by £195m due to longer debtor days, currency fluctuations and increased investment in new education programmes. Free cash flow declined by £115m to £657m, additionally reflecting from lower tax payments. Our average working capital to sales ratio improved by a further 0.4 percentage points to 13.8% reflecting the benefits from our shift to more digital and service-orientated businesses.

Return on invested capital

Our return on average invested capital was 9.1%, well ahead of our cost of capital and level with 2011. ROIC was affected by profit decline at Pearson in Practice and the sale of FTSE International (one of our least capital-intensive businesses), offset by a lower cash tax charge.

Our performance: 2012 financial overview continued

Statutory results

Our statutory results show a decrease of £603m in operating profit to £515m, from £1,118m in 2011, reflecting the absence in 2012 of the £412m profit on the sale of FTSE International in 2011 and the £113m closure-related costs on Pearson in Practice in 2012. Basic earnings per share similarly fell to 40.5p in 2012, down from 119.6p in 2011.

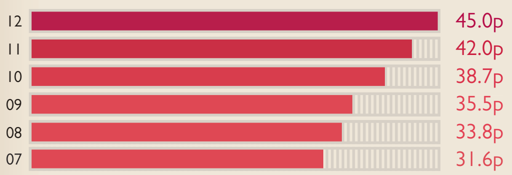
Balance sheet

Our net debt increased to £918m (£499m in 2011) reflecting acquisition investment of £759m and sustained organic investment in our business, partly offset by cash generation. Since 2000, Pearson's net debt/EBITDA ratio has fallen from 3.9x to 0.9x and our interest cover has increased from 3.1x to 18.0x.

Dividend

The board is proposing a dividend increase of 7% to 45.0p, subject to shareholder approval. 2012 will be Pearson's 21st straight year of increasing our dividend above the rate of inflation. Over the past ten years we have increased our dividend at a compound annual rate of 7%, returning more than £2.5bn to shareholders. We have a progressive dividend policy: we intend to sustain our dividend cover at around 2.0x over the long term, increasing our dividend more in line with earnings growth.

Dividend per share paid in fiscal year Pence



Outlook: 2013

We expect the external environment to remain challenging for our developed world and publishing businesses in 2013 owing to a combination of cyclical and structural factors: pressures on education budgets and college enrolments; retail consolidation; the shift in our business model from print sales to digital subscriptions; changing consumer behaviour and a dynamic competitive landscape. In general, we expect market conditions to remain favourable for our businesses in developing economies and education software and services.

In order to reshape the company to take advantage of significant growth opportunities, we will expense approximately £150m of restructuring costs in 2013 (the restructuring cost will be approximately £100m net of cost savings achieved in the year). This investment has two objectives:

1. to accelerate our transition from print to digital business models and from developed to developing economies; and
2. to separate Penguin activities from Pearson central services and operations, and to reduce fixed cost infrastructure in Pearson, in preparation for the Penguin Random House merger.

We expect this transformation programme to generate approximately £100m of annual cost savings from 2014. In 2014, we intend to reinvest the £100m of cost savings in the organic development of our fast-growing digital, services and emerging markets businesses and further restructuring, including the Penguin Random House integration. We expect these businesses to contribute to faster organic growth, improving margins and improved cash flow and capital intensity from 2015. The precise phasing of restructuring costs and benefits will depend on timing of completion of the Penguin Random House combination, which remains subject to regulatory approval and which we expect to complete in the second half of 2013.

At this early stage in the year we expect Pearson 2013 operating profits and adjusted EPS to be broadly level with 2012 before expensing these restructuring costs (compared to 2012 adjusted EPS of 82.6p under revised IAS 19 which we will adopt in 2013) and including Penguin for the full year.

This guidance is struck at the 2012 average exchange rate of £1:$1.59 and reflects the following outlook:

Education

In Education, we expect to achieve modest revenue growth in 2013 with margins similar to 2012.

North America

In North America, we anticipate modest growth with challenging cyclical and structural market conditions in publishing offset by growth in digital and services.

International

We expect our International education business to show good growth. Austerity measures will continue to affect education spending in much of the developed world and we expect a slower year for UK examinations and qualifications. However, we see significant opportunity in emerging markets in Asia, Latin America, the Middle East and Sub-Saharan Africa – which together accounted for 45% of our International education revenues in 2012.

Professional

Our Professional education business will reflect the closure of our UK professional training business and continued growth from our professional certification business.

FT Group

We expect the FT Group to benefit from continued growth in digital and subscription revenues in 2013 but advertising to remain weak and volatile with profits reflecting further actions to accelerate the shift from print to digital. Mergermarket will benefit from its high subscription renewal rates, with market activity likely to boost its core product offerings.

Penguin

As previously announced, subject to regulatory approval, we expect Penguin's combination with Random House to be completed in the second half of 2013. We believe that the combined organisation will have a stronger platform and greater resources to invest in rich content, new digital publishing models and high-growth emerging markets. The organisation will generate synergies from shared resources such as warehousing, distribution, printing and central functions. We expect market conditions to remain similar to 2012 with a tough environment in the physical bookstore channel but helped by good growth in digital.

Interest and tax

In 2013, our net interest charge to adjusted earnings will exclude pension income and charges following the adoption of IAS 19 revised and be similar to the £65m reported in 2012 on a comparable basis. We anticipate our P&L tax charge against adjusted earnings to be in the 23–25% range with our cash tax rates around the same level.

Exchange rates

Pearson generates approximately 60% of its sales in the US. A five cent move in the average £:$ exchange rate for the full year (which in 2012 was £1:$1.59) has an impact of approximately 1.4p on adjusted earnings per share.

North American Education

KEY PERFORMANCE INDICATORS

North American Education is Pearson's largest business, with 2012 sales of £2.7bn and operating profit of £536m.

Sales	
2012	£2,658m
2011	£2,584m
Headline growth	3%
CER growth	2%
Underlying growth	(4)%

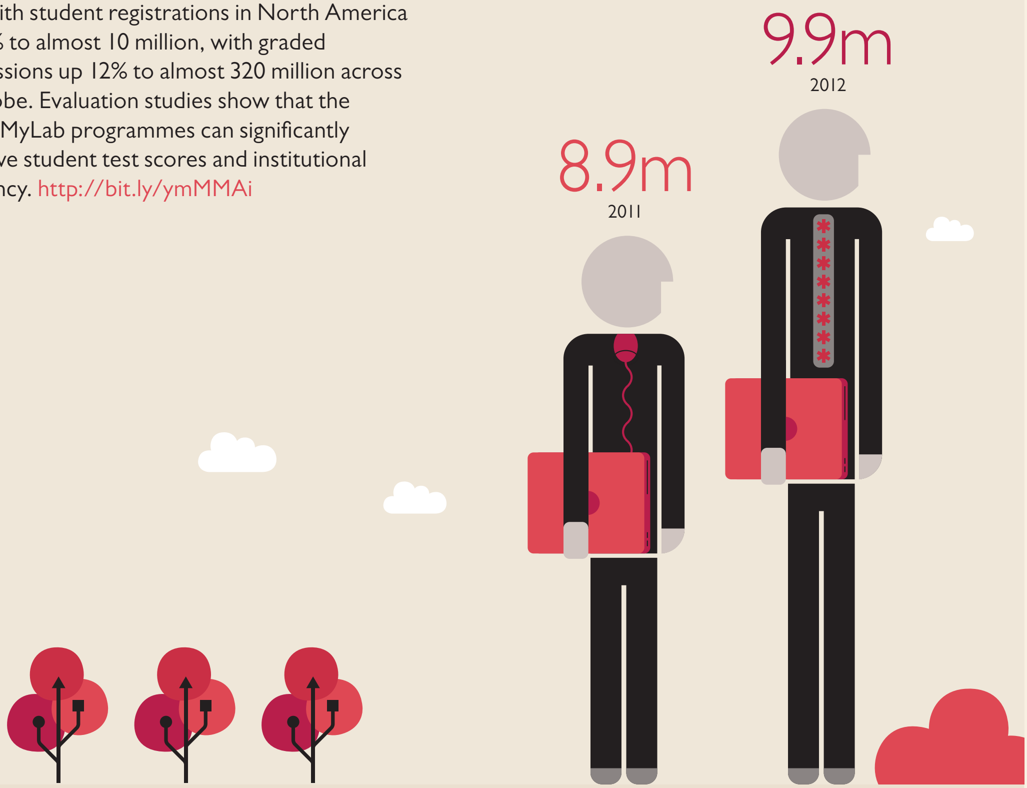
Adjusted operating profit	
2012	£536m
2011	£493m
Headline growth	9%
CER growth	8%
Underlying growth	3%

