

PEARSON PLC  
Form 20-F  
March 26, 2009

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**AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON March 26, 2009**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 20-F**

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
- or**
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**for the fiscal year ended December 31, 2008**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**for the transition period from**                      **to**
- or**
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Date of event requiring this shell company report**

**Commission file number 1-16055  
PEARSON PLC**

*(Exact name of Registrant as specified in its charter)*

**England and Wales**

*(Jurisdiction of incorporation or organization)*

**80 Strand**

**London, England WC2R 0RL**

*(Address of principal executive offices)*

**Stephen Jones**

**Telephone: +44 20 7010 2000**

**Fax: +44 20 7010 6060**

**80 Strand**

**London, England WC2R 0RL**

*(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)*

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

| <b>Title of Class</b>                                                                    | <b>Name of Each Exchange on Which Registered</b> |
|------------------------------------------------------------------------------------------|--------------------------------------------------|
| *Ordinary Shares, 25p par value                                                          | New York Stock Exchange                          |
| American Depositary Shares, each Representing One Ordinary Share, 25p per Ordinary Share | New York Stock Exchange                          |

\* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the SEC.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**  
**None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**  
**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock at the close of the period covered by the annual report:

Ordinary Shares, 25p par value 809,276,583

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer", in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing

US GAAP       International financial Reporting Standards as Issued by the International Accounting Standards Board       Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17

Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes

No

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**INTRODUCTION**

In this Annual Report on Form 20-F (the Annual Report ) references to Pearson , the Company or the Group are references to Pearson plc, its predecessors and its consolidated subsidiaries, except as the context otherwise requires.

Ordinary Shares refer to the ordinary share capital of Pearson of par value 25p each. ADSs refer to American Depositary Shares which are Ordinary Shares deposited pursuant to the Deposit Agreement dated March 21, 1995, amended and restated as of August 8, 2000 among Pearson, The Bank of New York as depositary (the Depositary ) and owners and holders of ADSs (the Deposit Agreement ). ADSs are represented by American Depositary Receipts ( ADRs ) delivered by the Depositary under the terms of the Deposit Agreement.

We have prepared the financial information contained in this Annual Report in accordance with International Financial Reporting Standards ( IFRS ) as issued by the International Accounting Standards Board ( IASB ) which in respect of the accounting standards applicable to the Group do not differ from IFRS as adopted by the European Union ( EU ). Unless we indicate otherwise, any reference in this Annual Report to our consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

We publish our consolidated financial statements in sterling. We have included, however, references to other currencies. In this Annual Report:

references to sterling , pounds , pence or £ are to the lawful currency of the United Kingdom,

references to euro or are to the euro, the lawful currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing the European Commission, and

references to US dollars , dollars , cents or \$ are to the lawful currency of the United States.

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = \$1.46, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2008, the last business day of 2008. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 28, 2009 the noon buying rate for sterling was £1.00 = \$1.43.

**FORWARD-LOOKING STATEMENTS**

You should not rely unduly on forward-looking statements in this Annual Report. This Annual Report, including the sections entitled Item 3. Key Information Risk Factors , Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects , contains forward-looking statements that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terms such as may , will , should , expect , intend , plan , anticipate , believe , estimate , predict , potential , continue or the negative of these comparable terminology. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

operations and prospects,

growth strategy,



funding needs and financing resources,

expected financial position,

market risk,

currency risk,

US federal and state spending patterns,

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debt levels, and

general market and economic conditions.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. In evaluating them, you should consider various factors, including the risks outlined under Item 3. Key Information Risk Factors, which may cause actual events or our industry's results to differ materially from those expressed or implied by any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

**Table of Contents****PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****Selected consolidated financial data**

Following the publication of SEC Release No 33-8879 Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, the Group no longer provides a reconciliation between IFRS and U.S. GAAP.

The tables below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated profit and loss account data for the years ended December 31, 2008, 2007 and 2006 and the selected consolidated balance sheet data as at December 31, 2008 and 2007 have been derived from our audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

The selected consolidated financial information should be read in conjunction with Item 5. Operating and Financial Review and Prospects and our consolidated financial statements and the related notes appearing elsewhere in this Annual Report. The information provided below is not necessarily indicative of the results that may be expected from future operations.

For convenience, we have translated the 2008 amounts into US dollars at the rate of £1.00 = \$1.46, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2008.

|                                                  | <b>Year Ended December 31</b> |             |             |             |             |             |
|--------------------------------------------------|-------------------------------|-------------|-------------|-------------|-------------|-------------|
|                                                  | <b>2008</b>                   | <b>2008</b> | <b>2007</b> | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|                                                  | \$                            | £           | £           | £           | £           | £           |
| (In millions, except for per share amounts)      |                               |             |             |             |             |             |
| <b>IFRS information:</b>                         |                               |             |             |             |             |             |
| <b>Consolidated Income Statement data</b>        |                               |             |             |             |             |             |
| Total sales                                      | 7,024                         | 4,811       | 4,162       | 3,990       | 3,662       | 3,340       |
| Total operating profit                           | 987                           | 676         | 574         | 522         | 497         | 359         |
| Profit after taxation from continuing operations | 603                           | 413         | 337         | 444         | 319         | 232         |
| Profit for the financial year                    | 472                           | 323         | 310         | 469         | 644         | 284         |
| <b>Consolidated Earnings data per share</b>      |                               |             |             |             |             |             |
| Basic earnings per equity share(1)               | \$ 0.53                       | 36.6p       | 35.6p       | 55.9p       | 78.2p       | 32.9p       |

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|                                                                   |         |         |         |         |         |         |
|-------------------------------------------------------------------|---------|---------|---------|---------|---------|---------|
| Diluted earnings per equity share(2)                              | \$ 0.53 | 36.6p   | 35.6p   | 55.8p   | 78.1p   | 32.9p   |
| Basic earnings from continuing operations per equity share(1)     | \$ 0.70 | 47.9p   | 39.0p   | 52.7p   | 37.5p   | 26.4p   |
| Diluted earnings from continuing operations per equity share(2)   | \$ 0.70 | 47.9p   | 39.0p   | 52.6p   | 37.4p   | 26.3p   |
| Dividends per ordinary share                                      | \$ 0.49 | 33.8p   | 31.6p   | 29.3p   | 27.0p   | 25.4p   |
| <b>Consolidated Balance Sheet data at period end</b>              |         |         |         |         |         |         |
| Total assets (non-current assets plus current assets)             | 14,448  | 9,896   | 7,292   | 7,213   | 7,600   | 6,578   |
| Net assets                                                        | 7,335   | 5,024   | 3,874   | 3,644   | 3,733   | 3,014   |
| Long-term obligations(3)                                          | (4,237) | (2,902) | (1,681) | (1,853) | (2,500) | (2,403) |
| Capital stock                                                     | 295     | 202     | 202     | 202     | 201     | 201     |
| Number of equity shares outstanding (millions of ordinary shares) | 809     | 809     | 808     | 806     | 804     | 803     |

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## Notes:

- (1) Basic earnings per equity share is based on profit for the financial period and the weighted average number of ordinary shares in issue during the period.
- (2) Diluted earnings per equity share is based on diluted earnings for the financial period and the diluted weighted average number of ordinary shares in issue during the period. Diluted earnings comprise earnings adjusted for the tax benefit on the conversion of share options by employees and the weighted average number of ordinary shares adjusted for the dilutive effect of share options.
- (3) Long-term obligations comprise any liabilities with a maturity of more than one year, including medium and long-term borrowings, derivative financial instruments, pension obligations and deferred income tax liabilities.
- (4) The results of the Data Management business (disposed in February 2008) have been included in discontinued operations for all years presented. The results of Government Solutions (disposed in February 2007) and Les Echos (disposed in December 2007) have been included in discontinued operations for all the years to 2007.

**Dividend information**

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders' approval at our annual general meeting. At our annual general meeting on May 1, 2009 our shareholders will be asked to approve a final dividend of 22.0p per ordinary share for the year ended December 31, 2008.

The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in the city of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2008 fiscal year will be paid on May 8, 2009.

| Fiscal year | Interim<br>(Pence per ordinary share) | Final | Total | Interim<br>(Cents per ordinary share) | Final | Total  |
|-------------|---------------------------------------|-------|-------|---------------------------------------|-------|--------|
| <b>2008</b> | 11.8                                  | 22.0  | 33.8  | 21.6                                  | 32.1* | 53.7** |
| 2007        | 11.1                                  | 20.5  | 31.6  | 22.4                                  | 39.9  | 62.3   |
| 2006        | 10.5                                  | 18.8  | 29.3  | 20.0                                  | 31.4  | 51.4   |
| 2005        | 10.0                                  | 17.0  | 27.0  | 17.8                                  | 29.8  | 47.6   |
| 2004        | 9.7                                   | 15.7  | 25.4  | 17.4                                  | 26.4  | 43.8   |

\* As the 2008 final dividend had not been paid by the filing date, the dividend was translated into cents using the noon buying rate for sterling at December 31, 2008.

\*\* The US dollar values for dividends paid are translated at actual rates on the date paid. In the prior table of selected consolidated financial data, the US dollar dividends per ordinary share are translated at the noon rate on December 31, 2008. The difference between the two amounts is due to the differing exchange rates on the date of

payment of the interim dividend and December 31, 2008.

Future dividends will be dependent on our future earnings, financial condition and cash flow, as well as other factors affecting the Group.

**Table of Contents****Exchange rate information**

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in the city of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2008 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = \$1.46. On February 28, 2009 the noon buying rate for sterling was £1.00 = \$1.43.

| <b>Month</b>   | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|
| February 2009  | \$ 1.49     | \$ 1.42    |
| January 2009   | \$ 1.53     | \$ 1.37    |
| December 2008  | \$ 1.55     | \$ 1.44    |
| November 2008  | \$ 1.62     | \$ 1.48    |
| October 2008   | \$ 1.78     | \$ 1.55    |
| September 2008 | \$ 1.86     | \$ 1.75    |

| <b>Year Ended December 31</b> | <b>Average rate</b> |
|-------------------------------|---------------------|
| 2008                          | \$ 1.84             |
| 2007                          | \$ 2.01             |
| 2006                          | \$ 1.84             |
| 2005                          | \$ 1.81             |
| 2004                          | \$ 1.83             |

**Risk factors**

*You should carefully consider the risk factors described below, as well as the other information included in this Annual Report. Our business, financial condition or results from operations could be materially adversely affected by any or all of these risks, or by other risks that we presently cannot identify.*

***Global economic conditions may adversely impact our financial performance.***

With the rapid deterioration in the global economic environment during 2008, there is an increased risk of a further weakening in trading conditions in 2009 which could adversely impact our financial performance. The effect of a continued deterioration in the global economy will vary across our different businesses and will depend on the depth, length and severity of any economic downturn. Specific economic risks by business are described more fully in the other risk factors below.

***A significant deterioration in Group profitability and/or cash flow caused by a severe economic depression 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.***

A prolonged and severe economic depression could significantly reduce the Group's revenues, profitability and cash flows as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms. A liquidity shortfall may delay certain development initiatives or may expose the Group to a need to negotiate further funding. If there was a steep decline in operating profit the Group might breach its banking covenants, creating (or exacerbating) a need for further funding (or a renegotiation of the terms of the bank credit agreement) to maintain operations. The current fragile state of the credit markets could expose the Group to a risk that it could neither re-negotiate its existing banking facilities, nor raise enough new funding, at a cost level that was sustainable for the business. Were this to occur, the inability to raise funding would likely lead to a curtailment in investment and growth plans, potential asset disposals (if possible), reduction or elimination in the dividend and in an extreme case a need to restructure the Group's debt, business model and terms of trade. In such event, the value of the group's equity could not be assured.



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***Our US educational textbook and assessment businesses may be adversely affected by changes in state and local educational funding resulting from either general economic conditions, changes in government educational funding, programs and legislation (both at the federal and state level), and/or changes in the state procurement process.***

The results and growth of our US educational textbook and assessment business is dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. State, local and municipal finances have been adversely affected by the US recession. In response to budget shortfalls, states and districts may reduce educational spending as they seek cost savings to mitigate budget deficits. Federal economic stimulus packages may provide additional educational funding to compensate for budget shortfalls at the state level.

Federal and/or state legislative changes can also affect the funding available for educational expenditure. Similarly changes in the state procurement process for textbooks, learning material and student tests, particularly in the adoptions market can also affect our markets. For example, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year.

There are multiple competing demands for educational funds and there is no guarantee that states will fund new textbooks or testing programs, or that we will win this business.

***Reductions in advertising revenues and/or circulation will adversely affect the profitability of our newspaper business.***

Our newspaper business has diversified its revenue streams but remains dependent on advertising income. The business has high operational gearing; relatively small changes in revenue, positive or negative, have a disproportionate effect on profitability. Any downturn in corporate and financial advertising spend due to the economic slowdown will negatively impact the results of the *Financial Times* newspaper.

Our customers can increasingly access their information through different channels and from alternative suppliers. This allows our newspaper businesses to distribute and monetize their content in new ways. Our ability to offer a range of content channels provides some protection against the risk of decline of any one format. For example, we might see a decline in print circulation in our more mature markets as readers migrate online, although we see further opportunities for growth in our less mature markets. However, if the migration of readers to new digital formats occurs more quickly than we expect, this is likely to adversely affect print advertising and our newspaper's profitability.

***At Penguin, changes in product distribution channels, increased book returns and/or customer bankruptcy may restrict our ability to grow and affect our profitability.***

New distribution channels, e.g. digital format, the internet, online retailers, combined with the concentration of retailer power pose both threats and opportunities to our traditional consumer publishing models, potentially impacting both sales volumes and pricing.

Penguin's financial performance can also be negatively affected if book return rates increase above historical average levels. Similarly, the bankruptcy of a major retail customer would disrupt short-term product supply to the market as well as result in a large debt write off. The economic slowdown has increased these risks in the short term.

***Our intellectual property and proprietary rights may not be adequately protected under current laws in some jurisdictions and that may adversely affect our results and our ability to grow.***

Our products largely comprise intellectual property delivered through a variety of media, including newspapers, books and the internet. We rely on trademark, copyright and other intellectual property laws to establish and protect our proprietary rights in these products.

We cannot be sure that our proprietary rights will not be challenged, invalidated or circumvented. Our intellectual property rights in countries such as the US and UK, jurisdictions covering the largest proportion of our

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operations, are well established. However, we also conduct business in other countries where the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Moreover, despite trademark and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization.

These unauthorized activities may be more easily facilitated by the internet. The lack of internet-specific legislation relating to trademark and copyright protection creates an additional challenge for us in protecting our proprietary rights relating to our online business processes and other digital technology rights. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

In that regard, preliminary settlements of a class action lawsuit brought against Google by the Authors Guild, and a companion lawsuit brought under the auspices of the Association of American Publishers, which challenged Google's plans to copy the full text of all books ever published without permission of the copyright owners, were reached in October 2008. Subject to a final court approval of the class action settlement, now scheduled for June 2009, the settlement would allow copyright owners of books covered by it to control the online display of those books by Google, with a sharing of revenues derived from that display.

***We operate in a highly competitive environment that is subject to rapid change and we must continue to invest and adapt to remain competitive.***

Our education, business information and book publishing businesses all operate in highly competitive markets, which are constantly changing in response to competition, technological innovations and other factors. A common trend facing all our businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. If we do not adapt rapidly to these changes we may lose business to faster more agile competitors, who increasingly are non-traditional competitors, making their identification all the more difficult.

Illustrations of the competitive threats we face at present include:

Students seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, used books or re-imported textbooks, causing us to lose sales and putting downward pressure on textbook prices in our major markets.

Competition from major publishers and other educational material and service providers, including not for profit organizations, in our US educational textbook and assessment businesses.

Penguin: authors' advances in consumer publishing. We compete with other publishing businesses to purchase the rights to author manuscripts. Our competitors may bid to a level at which we could not generate a sufficient return on our investment, and so, typically, we would not purchase these rights.

FT: we face competitive threats both from large media players and from smaller businesses, online portals and news redistributors operating in the digital arena and providing alternative sources of news and information.

People: the investments we make in our employees, combined with our employment policies and practices, we believe are critical factors enabling us to recruit and retain the very best people in our business sectors.

***A control breakdown or service failure in our school assessment businesses could result in financial loss and reputational damage.***

There are inherent risks associated with our school assessment businesses, both in the USA and the UK. A service failure caused by a breakdown in our testing and assessment processes could lead to a mis-grading of student tests and/or late delivery of test results to students and their schools. In either event we may be subject to legal claims, penalty charges under our contracts, non-renewal of contracts and/or the suspension or withdrawal of our accreditation to conduct tests. It is also possible that such events would result in adverse publicity, which may affect our ability to retain existing contracts and/or obtain new customers.

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In December 2008, the Qualifications and Curriculum Authority awarded Edexcel the 2009 National Curriculum Test (NCT) contract following the termination of the previous contractor who underperformed in delivering the 2008 NCT exams. This is a one year contract for marking Key Stage 2 tests for 2009 only. There is significant reputational risk to Pearson, should Edexcel fail to deliver on this contract. Given the 2008 problems, there will be intense government and media scrutiny of Edexcel's performance. Furthermore, as the contract was only awarded in late 2008, there is limited time to set up and deliver the required marking services.

***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.***

These businesses are characterized by multi-million pound sterling contracts spread over several years. As in any contracting business, there are inherent risks associated with the bidding process, start-up, operational performance and contract compliance (including penalty clauses) which could adversely affect our financial performance and/or reputation. Failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth.

At Edexcel, our UK Examination board and testing business, any change in UK Government policy to examination marking for example, introduction of new qualifications could have a significant impact on our present business model.

***We operate in markets which are dependent on Information Technology (IT) systems and technological change.***

All our businesses, to a greater or lesser extent, are dependent on information technology. We either provide software and/or internet services to our customers or we use complex IT systems and products to support our business activities, particularly in Interactive Data and business information publishing, back-office processing and infrastructure.

We face several technological risks associated with software product development and service delivery in our educational businesses, information technology security (including virus and hacker attacks), e-commerce, enterprise resource planning system implementations and upgrades. The failure to recruit and retain staff with relevant skills may constrain our ability to grow as we combine traditional publishing products with online and service offerings.

***Operational disruption to our business caused by a major disaster and/or external threats could restrict our ability to supply products and services to our customers.***

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers and large office facilities as well as relationships with third party print sites. We have also outsourced some support functions, including IT, to third party providers. Failure to recover from a major disaster, (e.g. fire, flood etc) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict our ability to service our customers. Similarly external threats, such as a flu pandemic, terrorist attacks, strikes, weather etc, could all affect our business and employees, disrupting our daily business activities.

***A major data privacy breach may cause reputational damage to our brands and financial loss.***

Across our businesses we hold large volumes of personal data including that of employees, customers and, in our assessment businesses, students and citizens. Failure to adequately protect personal data could lead to penalties, significant remediation costs, reputational damage, potential cancellation of some existing contracts and inability to

compete for future business.

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***Investment returns outside our traditional core US and UK markets may be lower than anticipated.***

To take advantage of international growth opportunities and to reduce our reliance on our core US and UK markets we are increasing our investments in a number of emerging markets, some of which are inherently more risky than our traditional markets. Political, economic, currency, reputational and corporate governance risks (including fraud) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets.

***Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions could lead to goodwill and intangible asset impairments.***

We continually acquire and dispose of businesses to achieve our strategic objectives. In 2007/08 we made two relatively large acquisitions, i.e. Harcourt Assessment and Harcourt Education International for \$950m and eCollege for \$491m.

Acquired goodwill and intangible assets could be impaired if we are unable to generate the anticipated revenue growth, synergies and/or cost savings associated with these or other acquisitions.

***Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements.***

We operate a number of pension plans throughout the world, the principal ones being in the UK and US. The major plans are self-administered with the plans' assets held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements. As these assets are invested in volatile capital markets, the plans may require additional funding from us, which could have an adverse impact on our results.

It is our policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. Our earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in our defined benefit plans. Our greatest exposure relates to our UK defined benefit pension plan, which is valued once every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requirements.

A full valuation of our UK defined benefit pension plan will be carried out during 2009. Any additional funding requirements will be evaluated on completion of this actuarial review and any additional contributions required are unlikely to be made until 2010.

***We generate a substantial proportion of our revenue in foreign currencies particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet.***

As with any international business our earnings can be materially affected by exchange rate movements. We are particularly exposed to movements in the US dollar to sterling exchange rate as approximately 60% of our revenue is generated in US dollars. Sales for 2008, translated at 2007 average rates, would have been £4,491m or 7% lower.

This is primarily a currency translation risk (i.e. non-cash flow item), and not a trading risk (i.e. cash flow item) as our currency trading flows are relatively limited.

Pearson generates approximately 60% of its sales in the US and each 5¢ change in the average £:\$ exchange rate for the full year (which in 2008 was £1:\$1.85) would have an impact of approximately 1p on adjusted earnings per share

and affect shareholders' funds by approximately £100m.

*Changes in our tax position can significantly affect our reported earnings and cash flows.*

Changes in corporate tax rates and/or other relevant tax laws in the UK and/or the US could have a material impact on our future reported tax rate and/or our future tax payments.



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### **ITEM 4. INFORMATION ON THE COMPANY**

#### **Pearson**

Pearson is an international media and education company with its principal operations in the education, business information and consumer publishing markets. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names, to inform, educate and entertain. We deliver our content in a variety of forms and through a variety of channels, including books, newspapers and online services. We increasingly offer services as well as content, from test creation, administration and processing to teacher development and school software. Though we operate in more than 60 countries around the world, today our largest markets are the US (59% of sales) and Europe (25% of sales) on a continuing basis.

Pearson was incorporated and registered in 1897 under the laws of England and Wales as a limited company and re-registered under the UK Companies Act as a public limited company in 1981. We conduct our operations primarily through our subsidiaries and other affiliates. Our principal executive offices are located at 80 Strand, London WC2R 0RL, United Kingdom (telephone: +44 (0) 20 7010 2000).

#### **Overview of operating divisions**

Pearson consists of three major worldwide businesses:

**Pearson Education** is the world's leading education company, providing educational materials, technologies, assessments and related services to teachers and students of all ages. It is also a leading provider of electronic learning programmes and of test development, processing and scoring services to educational institutions, corporations and professional bodies around the world. In 2008, Pearson Education operated through three worldwide segments, which we refer to as North American Education, International Education and Professional:

**The FT Group** provides business and financial news, data, comment and analysis, in print and online, to the international business community. It has two major parts:

FT Publishing includes the globally focused *Financial Times* newspaper and FT.com website, a range of specialist financial magazines and online services, and Mergermarket, which provides proprietary forward-looking insights and intelligence to businesses and financial institutions.

Interactive Data provides specialist financial data to financial institutions and retail investors. Pearson owns a 62% interest in Interactive Data, which is publicly listed on the New York Stock Exchange (NYSE:IDC).

The FT Group also has a 50% ownership stake in both The Economist Group and FTSE International.

**The Penguin Group** is one of the most famous brands in book publishing. We publish the works of many authors in an extensive portfolio of fiction, non-fiction and reference titles under imprints including Penguin, Hamish Hamilton, Putnam, Berkley, and Dorling Kindersley.

#### **Our strategy**

Over the past decade, we have set out to become the world's leading education company. Our objective is to help people make progress in their lives through more knowledge to help them live and learn.

Our goal is to produce consistent growth on three key financial measures – adjusted earnings per share, cash flow and return on invested capital – which we believe those are, together, good indicators that we are building long-term value of Pearson.

To achieve this goal, our strategy has four parts, common to all our businesses:

Content: We invest steadily in unique publishing of stories, lessons and information and keep replenishing it.

Technology and services: Content alone is not enough, and to make our content more useful and enticing, we often add technology. We now receive about a third of our annual sales from technology-based products and

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services, and these are many of our fastest-growing businesses. Digital services of one kind or another are fundamental to every part of Pearson today.

**International markets:** Though we currently generate approximately 60% of our sales in the US, our brands, content and technology travel well. All parts of Pearson operate in most developed markets and we are also investing in selected emerging markets, where the demand for information and education is growing particularly fast. Our international (meaning outside North America) education business, for example, has almost doubled its sales over the past five years. Five years ago, it accounted for 8% of Pearson's profits; today it is approaching 20%.

**Efficiency:** The businesses of Pearson have a lot in common, in costs, assets, and activities. Pooling those makes the company stronger and more efficient. It also allows our businesses to learn from each other and to collaborate to save money. On that basis we have invested for efficiency through savings in our individual businesses and through a strong centralised operations structure. We are integrated in many areas where our businesses share the same needs – purchasing, warehousing, distribution, facilities and real estate, project management, people resources, finance and accounting, and transactions. Over the past five years, we have increased our operating profit margins from 10.6% to 15.8% and reduced average working capital as a percentage of sales from 29.4% to 26.1%, freeing up cash for further investment.

## **Operating divisions**

### ***Pearson Education***

Pearson Education is one of the largest publishers of textbooks and online teaching materials. It serves the growing demands of teachers, students, parents and professionals throughout the world for stimulating and effective education programs in print and online.

We report Pearson Education's performance in the three segments: North American Education, International Education, and Professional. In 2008, Pearson Education had sales of £3,112m or 65% (63% in 2007) of Pearson's total. Of these, approximately 60% were generated in North America and approximately 40% in the rest of the world. Pearson Education generated 60% of Pearson's operating profit.

### ***North American Education***

Our North American business serves educators and students in the USA and Canada from early education through elementary, middle and high schools and into higher education with a wide range of products and services: curriculum textbooks and other learning materials; student assessments and testing services; and education technologies. Pearson has a leading position in each of these areas and a distinctive strategy of connecting those parts to support institutions and personalize learning. In 2008 we began to integrate our North American School and Higher Education companies, which we believe will bring significant opportunities to develop growth businesses, to share investments and technologies and to gain further efficiencies.

Our North American School business contains a unique mix of publishing, testing and technology products for the elementary and secondary school markets, which are increasingly integrated. The major customers of this business are state education boards and local school districts. The business publishes high quality curriculum programmes for school students, at both elementary and secondary level, under a number of imprints including Scott Foresman and Prentice Hall.

Our school testing business is the leading provider of test development, processing and scoring services to US states and the federal government. Its capabilities have been further enhanced through the integration of the recently acquired Harcourt Assessment business. We are also a leading provider of electronic learning programs for schools, and of Student Information Systems technology which enables elementary and secondary schools and school districts to record and manage information about student attendance and performance.

Our North American Higher Education business is the largest publisher of textbooks and related course materials for colleges and universities in the US. We publish across all of the main fields of study with imprints such as Prentice Hall, Addison Wesley, Allyn & Bacon and Benjamin Cummings. Typically, professors or other

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instructors select or adopt the text books and online resources they recommend for their students, which students then purchase either in a bookstore or online. Today the majority of our textbooks are accompanied by online services which include homework and assessment tools, study guides and course management systems that enable professors to create online courses. We have also introduced new formats such as downloadable audio study guides and electronic textbooks which are sold on subscription. In addition, we have a fast-growing custom publishing business which works with professors to produce textbooks and online resources specifically adapted for their particular course.

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2008 compared to year ended December 31, 2007 Sales and operating profit by division North American Education for a discussion of developments during 2008 with respect to this division.

### *International Education*

Our International Education business covers all educational publishing and related services outside North America.

Our International schools business publishes educational materials in local languages in a number of countries. We are one of the world's leading providers of English Language Teaching (ELT) materials for children and adults, published under the well-known Longman imprint. We bolstered our position further in international markets through the recent acquisition of the Harcourt Education International business.

Outside North America, our International higher education business adapts our textbooks and technology services for individual markets, and we have a growing local publishing program, with our key markets including the UK, Benelux, Mexico, Germany, Hong Kong, Korea, Taiwan, Singapore, Japan and Malaysia.

We are also a leading provider of testing, assessment and qualification services in a number of key markets including, the UK under the brand name Edexcel, Australia, New Zealand, South Africa, Hong Kong and the Middle East.

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2008 compared to year ended December 31, 2007 Sales and operating profit by division International Education for a discussion of developments during 2008 with respect to this division.

### *Professional*

Following the disposal of Government Solutions in 2007 and Data Management in 2008, our Professional education business is focused on publishing and other learning programmes for professionals in business and technology, and on testing and certifying adults to become professionals. Over the past five years we have significantly re-orientated our professional publishing business towards long-term growth markets and built professional testing into a profitable industry leader.

Our Professional education business publishes under the following imprints: Addison Wesley Professional, Prentice Hall PTR and Cisco Press (for IT professionals); Peachpit Press and New Riders Press (for graphics and design professionals); Que/Sams (consumer and professional imprint); and Prentice Hall Financial Times and Wharton School Publishing (for the business education market).

Our professional testing business, Pearson VUE, manages major long-term contracts to provide qualification and assessment services through its network of test centers around the world. Key customers include major technology companies, the Graduate Management Admissions Council, NCLEX, the Financial Industry Regulatory Authority and the UK's Driving Standards Agency.

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2008  
compared to year ended December 31, 2007 Sales and operating profit by division Professional for a discussion of  
developments during 2008 with respect to this division.

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### ***The FT Group***

The FT Group provides a broad range of data, analysis and services to an audience of internationally-minded business people and financial institutions. In 2008, the FT Group had sales of £796m, or 16% of Pearson's total sales (16% in 2007), and contributed 26% of Pearson's operating profit.