CASE STUDY

Online learning

Pearson's pioneering 'MyLab' digital learning, homework and assessment programmes grew well with student registrations in North America up 11% to almost 10 million, with graded submissions up 12% to almost 320 million across the globe. Evaluation studies show that the use of MyLab programmes can significantly improve student test scores and institutional efficiency. http://bit.ly/ymMMAi

Total number of MyLab registrations



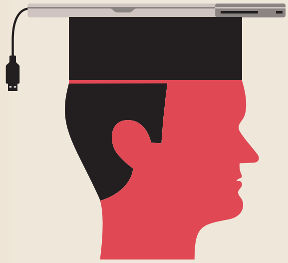
In 2012, our strength in digital and services businesses and tight cost control enabled us to perform ahead of our more traditional print publishing markets, which declined by 10% for the industry as a whole and were adversely affected by state budget pressures and declines in college enrolments.

Higher Education highlights in 2012 include:

- In Higher Education, the publishing market declined by 6% net in 2012, according to the Association of American Publishers. Total US College enrolments were 2% lower in 2012 than in 2011, affected by rising employment rates, state budget pressures and regulatory change affecting the for-profit sector. In a difficult trading environment Pearson gained share for the 14th consecutive year, again benefiting from our lead in technology and customisation.
- We launched Pearson Workforce Education which delivers more than 60 online courses in high demand occupational training areas from IT and Healthcare to management and soft skills courses; and Propero, which combines on-demand tutoring, student support and online courses to expand access to higher education and support degree completion.
- We announced the acquisition of a 5% stake in NOOK Media for $89.5m in December 2012 with the option to purchase up to an additional 5%, subject to certain conditions. This strategic investment will help accelerate customer access to digital content by pairing the company's leading expertise in online learning with NOOK Media's expertise in online distribution and customer service. This will facilitate improved discovery of available digital content and services, as well as seamless access.

CASE STUDY

eCollege registrations



Student registrations at eCollege grew 3% to 8.7 million, despite pressure in the for-profit college market. We won new online enterprise learning contracts with California State University and Rutgers University. Our strong managed enrolment services and student marketing product offering, coupled with continued strong growth at Arizona State University, helped our online enterprise learning business to grow 150% to almost 44,000 enrolments. In November 2012, we acquired EmbanetCompass for $650 million which provides a full range of services targeted towards online graduate programmes.

North American Education
continued

Assessment and Information highlights in 2012 include:

- At our Assessment and Information business, revenues were flat in 2012. State funding pressures and the transition to Common Core assessments continued to make market conditions tough for our state assessment and teacher testing businesses.
- The Partnership for Assessment of Readiness for College and Careers (PARCC), a consortium of 23 states, awarded Pearson and Educational Testing Service (ETS) the contract to develop test items that will be part of the new English and mathematics assessments to be administered from the 2014–2015 school year. The assessments will be based on what students need to be ready for college and careers, and will measure and track their progress along the way.
- We continued to produce strong growth in secure online testing, an important market for the future. We increased online testing volumes by more than 10%, delivering 6.5 million state accountability tests, 4.5 million constructed response items and 21 million spoken tests. We now assess oral proficiency in English, Spanish, French, Dutch, Arabic and Chinese. We also launched the Online Assessment Readiness Tool for the PARCC and the Smarter Balance Assessment Consortium (SBAC) Common Core consortia to help 45 states prepare for the transition to online assessments.
- We won new state contracts in Colorado and Missouri and a new contract with the College Board to deliver ReadiStep, a middle school assessment that measures and tracks college readiness skills. We extended our contract with the College Board to deliver the ACCUPLACER assessment, a computer-adaptive diagnostic, placement and online intervention system that supports 1,300 institutions and 7 million students annually.

CASE STUDY

Connections Education

Connections Education, which operates online K-12 schools in 22 states and a nationwide charter school programme, served more than 43,000 students in 2012, up 31% from 2011 and broadened its product offering to include virtual classrooms for public school campuses. Connections Academy Schools have consistently high performance ratings, particularly in states focused on measuring growth in student learning.

› We won five Race To The Top (RTTT) state deals (Kentucky, Florida, Colorado, North Carolina and New York) led by Schoolnet. PowerSchool won three state/province-level contracts (North Carolina, New Brunswick and Northwest Territories). We launched our mobile PowerSchool applications and grew our third-party partner ecosystem to over 50 partners. PowerSchool supports more than 12 million students, up more than 20% on 2011 while Schoolnet supports 8.3 million students, up almost 160% on 2011.

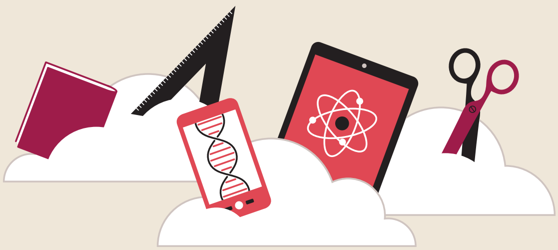
› Our clinical assessment business was boosted by strong growth at AIMSweb, our progress monitoring service which enables early intervention and remediation for struggling students. AIMSweb delivered 58 million assessments in 2012, up 12%.

School highlights in 2012 include:

› In School, the textbook publishing market declined 15% in 2012, according to the Association of American Publishers. There were several pressures on the industry including weakness in state budgets, a lower new adoption opportunity (total opportunity of $380m in 2012 against $650m in 2011) and delays in purchasing decisions during the transition to the new Common Core standards.

› Pearson gained share in very tough market conditions, taking an estimated 31% of new adoptions where we competed. enVisionMATH continued to perform strongly, with a recent *What Works Clearing House* study showing that students using the programme outperformed peers by between six and eight percentiles in maths across a broad range of student populations. iLit, our new digital reading intervention programme, was successfully implemented in 20 districts with early results showing strong reading gains.

CASE STUDY



OpenClass

OpenClass, Pearson's free learning management system, has been installed by almost 1,300 K-12 and college institutions in the US and now serves approximately 100,000 users. In November 2012, we launched Project Blue Sky, a cloud-based content service that allows college instructors to combine Open Educational Resources (OER) with instructor-created and Pearson content.

International Education

KEY PERFORMANCE INDICATORS

Our businesses in emerging markets continued to perform strongly, supported by good enrolment trends and sustained investment.

Sales

2012	£1,568m
2011	£1,424m
Headline growth	10%
CER growth	13%
Underlying growth	7%

Adjusted operating profit

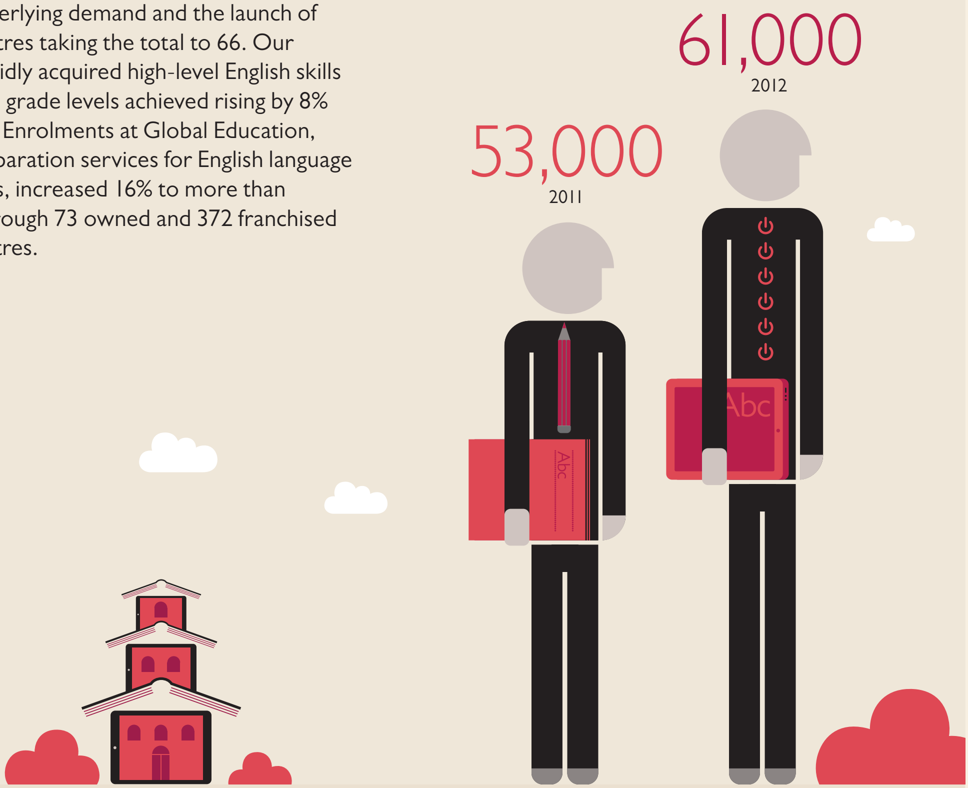
2012	£216m
2011	£196m
Headline growth	10%
CER growth	16%
Underlying growth	11%

CASE STUDY

Businesses in China

In China, student enrolments at Wall Street English increased 15% to almost 61,000, boosted by good underlying demand and the launch of ten new centres taking the total to 66. Our students rapidly acquired high-level English skills with average grade levels achieved rising by 8% during 2012. Enrolments at Global Education, our test preparation services for English language qualifications, increased 16% to more than 1 million, through 73 owned and 372 franchised learning centres.

Wall Street English student enrolments in China



Our businesses in emerging markets continued to perform strongly, supported by good enrolment trends and sustained investment. Our UK business was resilient during the year despite significant regulatory and policy changes across vocational and general qualifications, apprenticeships and higher education. In the rest of the world, a recovery in Japan following the 2011 tsunami and a strong competitive performance in Italy more than offset weak market conditions in Spain.

Key highlights in 2012 include:

- In English Language Learning, Wall Street English (WSE), Pearson's worldwide chain of English language centres for professionals, opened a net of 11 new centres around the world, bringing the total number to 460. Student numbers fell by 2% to more than 191,000, primarily due to the closure of a large franchise centre in Chile with approximately 7,000 students. MyEnglishLabs enrolments grew 60% to 263,000 supported by the launch of our next generation platform which supports 13 languages and 43 new courses. We acquired GlobalEnglish, a leading provider of cloud-based, on-demand Business English learning, assessment and performance support software, for $90m in cash in July 2012.
- More than 1.1 million students registered for our MyLab digital learning, homework and assessment programmes, an increase of 18%, with good growth in school, ELT and institutional selling in higher education.

United Kingdom highlights in 2012 include:

- In the United Kingdom, we marked more than 6.3 million GCSE, A/AS Level and other examinations with 90% using onscreen technology and more than 3.8 million test scripts for over half a million pupils taking National Curriculum Tests at Key Stage Two in 2012. We launched our Next Generation BTECs which are now the leading vocational qualification on the new funding and accountability frameworks in schools. Our vocational qualifications business grew well with the continued popularity of BTEC amongst employers and universities and a strong performance in work-based learning (with registrations now up to 170,000) further boosted by a good performance from EDI.

CASE STUDY

Sistema success in Brazil

In Brazil, we ended 2012 with 533,000 students in our public and private sistemas (or learning systems) and added 24,000 students in our two largest private sistemas, COC and Dom Bosco, up 8% on 2011. Our public sistema, NAME, includes the top performing lower secondary school in Brazil and test scores for all our public school students are, on average, 20% above the 2011 national IDEB standard for 4th and 8th grade students.

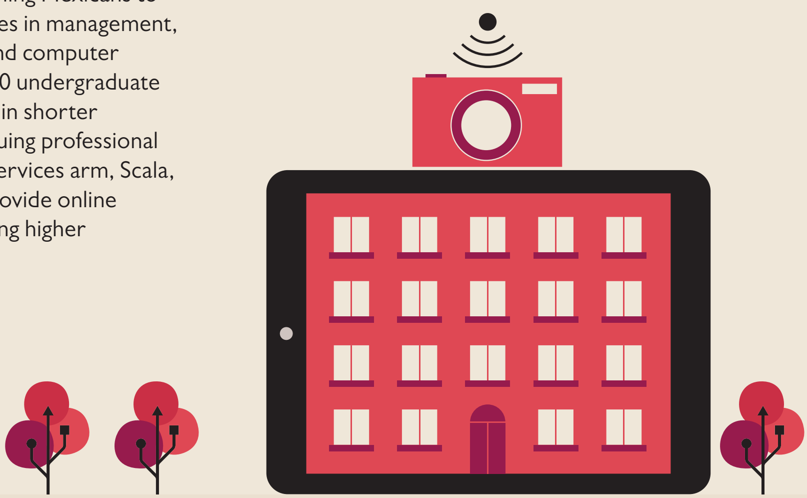
International Education
continued

- In South Africa we held share in school publishing in market conditions which were tougher than expected despite a year of major curriculum reform. Student enrolments grew strongly at CTI, up 19% to more than 10,000. We partnered with UNISA, South Africa's largest university and the largest distance learning provider in Africa, to provide 30,000 students with access to our MyLabs software, digital resources and customised eBooks.
- In India, TutorVista is now managing 35 schools and its multimedia teaching solution Digiclass is installed in approximately 17,000 classrooms. ActiveTeach, our digital learning platform for schools, was adopted by 200 schools serving approximately 100,000 students.
- In the Middle East, the Abu Dhabi Education Council purchased our print and digital Maths and Science resources for all schools from grades 6 to 10, the American University of Sharjah adopted MyLabs for four mathematics courses and three science courses, and we are providing access to digital course content for 5,000 students at Abu Dhabi's Higher Colleges of Technology through our Pearson e-texts iPad app.