It has two major parts: FT Publishing, a combination of the *Financial Times*, FT.com website, and a portfolio of financial magazines and online financial information companies; and Interactive Data, our 62%-owned financial information company. In recent years the FT Group has significantly shifted its business towards digital and subscription revenues.

### ***FT Publishing***

The *Financial Times* is one of the world's leading international daily business newspapers, with five editions in the UK, Europe, Middle East and Africa, the US and Asia.

Its main sources of revenue are from sales of the newspaper, advertising and conferences. The *Financial Times* is complemented by FT.com which sells content and advertising online, and which charges subscribers for detailed industry news, comment and analysis, while providing general news and market data to a wider audience. The new FT.com access model was successfully introduced in 2007 and is based on frequency of use and is intended to drive usage and accelerate advertising growth, while providing greater value and services to its premium paying customers.

FT Business publishes specialist information on the retail, personal and institutional finance industries through titles including *Investors Chronicle*, *Money Management*, *Financial Adviser* and *The Banker*.

Mergermarket, our online financial data and intelligence provider, provides early stage proprietary intelligence to financial institutions and corporates. Its key products include *Mergermarket*, *Debtwire*, *dealReporter*, *Wealthmonitor* and *Pharmawire* (which was launched in 2007).

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2008 compared to year ended December 31, 2007 Sales and operating profit by division FT Publishing for a discussion of developments during 2008 with respect to this division.

### ***Interactive Data***

Interactive Data is a leading provider of financial market data, analytics and related services to financial institutions, active traders and individual investors. The company's customers use its offerings to support their portfolio management and valuation, research and analysis, trading, sales and marketing, and client service activities. We own 62% of Interactive Data; the remaining 38% is publicly traded on the NYSE (for more information see NYSE:IDC).

See Item 5 Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2008 compared to year ended December 31, 2007 Sales and operating profit by division Interactive Data for a discussion of developments during 2008 with respect to this division.

### ***Les Echos***

The sale of Les Echos to LVMH for 240m (£174m) was completed in December 2007.

### ***Joint Ventures and Associates***

The FT Group also has a number of associates and joint ventures, including:

50% interest in The Economist Group, publisher of one of the world's leading weekly business and current affairs magazines.

50% interest in FTSE International, a joint venture with the London Stock Exchange, which publishes a wide range of global indices, including the FTSE index.



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50% interest in *Business Day* and *Financial Mail*, publishers of one of South Africa's leading financial newspapers and magazines.

33% interest in *Vedomosti*, a leading Russian business newspaper.

On March 27, 2008, Financial Times International Publishing Ltd sold its 50% partnership interest in Financial Times Deutschland GmbH & Co KG to Gruner & Jahr AG & Co KG.

### ***The Penguin Group***

Penguin is one of the most famous brands in book publishing. It publishes over 4,000 fiction and non-fiction books each year for readers of all ages, and has an extensive range of backlist and frontlist titles including top literary prize winners, classics, reference volumes and children's titles. Penguin ranks in the top three consumer publishers, based on sales in all major English speaking and related markets, including the US, the UK, Australia, Canada, South Africa and India.

Penguin is well known for its iconic Penguin brand, but it also publishes under many other imprints including, Hamish Hamilton, Putnam, Berkley, Dorling Kindersley, Puffin, and Ladybird. In 2008, Penguin had sales of £903m, representing 19% of Pearson's total sales (21% in 2007) and contributed 13% of Pearson's operating profit. Its largest market is the US, which generated around 57% of Penguin's sales in 2008. The Penguin Group earns around 98% of its revenues from the sale of hard cover and paperback books. The balance comes from audio books and e-books.

Penguin sells directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. It also sells through online retailers such as Amazon.com, as well as Penguin's own website.

See Item 5 Operating and Financial Review and Prospects—Results of Operations—Year ended December 31, 2008 compared to year ended December 31, 2007—Sales and operating profit by division—The Penguin Group for a discussion of developments during 2008 with respect to this division.

### **Operating cycles**

Pearson determines a normal operating cycle separately for each entity/cash generating unit within the Group with distinct economic characteristics. The normal operating cycle for each of the Group's education businesses is primarily based on the expected period over which the educational programs and titles will generate cash flows, and also takes account of the time it takes to produce the educational programs.

Particularly for the North American Education businesses, there are well established cycles operating in the market:

The School market is primarily driven by an adoption cycle in which major state education boards adopt programs and provide funding to schools for the purchase of these programs. There is an established and published adoption cycle with new adoptions taking place on average every 5 years for a particular subject. Once adopted, a program will typically sell over the course of the subsequent 5 years. The Company renews its pre-publication assets to meet the market adoption cycles. Therefore the operating cycle naturally follows the market cycle.

The Higher Education market has a similar pattern, with colleges and professors typically refreshing their courses and selecting revised programs on a regular basis, often in line with the release of new editions or new

technology offerings. The Company renews its pre-publication assets to meet the typical demand for new editions of, or revisions to, educational programs. Analysis of historical data shows that the average life cycle of Higher Education content is 5 years. Again the operating cycle mirrors the market cycle.

A development phase of typically 12 to 18 months for Higher Education and up to 24 months for School precedes the period during which the Company receives and delivers against orders for the products it has developed for the program.

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The International Education markets operate in a similar way although often with less formal adoption processes.

The operating cycles in respect of Professional and the Penguin segment are more specialized in nature as they relate to educational or heavy reference products released into smaller markets (e.g. the financial training, IT and travel sectors). Nevertheless, in these markets, there is still a regular cycle of product renewal, in line with demand which management monitor. Typically the life cycle is 5 years for Professional content and 4 years for Penguin content.

## **Competition**

All of Pearson's businesses operate in highly competitive environments.

Pearson Education competes with other publishers and creators of educational materials and services. These companies include large international companies, such as McGraw-Hill and Houghton Mifflin Harcourt, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology. Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

FT Publishing competes with newspapers and other information sources, such as The Wall Street Journal, by offering timely and expert journalism and market intelligence. It competes for advertisers with other forms of media based on the ability to offer an effective means for advertisers to reach their target audience. Interactive Data competes with Bloomberg and Thomson Reuters on a global basis for the provision of financial data to the back office of financial institutions. In Europe, Telekurs is also a direct competitor for these services. Smaller, more specialized vendors also compete with Interactive Data in certain market segments and in certain geographic areas.

The Penguin Group competes with other publishers of fiction and non-fiction books. Principal competitors include Random House, HarperCollins, and Hachette Group. Publishers compete by developing a portfolio of books by established authors and by seeking out and promoting talented new writers.

## **Intellectual property**

Our principal intellectual property assets consist of our trademarks and other rights in our brand names, particularly the *Financial Times* and the various imprints of Penguin and Pearson Education, as well as all copyrights for our content and our patents held in the testing business in the name of Pearson NCS. We believe we have taken all appropriate available legal steps to protect our intellectual property in all relevant jurisdictions.

## **Raw materials**

Paper is the principal raw material used by each of Pearson Education, the FT Group and the Penguin Group. We purchase most of our paper through our Global Sourcing department located in the United States. We have not experienced and do not anticipate difficulty in obtaining adequate supplies of paper for our operations, with sourcing available from numerous suppliers. While local prices fluctuate depending upon local market conditions, we have not experienced extensive volatility in fulfilling paper requirements. In the event of a sharp increase in paper prices, we have a number of alternatives to minimize the impact on our operating margins, including modifying the grades of paper used in production.

## **Government regulation**

The manufacture of certain of our products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Our operations are also subject to the risks and uncertainties attendant to

doing business in numerous countries. Some of the countries in which we conduct these operations maintain controls on the repatriation of earnings and capital and restrict the means available to us for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material to us. Accordingly, these controls have not significantly affected our international operations. Regulatory authorities may have enforcement powers that could have an impact on us. We believe, however, that we have taken and

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continue to take measures to comply with all applicable laws and governmental regulations in the jurisdictions where we operate so that the risk of these sanctions does not represent a material threat to us.

**Licenses, patents and contracts**

We are not dependent upon any particular licenses, patents or new manufacturing processes that are material to our business or profitability. Likewise, we are not materially dependent upon any contracts with suppliers or customers, including contracts of an industrial, commercial or financial nature.

**Legal Proceedings**

We and our subsidiaries are defendants in a number of legal proceedings including, from time to time, government and arbitration proceedings, which are incidental to our and their operations. We do not expect that the outcome of pending proceedings, either individually or in the aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had any such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our subsidiaries.

**Recent developments**

During 2008 Pearson's International Education business announced its intention to increase its stakes in Longman Nigeria from 29% to 51% for £9m and Maskew Miller Longman (its South African publishing business) from 50% to 85%. Under the terms of the Maskew Miller Longman agreement, Pearson intends to create a new Southern Africa business and in return for the increased stake in Maskew Miller Longman our current joint venture partner will receive £46m in cash and a 15% interest in Pearson's Heinemann and Edexcel businesses in that region.

In addition Pearson's International Education business also announced the acquisition of Fronter, a European online learning company based in Oslo, for £16m. The Longman Nigeria acquisition completed in early January 2009 and the Fronter acquisition in February 2009. The Maskew Miller Longman transaction is expected to complete in the second quarter of 2009 following regulatory approval.

**Organizational structure**

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries as at December 31, 2008, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

| <b>Name</b>              | <b>Country of incorporation/residence</b> | <b>Percentage interest/voting power</b> |
|--------------------------|-------------------------------------------|-----------------------------------------|
| <b>Pearson Education</b> |                                           |                                         |
| Pearson Education Inc.   | United States (Delaware)                  | 100%                                    |
| Pearson Education Ltd.   | England and Wales                         | 100%                                    |
| Edexcel Ltd.             | England and Wales                         | 100%                                    |
| NCS Pearson Inc.         | United States (Minnesota)                 | 100%                                    |
| <b>FT Group</b>          |                                           |                                         |

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|                                 |                          |      |
|---------------------------------|--------------------------|------|
| The Financial Times Limited     | England and Wales        | 100% |
| Mergermarket Ltd.               | England and Wales        | 100% |
| Interactive Data Corporation    | United States (Delaware) | 62%  |
| <b>The Penguin Group</b>        |                          |      |
| Penguin Group (USA) Inc.        | United States (Delaware) | 100% |
| The Penguin Publishing Co Ltd.  | England and Wales        | 100% |
| Dorling Kindersley Holdings Ltd | England and Wales        | 100% |

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Our headquarters are located at leasehold premises in London, England. We own or lease approximately 900 properties, including approximately 300 testing centers in more than 50 countries worldwide, the majority of which are located in the United Kingdom and the United States.

All of the properties owned and leased by us are suitable for their respective purposes and are in good operating condition. These properties consist mainly of offices, distribution centers and computer testing centers.

The vast majority of our printing is carried out by third party suppliers. We operate two small digital print operations as part of our Pearson Assessment & Testing businesses, one of which was sold as part of the February 2008 Data Management sale. These operations provide short-run and print-on-demand products, typically custom client applications.

We own the following principal properties at December 31, 2008:

| <b>General use of property</b> | <b>Location</b>             | <b>Area in square feet</b> |
|--------------------------------|-----------------------------|----------------------------|
| Warehouse/Office               | Kirkwood, New York, USA     | 524,000                    |
| Warehouse/Office               | Pittston, Pennsylvania, USA | 406,000                    |
| Office                         | Iowa City, Iowa, USA        | 310,000                    |
| Warehouse/Office               | Old Tappan, New Jersey, USA | 210,112                    |
| Warehouse/Office               | Cedar Rapids, Iowa, USA     | 205,000                    |
| Office                         | Southwark, London, UK       | 155,000                    |
| Office                         | Hadley, Massachusetts, USA  | 136,570                    |
| Printing                       | Owatonna, Minnesota, USA    | 128,000                    |

We lease the following principal properties at December 31, 2008:

| <b>General use of property</b> | <b>Location</b>                     | <b>Area in square feet</b> |
|--------------------------------|-------------------------------------|----------------------------|
| Warehouse/Office               | Lebanon, Indiana, USA               | 1,091,435                  |
| Warehouse/Office               | Cranbury, New Jersey, USA           | 886,747                    |
| Warehouse/Office               | Indianapolis, Indiana, USA          | 737,850                    |
| Warehouse/Office               | San Antonio, Texas, USA             | 559,258                    |
| Warehouse/Office               | Newmarket, Ontario, Canada          | 518,128                    |
| Office                         | Upper Saddle River, New Jersey, USA | 474,801                    |
| Warehouse/Office               | Rugby, UK                           | 446,077                    |
| Office                         | New York City, New York, USA        | 430,738                    |
| Office                         | London, UK                          | 282,917                    |
| Office                         | Harlow, UK                          | 231,850                    |
| Warehouse/Office               | Austin, Texas, USA                  | 226,076                    |
| Office                         | Boston, Massachusetts, USA          | 225,299                    |
| Warehouse                      | Scoresby, Victoria, Australia       | 197,255                    |
| Office                         | Boston, Massachusetts, USA          | 191,360*                   |

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|                  |                               |         |
|------------------|-------------------------------|---------|
| Office           | Glenview, Illinois, USA       | 187,500 |
| Warehouse/Office | Bedfordshire, UK              | 187,248 |
| Office           | Bloomington, Minnesota, USA   | 153,240 |
| Office           | Parsippany, New Jersey, USA   | 143,777 |
| Office           | Chandler, Arizona, USA        | 135,460 |
| Office           | New York City, New York, USA  | 116,039 |
| Warehouse        | San Antonio Zomeyucan, Mexico | 113,638 |
| Office           | London, UK                    | 112,000 |
| Warehouse        | Cape Town, South Africa       | 111,259 |
| Call Center      | Lawrence, Kansas, USA         | 105,000 |

\* Reduced to 53,248 square feet subsequent to year end



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**Capital Expenditures**

See Item 5. Operating and Financial Review and Prospects – Liquidity and Capital Resources for description of the Company's capital expenditure.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

The Company has not received, 180 days or more before the end of the 2008 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS as issued by the IASB.

**General overview**

***Introduction***

Sales from continuing operations increased from £4,162m in 2007 to £4,811m in 2008, an increase of 16%. The majority of the increase was in the North American and International Education businesses which benefited from acquisitions made in 2007 and 2008. The year on year growth was also significantly impacted by exchange rates, in particular the US dollar. The average US dollar exchange rate strengthened in comparison to sterling in 2008, which had the effect of increasing reported sales in 2008 by £320m when compared to the equivalent figure at constant 2007 rates. When measured at constant 2007 exchange rates, all of Pearson's businesses reported year on year growth.

Reported operating profit increased by 18% from £574m in 2007 to £676m in 2008. Acquisitions and the relative strength of the US dollar contributed to this increase and operating profit would have been £71m lower if translated at constant 2007 exchange rates. When measured at constant rates, the main contributors to the increase were the International Education and Interactive Data businesses which together with an increased contribution from acquisitions more than offset an increased charge for intangible amortization.

Profit before taxation in 2008 of £585m compares to a profit before taxation of £468m in 2007. The increase of £117m reflects the improved operating performance and reduced net finance costs. Net finance costs decreased from £106m in 2007 to £91m in 2008. The Group's net interest payable decreased by £6m in 2008 as although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from a fall in average US dollar and sterling interest rates during the year. Exchange losses of £11m in 2008 compare to a net exchange loss of £17m in 2007. The losses in 2008 mainly relate to the retranslation of foreign currency bank accounts together with other net losses on inter-company items. The losses in 2007 principally relate to exchange losses on legacy euro denominated debt held to hedge euro denominated proceeds from the sale of Les Echos. Partially offsetting interest payable and exchange is finance income relating to post retirement plans of £8m in 2008 compared to an income of £10m in 2007.

On February 22, 2008 the Group completed the sale of its Data Management business and this business has been included in discontinued operations for the period to February 22 in 2008, and the full years in 2007 and 2006.

In 2007, the Group completed the sale of its French newspaper business, Les Echos and its Government contracting business, Government Solutions. The results of Les Echos and Government Solutions have been shown as discontinued operations in the consolidated income statement for 2007 and 2006.

Net cash generated from operations increased to £894m in 2008 from £659m in 2007. The improved cash generation in 2008 was partly due to exchange but also represents strong cash conversion of operating profits from all of the Pearson businesses. On an average basis, the ratio of working capital to sales deteriorated slightly in the year largely as a result of higher working capital balances at new acquisitions. Average working capital comprises the average of the monthly carrying values over the relevant 12 month period for inventory, pre-publication costs,

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debtors and creditors. Net interest paid at £76m in 2008 was £14m below the previous year as the net interest charge in the income statement fell and the timing of payments was more favorable. Tax paid in 2008 remained consistent with the previous year at £89m compared to £87m in 2007. Net capital expenditure on property, plant and equipment after proceeds from sales increased from £72m in 2007 to £73m in 2008. The net cash outflow in respect of businesses acquired decreased from £472m in 2007 to £395m in 2008 whilst net proceeds from the disposal of businesses decreased from £469m in 2007 to £111m in 2008. Dividends from joint ventures and associates decreased by £9m largely due to smaller special dividends received from the Economist in 2008 compared to 2007. Dividends paid of £285m in 2008 (including £28m paid to minority interests) compares to £248m in 2007. After an unfavorable currency movement of £410m, overall net borrowings increased by 50% from £973m at the end of 2007 to £1,460m at the end of 2008.

### ***Outlook***

Pearson achieved a strong performance in 2008 against the backdrop of a sharp deterioration in the global economy. Though the company performed well, market conditions became more difficult for some of our businesses as the year went on.

In the fourth quarter, trading momentum remained strong for our education business. The Financial Times Group continued to achieve good growth in particular at Interactive Data and Mergermarket but FT Publishing saw a decline in advertising revenues (which now account for 4% of Pearson's sales). Consumer publishing markets in the US and the UK were challenging, but Penguin performed well in the key holiday selling season.

We are planning on the basis that the tough market conditions we saw for some of our businesses towards the end of 2008 are likely to persist throughout 2009. We expect to benefit from a range of early actions to revise products and supply lines, reduce costs and sustain investment.

### ***Pearson Education***

In Education, we are planning for weak conditions in the US School publishing market but expect continued growth in our Testing, Higher Education and International Education businesses. We expect the new US administration's emphasis on education, reflected in both the economic stimulus package and the focus on reform, to provide a significant boost to education institutions. The extent and timing of the impact on our business is unclear at this stage, so we have not included these factors in our guidance.

### ***FT Group***

At the FT Group, we anticipate continued strong demand for high-quality analysis of global business, finance, politics and economics; a tough year for advertising; strong renewal rates in our subscription businesses; and continued growth at Interactive Data.

### ***The Penguin Group***

At Penguin, we expect another good competitive performance in challenging trading conditions for book publishers and booksellers.

**Table of Contents*****Sales information by operating division***

The following table shows sales information for each of the past three years by operating division:

|                  | <b>Year Ended December 31</b> |             |             |
|------------------|-------------------------------|-------------|-------------|
|                  | <b>2008</b>                   | <b>2007</b> | <b>2006</b> |
|                  | <b>£m</b>                     | <b>£m</b>   | <b>£m</b>   |
| Education:       |                               |             |             |
| North American   | 2,002                         | 1,667       | 1,679       |
| International    | 866                           | 735         | 640         |
| Professional     | 244                           | 226         | 211         |
| FT Group:        |                               |             |             |
| FT Publishing    | 390                           | 344         | 280         |
| Interactive Data | 406                           | 344         | 332         |
| Penguin          | 903                           | 846         | 848         |
| Total            | 4,811                         | 4,162       | 3,990       |

***Sales information by geographic market supplied***

The following table shows sales information for each of the past three years by geographic region:

|                    | <b>Year Ended December 31</b> |             |             |
|--------------------|-------------------------------|-------------|-------------|
|                    | <b>2008</b>                   | <b>2007</b> | <b>2006</b> |
|                    | <b>£m</b>                     | <b>£m</b>   | <b>£m</b>   |
| European countries | 1,217                         | 1,102       | 1,003       |
| North America      | 3,028                         | 2,591       | 2,585       |
| Asia Pacific       | 415                           | 351         | 295         |
| Other countries    | 151                           | 118         | 107         |
| Total              | 4,811                         | 4,162       | 3,990       |

***Exchange rate fluctuations***

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was \$1.85 in 2008, \$2.00 in 2007 and \$1.84 in 2006. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2008, Pearson generated 59% of its sales in the US (2007: 59%; 2006: 61%). We estimate that a five cent change in the closing exchange rate between the US dollar and sterling in any year could affect our reported earnings per share by 1p and shareholders' funds by approximately £100m. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for more information. The year-end US dollar rate for 2008 was £1:\$1.44 compared to £1:\$1.99 for 2007. In terms of the year end rate, the weakening of sterling in comparison to the US dollar in 2008 was much more significant than in previous years and the relatively strong US

dollar had the effect of increasing shareholders' funds. The net effect of movement in all currencies in 2008 was an increase in our shareholders' funds of £1,050m (see also note 29 of 'Item 18. Financial Statements'). The year-end rate for the US dollar in 2007 was £1:\$1.99 compared to £1:\$1.96 for 2006. The comparative weakness of the US dollar was less significant in 2007 and the decrease in shareholders' funds due to the US dollar was outweighed by the strength of other currencies principally the Canadian dollar and the Euro which contributed to an overall increase in shareholders' funds due to exchange movements of £25m in 2007.

***Critical accounting policies***

Our consolidated financial statements, included in 'Item 18. Financial Statements', are prepared based on the accounting policies described in note 1 to the consolidated financial statements.

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Certain of our accounting policies require the application of management judgment in selecting assumptions when making significant estimates about matters that are inherently uncertain. Management bases its estimates on historical experience and other assumptions that it believes are reasonable. These policies are described in note 1a(3) in Item 18. Financial Statements .

## **Results of operations**

### ***Year ended December 31, 2008 compared to year ended December 31, 2007***

#### *Consolidated results of operations*

#### ***Sales***

Our total sales from continuing operations increased by £649m, or 16%, to £4,811m in 2008, from £4,162m in 2007. The increase reflected growth, on a constant exchange rate basis, across all the businesses together with additional contributions from acquisitions made in both 2007 and 2008. The year on year growth was impacted by movements in exchange rates, particularly in the US dollar. 2008 sales, translated at 2007 average exchange rates, would have been £4,491m.

Pearson Education increased sales by £484m or 18% from £2,628m to £3,112m. The North American business was the major contributor to the increase and although much of the increase was due to exchange and a contribution from the Harcourt Assessment acquisition in 2008, we estimate that after excluding acquisitions there was growth of 3% at constant last year exchange rates. The North American Education business saw growth ahead of the market in its US Higher Education business and strong performances in state testing, catalogue tests and clinical assessment in its US Assessment and Information division. These businesses offset some decline in the US School Curriculum business which faced a decline in the overall US school publishing market of 4.4% (source: Association of American Publishers). International Education sales also benefitted from exchange and a full year contribution from the Harcourt Publishing acquisition in 2007. After excluding the effect of acquisitions we estimate that there was growth of 2% at constant last year exchange rates. Although there was good growth in the International Publishing business, the loss of a key school testing contract held back growth in the International Assessment business. Professional sales increased in 2008 by 8% or 1% at constant last year exchange rates. Growth in professional testing and certification was partially offset by some decline in the professional publishing markets.

FT Group sales were 16% ahead of last year with growth at FT Publishing and Interactive Data. FT Publishing sales were up by 13% or 4% after excluding the contribution from acquisitions made in 2007 and 2008 and the effect of exchange. FT Publishing's sales growth was driven by a shift toward subscription and service based revenues. The newspaper maintained circulation but advertising revenues fell by 3% as the advertising market weakened in the fourth quarter of 2008. Interactive Data sales were up by 18% (9% at constant last year exchange rates and before the contribution from acquisitions) driven by strong sales to both existing and new institutional customers and the maintenance of renewal rates at approximately 95% within the institutional services sector.

Penguin's sales were up 7% in 2008 (3% at constant last year exchange rates and before the effect of portfolio changes) as a result of a strong publishing performance in all its markets in a year where the business continued to publish bestsellers and win awards.

Pearson Education, our largest business sector, accounted for 65% of our continuing business sales in 2008 compared to 63% in 2007. North America continued to be the most significant source of our sales and as a proportion of total continuing sales contributed 63% in 2008 and 62% in 2007.



**Table of Contents*****Cost of goods sold and operating expenses***

The following table summarizes our cost of sales and net operating expenses:

|                                   | <b>Year Ended<br/>December 31</b> |              |
|-----------------------------------|-----------------------------------|--------------|
|                                   | <b>2008</b>                       | <b>2007</b>  |
|                                   | <b>£m</b>                         | <b>£m</b>    |
| Cost of goods sold                | 2,174                             | 1,910        |
| Distribution costs                | 198                               | 202          |
| Administration and other expenses | 1,890                             | 1,600        |
| Other operating income            | (102)                             | (101)        |
| <b>Total</b>                      | <b>1,986</b>                      | <b>1,701</b> |

*Cost of goods sold.* Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs and royalty charges. Our cost of sales increased by £264m, or 14%, to £2,174m in 2008, from £1,910m in 2007. The increase corresponds to the increase in sales with cost of sales at 45.2% of sales in 2008 compared to 45.9% in 2007.

*Distribution costs.* Distribution costs consist primarily of shipping costs, postage and packing and have typically declined as the business moves more to online delivery of products.

*Administration and other expenses.* Our administration and other expenses increased by £290m, or 18%, to £1,890m in 2008, from £1,600m in 2007. As a percentage of sales they increased slightly to 39% in 2008 from 38% in 2007.

*Other operating income.* Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions together with income from sale of assets. Other operating income remained fairly consistent at £102m in 2008 compared to £101m in 2007.

***Share of results of joint ventures and associates***

The contribution from our joint ventures and associates increased slightly from £23m in 2007 to £25m in 2008. The majority of the profit comes from our 50% interest in the Economist.

***Operating profit***

The total operating profit increased by £102m, or 18%, to £676m in 2008 from £574m in 2007. 2008 operating profit, translated at 2007 average exchange rates, would have been £71m lower.

Operating profit attributable to Pearson Education increased by £45m, or 12%, to £406m in 2008, from £361m in 2007. The increase was mainly due to exchange which offset the effect of increased intangible amortization and the cost of integrating Harcourt Assessment with the existing Assessment businesses. Operating profit attributable to the FT Group increased by £39m, or 28%, to £179m in 2008, from £140m in 2007. The increase reflects exchange differences and a contribution from new acquisitions but also reflects improved margins at Interactive Data which offset some reorganization costs at the Financial Times. Operating profit attributable to the Penguin Group increased



by £18m, or 25%, to £91m in 2008, from £73m in 2007. Although Penguin benefitted from exchange there was also continued progress on margin improvement.

***Net finance costs***

Net finance costs decreased from £106m in 2007 to £91m in 2008. Net interest payable in 2008 was £89m, down from £95m in 2007. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from a fall in 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) fell by 2.3% to 3.1%. This reduction in floating market interest rates was partially offset by higher fixed bond coupons prevailing at the time of our 2008 bond issue. The overall result was a decrease in the Group's average net

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interest rate payable by 1.4% to 5.9%. In 2008 the net finance income relating to post-retirement plans was an income of £8m compared to an income of £10m in the previous year.

Other net finance costs relating to foreign exchange and short-term fluctuations in the market value of financial instruments included a net foreign exchange loss of £11m in 2008 compared to a loss of £17m in 2007. In 2008 the loss related to the retranslation of foreign currency bank overdrafts and a variety of inter-company items. In 2007 the loss mainly related to losses on Euro denominated debt used to hedge the receipt of proceeds from the sale of Les Echos. For a more detailed discussion of our borrowings and interest expenses see [Liquidity and Capital Resources](#), [Capital Resources](#) and [Borrowings](#) below and [Item 11. Quantitative and Qualitative Disclosures About Market Risk](#).

## ***Taxation***

The total tax charge in 2008 of £172m represents 29% of pre-tax profits compared to a charge of £131m or 28% of pre-tax profits in 2007. Our overseas profits, which arise mainly in the US are largely subject to tax at higher rates than the UK corporation tax rate (28.5% in 2008 compared to 30% in 2007). Higher tax rates were offset by releases from provisions reflecting continuing progress in agreeing our tax affairs with the authorities.

## ***Minority interests***

This comprises mainly the minority share in Interactive Data. Our share of Interactive Data remained at 62% throughout 2008, leaving the minority interest unchanged at 38%.

## ***Discontinued operations***

Discontinued operations relate to the disposal of Government Solutions (in February 2007), Les Echos (in December 2007), Datamark (in July 2007) and the Data Management business (in February 2008). The results of Government Solutions and Les Echos have been included in discontinued operations for 2007 and have been consolidated up to the date of sale. Operating profit for Government Solutions in 2007 was £2m and the loss on disposal after tax recorded in 2007 was £112m after a tax charge of £93m. Les Echos' operating profit in 2007 amounted to £1m and the profit on sale recorded in 2007 was £165m. There was no tax payable on the Les Echos sale. Datamark was bought with the eCollege acquisition in 2007 and immediately sold. The only profit or loss recognized relating to Datamark was a £7m tax benefit arising from the taxable loss on sale. The Data Management business was included in discontinued operations in 2007 and 2008. In 2007 the operating profit before impairment charges was £12m compared to £nil in 2008. The Data Management business was formerly part of the Group's Other Assessment and Testing cash-generating unit (CGU) and was carved out of this CGU in preparation for disposal. As a result, the Group recognized a goodwill impairment charge of £97m in 2007 in anticipation of the loss on disposal. The loss before tax on disposal in 2008 was £53m, mainly relating to the cumulative translation adjustment. There was a tax charge of £37m on the sale.

## ***Profit for the year***

The profit for the financial year in 2008 was £323m compared to a profit in 2007 of £310m. The overall increase of £13m was mainly due to the improved operating performance with a contribution from reduced net finance costs. Offsetting this was the increased tax charge and increased loss from the disposal of discontinued businesses.

## ***Earnings per ordinary share***

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 36.6p in 2008 compared to 35.6p in 2007 based on a weighted average number of shares in issue of 797.0m in 2008 and 796.8m in 2007. The increase in earnings per share was due to the increase in

profit for 2008 described above and was not significantly affected by the movement in the weighted average number of shares.

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The diluted earnings per ordinary share of 36.6p in 2008 and 35.6p in 2007 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

**Exchange rate fluctuations**

The strengthening of the US dollar and other currencies against sterling on an average basis had a positive impact on reported sales and profits in 2008 compared to 2007. 2008 sales, translated at 2007 average exchange rates, would have been lower by £320m and operating profit, translated at 2007 average exchange rates, would have been lower by £71m. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for a discussion regarding our management of exchange rate risks.

**Sales and operating profit by division**

The following tables summarize our sales and operating profit for each of Pearson's divisions. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. See also note 2 of Item 18. Financial Statements.

In our adjusted operating profit we have excluded amortization and adjustment of acquired intangibles. The amortization and adjustment of acquired intangibles is the amortization or subsequent adjustment of intangible assets acquired through business combinations. The charge is not considered to be fully reflective of the underlying performance of the Group.

Adjusted operating profit enables management to more easily track the underlying operational performance of the Group. A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

| £m                                                        | Year Ended December 31, 2008   |                            |                    |                           |                     |         | Total |
|-----------------------------------------------------------|--------------------------------|----------------------------|--------------------|---------------------------|---------------------|---------|-------|
|                                                           | North<br>American<br>Education | International<br>Education | FT<br>Professional | Interactive<br>Publishing | Interactive<br>Data | Penguin |       |
| Sales                                                     | 2,002                          | 866                        | 244                | 390                       | 406                 | 903     | 4,811 |
|                                                           | 42%                            | 18%                        | 5%                 | 8%                        | 8%                  | 19%     | 100%  |
| Total operating profit                                    | 258                            | 113                        | 35                 | 67                        | 112                 | 91      | 676   |
|                                                           | 38%                            | 17%                        | 5%                 | 10%                       | 17%                 | 13%     | 100%  |
| Add back:                                                 |                                |                            |                    |                           |                     |         |       |
| Amortization and<br>adjustment of acquired<br>Intangibles | 45                             | 22                         | 1                  | 7                         | 9                   | 2       | 86    |
| Adjusted operating profit:<br>continuing Operations       | 303                            | 135                        | 36                 | 74                        | 121                 | 93      | 762   |
| Adjusted operating profit:<br>discontinued Operations     |                                |                            |                    |                           |                     |         |       |
| Total adjusted operating<br>profit                        | 303                            | 135                        | 36                 | 74                        | 121                 | 93      | 762   |

*40%*

*17%*

*5%*

*10%*

*16%*

*12%*

*100%*

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| £m                                                                     | North                 |                            | Professional | FT<br>Publishing | Interactive<br>Data | Penguin | Total |
|------------------------------------------------------------------------|-----------------------|----------------------------|--------------|------------------|---------------------|---------|-------|
|                                                                        | American<br>Education | International<br>Education |              |                  |                     |         |       |
| Sales                                                                  | 1,667                 | 735                        | 226          | 344              | 344                 | 846     | 4,162 |
|                                                                        | 40%                   | 18%                        | 5%           | 8%               | 8%                  | 21%     | 100%  |
| Total operating profit                                                 | 253                   | 82                         | 26           | 50               | 90                  | 73      | 574   |
|                                                                        | 44%                   | 14%                        | 4%           | 9%               | 16%                 | 13%     | 100%  |
| Add back:<br>Amortization and<br>adjustment of acquired<br>Intangibles | 20                    | 10                         | 1            | 6                | 7                   | 1       | 45    |
| Adjusted operating profit:<br>continuing Operations                    | 273                   | 92                         | 27           | 56               | 97                  | 74      | 619   |
| Adjusted operating profit:<br>discontinued Operations                  |                       |                            | 14           | 1                |                     |         | 15    |
| Total adjusted operating<br>profit                                     | 273                   | 92                         | 41           | 57               | 97                  | 74      | 634   |
|                                                                        | 43%                   | 15%                        | 6%           | 9%               | 15%                 | 12%     | 100%  |

*North American Education*

North American Education sales increased by £335m, or 20%, to £2,002m in 2008, from £1,667m in 2007 and adjusted operating profit increased by £30m, or 11%, to £303m in 2008 from £273m in 2007. The results were significantly affected by the weakening of sterling, which we estimate increased sales by £156m and adjusted operating profit by £17m when compared to the equivalent figures at constant 2007 exchange rates. At constant exchange and after taking account of the contribution from acquisitions there was underlying growth in sales but some decline in profits as the contribution from the US school curriculum business declined in a falling market and we expensed costs on the integration of Harcourt Assessment.

In the US school market, the Association of American Publishers estimate that there was an overall decrease for the industry of 4.4% as state budget issues caused particular industry-wide weakness in the supplementary publishing segment and the open territories (those territories that do not have a state-wide adoption process). New adoption market share was 31% in the adoptions where Pearson competed (and 28% of the total new adoption market). The US School business launched enVisionMATH, an integrated print-and-digital elementary mathematics program (and the next generation of the innovative and highly successful California social studies program). enVisionMATH helped to gain a market-leading 38% share of all math adoptions, including 50% in Texas. The program also sold strongly across the Open Territories. During the year the U.S. Department of Defense awarded the US school business a five-year contract to provide elementary-school reading programs, including Pearson's Reading Street, for its schools around the world.

In the US Assessment and Information business, the integration of Harcourt Assessment progressed well with strong performances in state testing, catalogue tests and clinical assessments. The market-leading state assessments division continued to gain share, winning almost half of the contracts competed for by value and the business now provides

major state-wide testing services to 30 states. The business took the lead in online testing with over 3.8 million secure tests delivered across 13 states during the year, up from 2.5 million in 2007. The National Assessments division benefited from new long-term contracts including the American Diploma Project (a three-year contract to deliver Algebra II exams to a consortium of fifteen states); the College Board's Accuplacer program (a seven-year contract to deliver computer-adaptive reading, writing and maths test to assess college readiness); and the National Board for Professional Teaching Standards (a five-year contract to develop, administer and score its National Board Certification program for accomplished teachers, covering 25 certificate areas). The leading position in teacher certification was boosted by a three-year renewal in California, a six-year renewal in Oklahoma, a four-year renewal in New Mexico and a two-year contract to manage California's certification testing for teachers of English as a foreign language. The Clinical Assessments division benefited from the strong growth of our AimsWeb data management and progress monitoring service for the Response to Intervention (RTI) market (which

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monitors children who are having learning difficulty) and the publication of WAIS-IV and MMPI-RF, new editions of the leading products for assessing intelligence and personality. There were major contract wins in Student Information Systems including South Carolina (709,000 students), Dallas (165,000 students) and Baltimore (83,000 students). There were also continued gains by our new Edustructures business with State Education Agencies, and it successfully implemented proof-of-concept projects in Kansas and Alaska, and expanded projects in Virginia, South Carolina and Wyoming.

The US Higher Education publishing market was up 3.6% in 2008, according to the Association of American Publishers, benefiting from healthy enrolments, even in tougher economic conditions, and federal government action to support student funding. The industry continues to see strong demand for instructional materials that are enhanced by technology and customization. Our US Higher Education business grew significantly faster than the industry and outperformed the market for the tenth straight year. There was continued investment in established and new author franchises, such as Campbell and Reece's *Biology*, Tro's *Chemistry*, Lilienfeld, Lynn, Namy and Woolf's *Psychology* and Wysocki and Lynch's *DK Handbook*. There was also rapid growth in MyLab digital learning, homework and assessment programs, which now span the curriculum. MyLab products are now used by more than 4.3m students globally, with student registrations 48% higher than in 2007. Evaluation studies show that the use of the MyLab programs can significantly improve student test scores and institutional productivity. We saw strong growth in Custom Solutions with our expansion beyond custom textbooks to educational solutions including on-demand authoring of original content, customized technology, and on-demand curriculum, assessments and courseware. The Higher Education business formed new strategic partnerships to provide materials and online learning services to educational institutions. These included Rio Salado College in Arizona, which has 450 online classes and 48,000 students; the Colorado Community College system, providing digital textbooks for 17 courses; and the Louisiana Community & Technical College System, providing students with a customised online learning program across 47 campuses through the combination of custom textbooks, eCollege and MyLabs. eCollege, the platform for fully-online distance learning in higher education, increased enrolments by 34% to 2.5m and benefited from continued strong renewal rates. It achieved good new business performance in both the US and internationally, most notably in Brazil.

Overall margins in the North American Education business were lower at 15.1% in 2008 compared to 16.4% in 2007 with the majority of the decline attributable to the Harcourt Assessment integration costs.

*International Education*

International Education sales increased by £131m, or 18%, to £866m in 2008, from £735m in 2007 and adjusted operating profit increased by £43m, or 47%, to £135m in 2008 from £92m in 2007. The results benefit from exchange gains and a full year contribution in 2008 from the acquisition of Harcourt International.

In the UK, Edexcel received over 1.3 million registrations for vocational assessment which, when combined with more than 2.1 million registrations for general qualifications, made it one of the UK's largest assessment organisations. Edexcel marked 4.3m A-level and GCSE (national secondary school examinations) scripts onscreen, representing 88% of all student work marked by their examiners. Edexcel also made a significant investment in supporting the growth of academic and vocational qualifications both in the UK and internationally including the UK's new Diploma qualification for 14-19 year-olds, the IGCSE qualifications to meet the needs of International schools and colleges and BTEC, Edexcel's flagship vocational qualification where registrations have grown from about 70,000 to 250,000 in the last two years.

The UK school publishing business grew ahead of the market, with Harcourt International making a significant contribution. This was driven by curriculum reform and market share gains in the secondary market, helped by strong publishing, innovative technology and integrated assessment for learning. The combination of Pearson content, customisation capabilities and technology supported strong performances in Higher Education and ELT across the



European markets including France, Benelux and Central and Eastern Europe.

The MyLab digital learning, homework and assessment programmes were used internationally by more than 237,000 students, up 82% on 2007, and are now sold in more than 65 countries worldwide. MyLabs and Mastering Physics, two of Pearson's online education programmes, continue to win international adoptions, increasingly with localised versions for individual markets.

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In the Middle East, the business won a contract to deliver the Abu Dhabi Education Council's external assessment program over three years starting in 2009. The tests cover English, Arabic, mathematics and science for students in grades 3 to 11. Pearson worked with Jordan's Ministry of Education to build a test development system which has been enhanced to support the creation of test items and tests in Arabic, replacing a paper-based system.

In India, International Education saw rapid sales growth underpinned by strong local publishing of titles including *Macroeconomics* by Errol D. Sousa of IIM Ahmedabad and Upinder Singh's book on Ancient and Medieval Indian History. Two books published by Pearson Education won the First and Third Prize in the Delhi Management Association's DMA-NTPC Awards. In Thailand, Pearson secured its largest adoption of MyITLab outside North America at Sripatum University accompanied by the Go! Office 2007 series of textbooks.

International Education saw rapid growth in Mexico, the business' largest market in the Latin America region, with particularly strong growth in custom publishing. In English Language Teaching, we won an integrated custom publishing, academic support and services solutions contract with CONALEP, the national vocational/technical secondary program. We developed a custom publishing program for a leading test prep academy, CONAMAT, which included *Simplified Mathematics*, the best selling title of the program, selling over 20,000 units. In Panama, the Ministry of Education adopted Prentice Hall's Virtual Labs and Lab Manuals for Chemistry and Biology for 75,000 high school students. In Brazil, which has Latin America's largest and fastest-growing university population, Pearson provided custom publishing services to five leading universities in business, math, science, engineering and several other fields. There was growing success in Government tenders including a new local math series for middle schools in Mexico and the adoption of two levels of our primary Science program in Chile, adapted from our US Scott Foresman 5th/6th Grade program, to support local curriculum standards in Spanish. Strong growth of English Language Teaching materials across Latin America was underpinned by the performance in Mexico, Argentina, Colombia, Peru and Central America.

International Education margins continued to improve and the increase in the overall margin from 12.5% in 2007 to 15.6% in 2008 continued to reflect increases in both publishing and testing margins.

*Professional*

Professional sales increased by £18m, or 8%, to £244m in 2008 from £226m in 2007. Adjusted operating profit from continuing operations increased by £9m or 33% to £36m in 2008, from £27m in 2007. Sales were affected by the weakness of sterling, which increased sales by £15m when compared to the equivalent figures at constant 2007 exchange rates.

In professional testing (Pearson VUE), approximately 6m secure online tests were delivered in more than 4,000 test centers worldwide in 2008, an increase of 2% over 2007. Registration volumes for the Graduate Management Admissions Council test rose 12% worldwide in 2008, including a 22% increase outside the US. New business included contracts to provide certification exams for the Health Authority of Abu Dhabi, end of course exams for Maryland University College, certification exams for the Institute of Supply Management, the development and administration of tests for the Colorado Office of Barber and Cosmetology Licensure and an exclusive contract with Adobe. Renewals included contracts with the Georgia Insurance Licensing Board, the Virginia Board of Nursing, the Law National Admissions Consortium, Measurement Research Associates Inc., and the Kentucky Real Estate Commission. Pearson VUE also announced the transition of The Institute of Internal Auditors certification exam, the Certified Internal Auditor, from paper-and-pencil to computer-based test delivery. The Certified Internal Auditor designation is the only globally accepted certification for internal auditors and will be delivered in English, Japanese, French, Spanish and Italian. The business also agreed a partnership with NIIT Ltd. of India to expand Pearson VUE's certification network in India, extending a range of tests for students throughout the country. In a first phase, Pearson VUE and NIIT will set up testing facilities in Bangalore, Chennai, New Delhi, Hyderabad and Pune.

In Professional publishing, *The iPhone Developer's Cookbook* by Erica Sadun initially published online as a DRM-free ebook, became the number one computer book for Amazon Kindle and the number one book on Safari. And, when published in print form, became the number one Computers & Internet Book on Amazon. Scott Kelby, an author at our technology imprint Peachpit, was the top-selling author of computer books in the United States for the fifth consecutive year with titles such as *The iPhone Book*, *Mac OS X Leopard Book* and *The Adobe CS4 Book*

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*for Digital Photographers*. The Professional publishing business created nearly 200 video based educational lessons (230 hours of video) including Aaron Walter's *SEO And Beyond*, and Deitel & Associates' *C# 2008 Fundamentals I and II* and built new distribution channels for video via our web sites, and via Safari Books Online. The business developed a new iterative publishing programme called Rough Cuts which allows authors and customers to interact ahead of publication, building awareness and capturing customer contributions. Almost 25% of the print books published in 2008 entered the Rough Cuts program, benefiting from comments prior to print publication. There was also strong growth in eBooks, videos and other digital assets sold directly (via our websites and our joint venture, Safari Books Online) and through other digital retail outlets (such as the Amazon Kindle and Sony eReader). Sales of English and local language technology books saw good growth in international markets including the Middle East, South Africa, India and South America with best-sellers including *CCNA Exam Certification Library* by Wendell Odom, *Presentation Zen* by Garr Reynolds and *Effective Java 2E* by Josh Bloch. Titles by Pearson's business imprints, including FTpress and Wharton School Publishing, included *Financial Shock* by Mark Zandi, Chief Economist at Moody's and an advisor to the White House, on the causes of the credit crunch with particular emphasis on the sub-prime mortgage market.

Overall margins in the Professional business continued their rapid improvement and were higher at 14.8% in 2008 compared to 11.9% in 2006 as margins improved again in both the testing and professional publishing businesses.

*FT Publishing*

Sales at FT Publishing increased by £46m or 13%, from £344m in 2007 to £390m in 2008. Adjusted operating profit from continuing operations increased by £18m, from £56m in 2007 to £74m in 2008. The sales and profit increase is mainly generated by Mergermarket, which continued to perform strongly.

FT Publishing benefited from the shift towards subscription and service-based revenues despite a tough advertising market, particularly in the fourth quarter. *Financial Times* maintained worldwide newspaper circulation at approximately 435,000 (434,196 average for the June-December ABC period) and won both major UK press awards: Newspaper of the Year at the 2008 British Press Awards and Newspaper Awards. In the UK National Readership Survey, readership rose more than 16% to 418,000. *Financial Times* circulation revenues were up 16% as investment in content and demand for high-quality analysis of the global financial crisis supported increases in pricing and quality of circulation. FT Publishing advertising revenues were 3% lower for the full year, with a significantly weaker advertising market in the fourth quarter as financial institutions, technology companies and recruiters reduced their marketing investment. During 2008 we took a series of actions to reduce cost and prepare for more difficult trading conditions in 2009. The Financial Times continued to invest in international expansion and fast-growing markets. It successfully launched a new edition for the Middle East, and *Rui*, a lifestyle and wealth-management magazine for China's fast-growing business elite.

FT.com benefited from the launch of an innovative new access model involving registration for access to more than three articles per month. Subscribers grew 9% to 109,609, while registered users increased more than five-fold from about 150,000 at the end of 2007 to 966,000 at the end of 2008.

There was a strong performance from Mergermarket, benefiting from its digital subscription model, with contract renewal rates of almost 85%. The Mergermarket and Debtwire products performed particularly well, emphasising that the services remain valuable to customers throughout the cycle. Mergermarket launched two new products, Debtwire ABS and Debtwire Restructuring Database, in response to growing levels of distressed asset sales and restructuring funds. It continued to expand and acquire new customers geographically in the US, Europe and Asia, launching its M&A event-driven product, dealReporter, in Russia, Poland, Turkey, the UAE and South Africa. Mergermarket also continued to build its Pharmawire product for financial institutions that support the pharmaceutical industry. Mergermarket's conference business, Remark, had a strong year, with significant growth in the number of events,

attendees and newsletter publications. It also increased its digital offering in this business through video, podcasts and live webcasts. In January 2008, FT acquired Money-Media, which provides online news and commentary for the fund-management industry. During the year, Money-Media rolled out Ignites Europe, an online news service for people working with the European cross-border fund industry.

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At The Economist, in which Pearson owns a 50% stake, global weekly circulation increased by 6.4% to 1.39 m (for the July-December 2008 ABC period). FTSE, in which Pearson also owns a 50% stake, announced several new indices including expansion of the FTSE Environmental Opportunities Index and introduction, in partnership with the Athens Exchange, of the FTSE/ATHEX Liquid Mid Index. Our share of the profits of the Economist and FTSE totaled £18m in 2008 compared to £17m in 2007.

Overall margins at FT Publishing continued to increase driven by the online businesses and in 2008 were 19.0% compared to 16.3% in 2007.

### *Interactive Data*

Interactive Data, grew its sales by 18% from £344m in 2007 to £406m in 2008. Adjusted operating profit grew by 25% from £97m in 2007 to £121m in 2008. Interactive Data margins increased from 28.2% in 2007 to 29.8% in 2008. Both sales and adjusted operating profit were affected by the relative strength of the US dollar, which we estimate increased sales by £28m and adjusted operating profit by £9m when compared to the equivalent figures at constant 2007 exchange rates.

Interactive Data revenue growth was driven by strong new sales and approximately 95% renewal rates within its Institutional Services segment. Pricing and Reference Data continued to generate good growth in North America and Europe. Growth was primarily organic, providing additional services to customers; but it also benefited from bolt-on acquisitions, most recently the purchase of NDF, a leading provider of securities pricing, reference data and related services to most of the major financial institutions in Japan. Real-Time Services saw strong growth in its real-time data feeds business and continued expansion of its Managed Solutions business in the United States. Real-Time Services added a number of new market sources in North America and the Middle East. The Managed Solutions business announced that it had doubled the number of clients in the United States during the past year to 80. There was continued investment in expanding the breadth and depth of the data covered and products offered, including a new alliance to provide complex derivatives and structured product valuation services; and in the capacity of its real-time infrastructure to allow for the anticipated growth in real-time market data volumes.

Interactive Data continued to benefit from growth trends, including heightened scrutiny around the valuation of securities, increasing regulation, increasing adoption of low latency data for algorithmic trading and continuing need to differentiate wealth management offerings with bespoke client interface solutions.

### *The Penguin Group*

Penguin Group sales increased to £903m in 2008 from £846m in 2007 and adjusted operating profit was up 26% to £93m in 2008 from £74m in 2007. Both sales and adjusted operating profit were affected by the stronger US dollar which we estimate increased sales by £54m and adjusted operating profit by £16m when compared to the equivalent figures at constant 2007 exchange rates.

In the US, Penguin had a number one *New York Times* bestseller for 49 weeks of the year, including Patricia Cornwell's *Scarpetta*, Eckhart Tolle's *A New Earth* and Greg Mortenson's *Three Cups of Tea*. Penguin authors won the major industry awards. Junot Díaz won The Pulitzer Prize for Fiction and the National Book Critics Circle Award for Fiction for *The Brief Wondrous Life of Oscar Wao*, and Barton Gellman won the Pulitzer Prize for National Reporting.

In the UK, Penguin had 67 top ten bestsellers versus 52 in 2007, according to BookScan. The number one bestseller *Devil May Care*, the new James Bond novel by Sebastian Faulks, was the fastest-selling hardback fiction title in Penguin UK's history and third-bestselling in the UK in 2008. Other bestsellers included *This Charming Man* by

Marian Keyes, *The Beach House* by Jane Green and *Jamie's Ministry of Food* by Jamie Oliver. Penguin UK also published many more paperback originals, including Judith O'Reilly's *A Wife in the North*.

In Australia, Penguin was named Publisher of the Year at the Australian Book Industry Awards (and won four of the seven awards for individual books) and grew sales ahead of its markets with bestsellers including titles from Australian authors Bryce Courtenay and Tim Winton alongside international authors Marian Keyes and Eckhart Tolle. In India, Penguin is the largest trade publisher and continued to grow rapidly with authors such as Shobhaa

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De, Amitav Ghosh and Nandan Nilekani. It also won the major English language prizes in India's national book awards.

Penguin's eBook publishing and sales expanded significantly in 2008, with nearly five-fold growth in eBook sales in the US. Penguin worldwide now has 8,500 eBook titles available, more than double the number available in 2007 and during the year Penguin US launched an Enriched eBook Classics series with Jane Austen's *Pride and Prejudice*, which debuted in the top 10 on the Amazon Kindle bestseller list. The series is now sold via online stores on both Amazon.com and Penguin.com. Traffic for all Penguin's web sites increased 37% to 17 million unique users.

### ***Year ended December 31, 2007 compared to year ended December 31, 2006***

#### *Consolidated results of operations*

##### ***Sales***

Our total sales from continuing operations increased by £172m, or 4%, to £4,162m in 2007, from £3,990m in 2006. The increase reflected growth, on a constant exchange rate basis, across all the businesses together with additional contributions from acquisitions made in both 2006 and 2007. The year on year growth was impacted by movements in exchange rates, particularly in the US dollar. 2007 sales, translated at 2006 average exchange rates, would have been £4,385m.

Pearson Education had another year of growth with an increase in sales of 4%. The International Education business was the biggest contributor to this growth with an increase of 15%. Some of the Pearson Education increase was due to a full year contribution from acquisitions made in 2006 and to additional contribution from the Harcourt acquisition in 2007. We estimate that after excluding these acquisitions the growth would have been 6% at constant last year exchange rates.

In North America, US School publishing sales were up 3.5% compared to an industry increase of 2.7% (source: Association of American Publishers) as the business benefited from sustained investment in new basal programs and innovative digital services. US School testing grew in double digits and although US Higher Education sales were 1% behind the previous year on a headline basis, they would have been 6% ahead of the previous year at constant 2006 exchange rates and after taking account of portfolio changes. This increase meant that the US Higher Education business grew faster than the industry for the ninth successive year.

There was also faster growth in international school publishing and international testing sales, principally in the UK, where sales were up in double digits after benefiting from further contract wins, market share gains and strength in on-line assessment.

In the Professional business, Professional testing sales were up by 10% in 2007 as approximately 5.8m secure online tests were delivered in more than 5,000 testing centers worldwide. Professional publishing sales increased in 2007 by 7%, after a number of years of decline in the professional publishing markets, as it benefited from a focused and refreshed front list, a favorable software release schedule and sales from Safari Books Online, our electronic publishing platform (a joint venture with O'Reilly Media).

The FT Group sales were 12% ahead of 2006 with a full year contribution from Mergermarket acquired in the second half of 2006. FT Publishing sales were up by 23% or 12% after excluding the contribution from acquisitions made in 2006 and 2007. FT Publishing growth was driven by a 10% increase in advertising revenues, circulation up 2% and a strong contribution from FT.com. Interactive Data sales were up by 4% (8% at constant 2006 exchange rates and before the contribution from acquisitions) driven by strong sales to both existing and new institutional customers and a



renewal rate of approximately 95% within the institutional services sector.

Penguin's sales were flat year on year but would have increased by 3% translated at 2006 average exchange rates as a result of its successful global publishing performance and another outstanding year for bestsellers in the US and UK.

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Pearson Education, our largest business sector, accounted for 63% of our continuing business sales in both 2007 and 2006. North America continued to be the most significant source of our sales and as a proportion of total continuing sales contributed 62% in 2007 and 65% in 2006.

***Cost of goods sold and operating expenses***

The following table summarizes our cost of sales and net operating expenses:

|                                   | <b>Year Ended<br/>December 31</b> |                    |
|-----------------------------------|-----------------------------------|--------------------|
|                                   | <b>2007<br/>£m</b>                | <b>2006<br/>£m</b> |
| Cost of goods sold                | 1,910                             | 1,841              |
| Distribution costs                | 202                               | 232                |
| Administration and other expenses | 1,600                             | 1,518              |
| Other operating income            | (101)                             | (99)               |
| <b>Total</b>                      | <b>1,701</b>                      | <b>1,651</b>       |

*Cost of goods sold.* Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs and royalty charges. Our cost of sales increased by £69m, or 4%, to £1,910m in 2007, from £1,841m in 2006. The increase corresponds to the increase in sales with cost of sales at 45.9% of sales in 2007 compared to 46.1% in 2006.

*Distribution costs.* Distribution costs consist primarily of shipping costs, postage and packing and have typically declined as the business moves more to online delivery of products.

*Administration and other expenses.* Our administration and other expenses increased by £82m, or 5%, to £1,600m in 2007, from £1,518m in 2006. As a percentage of sales they remained at 38% in both 2007 and 2006.

*Other operating income.* Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions together with income from sale of assets. Other operating income increased marginally by 2% to £101m in 2007 from £99m in 2006.

***Share of results of joint ventures and associates***

The contribution from our joint ventures and associates decreased slightly from £24m in 2006 to £23m in 2007. Our share of profit from the Economist in 2006 included a one-off gain of £4m from the sale of its interest in Commonwealth Business Media Inc which was not repeated in 2007.

***Operating profit***

The total operating profit increased by £52m, or 10%, to £574m in 2007 from £522m in 2006. 2007 operating profit, translated at 2006 average exchange rates, would have been £34m higher.

Operating profit attributable to Pearson Education increased by £9m, or 3%, to £361m in 2007, from £352m in 2006. The increase was due to continued improvement in School and Professional margins, but was offset by an increase in intangible amortization from £18m in 2006 to £31m in 2007. Operating profit attributable to the FT Group increased by £28m, or 25%, to £140m in 2007, from £112m in 2006. The increase reflects the increase in revenues from both established businesses and an increased contribution from new acquisitions but also reflects improvements in margins particularly at FT Publishing. Operating profit attributable to the Penguin Group increased by £15m, or 26%, to £73m in 2007, from £58m in 2006 although the 2006 result included a one off goodwill charge of £7m relating to the recognition of pre-acquisition tax losses at Dorling Kindersley.

*Net finance costs*

Net finance costs increased from £74m in 2006 to £106m in 2007. Net interest payable in 2007 was £95m, up from £94m in 2006. Although we were partly protected by our fixed rate policy, the strong rise in average US dollar

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floating interest rates had an adverse effect. Year on year, average three month LIBOR (weighted for the Group's borrowings in US dollars, euros and sterling at the year end) rose by 0.5% to 5.4%, reflecting a rise in interest rates and a change in the currency mix of year end debt. These two factors, partly offset by a decrease in the Group's average net debt of £90m, increased the Group's average net interest rate payable by 0.3% to 7.3%. In 2007 the net finance income relating to post-retirement plans was an income of £10m compared to an income of £4m in the previous year.

Other net finance income relating to foreign exchange and short-term fluctuations in the market value of financial instruments included a net foreign exchange loss of £17m in 2007 compared to a gain of £19m in 2006. In 2007 the loss mainly related to losses on Euro denominated debt used to hedge the receipt of proceeds from the sale of Les Echos. In 2006 the exchange gains mainly relate to the unhedged exposure on Euro borrowings and swaps that could not be designated as a net investment under IAS 39. For a more detailed discussion of our borrowings and interest expenses see [Liquidity and Capital Resources](#), [Capital Resources](#) and [Borrowings](#) below and [Item 11. Quantitative and Qualitative Disclosures About Market Risk](#).