CASE STUDY

New online university launch in Mexico

In Mexico, we partnered with local curriculum and technology experts INITE to launch UTEL, a new university enabling Mexicans to enrol in online degree courses in management, IT, marketing, engineering and computer science. UTEL enrolled 2,500 undergraduate students and 4,000 learners in shorter corporate training or continuing professional education courses. UTEL's services arm, Scala, signed its first contract to provide online learning services to an existing higher education institution.



Professional Education

KEY PERFORMANCE INDICATORS

Our Professional Education business is focused on publishing, training, testing and certification for professionals.

Sales		Adjusted operating profit	
2012	£390m	2012	£37m
2011	£382m	2011	£66m
Headline growth	2%	Headline growth	(44)%
CER growth	2%	CER growth	(44)%
Underlying growth	(9)%	Underlying growth	(54)%

Our Professional Education business is focused on publishing, training, testing and certification for professionals. The weakness in our UK training business, Pearson in Practice, had a significant negative impact on our 2012 performance and resulted in our decision to exit the business. Other parts of the Professional division performed well.

Professional testing highlights in 2012 include:

- Professional testing continued to see good revenue and profit growth with test volumes at Pearson VUE up 7% on 2011 to almost 8 million with Certiport adding an additional 2.3 million tests, up 13% on 2011. There were key renewals of the National Council of State Boards of Nursing contract running until 2019 and the Computing Technology Industry Association contract was secured with Pearson VUE as the single vendor running through to 2017.
- We won a number of new contracts including a ten-year contract to administer all computer and paper-based tests for the Australia CPA Professional exams and five-year contracts with the National Center for Assessment in Saudi Arabia and the National Council of State Boards of Nursing to provide the NCLEX-RN in Canada beginning in 2015 for ten Canadian registered nurse (RN) regulatory bodies.
- The partnership with the American Council on Education to develop an online General Educational Development (GED) test aligned with new Common Core standards has now launched computer-based testing in 37 jurisdictions.
- Continuing our digital transformation, we adapted our booking service for the Driving Standards Agency (DSA) to work on mobile devices. We also introduced one-to-many biometric matching technology into testing centres to enhance fraud detection.

Professional training

- Professional training was very weak with our UK adult training business, Pearson in Practice, facing a dramatic fall in demand as a result of changes to the apprenticeships programme. We believe this business no longer has a sustainable model and announced in January that we are to exit Pearson in Practice. The cost of exit and impairment is £113m and is reported as a loss on closure in Pearson's 2012 statutory accounts.
- TQ continues to make significant progress in the direct delivery of training services overseas. In Saudi Arabia, we extended the contract to operate the Saudi Petroleum Services Institute for five years and won a five-year contract to run a new Institute at Al Khafji. In Oman, a TQ-led consortium won the bid to provide training to BP, including a wide range of technical and English language training for BP workers as they prepare to open up the Khazzan oilfield for full scale production in 2016.

Professional publishing highlights in 2012 include:

- Professional publishing grew modestly with good profit growth. In the US, growth of eBook sales and other digital products and services continued to outpace ongoing challenges in the traditional retail channel.

Financial Times Group

KEY PERFORMANCE INDICATORS

The FT Group is a leading provider of essential information in attractive niches of the global business information market.

Sales	
2012	£443m
2011	£427m
Headline growth	4%
CER growth	4%
Underlying growth	4%

Adjusted operating profit*	
2012	£49m
2011	£76m
Headline growth	(36)%
CER growth	(32)%
Underlying growth	(7)%

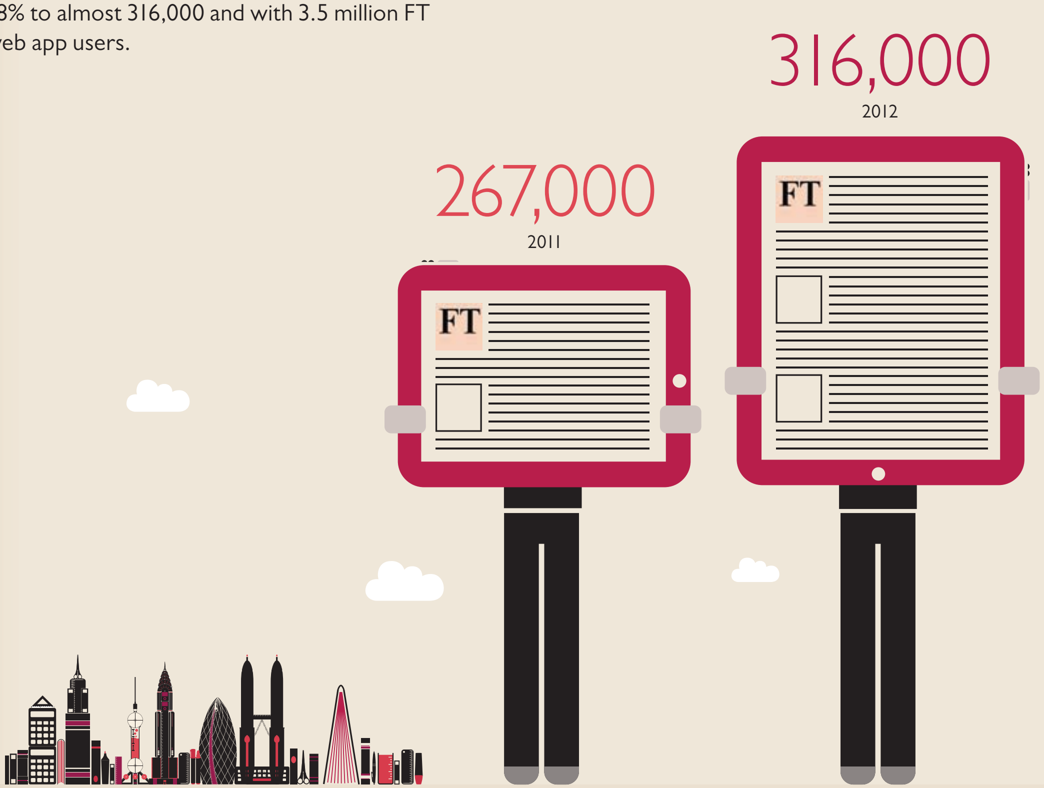
*Reflects the absence in 2012 of the £20m 2011 profit from Pearson's stake in FTSE International following its sale.

CASE STUDY

Growth in digital readership

The *Financial Times* digital readership continues to grow strongly with digital subscriptions increasing 18% to almost 316,000 and with 3.5 million FT web app users.

Financial Times digital subscriptions



Digital and services revenues accounted for 50% of FT Group revenues (31% in 2008). Content revenues comprised 61% of revenues (48% in 2008), while advertising accounted for 39% of FT Group revenues (52% in 2008).

Financial Times highlights in 2012 include:

- The *Financial Times* digital readership continues to grow strongly with digital subscriptions increasing 18% to almost 316,000 and with 3.5 million FT web app users. The FT's total paid circulation was more than 602,000 across print and online, modestly up on 2011, with digital subscriptions exceeding print circulation for the first time. The FT now has almost 2,800 direct corporate licences, up 40% on 2011.
- We continued to invest in new products and innovation, including launching a Windows 8 app and the FT web app on Chrome for Android; a bespoke web app for Latin America; a rebrand of the conferences division, FT Live, with the introduction of live streaming at key events; and the launch of GatekeeperIQ, a new subscription service to track large, retail investment platforms.
- Advertising was generally weak and volatile with poor visibility but the FT grew market share with mobile, luxury and business education showing good growth. Digital revenues benefited from the launch of FT SmartMatch, which automatically puts client content such as articles, white papers and videos in front of FT.com users while they're reading related FT news stories.
- FT Live, our events business, continued to grow strongly and launch new events, including the Global Commodities Summit, delivering more than 200 events that attracted over 17,000 delegates. We launched a digital portal that offers on-demand webinars, livestreamed events and social media tools.