***Taxation***

The total tax charge in 2007 of £131m represents 28% of pre-tax profits compared to a charge of just £4m or less than 1% of pre-tax profits in 2006. The low tax rate in 2006 was mainly accounted for by two factors. First, in anticipation of the disposal of Government Solutions, we recognized a deferred tax asset in relation to capital losses in the US where previously we were not confident that the benefit of the losses would be realized prior to their expiry. Second, in the light of our trading performance in 2006 and our strategic plans, together with the expected utilization of US net operating losses in the Government Solutions sale, we re-evaluated the likely utilization of operating losses both in the US and the UK; this enabled us to increase the amount of the deferred tax asset carried forward in respect of such losses. The combined effect of these two factors was to create a non-recurring credit of £127m in 2006 which was not repeated in 2007.

***Minority interests***

This comprises mainly the minority share in Interactive Data. Our share of Interactive Data remained at 62% throughout 2007, leaving the minority interest unchanged at 38%.

***Discontinued operations***

Discontinued operations relate to the disposal of Government Solutions (in February 2007), Les Echos (in December 2007), Datamark (in July 2007) and the Data Management business (in February 2008). The results of Government Solutions and Les Echos have been included in discontinued operations for 2007 and 2006 and have been consolidated up to the date of sale. Operating profit for Government Solutions in 2007 was £2m compared to £22m in 2006 and the loss on disposal after tax recorded in 2007 was £112m after a tax charge of £93m. Les Echos' operating profit in 2007 amounted to £1m compared to £5m in 2006 and the profit on sale recorded in 2007 was £165m. There was no tax payable on the Les Echos sale. Datamark was bought with the eCollege acquisition and immediately sold. The only profit or loss recognized relating to Datamark was a £7m tax benefit arising from the loss on sale. The Data Management business was held throughout 2006 and 2007 and the operating profit before impairment charges in 2007 was £12m compared to £13m in 2006. The Data Management business was formerly part of the Group's Other Assessment and Testing cash-generating unit (CGU) and was carved out of this CGU in preparation for disposal. As a result, the Group has recognized a goodwill impairment charge of £97m in 2007 in anticipation of the loss on disposal.

***Profit for the year***

The total profit for the financial year in 2007 was £310m compared to a profit in 2006 of £469m. The overall decrease of £159m was mainly due to the absence of the non-recurring tax credit of £127m recorded in 2006, the decrease in contribution from discontinued businesses of £52m and the increase in net finance costs of £32m, largely due to exchange losses. These items more than offset the increase in operating profit in 2007.

**Table of Contents*****Earnings per ordinary share***

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 35.6p in 2007 compared to 55.9p in 2006 based on a weighted average number of shares in issue of 796.8m in 2007 and 798.4m in 2006. The decrease in earnings per share was due to the decrease in profit for 2007 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 35.6p in 2007 and 55.8p in 2006 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

***Exchange rate fluctuations***

The weakening of the US dollar against sterling on an average basis had a negative impact on reported sales and profits in 2007 compared to 2006. 2007 sales, translated at 2006 average exchange rates, would have been higher by £223m and operating profit, translated at 2006 average exchange rates, would have been higher by £34m. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for a discussion regarding our management of exchange rate risks.

***Sales and operating profit by division***

The following tables summarize our sales and operating profit for each of Pearson's divisions. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. See also note 2 of Item 18. Financial Statements .

In our adjusted operating profit we have excluded amortization and adjustment of acquired intangibles, other gains and losses and other net finance costs of associates. The amortization and adjustment of acquired intangibles is the amortization or subsequent adjustment of intangible assets acquired through business combinations. The charge is not considered to be fully reflective of the underlying performance of the Group. Other gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and investments that are included within continuing operations but which distort the performance for the year.

Adjusted operating profit enables management to more easily track the underlying operational performance of the Group. A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

| <b>Year Ended December 31, 2007</b>     |                                         |                                    |                     |                          |                             |                |              |
|-----------------------------------------|-----------------------------------------|------------------------------------|---------------------|--------------------------|-----------------------------|----------------|--------------|
| <b>£m</b>                               | <b>North<br/>American<br/>Education</b> | <b>International<br/>Education</b> | <b>Professional</b> | <b>FT<br/>Publishing</b> | <b>Interactive<br/>Data</b> | <b>Penguin</b> | <b>Total</b> |
| Sales                                   | 1,667                                   | 735                                | 226                 | 344                      | 344                         | 846            | 4,162        |
|                                         | 40%                                     | 18%                                | 5%                  | 8%                       | 8%                          | 21%            | 100%         |
| Total operating profit                  | 253                                     | 82                                 | 26                  | 50                       | 90                          | 73             | 574          |
|                                         | 44%                                     | 14%                                | 4%                  | 9%                       | 16%                         | 13%            | 100%         |
| Add back:                               |                                         |                                    |                     |                          |                             |                |              |
| Amortization and adjustment of acquired | 20                                      | 10                                 | 1                   | 6                        | 7                           | 1              | 45           |

intangibles

|                                                    |     |     |    |    |     |     |      |
|----------------------------------------------------|-----|-----|----|----|-----|-----|------|
| Adjusted operating profit: continuing operations   | 273 | 92  | 27 | 56 | 97  | 74  | 619  |
| Adjusted operating profit: discontinued operations |     |     | 14 | 1  |     |     | 15   |
| Total adjusted operating profit                    | 273 | 92  | 41 | 57 | 97  | 74  | 634  |
|                                                    | 43% | 15% | 6% | 9% | 15% | 12% | 100% |

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| £m                                                        | North                 |                            | Professional | FT<br>Publishing | Interactive<br>Data | Penguin | Total |
|-----------------------------------------------------------|-----------------------|----------------------------|--------------|------------------|---------------------|---------|-------|
|                                                           | American<br>Education | International<br>Education |              |                  |                     |         |       |
| Sales                                                     | 1,679                 | 640                        | 211          | 280              | 332                 | 848     | 3,990 |
|                                                           | 42%                   | 16%                        | 5%           | 7%               | 8%                  | 22%     | 100%  |
| Total operating profit                                    | 266                   | 70                         | 16           | 30               | 82                  | 58      | 522   |
|                                                           | 51%                   | 13%                        | 3%           | 6%               | 16%                 | 11%     | 100%  |
| Add back:                                                 |                       |                            |              |                  |                     |         |       |
| Amortization and<br>adjustment of acquired<br>intangibles | 14                    | 3                          | 1            | 2                | 7                   | 8       | 35    |
| Other net gains and<br>losses including<br>associates     |                       |                            |              | (4)              |                     |         | (4)   |
| Other net finance costs<br>of associates                  |                       |                            |              | (1)              |                     |         | (1)   |
| Adjusted operating<br>profit: continuing<br>operations    | 280                   | 73                         | 17           | 27               | 89                  | 66      | 552   |
| Adjusted operating<br>profit: discontinued<br>Operations  |                       |                            | 35           | 5                |                     |         | 40    |
| Total adjusted<br>operating profit                        | 280                   | 73                         | 52           | 32               | 89                  | 66      | 592   |
|                                                           | 47%                   | 12%                        | 9%           | 6%               | 15%                 | 11%     | 100%  |

*North American Education*

North American Education sales decreased by £12m, or 1%, to £1,667m in 2007, from £1,679m in 2006 and adjusted operating profit decreased by £7m, or 2%, to £273m in 2007 from £280m in 2006. The results were significantly affected by the weakening of the US dollar, which we estimate reduced sales by £135m and adjusted operating profit by £22m when compared to the equivalent figures at constant 2006 exchange rates. At constant exchange there was strong underlying growth in sales and profits, the School results in 2007 benefited from a full year contribution from the acquisitions of National Evaluation Systems (NES), Chancery and PowerSchool made in 2006.

In the US school market, Pearson's school publishing revenues grew 3.5% against the Association of American Publishers' estimate of an increase for the industry of 2.7%. New adoption market share was 31% in the adoptions where Pearson competed (and 30% of the total new adoption market). The School business now has the number one or number two market share in reading, math, science and social studies. US School testing sales were up in double digits after high single digit growth in 2006 and growth in excess of 20% in 2005. School testing benefited from further contract wins, market share gains and strength in online assessment. US School margins improved again in 2007 with savings from the integration of acquired businesses and efficiency gains from the use of software platforms.



In US Higher Education sales were up by 6% (in US dollars) ahead of the Association of American Publishers estimate of industry growth for the ninth year in succession with rapid growth in online learning and custom publishing. In the US, investment in established and new author franchises, such as Campbell's *Biology*, Kotler's *Marketing Management*, Hubbard's *Economics* and Ciccarrelli's *Psychology*, continued to underpin the strong performance. The MyLab digital homework and assessment programs were launched in 22 new subject disciplines in 2007, increasing the total number of disciplines covered to 38. These programs support over 2,000 textbooks and were used globally by 2.9 million students in 2007 (up more than 30% on 2006). In corporate

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finance, one of the largest global markets in business education, Pearson published the successful first edition bestseller, Berk/DeMarzo's *Corporate Finance*, together with MyFinanceLab and Pearson's share of this market increased from 4% to 11% in the US. It is the most successful launch of a first edition in this discipline in more than a decade and one of Pearson's most successful global launches ever, winning university adoptions in 22 countries. In World History, the first edition of Fernandez-Armesto's *The World: A History* with MyHistoryLab increased Pearson's market share from 25% to 35%. In July 2007, we acquired eCollege which builds on Pearson's position as an education services provider. eCollege works with partner educational institutions to design, build and support online degree, certificate, diploma and professional development programs. Student enrollments increased by 44% in 2007 to 1.9 million. There was continued strong double digit growth in our custom solutions business which builds customized textbooks and online services and has become a leader in the creation of courseware and curricula for e-learning institutions.

Overall margins in the North American Education business were slightly lower at 16.4% in 2007 compared to 16.7% in 2006 as small declines in US publishing margins offset the improvement in US assessment and testing and Canadian margins.

*International Education*

International Education sales increased by £95m, or 15%, to £735m in 2007, from £640m in 2006 and adjusted operating profit increased by £19m, or 26%, to £92m in 2007 from £73m in 2006. The results benefit from the first contribution in 2007 from the acquisition of Harcourt International.

The International School business continued to grow with strong performances from the publishing businesses in South Africa and Australia. In Italy, the integration of PBM was completed and produced integration savings, margin improvement and market share gains in 2007. In School publishing, the acquisition of Harcourt International increased scale in our international education businesses bringing leading content for school and vocational customers in many markets including the UK, South Africa, Australia and New Zealand. The international testing business was again able to benefit from technology leadership. In the UK, we marked 9.6 million GCSE, AS and A-Level scripts, 4.6 million of which were on screen. Successful global English Language Teaching franchises in all major market franchises (primary, secondary, adult, business and exam preparation) drove strong growth. *English Adventure*, developed with Disney, grew successfully and has sold more than six million units in less than three years since launch.

International Higher Education publishing sales grew by 2%, benefiting from organic and acquisition investment. Particular areas of strength included local language editions of our major authors and custom publishing including the successful launch of local language science publishing in Germany. The MyLab and Mastering technology platforms are being successfully adapted for international markets and the MyLab programs are now being used in almost 50 countries with almost 160,000 student registrations for online courses in Europe, the Middle East and Africa.

International Education margins continued to improve and the increase in the overall margin from 11.4% in 2006 to 12.5% in 2007 reflected increases in both publishing and testing margins.

*Professional*

After excluding sales and adjusted operating profit from Government Solutions and the Data Management businesses (reported as discontinued), Professional sales increased by £15m, or 7%, to £226m in 2007 from £211m in 2006. Adjusted operating profit increased by £10m or 59% to £27m in 2007, from £17m in 2006. Sales were affected by the weakening US dollar, which reduced sales by £14m when compared to the equivalent figures at constant 2006 exchange rates.

Professional Testing sales were up by 10% in 2007. Approximately 5.8 million secure online tests were delivered in more than 5,000 test centers across the world in 2007. There was strong margin improvement as test volumes rose, driven by higher demand from existing customers such as GMAC (for business school applicants), NCLEX (for nurses) and the DSA/DVTA driving theory test. Additional contributions from new contracts included

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the American Board of Internal Medicine and the National Association Boards of Pharmacy. There were also strong renewals, including the Institute of Financial Services and the American Registry of Radiological Technologists.

Technology Publishing achieved good sales growth and significantly improved profitability, benefiting from a focused and refreshed front list, a favorable software release schedule and Safari Books Online, our electronic publishing platform (a joint venture with O'Reilly Media). Scott Kelby, a Peachpit author, is the top-selling US computer book author for the fourth consecutive year with titles including *The iPod Book*; *The Digital Photography Book*; and *The Adobe Photoshop Lightroom Book for Digital Photographers*. Good growth in Europe was helped by publishing for the new Windows Vista launch, a new partnership with Microsoft Press in the Netherlands and a successful move into digital publishing and training in Germany. Our business imprints Wharton School Publishing and FT Press, aided by Pearson's global distribution and strong retail relationships, had a successful year. Wharton School Publishing was recognized by the Amazon.com Best Business Books of 2007 with *We Are Smarter Than Me: How to Unleash the Power of Crowds in Your Business*, by Barry Libert and Jon Spector, and *Firms of Endearment: How World-Class Companies Profit from Passion and Purpose*, by Rajendra S. Sisodia, David B. Wolfe and Jaquish N. Sheth.

Overall margins in the Professional business were higher at 11.9% in 2007 compared to 8.1% in 2006 as margins continued to improve in both the testing and professional publishing businesses.

### *FT Publishing*

Sales at FT Publishing increased by £64m or 23%, from £280m in 2006 to £344m in 2007. Adjusted operating profit from continuing operations increased by £29m, from £27m in 2006 to £56m in 2007. The sales and profit increase benefits from a full year contribution from Mergermarket, acquired in the second half of 2006.

After excluding additional sales from a full year of ownership of Mergermarket, FT Publishing sales were up by 12% with advertising revenues up by 10%. FT newspaper circulation was up 2% to almost 440,000 (for the July-December 2007 Audit Bureau of Circulation, or ABC, measuring period), with a 19% increase in subscriptions. Digital subscribers to the FT were up 13% to 101,000 and monthly unique users were up 30% to 5.7 million. Monthly page views were up 33% to 48.2 million. FT.com attracted 150,000 new registered users since the launch of its innovative new access model in October 2007. There was a strong trading performance at FT Business as integration with the FT Newspaper helped to generate additional revenue and reduce costs. Mergermarket experienced rapid revenue growth with 90%+ subscription renewal rates and a series of new product launches around the world including *Pharmawire*, *Debtwire* in Asia Pacific and *dealReporter* in emerging markets in Europe, Middle East and Africa.

The Economist, in which Pearson owns a 50% stake, increased its circulation by 9% to 1.3 million (for the July-December 2007 ABC period). FTSE, in which Pearson also owns a 50% stake, achieved double digit sales growth, benefiting from a strong new business performance, a joint venture with Xinhua Finance in China and strong growth in Exchange Traded Fund (ETF) licenses.

Small acquisitions of complementary subscription-based and digital businesses made their first contribution to FT Publishing's results including: Infinata, a provider of research and business information to life science and financial services companies; and Exec-Appointments, a well-established global job site that focuses on the high-earning executive sector with approximately 200,000 registered executive users.

Overall margins at FT Publishing continued to increase as the newspaper becomes more profitable and in 2007 were 16.3% compared to 9.6% in 2006.

### *Interactive Data*

Interactive Data, grew its sales by 4% from £332m in 2006 to £344m in 2007. Adjusted operating profit grew by 9% from £89m in 2006 to £97m in 2007. Interactive Data margins increased from 26.8% in 2006 to 28.2% in 2007. Both sales and adjusted operating profit were affected by the weakening US dollar, which we estimate reduced sales by £20m and adjusted operating profit by £6m when compared to the equivalent figures at constant 2006 exchange rates.

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Sales growth at Interactive Data was driven primarily by strong sales to both existing and new institutional customers and a renewal rate of approximately 95% within the Institutional Services business. The business continued to focus on high value services and the Pricing and Reference Data business continued to generate good growth in North America and Europe. The business continues to broaden its coverage of complex securities by expanding its universe of European asset-backed and mortgage-backed securities. The business also launched a new web-based offering, the Basket Calculation Service, designed to provide clients with the indicative optimized portfolio value for equity and fixed income exchange traded funds. The Real-Time Services business achieved strong growth with new institutional sales in its two core product areas of real-time data feeds and managed solutions. There was growing adoption of the PlusFeed data service for algorithmic trading applications, a successful introduction of DirectPlus, a new ultra low latency direct exchange data service and excellent sales momentum for managed solutions in North America with new customers including media companies, online brokerages, stock exchanges and financial institutions. Fixed Income Analytics completed 30 new BondEdge® installations during the year and made good progress in the development of its next-generation BondEdge® platform. In the Active Trader Services business, eSignal experienced modest expansion of its direct subscriber base, delivered numerous innovations across its suite of Active Trader Services, and added new content and capabilities on its financial websites.

*The Penguin Group*

Penguin Group sales decreased slightly to £846m in 2007 from £848m in 2006 and adjusted operating profit up 12% to £74m in 2007 from £66m in 2006. Both sales and adjusted operating profit were affected by the weakening US dollar which we estimate reduced sales by £37m and adjusted operating profit by £4m when compared to the equivalent figures at constant 2006 exchange rates.

Penguin maintained its competitive performance in major markets with a successful global publishing performance led by Alan Greenspan's *The Age of Turbulence*, with almost 1 million hard cover copies shipped worldwide, and Kim Edwards' first novel, *The Memory Keeper's Daughter*, a global number one bestseller for Penguin in the US, UK, Australia and Canada. It was an outstanding year for bestsellers in the US with titles including Elizabeth Gilbert's *Eat, Pray, Love*, Khaled Hosseini's *A Thousand Splendid Suns* and Ken Follett's *World Without End*. UK bestsellers included Marian Keyes' *Anybody Out There?*, Jamie Oliver's *Jamie at Home*, Jeremy Clarkson's *Don't Stop Me Now* and Charlie Higson's *Double or Die*. Also in the UK, it was a strong year for the Brands & Licensing division driven by *The Dr Who Annual* (the second bestselling children's book of 2007) and bestselling *In the Night Garden* titles. DK delivered a strong global performance in traditional, custom and digital publishing, benefiting from innovative formats including *The Human Body Book*, personalized travel guides via [traveldk.com](http://traveldk.com) and the first DK textbooks for higher education markets.

In Australia, sales growth was generated from a publishing schedule including Bryce Courtenay with *The Persimmon Tree* and Dr. Manny Noakes with *CSIRO Total Wellbeing Diet Book 2*. In India, Penguin India celebrated its 20th anniversary in 2007 with continued rapid growth. Penguin authors won all the major English language prizes in India's national book awards: Vikram Chandra in fiction for *Sacred Games*, Vikram Seth in non-fiction for *Two Lives* and Kiran Desai in readers' choice for *The Inheritance of Loss*. In China, Jiang Rong and Howard Goldblatt won the inaugural Man Asian Literary prize for *Wolf Totem*, to be published in English around the world by Penguin in 2008, and in South Africa, another strong year was led by John van de Ruit's *Spud: The Madness Continues*.

Penguin continued to focus on efficiency and improvement in operating margins continues to benefit from the Pearson-wide renegotiation of major global paper, print and binding contracts and the integration of warehouse and back office operations in Australia and New Zealand. These efficiencies together with improved gross margins principally from innovation in formats such as the US premium paperback have helped to improve margins from 7.8% in 2006 to 8.7% in 2007.



**Table of Contents****Liquidity and capital resources*****Cash flows and financing***

Net cash generated from operations increased by £235m (or 36%), to £894m in 2008 from £659m in 2007. This increase reflected strong cash contributions from all businesses, together with the significant strengthening of the US dollar against sterling. The exchange rate for translation of dollar cash flows was \$1.56 in 2008 and \$1.99 in 2007. In 2008, the headline average working capital to sales ratio for our book publishing businesses deteriorated to 26.1% from 25.6% in 2007, reflecting the higher levels of working capital in Harcourt Assessments (purchased at the end of January 2008). The underlying working capital to sales ratio (excluding the effect of year on year portfolio changes) improved to 25.8% in 2008 from 25.9% in 2007. Average working capital is the average month end balance in the year of inventory (including pre-publication), receivables and payables. Net cash generated from operations increased by £38m (or 6%), to £659m in 2007 from £621m in 2006, even after a one-off special contribution of £100m to our UK pension fund (over and beyond the normal funding requirement). This increase reflected stronger cash contributions from all businesses, together with further improvements in working capital management. In 2007, the average working capital to sales ratio for our book publishing businesses improved to 25.6% from 26.3% in 2006.

Net interest paid decreased to £76m in 2008 from £90m in 2007. The decrease was due to the reduction in US and UK interest rates, with some offset from the higher level of debt following the acquisition of Harcourt Assessments and the strength of the US dollar relative to sterling. Net interest paid was £90m in 2007 compared to £82m in 2006. The 10% increase in 2007 over 2006 was primarily due to higher average interest rates in the UK and US.

Capital expenditure on property, plant and equipment was £75m in 2008, £86m in 2007 and £68m in 2006. The reduction in spend in 2008 reflects reduced infrastructure spend compared to 2007, although the Group continued to invest in digital technology. The increase in 2007 over 2006 reflects investment to update infrastructure, particularly at Penguin and FT Group.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £400m in 2008 against £476m in 2007 and £367m in 2006. The principal acquisitions in 2008 were of Harcourt Assessments for £321m and Money Media for £33m. The principal acquisitions in 2007 were Harcourt Education International for £155m and eCollege for £266m. In 2006, the principal acquisition was of Mergermarket for £109m. The balance related to various smaller bolt-on acquisitions (primarily in the school segment) including those of National Evaluation Systems and Paravia Bruno Mondadori.

The sale of subsidiaries and associates produced a cash inflow of £111m in 2008 against £469m in 2007 and £10m in 2006. All the proceeds in 2008 relate to the sale of the Data Management business. The principal disposals in 2007 were of Government Solutions for £278m and Les Echos for £156m. The disposal in 2006 relates entirely to the proceeds from the take-up of share options issued to minority shareholders.

The cash outflow from financing of £149m in 2008 reflects the repayment of one £100m bond, the repayment of borrowings against a short-term bridge financing facility and a further increase in the group dividend. Offsetting this, the Group successfully issued \$900m of US Dollar bonds in the year in spite of the challenging credit markets. The cash outflow from financing activities of £444m in 2007 represented the higher Group dividend (as the Group sought to match dividend growth more closely with earnings growth) and the repayment of one \$591m bond, offset in part by drawings on the Group's revolving credit facility. The cash outflow from financing of £348m in 2006 primarily reflects the payment of the Group dividend (at a higher dividend per share than 2005) and the repayment of a \$250m bond at its maturity date.



*Capital resources*

Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements in the educational materials business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December. Based on a review of historical trends in working capital requirements and of forecast monthly balance sheets for the next 12 months, we believe that we have sufficient funds available for the Group's present requirements, with an appropriate level of headroom

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given our portfolio of businesses and current plans. Our ability to expand and grow our business in accordance with current plans and to meet long-term capital requirements beyond this 12-month period will depend on many factors, including the rate, if any, at which our cash flow increases and the availability of public and private debt and equity financing, including our ability to secure bank lines of credit. We cannot be certain that additional financing, if required, will be available on terms favorable to us, if at all.

At December 31, 2008, our net debt was £1,460m compared to net debt of £973m at December 31, 2007. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash, cash equivalents and liquid resources. Cash equivalents comprise short-term deposits with a maturity of up to 90 days, while liquid resources comprise short-term deposits with maturities of more than 90 days and other marketable instruments which are readily realizable and held on a short-term basis. Short-term, medium-term and long-term borrowing amounted to £2,363m at December 31, 2008, compared to £1,608m at December 31, 2007 reflecting the impact of the strengthening of the US dollar relative to sterling and the additional US dollar bonds issued in the year. At December 31, 2008, cash and liquid resources were £685m, compared to £560m at December 31, 2007.

**Contractual obligations**

The following table summarizes the maturity of our borrowings and our obligations under non-cancelable operating leases, exclusive of anticipated interest payments.

|                                             | <b>At December 31, 2008</b> |                                          |                                        |                                     |                                    |
|---------------------------------------------|-----------------------------|------------------------------------------|----------------------------------------|-------------------------------------|------------------------------------|
|                                             | <b>Total<br/>£m</b>         | <b>Less<br/>than<br/>one year<br/>£m</b> | <b>One to<br/>two<br/>years<br/>£m</b> | <b>Two to<br/>five years<br/>£m</b> | <b>After five<br/>years<br/>£m</b> |
| Gross borrowings:                           |                             |                                          |                                        |                                     |                                    |
| Bank loans, overdrafts and commercial paper | 228                         |                                          |                                        | 228                                 |                                    |
| Variable rate loan notes                    |                             |                                          |                                        |                                     |                                    |
| Bonds                                       | 2,128                       | 244                                      |                                        | 626                                 | 1,258                              |
| Finance lease obligations                   | 7                           | 4                                        | 2                                      | 1                                   |                                    |
| Operating lease obligations                 | 1,612                       | 149                                      | 138                                    | 355                                 | 970                                |
| <b>Total</b>                                | <b>3,975</b>                | <b>397</b>                               | <b>140</b>                             | <b>1,210</b>                        | <b>2,228</b>                       |

At December 31, 2008 the Group had capital commitments for fixed assets, including finance leases already under contract, of £7m (2007: £9m). There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal claims. None of these claims or guarantees is expected to result in a material gain or loss.

The Group is committed to a quarterly fee of 0.125% on the unused amount of the Group's bank facility.

**Off-Balance sheet arrangements**

The Group does not have any off-balance sheet arrangements, as defined by the SEC Final Rule 67 (FR-67),

Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, that have or are reasonably likely to have a material current or future effect on the Group's financial position or results of operations.

***Borrowings***

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.

We have in place a committed revolving credit facility of \$1.75bn, of which \$92m matures in May 2011 and the balance of \$1.658bn matures in May 2012. At December 31, 2008, approximately \$1.56bn was available under

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this facility. This credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

We must maintain the ratio of our profit before interest, tax and amortization to our net interest payable at no less than 3:1; and

We must maintain the ratio of our net debt to our EBITDA, which we explain below, at no more than 4:1.

EBITDA refers to earnings before interest, taxes, depreciation and amortization. We are currently in compliance with these covenants.

***Treasury policy***

Our treasury policy is described in note 19 of Item 18. Financial Statements . For a more detailed discussion of our borrowing and use of derivatives, see Item 11. Quantitative and Qualitative Disclosures About Market Risk .

***Related parties***

There were no significant or unusual related party transactions in 2008, 2007 or 2006. Refer to note 36 in Item 18. Financial Statements .

**Accounting principles**

For a description of our principal accounting policies used refer to note 1 in Item 18. Financial Statements .

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****Directors and senior management**

We are managed by a board of directors and a chief executive who reports to the board and manages through a management committee. We refer to the board of directors and the chairman of the board of directors as our senior management .

The following table sets forth information concerning senior management, as of March 2009.

| <b>Name</b>       | <b>Age</b> | <b>Position</b>                                  |
|-------------------|------------|--------------------------------------------------|
| Glen Moreno       | 65         | Chairman                                         |
| Marjorie Scardino | 62         | Chief Executive                                  |
| David Arculus     | 62         | Non-executive Director                           |
| David Bell        | 62         | Director for People                              |
| Terry Burns       | 65         | Non-executive Director                           |
| Patrick Cescau    | 60         | Non-executive Director                           |
| Will Ethridge     | 57         | Chief Executive, Pearson Education North America |
| Rona Fairhead     | 47         | Chairman and Chief Executive, The FT Group       |
| Robin Freestone   | 50         | Chief Financial Officer                          |
| Susan Fuhrman     | 64         | Non-executive Director                           |
| Ken Hydon         | 64         | Non-executive Director                           |

John Makinson  
CK Prahalad

54 Chairman and Chief Executive, Penguin Group  
67 Non-executive Director

**Glen Moreno** was appointed chairman of Pearson on October 1, 2005. He is the senior independent director of Man Group plc and a director of Fidelity International Limited. He was recently made acting chairman of UK Financial Investments Limited, the company set up by HM Treasury to manage the government's shareholdings in UK banks.

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**Marjorie Scardino** joined the board and became chief executive in January 1997. She is a member of Pearson's nomination committee. She trained and practiced as a lawyer and was chief executive of The Economist Group from 1993 until joining Pearson. She is also vice chairman of Nokia Corporation and a director of several charitable organizations.

**David Arculus** became a non-executive director in February 2006 and currently serves on the audit and nomination committees and as chairman of the personnel committee. He is a non-executive director of Telefonica SA, and was previously chairman of O2 plc from 2004 until it was acquired by Telefonica at the beginning of 2006. His previous roles include chairman of Severn Trent plc and IPC Group, chief operating officer of United Business Media plc and group managing director of EMAP plc.

**David Bell** became a director in March 1996. He was appointed Pearson's director for people with responsibility for finding, keeping, rewarding and inspiring our employees across the Pearson Group. He is chairman of the *Financial Times* and Sadler's Wells Theatre. He is also chairman of Crisis, a charity for the homeless, Roehampton University, The Institute for War and Peace Reporting and the London Transport Museum.

**Terry Burns** became a non-executive director in May 1999 and the senior independent director in February 2004. He currently serves on the nomination and personnel committees. He was the UK government's chief economic advisor from 1980 until 1991 and Permanent Secretary of HM Treasury from 1991 until 1998. He is chairman of Alliance & Leicester plc, Abbey National plc and Glas Cymru Limited and is a non-executive director of Banco Santander Central Hispano. He was previously chairman of Marks and Spencer Group plc.

**Patrick Cescau** became a non-executive director in April 2002. He joined the audit committee in January 2005, and is also a member of the nomination committee. He was previously group chief executive of Unilever and currently serves as a non-executive director of Tesco plc.

**Will Ethridge** became a director in May 2008 and was appointed chief executive of Pearson's North American education business, spanning School, Higher Education and Professional publishing, assessment, technology and services. He previously held a number of senior positions within Pearson Education. He is chairman of CourseSmart, a publishers' consortium, vice chairman of the Association of American Publishers and a director of Interactive Data.

**Rona Fairhead** became a director in June 2002, originally as chief financial officer. She was appointed chairman and chief executive of the FT Group in June 2006 and became responsible for Pearson VUE in March 2008. From 1996 until 2001, she worked at ICI plc, where she served as executive vice president, group control and strategy. She is also chairman of Interactive Data, a non-executive director of HSBC Holdings plc and chairs the HSBC audit committee.

**Robin Freestone** became a director of Pearson and was appointed chief financial officer in June 2006, having previously served as deputy chief financial officer since 2004. He was previously group financial controller of Amersham plc (now part of GE). He qualified as a chartered accountant with Touche Ross (now Deloitte). He is also a non-executive director and founder shareholder of eChem Limited.

**Susan Fuhrman** became a non-executive director in July 2004. She is a member of the audit and nomination committees. She is president of Teachers College at Columbia University, America's oldest and largest graduate school of education having previously been Dean of the Graduate school of Education at the University of Pennsylvania. She is a member of the Board of Trustees of the Carnegie Foundation for the Advancement of Teaching and an officer of the National Academy of Education.

**Ken Hydon** became a non-executive director in February 2006 and currently serves on the personnel and nomination committees and as chairman of the audit committee. He is a non-executive director of Tesco plc, Reckitt Benckiser

Group plc and Royal Berks NHS Foundation Trust. He was previously finance director of Vodafone Group plc and of subsidiaries of Racal Electronics.

**John Makinson** became chairman of the Penguin Group in May 2001 and its chief executive officer in June 2002. He served as Pearson's finance director from March 1996 until June 2002. He is also chairman of the Institute of Public Policy Research and a director of The National Theatre and The International Rescue Committee (UK).

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**Coimbatore Krishnarao Prahalad** became a non-executive director in May 2008 and is a distinguished university professor of corporate strategy and international business at the University of Michigan Business School. He is a director of NCR, Hindustan Unilever Corporation, World Resources Institute and the Indus Entrepreneurs.

### **Compensation of senior management**

It is the role of the personnel committee (the Committee) to approve the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee. The Committee also takes note of the remuneration for those executives with base pay over a certain level, representing approximately the top 50 executives of the company.

#### ***Remuneration policy***

We want a performance culture that supports our strategy and goals and incentive programs that reward their achievement. Performance conditions for the company's various performance-related annual or long-term incentive plans are linked to the company's strategic objectives and aligned with the interests of shareholders

Our starting point continues to be that total remuneration (base compensation plus annual and long-term incentives) should reward both short and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional company performance.

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different objectives. Base salary reflects competitive market level, role and individual contribution. Annual incentives motivate the achievement of annual strategic goals. Bonus share matching encourages executive directors and other senior executives to acquire and hold Pearson shares and aligns executives' and shareholders' interests. Long-term incentives drive long-term earnings and share price growth and value creation and align executives' and shareholders' interests.

Consistent with its policy, the Committee places considerable emphasis on the performance-linked elements i.e. annual incentives, bonus share matching and long-term incentives. The Committee will continue to review the mix of fixed and performance-linked remuneration on an annual basis, consistent with its overall philosophy.

We want our executive directors' remuneration to be competitive with those of directors and executives in similar positions in comparable companies. We use a range of UK companies in different sectors including the media sector. Some are of a similar size to Pearson, while others are larger, but the method which the Committee's independent advisers use to make comparisons on remuneration takes this into account. All have very substantial overseas operations. We also use selected media companies in North America. We use these companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

#### ***Base salary***

Our normal policy is to review salaries annually consistent with the way we benchmark pay and taking into account the approach to pay across the company as a whole.

#### ***Allowances and benefits***

It is the company's policy that benefit programs should be competitive in the context of the local labor market, but as an international company we require executives to operate worldwide and recognize that recruitment also operates worldwide.



*Annual incentives*

The Committee establishes the annual incentive plans for the executive directors and the chief executives of the company's principal operating companies, including performance measures and targets. These plans then become the basis of the annual incentive plans below the level of the principal operating companies, particularly with regard

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to the performance measures used and the relationship between the incentive plan targets and the relevant business unit operating plans.

The Committee will continue to review the annual incentive plans each year and to revise the performance measures, targets and individual incentive opportunities in light of current conditions.

Annual incentive payments do not form part of pensionable earnings.

The financial performance measures relate to the company's main drivers of business performance at both the corporate, operating company and business unit level. Performance is measured separately for each item. For each performance measure, the Committee establishes thresholds, target and maximum levels of performance for different levels of payout.

With the exception of the chief executive, normally 10% of the total annual incentive opportunity for the executive directors and other members of the Pearson Management Committee is based on performance against personal objectives as agreed with the chief executive. These may include *inter alia* objectives relating to corporate social responsibility.

For 2009, the financial performance measures for Pearson plc are sales, operating profit (for the operating companies) and growth in underlying earnings per share for continuing operations at constant exchange rates (for Pearson plc), average working capital as a ratio to sales and operating cash flow. The selection and weighting of the performance measures takes into account the strategic objectives and the business priorities relevant to each operating company and to Pearson overall each year.

Since 2008, the individual annual incentive opportunities for the executive directors other than the chief executive have been expressed as absolute cash amounts. The Committee with the advice of the chief executive determines the aggregate level of annual incentives and individual incentive opportunities taking into account all relevant factors. These factors may include the profitability of the company, individual roles and responsibilities, market annual incentive levels, and the level of stretch in the performance targets.

For 2009, there is no change to the incentive opportunity for the chief executive which remains at 100% of base salary at target and 150% at maximum.

There is also no change to the average target individual incentive opportunity for the other executive directors which is £396,000 (the same as in 2008 on a like-for-like basis at constant exchange rates). The maximum opportunity remains at twice target (as in 2008).

The annual incentive plans are discretionary and the Committee reserves the right to make adjustments to payouts up or down if it believes exceptional factors warrant doing so. The committee may also award individual discretionary incentive payments and did so in 2008 for Will Ethridge in recognition of his contributions in such areas as his leadership efforts on the Google settlement and his oversight of Pearson's global content management programme.

| <b>Name</b>       | <b>Pearson<br/>plc</b> | <b>Operating<br/>company</b> | <b>Personal<br/>objectives</b> |
|-------------------|------------------------|------------------------------|--------------------------------|
| Marjorie Scardino | 100%                   |                              |                                |
| David Bell        | 90%                    |                              | 10%                            |
| Will Ethridge     | 45%                    | 35%                          | 20%                            |

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|                 |     |     |     |
|-----------------|-----|-----|-----|
| Rona Fairhead   | 30% | 60% | 10% |
| Robin Freestone | 90% |     | 10% |
| John Makinson   | 30% | 60% | 10% |

For Pearson plc, the performance measures were sales, earnings per share growth, average working capital to sales ratio and operating cash flow. Sales and underlying growth in adjusted earnings per share at constant exchange rates were above target but below maximum. Average working capital as a ratio to sales was above threshold but below target. Operating cash flow was above maximum.

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For Higher Education and Professional, the performance measures were sales, operating profit, average working capital as a ratio to sales and operating cash flow. Operating profit, average working capital as a ratio to sales and operating cash flow were all above maximum. Sales were above target but below maximum.

For FT Publishing, the performance measures were sales, operating profit and operating cash flow. Sales were below threshold. Operating profit was above threshold but below target. Operating cash flow was above maximum.

For Pearson VUE, the performance measures were sales, operating profit, average working capital as a ratio to sales and operating cash flow. Sales were above target but below maximum. Performance across all other measures was above maximum.

For Penguin Group, the performance measures were sales, operating margin, average working capital as a ratio to sales and operating cash flow. Sales were above target but below maximum. Operating margin was above threshold but below target. Average working capital as a ratio to sales and operating cash flow were above maximum.

### ***Bonus share matching***

In 2008, shareholders approved the renewal of the annual bonus share matching plan, which permits executive directors and senior executives around the company to invest up to 50% of any after-tax annual bonus in Pearson shares.

If the participant's invested shares are held, they will be matched subject to earnings per share growth over the three-year performance period on a gross basis up to a maximum of one matching share for every one held i.e. the number of matching shares will be equal to the number of shares that could have been acquired with the amount of the pre-tax annual bonus taken in invested shares.

One matching share for every two invested shares held i.e. 50% of the maximum matching award, will be released if the company's adjusted earnings per share increase in real terms by 3% per annum compound over the three-year performance period. One matching share for every one invested share held i.e. 100% of the maximum matching award, will be released if the company's adjusted earnings per share increase in real terms by 5% per annum compound over the same period.

For real growth in adjusted earnings per share of between 3% and 5% per annum compound, the rate at which the participant's invested shares will be matched will be calculated according to a straight-line sliding scale.

Real growth is calculated by reference to the UK Government's Index of Retail Prices (All Items). We choose to test our earnings per share growth against UK inflation over three years to measure the company's financial progress over the period to which the entitlement to matching shares relates.

Where matching shares vest in accordance with the plan, a participant will also receive dividend shares representing the gross value of dividends that would have been paid on the matching shares during the holding period and re-invested.

### ***Long-term incentives***

At the annual general meeting in April 2006, shareholders approved the renewal of the long-term incentive plan first introduced in 2001.

Executive directors, senior executives and other managers can participate in the plan which can deliver restricted stock and/or stock options. Approximately 5% of the company's employees currently hold awards under the plan. The aim is to give the Committee a range of tools with which to link corporate performance to management's long-term reward in a flexible way. It is not the Committee's intention to grant stock options in 2009.

Restricted stock granted to executive directors vests only when stretching corporate performance targets over a specified period have been met. Awards vest on a sliding scale based on performance over the period. There is no retesting. The Committee determines the performance measures and targets governing an award of restricted stock prior to grant.

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The performance measures that have applied since 2006 and that will apply for 2009 and subsequent awards for the executive directors are focused on delivering and improving returns to shareholders. These are relative total shareholder return, return on invested capital and earnings per share growth.

Restricted stock may be granted without performance conditions to satisfy recruitment and retention objectives. Restricted stock awards that are not subject to performance conditions will not be granted to any of the current executive directors.

The Committee's independent advisers verify each year the expected value of individual awards i.e. their net present value after taking into account the vesting schedule, risk of forfeiture and the probability that any performance targets will be met. The level of individual awards takes into account three factors: their expected values; the assessments by the Committee's independent advisers of market practice for comparable companies and of directors' total remuneration relative to the market and the face value of individual awards and their potential value should the performance targets be met in full.

Pearson wishes to encourage executives and managers to build up a long-term holding of shares so as to demonstrate their commitment to the company. To achieve this, for awards of restricted stock that are subject to performance conditions over a three-year period, 75% of the award vests at the end of the three-year period. The remaining 25% of the award only vests if the participant retains the after-tax number of shares that vest at year three for a further two years.

Where shares vest, participants receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested. The expected value of awards made on this basis take this into account.

There are limits on the amount of new-issue equity we can use. In any rolling ten-year period, no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans, and no more than 5% of Pearson equity will be issued, or be capable of being issued, under executive or discretionary plans. In addition, for existing shares no more than 5% of Pearson equity may be held in trust at any time.

### ***Shareholding policy***

We encourage executive directors to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee share ownership. We do not think it is necessary to specify a particular relationship of shareholding to salary because of the volatility of the stock market and the share retention features that already exist in the annual bonus share matching plan and long-term incentive plans.

### ***Service agreements***

In accordance with long established policy, all continuing executive directors have rolling service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues until retirement.

The committee reviewed the policy on executive employment agreements in 2008. For future executive directors, service agreements should provide that the company may terminate these agreements by giving no more than 12 months' notice. As an alternative to giving notice, the company may pay salary, target annual incentive and the cost of pension and other benefits in lieu, subject to mitigation. In the case of the longer serving directors with legacy employment agreements, the compensation payable in circumstances where the company terminates the agreements without notice or cause takes the form of liquidated damages.

There are no special provisions for notice, pay in lieu of notice or liquidated damages in the event of termination of employment in the event of a change of control of Pearson. On termination of employment, executive directors entitlements to any vested or unvested awards under Pearson's discretionary share plans are treated in accordance with the terms of the relevant plan.

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### ***Retirement benefits***

Executive directors participate in the pension arrangements set up for Pearson employees. Marjorie Scardino, Will Ethridge, John Makinson, Rona Fairhead and Robin Freestone will also have other retirement arrangements because of the cap on the amount of benefits that can be provided from the arrangements in the US and the UK.

The differences in the arrangements for the current executive directors reflect the different arrangements in the UK and the US and the changes in pension arrangements generally over the periods of their employment. The pension arrangements for all the executive directors include life insurance cover while in employment, and entitlement to a pension in the event of ill-health or disability. A pension for their spouse and/or dependants is also available on death.

In the US, the defined benefit arrangement is the Pearson Inc. Pension Plan. This plan provides a lump sum convertible to a pension on retirement. The lump sum accrued at 6% of capped compensation until 31 December 2001 when further benefit accruals ceased. Normal retirement age is 65 although early retirement is possible subject to a reduction for early payment. No increases are guaranteed for pensions in payment. There is a spouse's pension on death in service and the option to provide a death in retirement pension by reducing the member's pension.

The defined contribution arrangement in the US is a 401(k) plan. At retirement, the account balances will be used to provide benefits. In the event of death before retirement, the account balances will be used to provide benefits for dependants.

In the UK, the pension plan is the Pearson Group Pension Plan and executive directors participate in either the Final Pay or the Money Purchase 2003 section. Normal retirement age is 62, but, subject to company consent, retirement is currently possible after age 50 (age 55 from April 2010). In the Final Pay section, the accrued pension is reduced on retirement prior to age 60. Pensions in payment are guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower. Pensions for a member's spouse, dependant children and/or nominated financial dependant are payable in the event of death. In the Money Purchase 2003 section the account balances are used to provide benefits at retirement. In the event of death before retirement pensions for a member's spouse, dependant children and/or nominated financial dependant are payable.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However the Pearson Group Pension Plan has retained its own cap, which will increase annually in line with the UK Government's Index of Retail Prices (All Items). The cap was £117,600 as at 6 April 2008.

As a result of the UK Government's A-Day changes effective from April 2006, UK executive directors and other members of the Pearson Group Pension Plan who are, or become, affected by the lifetime allowance are provided with a cash supplement as an alternative to further accrual of pension benefits on a basis that is broadly cost neutral to the company.

### ***Marjorie Scardino***

Marjorie Scardino participates in the Pearson Inc. Pension Plan and the approved 401(k) plan.

Additional pension benefits are provided through an unfunded unapproved defined contribution plan and a funded defined contribution plan approved by HM Revenue and Customs as a corresponding plan to replace part of the unfunded plan. The account balance of the unfunded unapproved defined contribution plan is determined by reference to the value of a notional cash account that increases annually by a specified notional interest rate. This plan provides



the opportunity to convert a proportion of this notional cash account into a notional share account reflecting the value of a number of Pearson ordinary shares. The number of shares in the notional share account is determined by reference to the market value of Pearson shares at the date of conversion.

*David Bell*

David Bell is a member of the Pearson Group Pension Plan. He was eligible for a pension of two-thirds of his final base salary at age 62 due to his long service.

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### ***Will Ethridge***

Will Ethridge is a member of the Pearson Inc. Pension Plan and the approved 401(k) plan. He also participates in an unfunded, unapproved Supplemental Executive Retirement Plan (SERP) that provides an annual accrual of 2% of final average earnings, less benefits accrued in the Pearson Inc. Pension Plan and US Social Security. Additional defined contribution benefits are provided through a funded, unapproved 401(k) excess plan.

### ***Rona Fairhead***

Rona Fairhead is a member of the Pearson Group Pension Plan. Her pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on her behalf. Since April 2006, she has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

### ***Robin Freestone***

Robin Freestone is a member of the Money Purchase 2003 section of the Pearson Group Pension Plan. Company contributions are 16% of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

### ***John Makinson***

John Makinson is a member of the Pearson Group Pension Plan under which his pensionable salary is restricted to the plan earnings cap. The company ceased contributions on 31 December 2001 to his FURBS arrangement. During 2002 it set up an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for him. The UURBS tops up the pension payable from the Pearson Group Pension Plan and the closed FURBS to target a pension of two-thirds of a revalued base salary on retirement at age 62. The revalued base salary is defined as £450,000 effective at 1 June 2002, increased at 1 January each year by reference to the increase in the UK Government's Index of Retail Prices (All Items). In the event of his death a pension from the Pearson Group Pension Plan, the FURBS and the UURBS will be paid to his spouse or nominated financial dependant. Early retirement is possible from age 50 (age 55 from April 2010), with company consent.

The pension is reduced to reflect the shorter service, and before age 60, further reduced for early payment.

### ***Executive directors non-executive directorships***

Our policy is that executive directors may, by agreement with the board, serve as non-executives of other companies and retain any fees payable for their services.

The following executive directors served as non-executive directors elsewhere and received fees or other benefits for the period covered by this report as follows: Marjorie Scardino (Nokia Corporation and MacArthur Foundation); Rona Fairhead (HSBC Holdings plc) and Robin Freestone (eChem).

### ***Chairman's remuneration***

Our policy is that the chairman's pay should be set at a level that is competitive with those of chairmen in similar positions in comparable companies. He is not entitled to any annual or long-term incentive, retirement or other benefits.

There were no changes in the chairman's remuneration in 2008. With effect from 1 January 2007, his remuneration was £450,000 per year.

*Non-Executive directors*

Fees for non-executive directors are determined by the full board having regard to market practice and within the restrictions contained in Pearson's articles of association. Non-executive directors receive no other pay or

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benefits (other than reimbursement for expenses incurred in connection with their directorship of Pearson) and do not participate in the Pearson's equity-based incentive plans.

There were no changes in the structure and level of non-executive directors' fees in 2008. With effect from 1 July 2007, these were as follows:

|                                     | <b>Fees payable from<br/>July 1, 2007 (£)</b> |
|-------------------------------------|-----------------------------------------------|
| Non-executive director fee          | 60,000                                        |
| Chairmanship of audit committee     | 20,000                                        |
| Chairmanship of personnel committee | 15,000                                        |
| Membership of audit committee       | 10,000                                        |
| Membership of personnel committee   | 5,000                                         |
| Senior independent director         | 15,000                                        |

A minimum of 25% of the basic fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

Terry Burns also receives a fee in respect of his non-executive directorship at Edexcel.

Non-executive directors serve Pearson under letters of appointment and do not have service contracts. There is no entitlement to compensation on the termination of their directorships.

*Remuneration of senior management*

Excluding contributions to pension funds and related benefits, senior management remuneration for 2008 was as follows:

|                                      | <b>Salaries/<br/>Fees(1)<br/>£000</b> | <b>Annual<br/>Incentive(2)<br/>£000</b> | <b>Allowances(3)<br/>£000</b> | <b>Benefits(4)<br/>£000</b> | <b>Total(5)<br/>£000</b> |
|--------------------------------------|---------------------------------------|-----------------------------------------|-------------------------------|-----------------------------|--------------------------|
| <b>Non-executive Chairman</b>        |                                       |                                         |                               |                             |                          |
| Glen Moreno                          | 450                                   |                                         |                               |                             | 450                      |
| <b>Executive directors</b>           |                                       |                                         |                               |                             |                          |
| Marjorie Scardino                    | 950                                   | 1,017                                   | 55                            | 35                          | 2,057                    |
| David Bell                           | 469                                   | 493                                     |                               | 21                          | 983                      |
| Will Ethridge (appointed 1 May 2008) | 361                                   | 810                                     |                               |                             | 1,171                    |
| Rona Fairhead                        | 506                                   | 494                                     |                               | 36                          | 1,036                    |
| Robin Freestone                      | 450                                   | 491                                     |                               | 16                          | 957                      |
| John Makinson                        | 525                                   | 500                                     | 183                           | 32                          | 1,240                    |
| <b>Senior management as a group</b>  | <b>3,711</b>                          | <b>3,805</b>                            | <b>238</b>                    | <b>140</b>                  | <b>7,894</b>             |

Notes:

- (1) There will be no increase in base salary for the executive directors for 2009.
- (2) Will Ethridge's annual incentive includes a special award of Pearson shares in recognition of his contributions in such areas as his leadership efforts on the Google settlement and his oversight of Pearson's global content management programme. The after-tax amount will be invested in Pearson shares, which will be acquired and held under the annual bonus share matching plan in 2009.
- (3) Allowances for Marjorie Scardino include £43,560 in respect of housing costs and a US payroll supplement of £11,804. John Makinson is entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US and received £182,824 for 2008.
- (4) Benefits include company car, car allowance and UK health care premiums. US health and welfare benefits for Marjorie Scardino and Will Ethridge are self-insured and the company cost, after employee contributions, is

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tax free to employees. For Marjorie Scardino, benefits include £20,233 pension planning and financial advice. Marjorie Scardino, Rona Fairhead, David Bell and John Makinson have the use of a chauffeur.

- (5) No amounts as compensation for loss of office and no expense allowances chargeable to UK income tax were paid during the year.

**Share options of senior management**

This table sets forth for each director the number of share options held as of December 31, 2008 as well as the exercise price, rounded to the nearest whole pence/cent, and the range of expiration dates of these options.

| <b>Director</b>      | <b>Number of Options</b> | <b>(1)</b>     | <b>Exercise Price</b> | <b>Earliest Exercise Date</b> | <b>Expiry Date</b> |
|----------------------|--------------------------|----------------|-----------------------|-------------------------------|--------------------|
| Marjorie Scardino(2) | 37,583                   | c*             | 1372.4p               | 06/08/02                      | 06/08/09           |
|                      | 37,583                   | c*             | 1647.5p               | 06/08/02                      | 06/08/09           |
|                      | 41,550                   | d*             | 1421.0p               | 05/09/02                      | 05/09/11           |
|                      | 41,550                   | d*             | 1421.0p               | 05/09/03                      | 05/09/11           |
|                      | 41,550                   | d*             | 1421.0p               | 05/09/04                      | 05/09/11           |
|                      | 41,550                   | d*             | 1421.0p               | 05/09/05                      | 05/09/11           |
| <b>Total</b>         | <b>241,366</b>           |                |                       |                               |                    |
| David Bell           | 297                      | b              | 629.6p                | 08/01/09                      | 02/01/10           |
|                      | 821                      | b              | 690.4p                | 08/01/10                      | 02/01/11           |
|                      | 18,705                   | c*             | 1372.4p               | 06/08/02                      | 06/08/09           |
|                      | 18,705                   | c*             | 1647.5p               | 06/08/02                      | 06/08/09           |
|                      | 16,350                   | d*             | 1421.0p               | 05/09/02                      | 05/09/11           |
|                      | 16,350                   | d*             | 1421.0p               | 05/09/03                      | 05/09/11           |
|                      | 16,350                   | d*             | 1421.0p               | 05/09/04                      | 05/09/11           |
|                      | 16,350                   | d*             | 1421.0p               | 05/09/05                      | 05/09/11           |
| <b>Total</b>         | <b>103,928</b>           |                |                       |                               |                    |
| Will Ethridge        | 10,802                   | c*             | 1372.4p               | 06/08/02                      | 08/06/09           |
|                      | 10,802                   | c*             | 1647.5p               | 06/08/02                      | 08/06/09           |
|                      | 11,010                   | d*             | \$21.00               | 05/09/02                      | 09/05/11           |
|                      | 11,010                   | d*             | \$21.00               | 05/09/03                      | 09/05/11           |
|                      | 11,010                   | d*             | \$21.00               | 05/09/04                      | 09/05/11           |
|                      | 11,010                   | d*             | \$21.00               | 05/09/05                      | 09/05/11           |
|                      | 14,680                   | d*             | \$11.97               | 11/01/02                      | 11/01/11           |
|                      | 14,680                   | d*             | \$11.97               | 11/01/03                      | 11/01/11           |
|                      | 14,680                   | d*             | \$11.97               | 11/01/04                      | 11/01/11           |
|                      | <b>Total</b>             | <b>109,684</b> |                       |                               |                    |
| Rona Fairhead        | 2,371                    | b              | 690.4p                | 08/01/12                      | 02/01/13           |
|                      | 20,000                   | d*             | 822.0p                | 11/01/02                      | 11/01/11           |

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|        |    |        |          |          |
|--------|----|--------|----------|----------|
| 20,000 | d* | 822.0p | 11/01/03 | 11/01/11 |
| 20,000 | d* | 822.0p | 11/01/04 | 11/01/11 |

**Total** **62,371**

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| <b>Director</b> | <b>Number of Options</b> | <b>(1)</b> | <b>Exercise Price</b> | <b>Earliest Exercise Date</b> | <b>Expiry Date</b> |
|-----------------|--------------------------|------------|-----------------------|-------------------------------|--------------------|
| Robin Freestone | 1,757                    | b          | 534.8p                | 08/01/11                      | 02/01/12           |
| <b>Total</b>    | <b>1,757</b>             |            |                       |                               |                    |
| John Makinson   | 4,178                    | b          | 424.8p                | 08/01/10                      | 02/01/11           |
|                 | 21,477                   | c*         | 1372.4p               | 06/08/02                      | 06/08/09           |
|                 | 21,477                   | c*         | 1647.5p               | 06/08/02                      | 06/08/09           |
|                 | 19,785                   | d*         | 1421.0p               | 05/09/02                      | 05/09/11           |
|                 | 19,785                   | d*         | 1421.0p               | 05/09/03                      | 05/09/11           |
|                 | 19,785                   | d*         | 1421.0p               | 05/09/04                      | 05/09/11           |
|                 | 19,785                   | d*         | 1421.0p               | 05/09/05                      | 05/09/11           |
| <b>Total</b>    | <b>126,272</b>           |            |                       |                               |                    |

Notes:

- (1) Shares under option are designated as: **a** executive; **b** worldwide save for shares; **c** premium priced; and **d** long-term incentive; and \* where options are exercisable.

**a Executive**

The plans under which these options were granted were replaced with the introduction of the long-term incentive plan in 2001. No executive options have been granted to the directors since 1998. All options have now lapsed, having been unexercised at the tenth anniversary of the date of grant.

**b Worldwide save for shares**

The acquisition of shares under the worldwide save for shares plan is not subject to the satisfaction of a performance target.

**c Premium priced**

The plan under which these options were granted was replaced with the introduction of the long-term incentive plan in 2001. No Premium Priced Options (PPOs) have been granted to the directors since 1999. The share price targets for the three-year and five-year tranches of PPOs granted in 1999 have already been met prior to 2008. The share price target for the seven-year tranche of PPOs granted in 2000 was not met in 2008 and the options lapsed. The secondary real growth in earnings per share target for any PPOs to become exercisable has already been met prior to 2008. All PPOs that remain outstanding lapse if they remain unexercised at the tenth anniversary of the date of grant.

**d Long-term incentive**

All options that remain outstanding are exercisable and lapse if they remain unexercised at the tenth anniversary of the date of grant.



- (2) In addition, Marjorie Scardino contributes US\$1,000 per month (the maximum allowed) to the US employee stock purchase plan. The terms of this plan allow participants to make monthly contributions for one year and to acquire shares at the end of that period at a price that is the lower of the market price at the beginning or the end of the period, both less 15%.

**Table of Contents****Share ownership of senior management**

The table below sets forth the number of ordinary shares and restricted shares held by each of our directors as at February 28, 2009. Additional information with respect to share options held by, and bonus awards for, these persons is set out above in *Remuneration of Senior Management* and *Share Options for Senior Management*. The total number of ordinary shares held by senior management as of February 28, 2009 was 1,916,299 representing less than 1% of the issued share capital on February 28, 2009.

| <b>As at March 31, 2009</b> | <b>Ordinary<br/>shares(1)</b> | <b>Restricted<br/>shares(2)</b> |
|-----------------------------|-------------------------------|---------------------------------|
| Glen Moreno                 | 210,000                       |                                 |
| Marjorie Scardino           | 632,755                       | 1,957,861                       |
| David Arculus               | 11,740                        |                                 |
| David Bell                  | 250,348                       | 593,970                         |
| Terry Burns                 | 10,290                        |                                 |
| Patrick Cescau              | 4,144                         |                                 |
| Will Ethridge               | 128,758                       | 490,192                         |
| Rona Fairhead               | 209,259                       | 699,460                         |
| Robin Freestone             | 44,379                        | 400,216                         |
| Susan Fuhrman               | 7,365                         |                                 |
| Ken Hydon                   | 8,559                         |                                 |
| John Makinson               | 397,733                       | 668,469                         |
| CK Prahalad                 | 969                           |                                 |

## Notes:

- (1) Amounts include shares acquired by individuals under the annual bonus share matching plan and amounts purchased in the market by individuals.
- (2) Restricted shares comprise awards made under the annual bonus share matching and long-term incentive plans. The number of shares shown represents the maximum number of shares which may vest, subject to the performance conditions being fulfilled.