CASE STUDY

Growth in mobile

Mobile devices now account for 30% of FT.com traffic and 15% of new subscriptions.

- Educational services are an important area of expansion. The FT Non-Executive Director Certificate (in partnership with Pearson Learning Studio and Edexcel) was attended by over 150 candidates across five intakes. FT Newslines, an annotations tool on FT.com that allows students and faculties from around the world to create and share annotations on FT articles, is now being used at many business schools. The new FTChinese MBA Gym App, which features tailored training courses categorised by topic, has ranked among the top paid-for education apps on the iTunes Store and was recognised as one of the 'App Store Best of 2012' by Apple in China.
- Money-Media revenues and profits continued to grow well boosted by a strong subscription performance, with the number of individual users growing 6% year on year to 220,000, and new product launches, including Ignites Retirement Research which broadens Money-Media's product offering into the investment industry research sector.

Economist Group highlights in 2012 include:

- In The Economist Group (50% owned by Pearson), *The Economist* launched three HTML5-powered apps in collaboration with FT Labs. *The Economist*'s worldwide print and digital circulation increased by 2% to 1.67 million (at 31 December 2012) of which 150,000 customers bought digital-only copies. The Economist Intelligence Unit acquired Clearstate in Singapore and Bazian, a London-based healthcare research company, as part of its strategy to build a healthcare information business.

Mergermarket highlights in 2012 include:

- Mergermarket grew well, despite challenging markets, due to a good performance from Debtwire, mergermarket, Xtract and Remark underpinned by a strong offering following investment in its product breadth, strong editorial analysis and global presence. We launched several new products and services, including a new mergermarket Android app, a Debtwire Analytics platform in Europe and Policy and Regulatory Report (PaRR), a global intelligence, analysis and proprietary data product focused on competition law, IP and trade law, and sector-specific regulatory change. We also expanded our coverage in faster growth markets such as Latin America, China and the Middle East, generating new business and extending our international reach.

Penguin

KEY PERFORMANCE INDICATORS

Penguin is one of the most famous brands in book publishing, known around the world for the quality of its publishing and its consistent record of innovation.

Sales

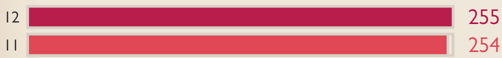
2012	£1,053m
2011	£1,045m
Headline growth	1%
CER growth	1%
Underlying growth	(2)%

Adjusted operating profit

2012	£98m
2011	£111m
Headline growth	(12)%
CER growth	(11)%
Underlying growth	(14)%

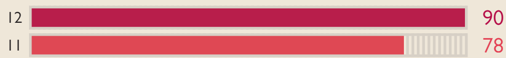
CASE STUDY

US bestsellers No.



The number of Penguin books entering the Top Ten bestseller lists in the US (*New York Times*).

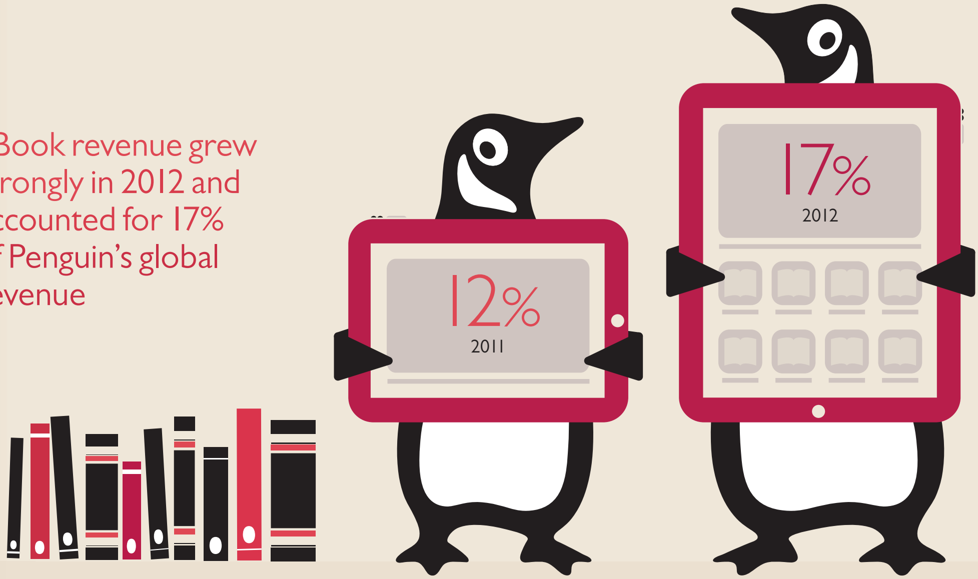
UK bestsellers No.



The number of Penguin books entering the Top Ten besteller lists in the UK (Nielsen Bookscan Top Ten).

eBook sales % of sales

eBook revenue grew strongly in 2012 and accounted for 17% of Penguin's global revenue



In October 2012, Pearson and Bertelsmann announced an agreement to create the world's leading consumer publishing company by combining Penguin and Random House. Pearson will own 47% of the combined organisation, which is subject to regulatory approval and is expected to complete in the second half of 2013. We believe that the combined organisation will have a stronger platform and greater resources to invest in rich content, new digital publishing models and high-growth emerging markets.

In market conditions that remained challenging, Penguin had a solid year with momentum and share improving in the second half of the year. It also made several moves to offer a broader range of services to more authors across more platforms in more markets.

Key highlights in 2012 include:

› In the United States, we published 255 *New York Times* bestsellers (254 in 2011) including *No Easy Day: The Firsthand Account of the Mission that Killed Osama bin Laden* by 'Mark Owen', *Bared to You* by Sylvia Day and Nate Silver's *The Signal and the Noise* as well as new titles from bestselling authors including Ken Follett, Nora Roberts, Tom Clancy and Harlan Coben.

› In the UK, we published 90 Bookscan bestsellers, our best year on record (and compared to 78 in 2011) including Sylvia Day's *Bared to You*; Jamie Oliver's *15 Minute Meals*; Clare Balding's *My Animals and Other Family* and Daniel Kahneman's *Thinking, Fast and Slow*.

› eBook revenue grew strongly in 2012 and accounted for 17% of Penguin's global revenue (12% in 2011), and almost 30% in the US (20% in 2011). We continued to invest in digital publishing programmes, making eBooks available in new markets including Australia, India, Brazil and China; launching a number of digital-only imprints around the world and expanding our eSpecials list. Global app sales grew by more than 200% driven by brands including Wreck this App, Mad Libs, Moshi Monsters and LEGO®. DK was Apple's only trade publisher launch partner for the January launch of the iBooks Author 2 platform and now has more than 50 interactive titles available.

CASE STUDY

Strong publishing list for 2013

Penguin has a strong publishing list for 2013 with major new books from authors including Khaled Hosseini, Elizabeth Gilbert, Sylvia Day, Nora Roberts, Nathaniel Philbrick and Sarah Dessen in the US, and Jamie Oliver, John Le Carré, Jennifer Saunders, Malcolm Gladwell, Steven D Levitt & Stephen J Dubner, Jeremy Paxman, Jonathan Coe and John Green in the UK. DK will launch more LEGO® titles, including the LEGO® Play book, and *Mary Berry's Cookery Course*. New apps for 2013 include *Anne Frank: The Diary of a Young Girl*, *I'm Ready to Spell* and *Poems by Heart*.