**Employee share ownership plans*****Worldwide save for shares and US employee share purchase plans***

In 1998, we introduced a worldwide save for shares plan. Under this plan, our employees around the world have the option to save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the commencement of the employee's participation in the plan.

In the United States, this plan operates as a stock purchase plan under Section 423 of the US Internal Revenue Code of 1986. This plan was introduced in 2000 following Pearson's listing on the New York Stock Exchange. Under it,

participants save a portion of their monthly salary over six month periods, at the end of which they have the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

### **Board Practices**

Our board currently comprises the chairman, who is a part-time non-executive director, six executive directors and six non-executive directors. Our articles of association provide that at every annual general meeting, one-third of the board of directors, or the number nearest to one-third, shall retire from office. The directors to retire each year are the directors who have been longest in office since their last election or appointment. A retiring director is eligible for re-election. If at any annual general meeting, the place of a retiring director is not filled, the retiring director, if willing, is deemed to have been re-elected, unless at or prior to such meeting it is expressly resolved not

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to fill the vacated office, or unless a resolution for the re-election of that director has been put to the meeting and lost. Our articles of association also provide that every director be subject to re-appointment by shareholders at the next annual general meeting following their appointment.

However this year, and in future years, in accordance with good corporate governance, the board have resolved that all directors should offer themselves for re-election on an annual basis at the company's annual general meeting. Accordingly, all of the directors will offer themselves for re-election, (or reappointment in the case of directors who were appointed since the last meeting), at the forthcoming AGM on 1 May 2009.

Details of our approach to corporate governance and an account of how we comply with NYSE requirements can be found on our website ([www.pearson.com/investor/corpgov.htm](http://www.pearson.com/investor/corpgov.htm)).

The board of directors has established the following committees, all of which report to the board. Each committee has its own written terms of reference setting out their authority and duties. These can be found on our website ([www.pearson.com/investor/governance](http://www.pearson.com/investor/governance))

### ***Audit committee***

This committee provides the board with a vehicle to appraise our financial management and reporting and to assess the integrity of our accounting procedures and financial controls. Ken Hydon chairs this committee and its other members are David Arculus, Patrick Cescau and Susan Fuhrman. Ken Hydon is also the designated audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission. Our internal and external auditors have direct access to the committee to raise any matter of concern and to report the results of work directed by the committee.

### ***Personnel committee***

This committee meets regularly to decide the remuneration and benefits of the executive directors and the chief executives of our three operating divisions. The committee also recommends the chairman's remuneration to the board of directors for its decision and reviews management development and succession plans. David Arculus chairs this committee and its other members are Terry Burns, Glen Moreno and Ken Hydon.

### ***Nomination committee***

This committee meets from time to time as necessary to consider the appointment of new directors. The committee is chaired by Glen Moreno and comprises Marjorie Scardino and all of the non-executive directors.

## **Employees**

The average number of persons employed by us during each of the three fiscal years ended 2008 were as follows:

33,680 in fiscal 2008,

32,692 in fiscal 2007, and

34,341 in fiscal 2006.

We, through our subsidiaries, have entered into collective bargaining agreements with employees in various locations. Our management has no reason to believe that we would not be able to renegotiate any such agreements on

satisfactory terms. We encourage employees to contribute actively to the business in the context of their particular job roles and believe that the relations with our employees are generally good.

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The table set forth below shows for 2008, 2007 and 2006 the average number of persons employed in each of our operating divisions.

| <b>Average number employed</b> | <b>2008</b>   | <b>2007</b>   | <b>2006</b>   |
|--------------------------------|---------------|---------------|---------------|
| North American Education       | 15,412        | 14,327        | 12,710        |
| International Education        | 5,718         | 5,291         | 4,472         |
| Professional                   | 2,641         | 2,540         | 2,223         |
| Penguin                        | 4,112         | 4,163         | 3,943         |
| FT Publishing                  | 2,379         | 2,083         | 1,766         |
| Interactive Data               | 2,413         | 2,300         | 2,200         |
| Other                          | 909           | 918           | 900           |
| <b>Continuing operations</b>   | <b>33,584</b> | <b>31,622</b> | <b>28,214</b> |
| Discontinued operations        | 96            | 1,070         | 6,127         |
| <b>Total</b>                   | <b>33,680</b> | <b>32,692</b> | <b>34,341</b> |

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

To our knowledge, as of February 28, 2009, the only beneficial owners of 3% or more of our issued and outstanding ordinary share capital were Legal & General Group plc which owned 33,336,528 ordinary shares representing 4.12% of our outstanding ordinary shares. On February 28, 2009, record holders with registered addresses in the United States held 33,008,366 ADRs, which represented 4.08% of our outstanding ordinary shares. Some of these ADRs are held by nominees and so these numbers may not accurately represent the number of beneficial owners in the United States.

Loans and equity advanced to joint ventures and associates during the year and as at December 31, 2008 are shown in note 12 in Item 18. Financial Statements. Amounts due from joint ventures and associates are set out in note 22 and dividends receivable from joint ventures and associates are set out in note 12 in Item 18. Financial Statements. There were no other related party transactions in 2008.

**ITEM 8. FINANCIAL INFORMATION**

The financial statements filed as part of this Annual Report are included on pages F-1 through F-70 hereof.

Other than those events described in note 37 in Item 18. Financial Statements of this Form 20-F and seasonal fluctuations in borrowings, there has been no significant change to our financial condition or results of operations since December 31, 2008. Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements of the educational book business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December.

Our policy with respect to dividend distributions is described in response to Item 3. Key Information above.

**ITEM 9. THE OFFER AND LISTING**

The principal trading market for our ordinary shares is the London Stock Exchange. Our ordinary shares also trade in the United States in the form of ADSs evidenced by ADRs under a sponsored ADR facility with The Bank of New York as depository. We established this facility in March 1995 and amended it in August 2000 in connection with our New York Stock Exchange listing. Each ADS represents one ordinary share.

The ADSs trade on the New York Stock Exchange under the symbol `PSO` .

The following table sets forth the highest and lowest middle market quotations, which represent the average of closing bid and asked prices, for the ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the average daily trading volume on the London Stock Exchange:

on an annual basis for our five most recent fiscal years,

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on a quarterly basis for our most recent quarter and two most recent fiscal years, and

on a monthly basis for the six most recent months.

| Reference period                                            | Ordinary shares    |     | Average daily trading volume<br><br>(Ordinary shares) |
|-------------------------------------------------------------|--------------------|-----|-------------------------------------------------------|
|                                                             | High<br>(In pence) | Low |                                                       |
| <i>Five most recent fiscal years</i>                        |                    |     |                                                       |
| 2008                                                        | 733                | 519 | 4,758,300                                             |
| 2007                                                        | 915                | 695 | 6,405,600                                             |
| 2006                                                        | 811                | 671 | 5,004,500                                             |
| 2005                                                        | 695                | 608 | 5,296,700                                             |
| 2004                                                        | 682                | 579 | 6,219,200                                             |
| <i>Most recent quarter and two most recent fiscal years</i> |                    |     |                                                       |
| 2008 Fourth quarter                                         | 651                | 520 | 5,603,400                                             |
| Third quarter                                               | 705                | 570 | 4,748,000                                             |
| Second quarter                                              | 710                | 611 | 3,590,800                                             |
| First quarter                                               | 733                | 682 | 5,083,300                                             |
| 2007 Fourth quarter                                         | 798                | 695 | 5,156,300                                             |
| Third quarter                                               | 843                | 729 | 6,481,400                                             |
| Second quarter                                              | 915                | 825 | 7,390,600                                             |
| First quarter                                               | 872                | 762 | 6,632,100                                             |
| <i>Most recent six months</i>                               |                    |     |                                                       |
| February 2009                                               | 677                | 627 | 4,575,200                                             |
| January 2009                                                | 674                | 584 | 6,426,800                                             |
| December 2008                                               | 651                | 593 | 4,387,800                                             |
| November 2008                                               | 622                | 567 | 4,736,800                                             |
| October 2008                                                | 633                | 520 | 7,449,400                                             |
| September 2008                                              | 705                | 580 | 5,560,800                                             |

**ITEM 10. ADDITIONAL INFORMATION****Memorandum and articles of association**

We summarize below the material provisions of our memorandum and articles of association, as amended, which have been filed as an exhibit to our annual report on Form 20-F for the year ended December 31, 2008. The summary below is qualified entirely by reference to the Memorandum and Articles of Association. We have multiple business objectives and purposes and are authorized to do such things as the board may consider fit to further our interests or incidental or conducive to the attainment of our objectives and purposes.

**Directors powers**



Our business shall be managed by the board of directors and the board may exercise all such of our powers as are not required by law or by the Articles of Association to be exercised by resolution of the shareholders in general meeting.

***Interested directors***

For the purposes of section 175 of the Companies Act 2006 the board may authorise any matter proposed to it which would, if not so authorised, involve a breach of duty by a Director under that section, including, without

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limitation, any matter which relates to a situation in which a Director has, or can have, an interest which conflicts, or possibly may conflict, with the interests of the Company. Any such authorisation will be effective only if:

- (a) any requirement as to quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

The board may (whether at the time of the giving of the authorisation or subsequently) make any such authorisation subject to any limits or conditions it expressly imposes but such authorisation is otherwise given to the fullest extent permitted. The board may vary or terminate any such authorisation at any time.

Provided that he has disclosed to the board the nature and extent of his interest, a Director notwithstanding his office:

- (a) may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise (directly or indirectly) interested;
- (b) may act by himself or his firm in a professional capacity for the Company (otherwise than as auditor) and he or his firm shall be entitled to remuneration for professional services as if he were not a Director;
- (c) may be a director or other officer of, or employed by, or a party to a transaction or arrangement with, or otherwise interested in, any body corporate in which the Company is otherwise (directly or indirectly) interested.

A Director shall not, by reason of his office, be accountable to the Company for any remuneration or other benefit which he derives from any office or employment or from any transaction or arrangement or from any interest in any body corporate:

- (a) the acceptance, entry into or existence of which has been approved by the board (subject, in any such case, to any limits or conditions to which such approval was subject); or
- (b) which he is permitted to hold or enter into by virtue of paragraph (a), (b) or (c) above;

nor shall the receipt of any such remuneration or other benefit constitute a breach of his duty under section 176 of the Act.

A Director shall be under no duty to the Company with respect to any information which he obtains or has obtained otherwise than as a director of the Company and in respect of which he owes a duty of confidentiality to another person. However, to the extent that his relationship with that other person gives rise to a conflict of interest or possible conflict of interest, which has been approved by the board: the director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he fails:

- (a) to disclose any such information to the board or to any Director or other officer or employee of the Company; and/or
- (b) to use or apply any such information in performing his duties as a Director of the Company.

Where the existence of a Director's relationship with another person has been approved by the board and his relationship with that person gives rise to a conflict of interest or possible conflict of interest, the Director shall not be in breach of the general duties he owes to the Company by virtue of sections 171 to 177 of the Act because he:

- (a) absents himself from meetings of the board at which any matter relating to the conflict of interest or possible conflict of interest will or may be discussed or from the discussion of any such matter at a meeting or otherwise; and/or
- (b) makes arrangements not to receive documents and information relating to any matter which gives rise to the conflict of interest or possible conflict of interest sent or supplied by the Company and/or for such documents and information to be received and read by a professional adviser,

for so long as he reasonably believes such conflict of interest or possible conflict of interest subsists.

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Notwithstanding the foregoing, a director will be entitled to vote, and be counted in the quorum, on any resolution concerning any of the following matters:

the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of or for the benefit of the Company or any of its subsidiaries;

the giving of any guarantee, security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which he himself has assumed responsibility in whole or in part and whether alone or jointly with others under a guarantee or indemnity or by the giving of security;

any proposal relating to the Company or any of its subsidiary undertakings where it is offering securities in which offer a Director is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which a Director is to participate;

any proposal relating to another company in which he and any persons connected with him do not to his knowledge hold an interest in shares (as that term is used in sections 820 to 825 of the Companies Act 2006) representing one per cent. or more of either any class of the equity share capital, or the voting rights, in such company;

any proposal relating to an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; and

any proposal concerning insurance that we propose to maintain or purchase for the benefit of directors or for the benefit of persons, including directors.

Where proposals are under consideration concerning the appointment of two or more directors to offices or employment with us or any company in which we are interested, these proposals may be divided and considered separately and each of these directors, if not prohibited from voting under the proviso of the fourth clause above, will be entitled to vote and be counted in the quorum with respect to each resolution except that concerning his or her own appointment.

***Borrowing powers***

The board of directors may exercise all powers to borrow money and to mortgage or charge our undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any of our or any third party's debts, liabilities or obligations. The board of directors must restrict the borrowings in order to secure that the aggregate amount of undischarged monies borrowed by us (and any of our subsidiaries), but excluding any intra-group debts, shall not at any time exceed a sum equal to twice the aggregate of the adjusted capital and reserves, unless the shareholders in general meeting sanction an excession of this limitation.

***Other provisions relating to directors***

Under the articles of association, directors are paid out of our funds for their services as we may from time to time determine by ordinary resolution and, in the case of non-executive directors, up to an aggregate of £750,000 or such other amounts as resolved by the shareholders at a general meeting. Directors currently are not required to be qualified by owning our shares. Changes to the Companies Act, which came into force on April 7, 2007, now permit the appointment of a director age 70 or over.

*Annual general meetings*

Shareholders' meetings could previously be either annual general meetings or extraordinary general meetings. However the concept of an extraordinary meeting has not been retained by the Companies Act 2006 and shareholder meetings can now only be annual general meetings.

The following matters are usually transacted at an annual general meeting:

approving dividends;

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consideration of the accounts and balance sheet;

ordinary reports of the board of directors and auditors and any other documents required to be annexed to the balance sheet;

as holders of ordinary shares vote for the election of one-third of the members of the board of directors at every annual general meeting, the appointment or election of directors in the place of those retiring by rotation or otherwise;

appointment or reappointment of, and determination of the remuneration of, the auditors; and

the renewal, limitation, extension, variation or grant of any authority of or to the board, pursuant to the Companies Act 1985, to allot securities.

We hold our annual general meeting within fifteen months after the date of the preceding annual general meeting, at a place and time determined by the board.

The board may call a general meeting whenever it thinks fit. If at any time there are not within the United Kingdom sufficient directors capable of acting to form a quorum, any director or any two members may convene a general meeting in the same manner as nearly as possible as that in which meetings may be convened by the board.

No business shall be dealt with at any general meeting unless a quorum is present when the meeting proceeds to business. Three members present in person and entitled to vote shall be a quorum for all purposes. A corporation being a member shall be deemed to be personally present if represented by its duly authorized representative.

If a quorum for a meeting convened at the request of shareholders is not present within fifteen minutes of the appointed time, the meeting will be dissolved. In any other case, the general meeting will be adjourned to the same day in the next week, at the same time and place, or to a time and place that the chairman fixes. If at that rescheduled meeting a quorum is not present within fifteen minutes from the time appointed for holding the meeting, the shareholders present in person or by proxy will be a quorum. The chairman or, in his absence, the deputy chairman or any other director nominated by the board, will preside as chairman at every general meeting. If no director is present at the general meeting or no director consents to act as chairman, the shareholders present shall elect one of their number to be chairman of the meeting.

***Ordinary shares***

Certificates representing ordinary shares are issued in registered form and, subject to the terms of issue of those shares, are issued following allotment or receipt of the form of transfer bearing the appropriate stamp duty by our registrars, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6TH, United Kingdom, telephone number +44-845-607-6838.

***Share capital***

Any share may be issued with such preferred, deferred or other special rights or other restrictions as we may determine by way of a shareholders' vote in general meeting. Subject to the Companies Act 2006, any shares may be issued on terms that they are, or at our or the shareholders' option are, liable to be redeemed on such terms and in such manner as we, before the issue of the shares, may determine by special resolution of the shareholders.

There are no provisions in the Articles of Association which discriminate against any existing or prospective shareholder as a result of such shareholder owning a substantial number of shares.

Subject to the terms of the shares which have been issued, the directors may from time to time make calls upon the shareholders in respect of any moneys unpaid on their shares, provided that (subject to the terms of the shares so issued) no call on any share shall be payable at less than fourteen clear days from the last call. The directors may, if they see fit, receive from any shareholder willing to advance the same, all and any part of the moneys uncalled and unpaid upon any shares held by him.

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### ***Changes in capital***

We may from time to time, by ordinary resolution:

consolidate and divide our share capital into shares of a larger amount than its existing shares; or

sub-divide all of or any of our existing shares into shares of smaller amounts than is fixed by the Memorandum of Association, subject to the Companies Act 2006; or

cancel any shares which, at the date of passing of the resolution, have not been taken, or agreed to be taken, by any person and diminish the amount of our share capital by the amount of the shares so cancelled.

We may, from time to time, by ordinary resolution increase our share capital and, by special resolution, decrease our share capital, capital redemption reserve fund and any share premium account in any way.

### ***Voting rights***

Every holder of ordinary shares present in person at a meeting of shareholders has one vote on a vote taken by a show of hands. On a poll, every holder of ordinary shares who is present in person or by proxy has one vote for every ordinary share of which he or she is the holder. Voting at any meeting of shareholders is by a show of hands unless a poll is properly demanded before the declaration of the results of a show of hands. A poll may be demanded by:

the chairman of the meeting;

at least three shareholders present in person or by proxy and entitled to vote;

any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting; or

any shareholder or shareholders present in person or by proxy holding shares conferring a right to vote at the meeting being shares on which the aggregate sum paid up is equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

### ***Dividends***

Holders of ordinary shares are entitled to receive dividends out of our profits that are available by law for distribution, as we may declare by ordinary resolution, subject to the terms of issue thereof. However, no dividends may be declared in excess of an amount recommended by the board of directors. The board may pay interim dividends to the shareholders as it deems fit. We may invest or otherwise use all dividends left unclaimed for six months after having been declared for our benefit, until claimed. All dividends unclaimed for a period of twelve years after having been declared will be forfeited and revert to us.

The directors may, with the sanction of a resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid, in whole or in part, instead of cash in respect of such dividend.

The directors may deduct from any dividend payable to any shareholder all sums of money (if any) presently payable by that shareholder to us on account of calls or otherwise in relation to our shares.



***Liquidation rights***

In the event of our liquidation, after payment of all liabilities, our remaining assets would be used to repay the holders of ordinary shares the amount they paid for their ordinary shares. Any balance would be divided among the holders of ordinary shares in proportion to the nominal amount of the ordinary shares held by them.

***Other provisions of the articles of association***

Whenever our capital is divided into different classes of shares, the special rights attached to any class may, unless otherwise provided by the terms of the issue of the shares of that class, be varied or abrogated, either with the

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written consent of the holders of three-fourths of the issued shares of the class or with the sanction of an extraordinary resolution passed at a separate meeting of these holders.

In the event that a shareholder or other person appearing to the board of directors to be interested in ordinary shares fails to comply with a notice requiring him or her to provide information with respect to their interest in voting shares pursuant to section 820 of the Companies Act 2006, we may serve that shareholder with a notice of default. After service of a default notice, that shareholder shall not be entitled to attend or vote at any general meeting or at a separate meeting of holders of a class of shares or on a poll until he or she has complied in full with our information request.

If the shares described in the default notice represent at least one-fourth of 1% in nominal value of the issued ordinary shares, then the default notice may additionally direct that in respect of those shares:

we will not pay dividends (or issue shares in lieu of dividends); and

we will not register transfers of shares unless the shareholder is not himself in default as regards supplying the information requested and the transfer, when presented for registration, is in such form as the board of directors may require to the effect that after due and careful inquiry, the shareholder is satisfied that no person in default is interested in any of the ordinary shares which are being transferred or the transfer is an approved transfer, as defined in our articles of association.

No provision of our articles of association expressly governs the ordinary share ownership threshold above which shareholder ownership must be disclosed. Under the Companies Act 2006, any person who acquires, either alone or, in specified circumstances, with others:

a material interest in our voting share capital equal to or in excess of 3%; or

a non-material interest equal to or in excess of 10%,

comes under an obligation to disclose prescribed particulars to us in respect of those ordinary shares. A disclosure obligation also arises where a person's notifiable interests fall below the notifiable percentage, or where, above that level, the percentage of our voting share capital in which a person has a notifiable interest increases or decreases.

### ***Limitations affecting holders of ordinary shares or ADSs***

Under English law and our memorandum and articles of association, persons who are neither UK residents nor UK nationals may freely hold, vote and transfer ordinary shares in the same manner as UK residents or nationals.

With respect to the items discussed above, applicable UK law is not materially different from applicable US law.

### **Material contracts**

Pearson has not entered into any contracts outside the ordinary course of business during the two year period immediately preceding the date of this annual report.

### ***Executive employment contracts***

We have entered into agreements with each of our executive directors pursuant to which such executive director is employed by us. These agreements describe the duties of such executive director and the compensation to be paid by

us. See Item 6. Directors, Senior Management and Employees Compensation of Senior Management . Each agreement may be terminated by us on 12 months notice or by the executive director on six months notice. In the event we terminate any executive director without giving the full 12 months advance notice, the executive director is entitled to receive liquidated damages equal to 12 months base salary and benefits together with a proportion of potential bonus.

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**Exchange controls**

There are no UK government laws, decrees, regulations or other legislation which restrict or which may affect the import or export of capital, including the availability of cash and cash equivalents for use by us or the remittance of dividends, interest or other payments to nonresident holders of our securities, except as otherwise described under Tax Considerations below.

**Tax considerations**

The following is a discussion of the material US federal income tax considerations and UK tax considerations arising from the acquisition, ownership and disposition of ordinary shares and ADSs by a US holder. A US holder is:

an individual citizen or resident of the US, or

a corporation created or organized in or under the laws of the US or any of its political subdivisions, or

an estate or trust the income of which is subject to US federal income taxation regardless of its source.

This discussion deals only with ordinary shares and ADSs that are held as capital assets by a US holder, and does not address tax considerations applicable to US holders that may be subject to special tax rules, such as:

dealers or traders in securities or currencies,

financial institutions or other US holders that treat income in respect of the ordinary shares or ADSs as financial services income,

insurance companies,

tax-exempt entities,

US holders that hold the ordinary shares or ADSs as a part of a straddle or conversion transaction or other arrangement involving more than one position,

US holders that own, or are deemed for US tax purposes to own, 10% or more of the total combined voting power of all classes of our voting stock,

US holders that have a principal place of business or tax home outside the United States, or

US holders whose functional currency is not the US dollar.

For US federal income tax purposes, holders of ADSs will be treated as the owners of the ordinary shares represented by those ADSs.

In addition, the following discussion assumes that The Bank of New York will perform its obligations as depository in accordance with the terms of the depository agreement and any related agreements.

**Because US and UK tax consequences may differ from one holder to the next, the discussion set out below does not purport to describe all of the tax considerations that may be relevant to you and your particular situation. Accordingly, you are advised to consult your own tax advisor as to the US federal, state and local, UK and other, including foreign, tax consequences of investing in the ordinary shares or ADSs. The statements of US and UK tax law set out below are based on the laws and interpretations in force as of the date of this Annual Report, and are subject to any changes occurring after that date.**

*UK income taxation of distributions*

The UK does not impose dividend withholding tax on dividends paid to US holders.

*US income taxation of distributions*

Distributions that we make with respect to the ordinary shares or ADSs, other than distributions in liquidation and distributions in redemption of stock that are treated as exchanges, will be taxed to US holders as ordinary dividend income to the extent that the distributions do not exceed our current and accumulated earnings and profits.

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The amount of any distribution will equal the amount of the cash distribution. Distributions, if any, in excess of our current and accumulated earnings and profits will constitute a non-taxable return of capital to a US holder and will be applied against and reduce the US holder's tax basis in its ordinary shares or ADSs. To the extent that these distributions exceed the tax basis of the US holder in its ordinary shares or ADSs, the excess generally will be treated as capital gain.

Dividends that we pay will not be eligible for the dividends received deduction generally allowed to US corporations under Section 243 of the Code.

In the case of distributions in pounds, the amount of the distributions generally will equal the US dollar value of the pounds distributed, determined by reference to the spot currency exchange rate on the date of receipt of the distribution by the US holder in the case of shares or by The Bank of New York in the case of ADSs, regardless of whether the US holder reports income on a cash basis or an accrual basis. The US holder will realize separate foreign currency gain or loss only to the extent that this gain or loss arises on the actual disposition of pounds received. For US holders claiming tax credits on a cash basis, taxes withheld from the distribution are translated into US dollars at the spot rate on the date of the distribution; for US holders claiming tax credits on an accrual basis, taxes withheld from the distribution are translated into US dollars at the average rate for the taxable year.

A distribution by the Company to noncorporate shareholders before 2011 will be taxed as net capital gain at a maximum rate of 15%, provided certain holding periods are met, to the extent such distribution is treated as a dividend under US federal income tax principles.

### ***UK income taxation of capital gains***

Under the Income Tax Treaty, each country generally may tax capital gains in accordance with the provisions of its domestic law. Under present UK law, a US holder that is not a resident, and, in the case of an individual, not ordinarily resident, in the UK for UK tax purposes and who (in the case of an individual) does not carry on a trade, profession or vocation in the UK through a branch or agency, or (in the case of a company) does not carry on a trade in the UK through a UK permanent establishment, to which ordinary shares or ADSs are attributable will not be liable for UK taxation on capital gains or eligible for relief for allowable losses, realized on the sale or other disposal (including redemption) of these ordinary shares or ADSs.

### ***US income taxation of capital gains***

Upon a sale or exchange of ordinary shares or ADSs to a person other than Pearson, a US holder will recognize gain or loss in an amount equal to the difference between the amount realized on the sale or exchange and the US holder's adjusted tax basis in the ordinary shares or ADSs. Any gain or loss recognized will be capital gain or loss and will be long-term capital gain or loss if the US holder has held the ordinary shares or ADSs for more than one year.

Long-term capital gain of a noncorporate US holder is generally taxed at a maximum rate of 15%. This long-term capital gain rate is scheduled to expire in 2011.

Gain or loss realized by a US holder on the sale or exchange of ordinary shares or ADSs generally will be treated as US-source gain or loss for US foreign tax credit purposes.

### ***Estate and gift tax***

The current Estate and Gift Tax Convention, or the Convention, between the US and the UK generally relieves from UK Inheritance Tax (the equivalent of US Estate and Gift Tax) the transfer of ordinary shares or of ADSs where the transferor is domiciled in the US, for the purposes of the Convention. This relief will not apply if the ordinary shares

or ADSs are part of the business property of an individual's permanent establishment in the UK or pertain to the fixed base in the UK of a person providing independent personal services. If no relief is given under the Convention, inheritance tax may be charged on the amount by which the value of the transferor's estate is reduced as a result of any transfer made by way of gift or other gratuitous transfer by an individual, in general within seven years of death, or on the death of an individual. In the unusual case where ordinary shares or ADSs are subject to both UK Inheritance Tax and US Estate or Gift Tax, the Convention generally provides for tax paid in the UK to be

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credited against tax payable in the US or for tax paid in the US to be credited against tax payable in the UK based on priority rules set forth in the Convention.

### ***Stamp duty***

No stamp duty or stamp duty reserve tax (SDRT) will be payable in the UK on the purchase or transfer of an ADS, provided that the ADS, and any separate instrument or written agreement of transfer, remain at all times outside the UK and that the instrument or written agreement of transfer is not executed in the UK. Stamp duty or SDRT is, however, generally payable at the rate of 1.5% of the amount or value of the consideration or, in some circumstances, the value of the ordinary shares, where ordinary shares are issued or transferred to a person whose business is or includes issuing depositary receipts, or to a nominee or agent for such a person.

A transfer for value of the underlying ordinary shares will generally be subject to either stamp duty or SDRT, normally at the rate of 0.5% of the amount or value of the consideration. A transfer of ordinary shares from a nominee to its beneficial owner, including the transfer of underlying ordinary shares from the Depositary to an ADS holder, under which no beneficial interest will not be subject to stamp duty or SDRT.

### ***Close company status***

We believe that the close company provisions of the UK Income and Corporation Taxes Act 1988 do not apply to us.

## **Documents on display**

Copies of our Memorandum and Articles of Association and filed as exhibits to this Annual Report and certain other documents referred to in this Annual Report are available for inspection at our registered office at 80 Strand, London WC2R 0RL (c/o the Company Secretary), or, in the US, at the registered office of Pearson Inc. at 1330 Avenue of the Americas, 7th Floor, New York, New York, during usual business hours upon reasonable prior request.

## **ITEM 11. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

### **Introduction**

Our principal market risks are changes in interest rates and currency exchange rates. Following an evaluation of these positions, we selectively enter into derivative financial instruments to manage our risk exposure. For this purpose, we primarily use interest rate swaps, interest rate caps and collars, forward rate agreements, currency swaps and forward foreign exchange contracts. Managing market risks is the responsibility of the chief financial officer, who acts pursuant to policies approved by the board of directors. The Audit Committee receives regular reports on our treasury activities, and we periodically meet with external advisers to review our activities.

We have a policy of not undertaking any speculative transactions, and we do not hold our derivative and other financial instruments for trading purposes.

We have formulated policies for hedging exposures to interest rate and foreign exchange risk, and have used derivatives to ensure compliance with these policies. Although the majority of our derivative contracts were transacted without regard to existing IFRS requirements on hedge accounting, during 2008 and 2007 we qualified for hedge accounting under IFRS on a number of our key derivative contracts.

The following discussion addresses market risk only and does not present other risks that we face in the normal course of business, including country risk, credit risk and legal risk.



**Interest rates**

The Group's financial exposure to interest rates arises primarily from its borrowings. The Group manages its exposure by borrowing at fixed and variable rates of interest, and by entering into derivative transactions. Objectives approved by the board concerning the proportion of debt outstanding at fixed rates govern the use of these financial instruments.

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The Group's objectives are applied to core net debt, which is measured at the year-end and comprises borrowings net of cash and other liquid funds. Our objective is to maintain a proportion of forecast core net debt in fixed or capped form for the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% each year.

The principal method of hedging interest rate risk is to enter into an agreement with a bank counterparty to pay a fixed rate and receive a variable rate, known as a swap. Under interest rate swaps, the Group agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and variable-rate amounts calculated by reference to an agreed notional principal amount. The majority of the Group's swap contracts are US dollar denominated, and some of them have deferred start dates, in order to maintain the desired risk profile as other contracts mature. The variable rates received are normally based on three-month or six-month LIBOR, and the dates on which these rates are set do not necessarily exactly match those of the hedged borrowings. Management believes that our portfolio of these types of swaps is an efficient hedge of our portfolio of variable rate borrowings.

In addition, from time to time, the Group issues bonds or other capital market instruments to refinance existing debt. To avoid the fixed rate on a single transaction unduly influencing our overall net interest expense, our typical practice is to enter into a related derivative contract effectively converting the interest rate profile of the bond transaction to a variable interest rate. In some cases, the bond issue is denominated in a different currency to the Group's desired borrowing risk profile and the Group enters into a related cross currency interest rate swap in order to maintain this risk profile, which is predominantly borrowings denominated in US dollars.

The Group's accounting objective in its use of interest rate derivatives is to minimize the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces significantly the income statement impact of changes in the market value of a derivative). The Group then divides the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimized.

## **Currency exchange rates**

Although the Group is based in the UK, it has significant investments in overseas operations. The most significant currency in which the Group trades is the US dollar.

The Group's policy is to align approximately the currency composition of its core net borrowings with its forecast operating profit before depreciation and amortization. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. This policy applies only to currencies that account for more than 15% of group operating profit, which currently are the US dollar and sterling. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, the Group's policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit. Following the board's approval of a policy change in October 2008, currencies that account for less than 15% of Group operating profit before depreciation and amortisation may now be included in the above hedging process at the request of the chief financial officer. At the balance sheet date, no hedging transactions had been undertaken under that authority.

At December 31, 2008 the Group's net borrowings in our main currencies (taking into account the effect of cross currency rate swaps) were: US dollar £1,777m, and sterling £127m.

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and

income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of reporting under IFRS.

Investments in overseas operations are consolidated for accounting purposes by translating values in one currency to another currency, in particular from US dollars to sterling. Fluctuations in currency exchange rates affect the currency values recorded in our accounts, although they do not give rise to any realized gain or loss, nor to any currency cash flows.

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The Group is also exposed to currency exchange rates in its cash transactions and its investments in overseas operations. Cash transactions typically for purchases, sales, interest or dividends require cash conversions between currencies. Fluctuations in currency exchange rates affect the cash amounts that the Group pays or receives.

### **Forward foreign exchange contracts**

The Group sometimes uses forward foreign exchange contracts where a specific major project or forecasted cash flow, including acquisitions and disposals, arises from a business decision that has used a specific foreign exchange rate. The Group's policy is to effect routine transactional conversions between currencies, for example to collect receivables or settle payables, at the relevant spot exchange rate.

The Group seeks to offset purchases and sales in the same currency, even if they do not occur simultaneously. In addition, its debt and cash portfolios management gives rise to temporary currency shortfalls and surpluses. Both of these activities require using short-dated foreign exchange swaps between currencies.

Although the Group prepares its consolidated financial statements in sterling, significant sums have been invested in overseas assets, particularly in the US. Therefore, fluctuations in currency exchange rates, particularly between the US dollar and sterling, and to a lesser extent between the euro and sterling, are likely to affect shareholders' funds and other accounting values.

### **Derivatives**

Under IFRS, the Group is required to record all derivative instruments on the balance sheet at fair value. Derivatives not classified as hedges are adjusted to fair value through earnings. Changes in fair value of the derivatives that the Group has designated and that qualify as effective hedges are either recorded in reserves or are offset in earnings by the corresponding movement in the fair value of the underlying hedged item. Any ineffective portion of derivatives that are classified as hedges is immediately recognized in earnings.

In 2008 and 2007 the Group met the prescribed designation requirements and hedge effectiveness tests under IFRS for some of its derivative contracts. As a result, the movements in the fair value of the effective portion of fair value hedges and net investment hedges have been offset in earnings and reserves respectively by the corresponding movement in the fair value of the underlying hedged item.

In line with the Group's treasury policy, none of these instruments were considered trading instruments and each instrument was transacted solely to match an underlying financial exposure.

### **Quantitative information about market risk**

The sensitivity of the Group's derivative portfolio to changes in interest rates is found in note 19 of Item 18. Financial Statements .

### **ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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**PART II**

**ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES***

None.

**ITEM 14. *MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS***

None.

**ITEM 15. *CONTROLS AND PROCEDURES***

**Disclosure Controls and Procedures**

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2008 was carried out by us under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation the Chief Executive Officer and Chief Financial Officer concluded that Pearson's disclosure controls and procedures have been designed to provide, and are effective in providing, reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow such timely decision regarding required disclosures. A controls system, no matter how well designed and operated cannot provide absolute assurance to achieve its objectives.

**Management's Annual Report on Internal Control Over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management has assessed the effectiveness of internal control over financial reporting, as at December 31, 2008, and has concluded that such internal control over financial reporting was effective.

PricewaterhouseCoopers LLP, which has audited the consolidated financial statements of the Company for the year ended December 31, 2008, has also audited the effectiveness of the Company's internal control over financial reporting under Auditing Standard No. 5 of the Public Company Accounting Oversight Board (United States). Their audit report may be found on page F-2.

**Change in Internal Control Over Financial Reporting**

During the period covered by this Annual Report on Form 20-F, Pearson has made no significant changes to its internal controls over financial reporting that have materially affected or are reasonably likely to materially affect Pearson's internal control over financial reporting.

**ITEM 16A. *AUDIT COMMITTEE FINANCIAL EXPERT***

The members of the Board of Directors of Pearson plc have determined that Ken Hydon is an audit committee financial expert within the meaning of the applicable rules and regulations of the US Securities and Exchange Commission.

**Table of Contents****ITEM 16B. CODE OF ETHICS**

Pearson has adopted a code of ethics (the Pearson code of business conduct) which applies to all employees including the Chief Executive Officer and Chief Financial Officer and other senior financial management. This code of ethics is available on our website ([www.pearson.com/investor/corpgov.htm](http://www.pearson.com/investor/corpgov.htm)). The information on our website is not incorporated by reference into this report.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

In 2003, the audit committee adopted a revised policy for external auditor services, which is re-approved annually. The policy requires all audit engagements undertaken by our external auditors, PricewaterhouseCoopers LLP, to be approved by the audit committee. The policy permits the auditors to be engaged for other services provided the engagement is specifically approved in advance by the committee or alternatively meets the detailed criteria of specific pre-approved services and is notified to the committee.

The Group Chief Financial Officer can procure pre-approved services, as defined in the audit committee's policy for auditor services, of up to an amount of £100,000 per engagement, subject to a cumulative limit of £500,000 per year. The limit of £100,000 will be subject to annual review by the audit committee. Where pre-approval has not been granted for a service or where the amount is above these limits, specific case by case approval must be obtained from the audit committee prior to the engagement of our auditor.

| <b>Auditors Remuneration</b> | <b>2008</b> | <b>2007</b> |
|------------------------------|-------------|-------------|
|                              | <b>£m</b>   | <b>£m</b>   |
| Audit fees                   | 5           | 4           |
| Tax fees                     | 2           | 2           |
| All other fees               | 1           | 1           |

Audit fees include £35,000 (2007: £35,000) of audit fees relating to the audit of the parent company.

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated to audit fees paid.

Tax services include services related to tax planning and various other tax advisory services.

Other services include due diligence on acquisitions and services related to the disposal of the Data Management business.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASES**

| <b>Total number<br/>of</b> | <b>Maximum<br/>number<br/>of shares that</b> |
|----------------------------|----------------------------------------------|
|----------------------------|----------------------------------------------|

| <b>Period</b>                           | <b>Total number<br/>of<br/>shares<br/>purchased</b> | <b>Average<br/>price<br/>paid per<br/>share</b> | <b>units<br/>purchased<br/>as part of<br/>publicly<br/>announced<br/>plans<br/>or programs</b> | <b>may yet be<br/>purchased<br/>under<br/>the plans or<br/>programs</b> |
|-----------------------------------------|-----------------------------------------------------|-------------------------------------------------|------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------|
| February 1, 2007 - February 28, 2007    | 1,000,000                                           | £8.19                                           | N/A                                                                                            | N/A                                                                     |
| June 1, 2007 - June 30, 2007            | 2,500,000                                           | £8.39                                           | N/A                                                                                            | N/A                                                                     |
| December 1, 2007 - December 31,<br>2007 | 1,400,000                                           | £7.31                                           | N/A                                                                                            | N/A                                                                     |
| June 1, 2008 - June 30, 2008            | 2,000,000                                           | £6.14                                           | N/A                                                                                            | N/A                                                                     |

Purchases of shares were made to satisfy obligations under Pearson employee share award programs. All purchases were made in open-market transactions. None of the foregoing share purchases was made as part of a publicly announced plan or program.

**ITEM 16F. CHANGE IN REGISTRANT S CERTIFYING AUDITOR**

Not applicable.



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**ITEM 16G. CORPORATE GOVERNANCE**

In November 2003, the US Securities and Exchange Commission approved changes to the New York Stock Exchange's listing standards related to the corporate governance practices of listed companies. As a listed non-US issuer, Pearson is required to comply with some of the rules, and otherwise must disclose any significant ways in which our corporate governance practices differ from those followed by US companies under the NYSE listing standards. At this time, the Company believes that it is in compliance in all material respects with all the NYSE rules except that the Nomination Committee is not composed entirely of independent directors, and that it is the full board, not the Nomination Committee, that develops and recommends corporate governance principles.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The financial statements filed as part of this Annual Report are included on pages F-1 through F-70 hereof.

**ITEM 19. EXHIBITS**

- 1.1 Memorandum and Articles of Association of Pearson plc.
- 8.1 List of Significant Subsidiaries.
- 12.1 Certification of Chief Executive Officer.
- 12.2 Certification of Chief Financial Officer.
- 13.1 Certification of Chief Executive Officer.
- 13.2 Certification of Chief Financial Officer.
- 15 Consent of PricewaterhouseCoopers LLP.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of Pearson plc**

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows and of recognized income and expense present fairly, in all material respects, the financial position of Pearson plc and its subsidiaries (the Group) at December 31, 2008 and December 31, 2007 and the results of their operations and cash flows for each of the three years in the period ended December 31, 2008, in conformity with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board. Also, in our opinion the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Group's management are responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control Over Financial Reporting appearing under Item 15 of this Form 20-F. Our responsibility is to express opinions on these financial statements and on the Group's internal control over financial reporting based on our integrated audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

London  
United Kingdom  
March 26, 2009

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**Consolidated Income Statement**  
**Year ended 31 December 2008**  
All figures in £ millions

|                                                                                                                                                                                   | Notes | 2008         | 2007    | 2006    |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|--------------|---------|---------|
| <b>Continuing operations</b>                                                                                                                                                      |       |              |         |         |
| Sales                                                                                                                                                                             | 2     | 4,811        | 4,162   | 3,990   |
| Cost of goods sold                                                                                                                                                                | 4     | (2,174)      | (1,910) | (1,841) |
| <b>Gross profit</b>                                                                                                                                                               |       | <b>2,637</b> | 2,252   | 2,149   |
| Operating expenses                                                                                                                                                                | 4     | (1,986)      | (1,701) | (1,651) |
| Share of results of joint ventures and associates                                                                                                                                 | 12    | 25           | 23      | 24      |
| <b>Operating profit</b>                                                                                                                                                           | 2     | <b>676</b>   | 574     | 522     |
| Finance costs                                                                                                                                                                     | 6     | (136)        | (150)   | (133)   |
| Finance income                                                                                                                                                                    | 6     | 45           | 44      | 59      |
| <b>Profit before tax</b>                                                                                                                                                          |       | <b>585</b>   | 468     | 448     |
| Income tax                                                                                                                                                                        | 7     | (172)        | (131)   | (4)     |
| <b>Profit for the year from continuing operations</b>                                                                                                                             |       | <b>413</b>   | 337     | 444     |
| (Loss)/gain for the year from discontinued operations                                                                                                                             | 3     | (90)         | (27)    | 25      |
| <b>Profit for the year</b>                                                                                                                                                        |       | <b>323</b>   | 310     | 469     |
| <b>Attributable to:</b>                                                                                                                                                           |       |              |         |         |
| Equity holders of the company                                                                                                                                                     |       | 292          | 284     | 446     |
| Minority interest                                                                                                                                                                 |       | 31           | 26      | 23      |
| <b>Earnings per share for profit from continuing and discontinued operations attributable to the equity holders of the company during the year (expressed in pence per share)</b> |       |              |         |         |
| basic                                                                                                                                                                             | 8     | <b>36.6p</b> | 35.6p   | 55.9p   |
| diluted                                                                                                                                                                           | 8     | <b>36.6p</b> | 35.6p   | 55.8p   |
| <b>Earnings per share for profit from continuing operations attributable to the equity holders of the company during the year (expressed in pence per share)</b>                  |       |              |         |         |
| basic                                                                                                                                                                             | 8     | <b>47.9p</b> | 39.0p   | 52.7p   |
| diluted                                                                                                                                                                           | 8     | <b>47.9p</b> | 39.0p   | 52.6p   |

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**Consolidated Statement of Recognised Income and Expense**  
**Year ended 31 December 2008**  
**All figures in £ millions**

|                                                                  | Notes | 2008         | 2007 | 2006  |
|------------------------------------------------------------------|-------|--------------|------|-------|
| Net exchange differences on translation of foreign operations    | 29    | <b>1,050</b> | 25   | (417) |
| Actuarial (losses)/gains on retirement benefit obligations Group | 25    | <b>(71)</b>  | 80   | 107   |
| Actuarial losses on retirement benefit obligations associate     | 12    | <b>(3)</b>   |      |       |
| Taxation on items charged to equity                              | 7     | <b>2</b>     | 29   | 12    |
| <b>Net income recognised directly in equity</b>                  |       | <b>978</b>   | 134  | (298) |
| Profit for the year                                              |       | <b>323</b>   | 310  | 469   |
| <b>Total recognised income and expense for the year</b>          |       | <b>1,301</b> | 444  | 171   |
| <b>Attributable to:</b>                                          |       |              |      |       |
| Equity holders of the company                                    |       | <b>1,270</b> | 418  | 148   |
| Minority interest                                                |       | <b>31</b>    | 26   | 23    |

**Consolidated Balance Sheet**  
**At 31 December 2008**  
**All figures in £ millions**

|                                                   | Notes | 2008         | 2007  |
|---------------------------------------------------|-------|--------------|-------|
| <b>Assets</b>                                     |       |              |       |
| <b>Non-current assets</b>                         |       |              |       |
| Property, plant and equipment                     | 10    | <b>423</b>   | 355   |
| Intangible assets                                 | 11    | <b>5,353</b> | 3,814 |
| Investments in joint ventures and associates      | 12    | <b>23</b>    | 20    |
| Deferred income tax assets                        | 13    | <b>372</b>   | 328   |
| Financial assets Derivative financial instruments | 16    | <b>181</b>   | 23    |
| Retirement benefit assets                         | 25    | <b>49</b>    | 62    |
| Other financial assets                            | 15    | <b>63</b>    | 52    |
| Other receivables                                 | 22    | <b>152</b>   | 129   |
|                                                   |       | <b>6,616</b> | 4,783 |
| <b>Current assets</b>                             |       |              |       |
| Intangible assets Pre-publication                 | 20    | <b>695</b>   | 450   |
| Inventories                                       | 21    | <b>501</b>   | 368   |
| Trade and other receivables                       | 22    | <b>1,342</b> | 946   |
| Financial assets Derivative financial instruments | 16    | <b>3</b>     | 28    |
| Financial assets Marketable securities            | 14    | <b>54</b>    | 40    |

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|                                                  |    |              |       |
|--------------------------------------------------|----|--------------|-------|
| Cash and cash equivalents (excluding overdrafts) | 17 | <b>685</b>   | 560   |
|                                                  |    | <b>3,280</b> | 2,392 |
| Non-current assets classified as held for sale   | 31 |              | 117   |
|                                                  |    | <b>3,280</b> | 2,509 |
| <b>Total assets</b>                              |    | <b>9,896</b> | 7,292 |

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**Consolidated Balance Sheet (Continued)**  
**At 31 December 2008**  
**All figures in £ millions**

|                                                                                     | Notes | 2008           | 2007    |
|-------------------------------------------------------------------------------------|-------|----------------|---------|
| <b>Liabilities</b>                                                                  |       |                |         |
| <b>Non-current liabilities</b>                                                      |       |                |         |
| Financial liabilities – Borrowings                                                  | 18    | <b>(2,019)</b> | (1,049) |
| Financial liabilities – Derivative financial instruments                            | 16    | <b>(15)</b>    | (16)    |
| Deferred income tax liabilities                                                     | 13    | <b>(447)</b>   | (287)   |
| Retirement benefit obligations                                                      | 25    | <b>(167)</b>   | (95)    |
| Provisions for other liabilities and charges                                        | 23    | <b>(33)</b>    | (44)    |
| Other liabilities                                                                   | 24    | <b>(221)</b>   | (190)   |
|                                                                                     |       | <b>(2,902)</b> | (1,681) |
| <b>Current liabilities</b>                                                          |       |                |         |
| Trade and other liabilities                                                         | 24    | <b>(1,429)</b> | (1,050) |
| Financial liabilities – Borrowings                                                  | 18    | <b>(344)</b>   | (559)   |
| Financial liabilities – Derivative financial instruments                            | 16    | <b>(5)</b>     |         |
| Current income tax liabilities                                                      |       | <b>(136)</b>   | (96)    |
| Provisions for other liabilities and charges                                        | 23    | <b>(56)</b>    | (23)    |
|                                                                                     |       | <b>(1,970)</b> | (1,728) |
| Liabilities directly associated with non-current assets classified as held for sale | 31    |                | (9)     |
|                                                                                     |       | <b>(4,872)</b> | (3,418) |
| <b>Net assets</b>                                                                   |       | <b>5,024</b>   | 3,874   |
| <b>Equity</b>                                                                       |       |                |         |
| Share capital                                                                       | 27    | <b>202</b>     | 202     |
| Share premium                                                                       | 27    | <b>2,505</b>   | 2,499   |
| Treasury shares                                                                     | 28    | <b>(222)</b>   | (216)   |
| Other reserves                                                                      | 29    | <b>586</b>     | (514)   |
| Retained earnings                                                                   | 29    | <b>1,679</b>   | 1,724   |
| <b>Total equity attributable to equity holders of the company</b>                   |       | <b>4,750</b>   | 3,695   |
| Minority interest                                                                   |       | <b>274</b>     | 179     |
| <b>Total equity</b>                                                                 |       | <b>5,024</b>   | 3,874   |

These financial statements have been approved for issue by the board of directors on 6 March 2009 and signed on its behalf by

Robin Freestone *Chief financial officer*





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**Consolidated Cash Flow Statement**  
**Year ended 31 December 2008**  
**All figures in £ millions**

|                                                               | Notes | 2008         | 2007  | 2006  |
|---------------------------------------------------------------|-------|--------------|-------|-------|
| <b>Cash flows from operating activities</b>                   |       |              |       |       |
| Net cash generated from operations                            | 33    | <b>894</b>   | 659   | 621   |
| Interest paid                                                 |       | <b>(87)</b>  | (109) | (106) |
| Tax paid                                                      |       | <b>(89)</b>  | (87)  | (59)  |
| <b>Net cash generated from operating activities</b>           |       | <b>718</b>   | 463   | 456   |
| <b>Cash flows from investing activities</b>                   |       |              |       |       |
| Acquisition of subsidiaries, net of cash acquired             | 30    | <b>(395)</b> | (472) | (363) |
| Acquisition of joint ventures and associates                  |       | <b>(5)</b>   | (4)   | (4)   |
| Purchase of investments                                       |       | <b>(1)</b>   |       |       |
| Purchase of property, plant and equipment (PPE)               |       | <b>(75)</b>  | (86)  | (68)  |
| Proceeds from sale of investments                             |       | <b>5</b>     |       |       |
| Proceeds from sale of PPE                                     | 33    | <b>2</b>     | 14    | 8     |
| Purchase of intangible assets                                 |       | <b>(45)</b>  | (33)  | (29)  |
| Disposal of subsidiaries, net of cash disposed                | 32    | <b>111</b>   | 469   | 10    |
| Interest received                                             |       | <b>11</b>    | 19    | 24    |
| Dividends received from joint ventures and associates         |       | <b>23</b>    | 32    | 45    |
| <b>Net cash used in investing activities</b>                  |       | <b>(369)</b> | (61)  | (377) |
| <b>Cash flows from financing activities</b>                   |       |              |       |       |
| Proceeds from issue of ordinary shares                        | 27    | <b>6</b>     | 12    | 11    |
| Purchase of treasury shares                                   |       | <b>(47)</b>  | (72)  | (36)  |
| Proceeds from borrowings                                      |       | <b>455</b>   | 272   | 84    |
| Liquid resources acquired                                     |       |              | (15)  | (24)  |
| Repayment of borrowings                                       |       | <b>(275)</b> | (391) | (145) |
| Finance lease principal payments                              |       | <b>(3)</b>   | (2)   | (3)   |
| Dividends paid to company's shareholders                      | 9     | <b>(257)</b> | (238) | (220) |
| Dividends paid to minority interest                           |       | <b>(28)</b>  | (10)  | (15)  |
| <b>Net cash used in financing activities</b>                  |       | <b>(149)</b> | (444) | (348) |
| Effects of exchange rate changes on cash and cash equivalents |       | <b>(103)</b> | 3     | (44)  |
| <b>Net increase/(decrease) in cash and cash equivalents</b>   |       | <b>97</b>    | (39)  | (313) |
| Cash and cash equivalents at beginning of year                |       | <b>492</b>   | 531   | 844   |
| <b>Cash and cash equivalents at end of year</b>               | 17    | <b>589</b>   | 492   | 531   |



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**Notes to the Consolidated Financial Statements**

**General information**

Pearson plc (the company) and its subsidiaries (together the Group) are international media businesses covering education, business information and consumer publishing.

The company is a limited liability company incorporated and domiciled in England. The address of its registered office is 80 Strand, London WC2R 0RL.

The company has its primary listing on the London Stock Exchange but is also listed on the New York Stock Exchange.

These consolidated financial statements were approved for issue by the board of directors on 6 March 2009.

**1. Accounting policies**

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

**a. Basis of preparation**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 1985 and/or the Companies Act 2006 (as applicable) applicable to companies reporting under IFRS. These consolidated financial statements are also prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB). In respect of the accounting standards applicable to the Group there is no difference between EU-adopted and IASB-adopted IFRS. The Group transitioned from UK GAAP to IFRS on 1 January 2003.

These consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value.

***(1) Interpretations and amendments to published standards effective in 2008***

The Group adopted IFRIC 14 – IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, effective for annual reporting periods beginning on or after 1 January 2008, in the prior accounting period. IFRIC 14 resulted in no change to the full recognition of the pension asset as disclosed in note 25.

The Group has adopted Reclassification Amendments to IAS 39 – Financial Instruments: Recognition and Measurement and IFRS 7 – Financial Instruments: Disclosures, issued in October 2008 but effective from 1 July 2008. The amendments allow additional reclassifications of certain classifications of financial instruments in rare circumstances, and management determined this was not relevant to the Group.

IFRIC 11 – Group and Treasury Share Transactions is effective for annual reporting periods beginning on or after 1 March 2007. This addresses how to apply IFRS 2 – Share-based Payment to arrangements involving an entity's own equity instruments, or equity instruments of another entity in the same group, in the stand alone accounts of the parent

and group companies. Management have assessed that this interpretation has no impact on the Group's financial statements.

IFRIC 12 *Service Concession Arrangements* is effective for annual reporting periods beginning on or after 1 January 2008. This addresses the accounting by private sector entities that, by contract with a government, participate in developing, financing, operating and maintaining infrastructure assets relating to public services traditionally provided by governments. As none of the Group entities participate in these activities, IFRIC 12 is not relevant to the Group.

**(2) *Standards, interpretations and amendments to published standards that are not yet effective*** The Group has decided to early adopt IFRS 8 *Operating Segments* which is effective for annual reporting periods

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**Notes to the Consolidated Financial Statements (Continued)**

beginning on or after 1 January 2009. The new standard requires a management approach to reporting segmental information. After changes in the organisational structure within the Education business, six revised reporting segments were identified under IFRS 8 as detailed in note 2. The impact of the standard has been to revise the disclosure for the reported segments. Comparatives for 2007 have been restated.

The Group has not early adopted the following new pronouncements that are not yet effective:

**Amendments to IFRS 2 Share-based Payment** (effective for annual reporting periods beginning on or after 1 January 2009). The amendment clarifies that only service and performance conditions are vesting conditions, and that all cancellations whether Group or counterparty, should be accounted for the same way.

**IAS 1 (Revised) Presentation of Financial Statements** (effective for annual reporting periods beginning on or after 1 January 2009). The amendments provide a number of presentational changes to the financial statements including prohibiting the presentation of items of income and expense in the statement of changes in equity and requiring them to be shown in a performance statement, the option to present the performance statement as a single statement of comprehensive income and the requirement to include a balance sheet as at the beginning of the earliest comparative period when an entity applies a retrospective change in accounting policy or makes a retrospective restatement.

**IFRS 3 (Revised) Business Combinations** and amendments to **IAS 27 Consolidated and Separate Financial Statements**, (effective for annual reporting periods beginning on or after 1 July 2009). The amendments affect the accounting for business combinations including the requirement to remeasure the fair value of previously held interests in step acquisitions with any gain or loss arising being recognised in the income statement, the requirement to expense acquisition costs and to recognise adjustments to contingent consideration in the income statement.

**Amendments to IAS 39 Financial Instruments: Recognition and Measurement** (effective for annual reporting periods beginning on or after 1 July 2009). The amendments clarify that inflation may only be hedged where changes in inflation are a specified portion of cash flows of a financial instrument, and also clarify hedging with options.

**Improvements to Financial Reporting Standards 2008** (mostly effective for annual reporting periods beginning on or after 1 January 2009). This is the first standard published under the IASB's annual improvements process which is designed to deal with non-urgent minor amendments to standards. Thirty five amendments were issued, 24 resulting in changes in presentation, recognition or measurement, and 11 are expected to have no or minimal effect on accounting.

**IFRIC 16 Hedges of a Net Investment in Foreign Operations** (effective for annual reporting periods beginning on or after 1 October 2008). IFRIC 16 provides guidance on net investment hedging including which foreign currency risks within the Group qualify for hedging, and where the hedging instruments can be held within the Group.

Management is currently assessing the impact of these new standards and interpretations on the Group's financial statements.

In addition, management has assessed the relevance of the following amendments and interpretations with respect to the Group's operations:

Amendments to IAS 23 Borrowing Costs (effective for annual reporting periods beginning on or after 1 January 2009). The amendment requires capitalisation of borrowing costs that relate to qualifying assets (ones that take a substantial amount of time to get ready for use or sale, with the exception of assets measured at fair value or inventories manufactured in large quantities or on a repetitive basis). Management assessed the relevance of this amendment with respect to Group operations and concluded that it is not currently applicable to the Group as there are no material qualifying assets.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements Puttable Financial Instruments and Obligations arising on liquidation (effective for annual reporting periods beginning on or after 1 January 2009). The amendment requires puttable financial instruments, or instruments that impose on the entity an obligation to another party in respect of a share of net assets only on liquidation, to be classified as equity. Management assessed the relevance of this amendment with respect to the Group and concluded it is not relevant.

IFRIC 13 Customer Loyalty Programmes (effective for annual reporting periods beginning on or after 1 July 2008). IFRIC 13 explains how entities that grant loyalty award credits to customers should account for their obligations to provide free or discounted goods or services to customers who redeem award credits. As no Group entities operate a customer loyalty programme IFRIC 13 is not relevant to the Group.

IFRIC 15 Agreements for the Construction of Real Estate (effective for annual reporting periods beginning on or after 1 January 2009). IFRIC 15 addresses the accounting by entities that undertake the construction of real estate, with guidance on determining whether an agreement for the construction of real estate falls within the scope of IAS 11 Construction Contracts or IAS 18 Revenue. As no Group entities undertake the construction of real estate IFRIC 15 is not relevant to the Group.