Penguin
continued

› In Brazil, we acquired 45% of Companhia das Letras, a leading trade book publisher. In India, we launched a local eBook programme and enjoyed considerable success in commercial fiction with bestselling authors including Ravinder Singh and Shobhaa De. In China, we expanded our local publishing programmes in both Chinese and English with more than 100 titles now available, including a first local language top ten title, tennis player Li Na's autobiography, and we launched our first list of eBooks.

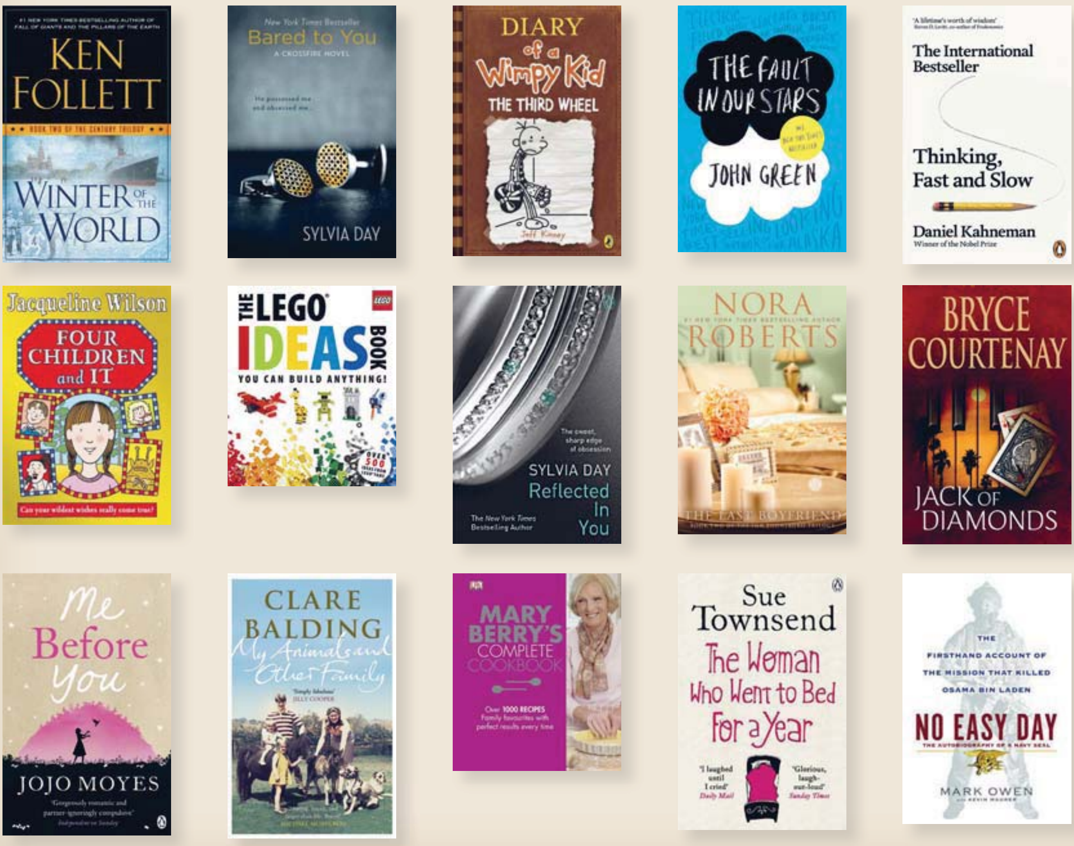
› DK performed strongly and grew share globally led by our LEGO® publishing list. In the UK, DK celebrated a number one bestseller with *Mary Berry's Complete Cookbook*, which has sold more than one million copies worldwide. BradyGames had bestsellers with *Borderlands 2*, *Skylanders Giants* and *Call of Duty: Black Ops II*.

› Author Solutions, which we acquired in July 2012 for $116m, had a good start. It is the world's leading provider of professional self-publishing services and broadens our expertise in online marketing, consumer analytics, professional services and user-generated content. In February 2013 Penguin India launched Partridge, a new self-publishing imprint, in partnership with Author Solutions.

CASE STUDY

Pick of the year

In 2012, Penguin enjoyed bestseller success around the world, including publishing 255 *New York Times* bestsellers and 90 top ten bestsellers in the UK. Here's a taste of the highlights:



Other financial information

	2012 £m	2011 £m
Net finance costs		
Net interest payable	(65)	(55)
Finance income in respect of employee benefit plans	13	3
Net finance costs reflected in adjusted earnings	(52)	(52)
Other net finance costs	(29)	(19)
Total net finance costs	(81)	(71)

Net finance costs reported in our adjusted earnings comprise net interest payable and net finance income relating to post-retirement plans.

Net interest payable in 2012 was £65m, up from £55m in 2011. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) rose by 0.2% to 0.5%. This increase in floating market interest rates combined with an increase in the Group's average net debt helped drive the Group's higher interest charge. These factors combined with a decrease in interest income on deposits and the impact of new notes issued in 2012 created an increase in the Group's average net interest payable from 6.5% to 7.0%. The Group's average net debt rose by £92m, largely reflecting the acquisition activity during 2012.

Net finance income relating to post-retirement plans was £13m in 2012 compared to £3m in 2011. Also included in the statutory definition of net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. Finance costs for put options and deferred consideration are excluded from adjusted earnings as they relate to future earn outs and similar payments on acquisitions and therefore do not reflect cash expended. Foreign exchange and other gains and losses are excluded from adjusted earnings as they represent short-term fluctuations in market value and are subject to significant volatility. These 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 2012, the total of these items excluded from adjusted earnings was a loss of £29m compared to a loss of £19m in 2011. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2011 the loss relates mainly to foreign exchange differences on a proportion of the unhedged US dollar proceeds from the Interactive Data sale in 2010.

Funding position and liquid resources

The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer-term loans from banks and capital markets. Our objective is to secure continuity of funding at a reasonable cost from diverse sources and with varying maturities. The Group does not use off-balance sheet special purpose entities as a source of liquidity or for any other financing purposes. The net debt position of the Group is set out below.

	2012 £m	2011 £m
Cash and cash equivalents	1,062	1,369
Marketable securities	6	9
Net derivative assets	178	174
Bonds	(2,200)	(1,955)
Bank loans and overdrafts	(55)	(78)
Finance leases	(17)	(18)
Net debt – continuing	(1,026)	(499)
Net cash classified as held for sale	108	–
Total net debt	(918)	(499)

Acquisition activity in 2012, is a large contributor to the increase in the Group's net debt. Reflecting the geographical and currency split of our business, a large proportion of our debt is denominated in US dollars (see note 19 for our policy). The strengthening of sterling against the US dollar during 2012 (from $1.55 to $1.63:£1) decreases the sterling equivalent value of our reported net debt.

Other financial information
continued

The Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group's policy is to strive to maintain a rating of Baa1/ BBB+ over the long term.

In May 2012, the Group accessed the capital markets, raising $500m through the sale of notes maturing in May 2022 and bearing interest at 3.75%. The notes were swapped to floating rate to conform with the policy described in note 19.

The Group has a $1,750m committed revolving credit facility which matures in November 2015. At 31 December 2012 this facility was undrawn. The facility is used for short-term drawings and providing refinancing capabilities, including acting as a back-up for our US commercial paper programme. This programme is primarily used to finance our US working capital requirements, in particular our US educational businesses which have a peak borrowing requirement in June. At 31 December 2012, no commercial paper was outstanding.

The Group also maintains other committed and uncommitted facilities to finance short-term working capital requirements in the ordinary course of business.

Further details of the Group's approach to the management of financial risks are set out in note 19 to the financial statements.

Taxation

The effective tax rate on adjusted earnings in 2012 was 23.1% as compared to an effective rate of 22.4% in 2011. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 24.5% in 2012 and 26.5% in 2011). These higher tax rates were offset by amortisation-related tax deductions and by prior year adjustments including those arising from settlements with tax authorities.

The reported tax charge on a statutory basis was £148m (34.1%) compared to a charge of £162m (15.5%) in 2011. The increase in the statutory rate is largely due to the lack of tax relief on the loss on closure of Pearson in Practice together with the effect of a low tax charge in 2011 on the gain on disposal of FTSE International.

Tax paid in 2012 was £65m compared to £151m in 2011. The reduction in the 2012 tax paid is largely the result of the permitted deferral of US tax payments into 2013 following Hurricane Sandy.

Discontinued operations

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction is expected to complete in 2013 and, at that point, Pearson will no longer control the Penguin Group of companies but will equity account for its 47% associate interest. The loss of control results in the Penguin business being classified as held for sale on the Pearson balance sheet at 31 December 2012 and the results for both 2011 and 2012 have been included in discontinued operations. Also included in discontinued operations are the costs associated with the formation of the Penguin Random House venture including provision for the settlement of litigation associated with the agency arrangements for ebooks.

Non-controlling interest

There are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to the Group numbers.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £238m in 2012 compares to a loss in 2011 of £44m. The Group is principally exposed to movements in the US dollar as a significant proportion of the Group's operations are based in the US. In 2011 the US dollar strengthened only slightly from an opening rate of £1:$1.57 to a closing rate at the end of that year of £1:$1.55. Other currency movements were relatively more significant in 2011 causing a small loss. In 2012 the US dollar has weakened to close at £1:$1.63 and was the most significant contributor to the increase in the loss.

Also included in other comprehensive income in 2012 is an actuarial loss of £122m in relation to post-retirement plans. This loss arose largely because of unfavourable changes in the discount rate and other assumptions used in the actuarial valuation that offset the effect of continuing asset returns and deficit funding in the UK plan. In 2011 the loss of £64m was also due to discount rate and other assumption changes outweighing improved asset returns and deficit funding.

Dividends

The dividend accounted for in our 2012 financial statements totalling £346m represents the final dividend in respect of 2011 (28.0p) and the interim dividend for 2012 (15.0p). We are proposing a final dividend for 2012 of 30.0p, bringing the total paid and payable in respect of 2012 to 45.0p, a 7% increase on 2011. This final 2012 dividend was approved by the board in February 2013, is subject to approval at the forthcoming AGM and will be charged against 2013 profits. For 2012, the dividend is covered 1.9 times by adjusted earnings.

We seek to maintain a balance between the requirements of our shareholders for a rising stream of dividend income and the reinvestment opportunities which we identify around the Group and through acquisitions. The board expects to raise the dividend above inflation, more in line with earnings growth, thereby maintaining dividend cover at around two times earnings in the long term.

Pensions

Pearson operates a variety of pension plans. Our UK Group 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 post-retirement benefits for continuing operations amounted to £84m in 2012 (2011: £82m) of which a charge of £97m (2011: £85m) was reported in operating profit and a net benefit of £13m (2011: £3m) was reported against net finance costs. In addition to these amounts, in 2012 a charge of £11m (2011: £11m) has been reported in operating profit in respect of discontinued operations.

The overall surplus on the UK Group plan of £25m at the end of 2011 has become a deficit of £19m at 31 December 2012. The deficit has arisen due to unfavourable movements in the discount rate and other assumptions used to value the liabilities, offset by continuing asset returns and deficit funding. In total, our worldwide deficit in respect of pensions and post-retirement benefits increased from £141m in 2011 to £198m at the end of 2012; this amount includes a deficit of £26m which specifically relates to Penguin and has been classified as a liability held for sale.

Acquisitions

In May 2012, the Professional business acquired Certiport Inc. for $140m. Certiport is based in the US and is a leading provider of certification and assessment programmes in IT and digital literacy. In July 2012, the International Education business completed the purchase of GlobalEnglish Corporation, a leading provider of cloud-based, on demand business English learning, assessment and performance support software for a net cash consideration of $90m. Also in July 2012, Penguin acquired Author Solutions, Inc., the world's leading provider of professional self-publishing services, for $116m in cash. The $650m acquisition of EmbanetCompass by the North American Education business was completed in November 2012. EmbanetCompass partners with leading non-profit colleges in North America to provide online learning solutions for university programmes.

Net cash consideration for all acquisitions made in the year ended 31 December 2012 was £759m and provisional goodwill recognised was £505m. In total, acquisitions completed in the year contributed an additional £45m of sales and £5m of operating profit before acquisition costs and intangible amortisation.

Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC remained flat at 9.1% in both 2011 and 2012. The impact of lower cash tax payments in 2012 has been offset by slightly lower profit and increased investment in new acquisitions.

Other financial information
continued

Capital expenditure

Net capital expenditure in the year on property, plant equipment and software amounted to £152m. The analysis of capital expenditure and details of capital commitments are shown in notes 10, 11 and 36 of the financial statements.

Related party transactions

Transactions with related parties are shown in note 37 of the financial statements.

Post balance sheet events

In January 2013, the Group completed the purchase of a 5% equity investment in NOOK Media, LLC for $89.5m. NOOK Media is a new company consisting of Barnes & Noble's digital businesses including its NOOK e-reader and tablets, the NOOK digital bookstore and its 674 college bookstores across America.

In February 2013 the Group completed the purchase of the remaining minority interest in Tutorvista, the Bangalore-based tutoring services company for £17m.

Supplier payment policy

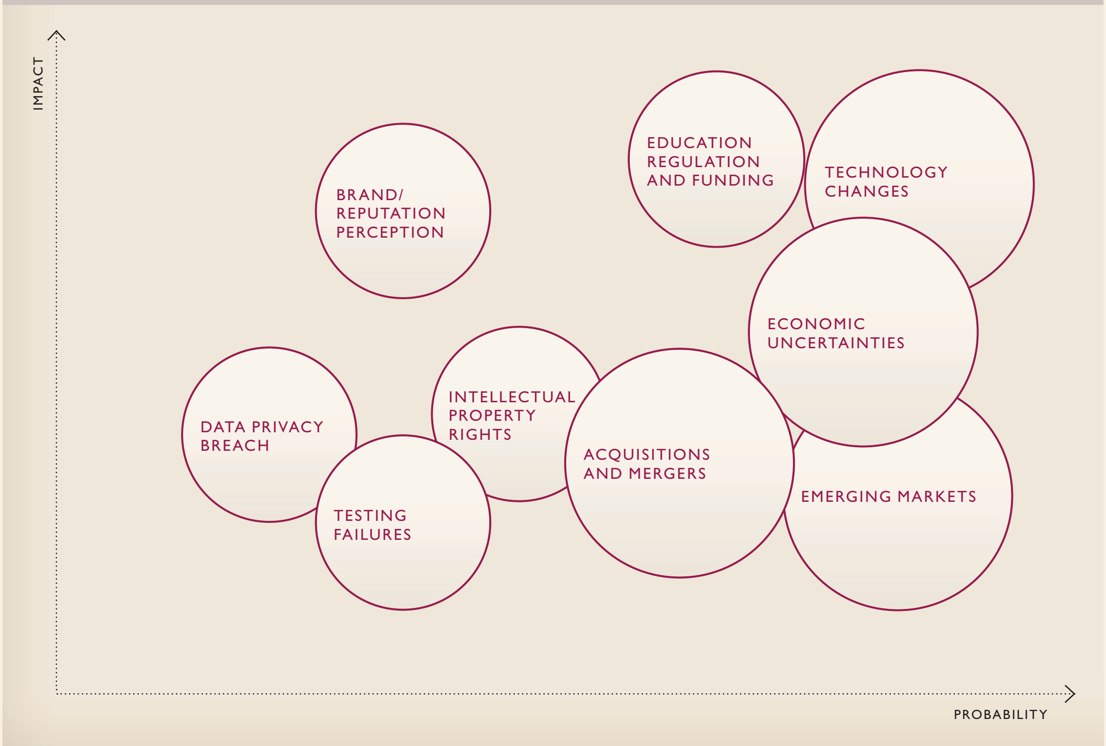
Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. These supplier payment terms vary by operating company, reflecting the different industries and countries in which they operate. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all the relevant terms and conditions. Group trade creditors at 31 December 2012 were equivalent to approximately 34 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

Principal risks and uncertainties

Our principal risks and uncertainties are outlined below. These are the most significant risks that may adversely affect our business strategy, financial position or future performance. The risk assessment process evaluates the probability of the risk materialising and the financial or strategic impact of the risk. Those risks which have a higher probability and significant impact on strategy, reputation or operations or a financial impact greater than £40 million are identified as principal risks. The risk assessment and reporting criteria are designed to provide the board with a consistent, Group-wide perspective of the key risks. The reports to the board, which are submitted twice per year, include an assessment of the probability and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.

We conduct regular risk reviews to identify risk factors which may affect our business and financial performance and to assist management in prioritising their response to those risks. Our Group internal audit and risk assurance function facilitates risk reviews with each business, shared service operations and corporate functions, identifying measures and controls to mitigate these risks. These reviews are designed so that the different businesses are able to tailor and adapt their risk management processes to suit their specific circumstances. Management is responsible for considering and executing the appropriate action to mitigate these risks whenever possible. It is not possible to identify every risk that could affect our businesses, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise and/or adversely affect our business or financial performance.

PRINCIPAL RISKS – IMPACT AND PROBABILITY



Principal risks and uncertainties
continued

Principal risks	Mitigating factors
TECHNOLOGY CHANGES	
Our education, business information and book publishing businesses will be impacted by the rate of and state of technological change, including the digital revolution and other disruptive technologies. We operate in markets which are dependent on Information Technology (IT) systems and technological change.	We are transforming our products and services for the digital environment along with managing our print inventories. Our content is being adapted to new technologies across our businesses and is priced to drive demand. We develop new distribution channels by adapting our product offering and investing in new formats. We continue to monitor contraction in the consumer book market to minimise the impact of customer bankruptcy. We mitigate IT risks by establishing strong IT policies and operational controls, employing project management techniques to manage new software developments and/or systems implementations and have implemented an array of security measures to protect our IT assets from attacks or failures that could impact the confidentiality, availability or integrity of our systems.
EDUCATION REGULATION AND FUNDING	
Our US educational solutions and assessment businesses and our UK training businesses may be adversely affected by changes in government funding resulting from either general economic conditions, changes in government educational funding, programmes, policy decisions, legislation and/or changes in the procurement processes.	In the US we actively monitor changes through participation in advisory boards and representation on standard setting committees. Our customer relationship teams have detailed knowledge of each state market. We are investing in new and innovative ways to expand and combine our product and services to provide a superior customer offering when compared to our competitors, thereby reducing our reliance on any particular funding stream in the US market. We work through our own government relations team and our industry trade associations including the Association of American Publishers. We are also monitoring municipal funding and the impact on our education receivables. In the UK we maintain relationships with those government departments and agencies that are responsible for policy and funding. We work proactively with them to ensure our education, training and apprenticeship programmes meet existing and new government objectives at the right quality. Changes in the UK government's funding policy for apprenticeships affected the business model for the Pearson in Practice adult training business. As a result, in January 2013 we announced that we will exit this particular business. We will continue to provide training and support for young adults who wish to develop skills and enter the UK workforce through our qualifications and curriculum businesses.
ECONOMIC UNCERTAINTIES	
Global economic conditions may adversely impact our financial performance. A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants. We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuation could adversely affect our earnings and the strength of our balance sheet.	The Group's approach to funding is described on page 27 and the Group's approach to the management of financial risks is set out in note 19 to the financial statements.

Principal risks	Mitigating factors
INTELLECTUAL PROPERTY RIGHTS	
If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.	We seek to mitigate this type of risk through general vigilance, co-operation with other publishers and trade associations, advances in technology, as well as recourse to law as necessary. Digital rights management standards and monitoring programmes have been developed. We have a piracy task force to identify weaknesses and remediate breaches. We monitor activities and regulations in each market for developments in copyright/intellectual property law and enforcement and take legal action where necessary.
EMERGING MARKETS	
Our investment into inherently riskier emerging markets is growing and the returns may be lower than anticipated.	We draw on our experience of developing businesses outside our core markets and our existing international infrastructure to manage specific country risks. We continue to strengthen our financial control and managerial resources in these markets to manage expansion. The diversification of our international portfolio, and relative size of 'emerging markets' in relation to the Group, further minimises the effect any one territory could have on the overall Group results.
DATA PRIVACY BREACH	
Failure to comply with data privacy regulations and standards or weakness in internet security could result in a major data privacy breach causing reputational damage to our brands and financial loss.	Through our global security team we have established various data privacy and security programmes. We constantly test and re-evaluate our data security procedures and controls across all our businesses with the aim of ensuring personal data is secured and we comply with relevant legislation and contractual requirements. We pursue appropriate privacy accreditations, e.g., TRUSTe Privacy and Safe Harbor Seal. We regularly monitor regulation changes to assess impact on existing processes and programmes.
TESTING FAILURES	
A control breakdown or service failure in our school assessment businesses could result in financial loss and reputational damage. Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed.	We seek to minimise the risk of a breakdown in our student marking with the use of robust quality assurance procedures and controls and oversight of contract performance, combined with our investment in technology, project management and skills development of our people. In addition to the internal business procedures and controls implemented to ensure we successfully deliver on our contractual commitments, we also seek to develop and maintain good relationships with our customers to minimise associated risks. We also look to diversify our portfolio to minimise reliance on any single contract.
ACQUISITIONS AND MERGERS	
Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations could lead to goodwill and intangible asset impairments.	We perform pre-transaction due diligence and closely monitor actual performance to ensure we are meeting operational and financial targets. Any divergence from these plans will result in management action to improve performance and minimise the risk of any impairments. Executive management and the board receive regular reports on the status of acquisition and mergers. In October 2012, we announced an agreement with Bertelsmann to combine our respective consumer publishing businesses in a newly-created venture named Penguin Random House. The combination is subject to customary regulatory and other approvals and is expected to complete in the second half of 2013.
BRAND/REPUTATION PERCEPTION	
Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.	We mitigate this risk through the development of comprehensive processes to enable our business units to effectively manage relationships with stakeholders, customers, communities and employees. We have an ongoing process to understand and evaluate potential brand threats and monitor and evaluate information about our brand across media sources.