IFRIC 17 Distributions of Non-cash Assets to Owners (effective for annual reporting periods beginning on or after 1 July 2009). IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends, including recognition upon authorisation and measurement at fair value of assets distributed, with any difference between fair value and carrying value of these assets being recognised in the income statement when an entity settles the dividend payable. This does not apply to distributions of non-cash assets under common control. This interpretation will have no impact on the Group financial statements as the Group does not currently distribute non-cash assets.

**(3) Critical accounting assumptions and judgements** The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting assumptions. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas requiring a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are discussed in the relevant accounting policies under the following headings:

|                     |                        |
|---------------------|------------------------|
| Intangible assets:  | Goodwill               |
| Intangible assets:  | Pre-publication assets |
| Royalty advances    |                        |
| Taxation            |                        |
| Employee benefits:  | Pension obligations    |
| Revenue recognition |                        |

**b. Consolidation**

**(1) Business combinations** The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.



Where the settlement of consideration payable is deferred, or contingent on future events, the fair value of the deferred component is determined by discounting the amount payable or probable to be paid to its present value using an appropriate discount rate.

Identifiable assets and contingent assets acquired and identifiable liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. For material acquisitions, the fair value of the acquired intangible assets is determined by an external, independent valuer. The excess of the

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. See note 1e(1) for the accounting policy on goodwill.

**(2) Subsidiaries** Subsidiaries are entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

**(3) Joint ventures and associates** Joint ventures are entities in which the Group holds an interest on a long-term basis and which are jointly controlled, with one or more other venturers, under a contractual arrangement. Associates are entities over which the Group has significant influence but not the power to control the financial and operating policies, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in joint ventures and associates are accounted for by the equity method and are initially recognised at cost.

The Group's share of its joint ventures' and associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The Group's share of its joint ventures' and associates' results is recognised as a component of operating profit as these operations form part of the core publishing business of the Group and an integral part of existing wholly owned businesses. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in a joint venture or associate equals or exceeds its interest in the joint venture or associate, the Group does not recognise further losses, unless the Group has incurred obligations or made payments on behalf of the joint venture or associate.

**c. Foreign currency translation**

**(1) Functional and presentation currency** Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling, which is the company's functional and presentation currency.

**(2) Transactions and balances** Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying net investment hedges.

Translation differences on other non-monetary items such as equities held at fair value are reported as part of the fair value gain or loss through the income statement. Fair value adjustments on non-monetary items such as equities classified as available for sale financial assets, are included in the fair value reserve in equity.

**(3) Group companies** The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- i) assets and liabilities are translated at the closing rate at the date of the balance sheet;
- ii) income and expenses are translated at average exchange rates;

iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. The Group treats specific inter-company loan balances, which are not intended to be repaid in the foreseeable future, as part of its net investment. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

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**Notes to the Consolidated Financial Statements (Continued)**

At the date of transition to IFRS the cumulative translation differences in respect of foreign operations have been deemed to be zero.

Any gains and losses on disposals of foreign operations will exclude translation differences that arose prior to the transition date.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was \$1.85 (2007: \$2.00; 2006: \$1.84) and the year end rate was \$1.44 (2007: \$1.99; 2006: \$1.96).

**d. Property, plant and equipment**

Property, plant and equipment is stated at historical cost less depreciation. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives as follows:

Buildings (freehold): 20-50 years

Buildings (leasehold): over the period of the lease

Plant and equipment: 3-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The carrying value of an asset is written down to its recoverable amount if the carrying value of the asset is greater than its estimated recoverable amount.

**e. Intangible assets**

**(1) Goodwill** Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary or associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates and joint ventures is included in investments in associates and joint ventures.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. An impairment loss is recognised to the extent that the carrying value of goodwill exceeds the recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. These calculations require the use of estimates and significant management judgement. A description of the key assumptions and sensitivities is included in note 11. Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

IFRS 3 Business Combinations has not been applied retrospectively to business combinations before the date of transition to IFRS. Subject to the transition adjustments to IFRS required by IFRS 1, the accounting for business combinations before the date of transition has been grandfathered.

**(2) *Acquired software*** Software separately acquired for internal use is capitalised at cost. Software acquired in material business combinations is capitalised at its fair value as determined by an independent valuer. Acquired software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

**(3) *Internally developed software*** Internal and external costs incurred during the preliminary stage of developing computer software for internal use are expensed as incurred. Internal and external costs incurred to develop computer software for internal use during the application development stage are capitalised if the Group expects economic benefits from the development. Capitalisation in the application development stage begins once the Group can reliably measure the expenditure attributable to the software development and has demonstrated its

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

intention to complete and use the software. Internally developed software is amortised on a straight-line basis over its estimated useful life of between three and eight years.

**(4) Acquired intangible assets** Acquired intangible assets include customer lists and relationships, trademarks and brands, publishing rights, content and technology. These assets are capitalised on acquisition at cost and included in intangible assets. Intangible assets acquired in material business combinations are capitalised at their fair value as determined by an independent valuer. Intangible assets are amortised over their estimated useful lives of between two and 20 years, using a depreciation method that reflects the pattern of their consumption.

**(5) Pre-publication assets** Pre-publication costs represent direct costs incurred in the development of educational programmes and titles prior to their publication. These costs are recognised as current intangible assets where the title will generate probable future economic benefits and costs can be measured reliably. Pre-publication assets are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected operating life cycle of the title, with a higher proportion of the amortisation taken in the earlier years. The investment in pre-publication assets has been disclosed as part of cash generated from operations in the cash flow statement (see note 33).

The assessment of the recoverability of pre-publication assets and the determination of the amortisation profile involve a significant degree of judgement based on historical trends and management estimation of future potential sales. An incorrect amortisation profile could result in excess amounts being carried forward as intangible assets that would otherwise have been written off to the income statement in an earlier period. Reviews are performed regularly to estimate recoverability of pre-publication assets. The carrying amount of pre-publication assets is set out in note 20.

**f. Other financial assets**

Other financial assets, designated as available for sale investments, are non-derivative financial assets measured at estimated fair value. Changes in the fair value are recorded in equity in the fair value reserve. On the subsequent disposal of the asset, the net fair value gains or losses are taken to the income statement.

**g. Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale. Provisions are made for slow moving and obsolete stock.

**h. Royalty advances**

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated then this will have an adverse effect on operating profits as these excess amounts will be written off.

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors. The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be

consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non-current assets.

**i. Newspaper development costs**

Investment in the development of newspaper titles consists of measures to increase the volume and geographical spread of circulation. The measures include additional and enhanced editorial content, extended

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**Notes to the Consolidated Financial Statements (Continued)**

distribution and remote printing. These costs are expensed as incurred as they do not meet the criteria under IAS 38 to be capitalised as intangible assets.

**j. Cash and cash equivalents**

Cash and cash equivalents in the cash flow statement include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are included in borrowings in current liabilities in the balance sheet.

Short-term deposits and marketable securities with maturities of greater than three months do not qualify as cash and cash equivalents. Movements on these financial instruments are classified as cash flows from financing activities in the cash flow statement as these amounts are used to offset the borrowings of the Group.

**k. Share capital**

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where any Group company purchases the company's equity share capital (Treasury shares) the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable transaction costs and the related income tax effects, is included in equity attributable to the company's equity holders.

**l. Borrowings**

Borrowings are recognised initially at fair value, which is proceeds received net of transaction costs incurred. Borrowings are subsequently stated at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest is included as part of borrowings. Where a debt instrument is in a fair value hedging relationship, an adjustment is made to its carrying value to reflect the hedged risk. Interest on borrowings is expensed as incurred.

**m. Derivative financial instruments**

Derivatives are recognised at fair value and remeasured at each balance sheet date. The fair value of derivatives is determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models. The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of its bonds (fair value hedges) or hedges of net investments in foreign operations (net investment hedges).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.



The effective portion of changes in the fair value of derivatives that are designated and qualify as net investment hedges are recognised in equity. Gains and losses accumulated in equity are included in the income statement when the corresponding foreign operation is disposed of. Gains or losses relating to the ineffective portion are recognised immediately in finance income or finance costs in the income statement.

Certain derivatives do not qualify or are not designated as hedging instruments. Such derivatives are classified at fair value and any movement in their fair value is recognised immediately in finance income or finance costs in the income statement.

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**Notes to the Consolidated Financial Statements (Continued)**

**n. Taxation**

Current tax is recognised on the amounts expected to be paid or recovered under the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided in respect of the undistributed earnings of subsidiaries other than where it is intended that those undistributed earnings will not be remitted in the foreseeable future.

Current and deferred tax are recognised in the income statement, except when the tax relates to items charged or credited directly to equity, in which case the tax is also recognised in equity.

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the estimates in relation to the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, significant judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income together with any future tax planning strategies.

**o. Employee benefits**

**(1) Pension obligations** The retirement benefit asset and obligation recognised in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of plan assets at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting estimated future cash flows using yields on high quality corporate bonds which have terms to maturity approximating the terms of the related liability.

The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions, which include the discount rate, inflation rate, salary growth, longevity and expected return on scheme assets.

Actuarial gains and losses arising from differences between actual and expected returns on plan assets, experience adjustments on liabilities and changes in actuarial assumptions are recognised immediately in the statement of recognised income and expense.

The service cost, representing benefits accruing over the year, is included in the income statement as an operating cost. The unwinding of the discount rate on the scheme liabilities and the expected return on scheme assets are presented as finance costs or finance income.

Obligations for contributions to defined contribution pension plans are recognised as an operating expense in the income statement as incurred.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

**(2) Other post-retirement obligations** The expected costs of post-retirement healthcare and life assurance benefits are accrued over the period of employment, using a similar accounting methodology as for defined benefit pension obligations. The liabilities and costs relating to material other post-retirement obligations are assessed annually by independent qualified actuaries.

**(3) Share-based payments** The fair value of options or shares granted under the Group's share and option plans is recognised as an employee expense after taking into account the Group's best estimate of the number of awards expected to vest. Fair value is measured at the date of grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of grant unless another method is more appropriate. Any proceeds received are credited to share capital and share premium when the options are exercised. The Group has applied IFRS 2 Share-based Payment retrospectively to all options granted but not fully vested at the date of transition to IFRS.

**p. Provisions**

Provisions are recognised if the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the effect is material.

The Group recognises a provision for deferred consideration when the payment of the deferred consideration is probable.

The Group recognises a provision for onerous lease contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. The provision is based on the present value of future payments for surplus leased properties under non-cancellable operating leases, net of estimated sub-leasing revenue.

**q. Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services net of value-added tax and other sales taxes, rebates and discounts, and after eliminating sales within the Group.

Revenue from the sale of books is recognised when title passes. A provision for anticipated returns is made based primarily on historical return rates. If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period.

Circulation and advertising revenue is recognised when the newspaper or other publication is published. Subscription revenue is recognised on a straight-line basis over the life of the subscription.

Where a contractual arrangement consists of two or more separate elements that can be provided to customers either on a stand-alone basis or as an optional extra, such as the provision of supplementary materials with textbooks, revenue is recognised for each element as if it were an individual contractual arrangement.

Revenue from multi-year contractual arrangements, such as contracts to process qualifying tests for individual professions and government departments, is recognised as performance occurs. The assumptions, risks, and uncertainties inherent in long-term contract accounting can affect the amounts and timing of revenue and related

expenses reported. Certain of these arrangements, either as a result of a single service spanning more than one reporting period or where the contract requires the provision of a number of services that together constitute a single project, are treated as long-term contracts with revenue recognised on a percentage of completion basis. Losses on contracts are recognised in the period in which the loss first becomes foreseeable. Contract losses are determined to be the amount by which estimated total costs of the contract exceed the estimated total revenues that will be generated by the contract.

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**Notes to the Consolidated Financial Statements (Continued)**

On certain contracts, where the Group acts as agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third-party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue.

Income from recharges of freight and other activities which are incidental to the normal revenue generating activities is included in other income.

**r. Leases**

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in financial liabilities – borrowings. The interest element of the finance cost is charged to the income statement over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the asset or the lease term.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases by the lessee. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

**s. Dividends**

Dividends are recorded in the Group's financial statements in the period in which they are approved by the company's shareholders. Interim dividends are recorded in the period in which they are approved and paid.

**t. Non-current assets and liabilities held for sale**

Assets and liabilities are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if it is intended to recover their carrying amount principally through a sale transaction rather than through continuing use. No depreciation is charged in respect of non-current assets classified as held for sale. Amounts relating to non-current assets and liabilities held for sale are classified as discontinued operations in the income statement where appropriate.

**u. Trade receivables**

Trade receivables are stated at fair value after provision for bad and doubtful debts and anticipated future sales returns (see also note 1q).

**2. Segment information**

Following the adoption of IFRS 8 *Operating Segments* and changes in the organisational structure of the Education business, the Group has revised its reporting segments. The Group is now organised into six segments:

***North American Education*** – Educational publishing and testing for the school and higher education market within the USA and Canada;

***International Education*** Educational publishing and testing for the school and higher education market outside of North America;

***Professional*** Business and technology publishing and testing and certification for professional bodies;

***FT Publishing*** Publisher of the *Financial Times*, business magazines and specialist information;

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**Interactive Data** Provider of financial and business information to financial institutions and retail investors;

**Penguin** Publisher with brand imprints such as Penguin, Putnam, Berkley, Viking, Dorling Kindersley.

For more detail on the services and products included in each business segment refer to Item 4 of this Form 20-F.

|                                                       | 2008                           |                            |              |                  |                     |              |            |              |
|-------------------------------------------------------|--------------------------------|----------------------------|--------------|------------------|---------------------|--------------|------------|--------------|
|                                                       | North<br>American<br>Education | International<br>Education | Professional | FT<br>Publishing | Interactive<br>Data | Penguin      | Corporate  | Group        |
| Notes                                                 | All figures in £ millions      |                            |              |                  |                     |              |            |              |
| <b>Continuing operations</b>                          |                                |                            |              |                  |                     |              |            |              |
| Sales (external)                                      | 2,002                          | 866                        | 244          | 390              | 406                 | 903          |            | 4,811        |
| Sales (inter-segment)                                 |                                |                            | 4            |                  |                     | 22           |            | 26           |
| Adjusted operating profit                             | 303                            | 135                        | 36           | 74               | 121                 | 93           |            | 762          |
| Amortisation of acquired intangibles                  | (45)                           | (22)                       | (1)          | (7)              | (9)                 | (2)          |            | (86)         |
| <b>Operating profit</b>                               | <b>258</b>                     | <b>113</b>                 | <b>35</b>    | <b>67</b>        | <b>112</b>          | <b>91</b>    |            | <b>676</b>   |
| Finance costs                                         | 6                              |                            |              |                  |                     |              |            | (136)        |
| Finance income                                        | 6                              |                            |              |                  |                     |              |            | 45           |
| <b>Profit before tax</b>                              |                                |                            |              |                  |                     |              |            | <b>585</b>   |
| Income tax                                            | 7                              |                            |              |                  |                     |              |            | (172)        |
| <b>Profit for the year from continuing operations</b> |                                |                            |              |                  |                     |              |            | <b>413</b>   |
| Segment assets                                        | 4,952                          | 1,358                      | 423          | 482              | 524                 | 1,211        | 923        | 9,873        |
| Joint ventures                                        | 12                             | 8                          |              | 2                |                     | 3            |            | 13           |
| Associates                                            | 12                             | 4                          |              | 6                |                     |              |            | 10           |
| Assets continuing operations                          | 4,952                          | 1,370                      | 423          | 490              | 524                 | 1,214        | 923        | 9,896        |
| Assets discontinued operations                        |                                |                            |              |                  |                     |              |            |              |
| <b>Total assets</b>                                   | <b>4,952</b>                   | <b>1,370</b>               | <b>423</b>   | <b>490</b>       | <b>524</b>          | <b>1,214</b> | <b>923</b> | <b>9,896</b> |
| <b>Other segment items</b>                            |                                |                            |              |                  |                     |              |            |              |
|                                                       | 12                             | 5                          |              | 19               |                     | 1            |            | 25           |



Share of results of joint  
ventures and associates

|                     |            |            |           |           |           |           |           |            |
|---------------------|------------|------------|-----------|-----------|-----------|-----------|-----------|------------|
| Capital expenditure | 10, 11, 20 | <b>224</b> | <b>82</b> | <b>22</b> | <b>17</b> | <b>25</b> | <b>51</b> | <b>421</b> |
| Depreciation        | 10         | <b>25</b>  | <b>12</b> | <b>8</b>  | <b>13</b> | <b>13</b> | <b>9</b>  | <b>80</b>  |
| Amortisation        | 11, 20     | <b>219</b> | <b>69</b> | <b>12</b> | <b>12</b> | <b>12</b> | <b>36</b> | <b>360</b> |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

| Notes                                                 | 2007                          |                            |              |                  |                     |     |     | Penguin<br>Corporate Group |
|-------------------------------------------------------|-------------------------------|----------------------------|--------------|------------------|---------------------|-----|-----|----------------------------|
|                                                       | North<br>America<br>Education | International<br>Education | Professional | FT<br>Publishing | Interactive<br>Data |     |     |                            |
| <b>Continuing operations</b>                          |                               |                            |              |                  |                     |     |     |                            |
| Sales (external)                                      | 1,667                         | 735                        | 226          | 344              | 344                 | 846 |     | 4,162                      |
| Sales (inter-segment)                                 | 1                             |                            |              |                  |                     | 19  |     | 20                         |
| Adjusted operating profit                             | 273                           | 92                         | 27           | 56               | 97                  | 74  |     | 619                        |
| Amortisation of acquired intangibles                  | (20)                          | (10)                       | (1)          | (6)              | (7)                 | (1) |     | (45)                       |
| <b>Operating profit</b>                               | 253                           | 82                         | 26           | 50               | 90                  | 73  |     | 574                        |
| Finance costs                                         | 6                             |                            |              |                  |                     |     |     | (150)                      |
| Finance income                                        | 6                             |                            |              |                  |                     |     |     | 44                         |
| <b>Profit before tax</b>                              |                               |                            |              |                  |                     |     |     | 468                        |
| Income tax                                            | 7                             |                            |              |                  |                     |     |     | (131)                      |
| <b>Profit for the year from continuing operations</b> |                               |                            |              |                  |                     |     |     | 337                        |
| Segment assets                                        | 3,536                         | 1,013                      | 291          | 397              | 330                 | 937 | 651 | 7,155                      |
| Joint ventures                                        | 12                            | 5                          |              | 4                |                     | 2   |     | 11                         |
| Associates                                            | 12                            | 1                          | 3            | 5                |                     |     |     | 9                          |
| Assets continuing operations                          | 3,537                         | 1,021                      | 291          | 406              | 330                 | 939 | 651 | 7,175                      |
| Assets discontinued operations                        |                               |                            | 117          |                  |                     |     |     | 117                        |
| <b>Total assets</b>                                   | 3,537                         | 1,021                      | 408          | 406              | 330                 | 939 | 651 | 7,292                      |
| <b>Other segment items</b>                            |                               |                            |              |                  |                     |     |     |                            |
| Share of results of joint ventures and associates     | 12                            | 6                          | 1            | 16               |                     |     |     | 23                         |
| Capital expenditure                                   | 10, 11, 20                    | 136                        | 109          | 20               | 28                  | 19  | 44  | 356                        |
| Depreciation                                          | 10                            | 26                         | 7            | 9                | 9                   | 10  | 7   | 68                         |
| Amortisation                                          | 11, 20                        | 159                        | 45           | 11               | 9                   | 8   | 30  | 262                        |



**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

|                                                       | 2006            |               |              |               |                  |         |           | Group |
|-------------------------------------------------------|-----------------|---------------|--------------|---------------|------------------|---------|-----------|-------|
|                                                       | North           | International | Professional | FT Publishing | Interactive Data | Penguin | Corporate |       |
|                                                       | Notes Education | Education     | Education    | Education     | Data             | Penguin | Corporate |       |
| <b>All figures in £ millions</b>                      |                 |               |              |               |                  |         |           |       |
| <b>Continuing operations</b>                          |                 |               |              |               |                  |         |           |       |
| Sales (external)                                      | 1,679           | 640           | 211          | 280           | 332              | 848     |           | 3,990 |
| Sales (inter-segment)                                 |                 |               | 1            |               |                  | 18      |           | 19    |
| Adjusted operating profit                             | 280             | 73            | 17           | 27            | 89               | 66      |           | 552   |
| Amortisation of acquired intangibles                  | (14)            | (3)           | (1)          | (2)           | (7)              | (8)     |           | (35)  |
| Other net gains and losses of associates              |                 |               |              | 4             |                  |         |           | 4     |
| Other net finance costs of associates                 |                 |               |              | 1             |                  |         |           | 1     |
| <b>Operating profit</b>                               | 266             | 70            | 16           | 30            | 82               | 58      |           | 522   |
| Finance costs                                         | 6               |               |              |               |                  |         |           | (133) |
| Finance income                                        | 6               |               |              |               |                  |         |           | 59    |
| <b>Profit before tax</b>                              |                 |               |              |               |                  |         |           | 448   |
| Income tax                                            | 7               |               |              |               |                  |         |           | (4)   |
| <b>Profit for the year from continuing operations</b> |                 |               |              |               |                  |         |           | 444   |
| Segment assets                                        | 3,401           | 795           | 415          | 317           | 314              | 954     | 703       | 6,899 |
| Joint ventures                                        |                 | 5             |              | 4             |                  | 3       |           | 12    |
| Associates                                            |                 | 4             |              | 4             |                  |         |           | 8     |
| Assets continuing operations                          | 3,401           | 804           | 415          | 325           | 314              | 957     | 703       | 6,919 |
| Assets discontinued operations                        |                 |               | 294          |               |                  |         |           | 294   |
| <b>Total assets</b>                                   | 3,401           | 804           | 709          | 325           | 314              | 957     | 703       | 7,213 |
| <b>Other segment items</b>                            |                 |               |              |               |                  |         |           |       |
| Share of results of joint ventures and associates     |                 | 6             | 1            | 17            |                  |         |           | 24    |
| Capital expenditure                                   | 141             | 71            | 30           | 19            | 20               | 38      |           | 319   |
| Depreciation                                          | 15              | 14            | 19           | 9             | 13               | 7       |           | 77    |

|              |     |    |    |   |   |    |     |
|--------------|-----|----|----|---|---|----|-----|
| Amortisation | 136 | 59 | 21 | 4 | 7 | 34 | 261 |
|--------------|-----|----|----|---|---|----|-----|

In 2008, sales from the provision of goods were £3,411m (2007: £3,053m; 2006: £2,996m) and sales from the provision of services were £1,400m (2007: £1,109m; 2006: £994m). Sales from the Group's educational publishing, consumer publishing and newspaper business are classified as being from the provision of goods and sales from its assessment and testing, market pricing, corporate training and management service businesses are classified as being from the provision of services.

Corporate costs are allocated to business segments on an appropriate basis depending on the nature of the cost and therefore the segment result is equal to the Group operating profit. Inter-segment pricing is determined on an arm's-length basis. Segment assets consist of property, plant and equipment, intangible assets, inventories, receivables, retirement benefit assets and deferred taxation and exclude cash and cash equivalents and derivative assets. Corporate assets comprise cash and cash equivalents, marketable securities and derivative financial instruments. Capital expenditure comprises additions to property, plant and equipment and intangible assets, including pre-publication but excluding goodwill (see notes 10, 11 and 20).

Property, plant and equipment and intangible assets acquired through business combination were £253m (2007: £226m) (see note 30). Capital expenditure, depreciation and amortisation include amounts relating to discontinued operations. Discontinued operations relate to the Data Management business in 2008 and to the Data Management business, Government Solutions, Datamark and Les Echos in 2007 (see note 3).

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The Group operates in the following main geographic areas:

|                                | 2008                      | Sales<br>2007 | 2006  | Non-current assets<br>2008 | 2007  | 2006  |
|--------------------------------|---------------------------|---------------|-------|----------------------------|-------|-------|
|                                | All figures in £ millions |               |       |                            |       |       |
| <b>Continuing operations</b>   |                           |               |       |                            |       |       |
| UK                             | <b>754</b>                | 721           | 659   | <b>701</b>                 | 724   | 545   |
| Other European countries       | <b>463</b>                | 381           | 344   | <b>224</b>                 | 140   | 142   |
| USA                            | <b>2,861</b>              | 2,448         | 2,443 | <b>4,624</b>               | 3,146 | 3,115 |
| Canada                         | <b>167</b>                | 143           | 142   | <b>209</b>                 | 183   | 163   |
| Asia Pacific                   | <b>415</b>                | 351           | 295   | <b>179</b>                 | 114   | 97    |
| Other countries                | <b>151</b>                | 118           | 107   | <b>14</b>                  | 11    | 11    |
| <b>Total continuing</b>        | <b>4,811</b>              | 4,162         | 3,990 | <b>5,951</b>               | 4,318 | 4,073 |
| <b>Discontinued operations</b> |                           |               |       |                            |       |       |
| UK                             |                           | 1             | 17    |                            |       |       |
| Other European countries       |                           | 82            | 86    |                            |       |       |
| USA                            | <b>8</b>                  | 78            | 314   |                            | 117   | 294   |
| Canada                         |                           |               |       |                            |       |       |
| Other countries                |                           | 6             | 16    |                            |       |       |
| <b>Total discontinued</b>      | <b>8</b>                  | 167           | 433   |                            | 117   | 294   |
| <b>Total</b>                   | <b>4,819</b>              | 4,329         | 4,423 | <b>5,951</b>               | 4,435 | 4,367 |

Sales are allocated based on the country in which the customer is located. This does not differ materially from the location where the order is received. Non-current assets are based on the subsidiaries country of domicile. This is not materially different to the location of the assets. Non-current assets comprise property, plant and equipment, intangible assets, investments in joint ventures and associates, other receivables and non-current assets classified as held for sale.

**3. Discontinued operations**

Discontinued operations relate to the Group's interest in Government Solutions (sold on 15 February 2007), Datamark (sold on 31 July 2007), Les Echos (sold on 24 December 2007) and the Data Management business (sold on 22 February 2008).

The results of the Data Management business (previously included in the Professional segment) have been included in discontinued operations for 2006, 2007 and 2008. In anticipation of the loss on sale, an impairment to held for sale goodwill was charged to the income statement in 2007. The assets and liabilities of the Data Management business were reported as held for sale in the 31 December 2007 balance sheet.

The results of Government Solutions (previously included in the Professional segment) and Les Echos (previously included in the FT Publishing segment) were included in discontinued operations for 2006 and 2007 and were consolidated up to the date of sale.

Datamark was sold immediately following its acquisition as part of the eCollege transaction and consequently none of the results for this business were consolidated.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

An analysis of the results and cash flows of discontinued operations are as follows:

|                                                        | <b>2008<br/>Data<br/>Management<br/>All figures<br/>in £ millions</b> |
|--------------------------------------------------------|-----------------------------------------------------------------------|
| Sales                                                  | <b>8</b>                                                              |
| Operating profit                                       |                                                                       |
| <b>Profit before tax</b>                               |                                                                       |
| Attributable tax expense                               |                                                                       |
| <b>Profit after tax</b>                                |                                                                       |
| Loss on disposal of discontinued operations before tax | <b>(53)</b>                                                           |
| Attributable tax expense                               | <b>(37)</b>                                                           |
| <b>Loss for the year from discontinued operations</b>  | <b>(90)</b>                                                           |
| Operating cash flows                                   |                                                                       |
| Investing cash flows                                   |                                                                       |
| Financing cash flows                                   |                                                                       |
| <b>Total cash flows</b>                                |                                                                       |

|                                 | <b>2007</b>                      |              |                   |                  |              |
|---------------------------------|----------------------------------|--------------|-------------------|------------------|--------------|
|                                 | <b>Data</b>                      | <b>Les</b>   | <b>Government</b> |                  |              |
|                                 | <b>Management</b>                | <b>Echos</b> | <b>Datamark</b>   | <b>Solutions</b> | <b>Total</b> |
|                                 | <b>All figures in £ millions</b> |              |                   |                  |              |
| Sales                           | 56                               | 82           |                   | 29               | 167          |
| Operating profit                | 12                               | 1            |                   | 2                | 15           |
| Goodwill impairment             | (97)                             |              |                   |                  | (97)         |
| <b>(Loss)/profit before tax</b> | <b>(85)</b>                      | <b>1</b>     |                   | <b>2</b>         | <b>(82)</b>  |
| Attributable tax expense        | (4)                              |              |                   | (1)              | (5)          |



|                                                                 |             |            |          |              |             |
|-----------------------------------------------------------------|-------------|------------|----------|--------------|-------------|
| <b>(Loss)/profit after tax</b>                                  | <b>(89)</b> | <b>1</b>   |          | <b>1</b>     | <b>(87)</b> |
| Profit/(loss) on disposal of discontinued operations before tax |             | 165        |          | (19)         | 146         |
| Attributable tax (expense)/benefit                              |             |            | 7        | (93)         | (86)        |
| <b>(Loss)/profit for the year from discontinued operations</b>  | <b>(89)</b> | <b>166</b> | <b>7</b> | <b>(111)</b> | <b>(27)</b> |
| Operating cash flows                                            | 11          | 4          |          | (8)          | 7           |
| Investing cash flows                                            | (1)         | 4          |          |              | 3           |
| Financing cash flows                                            | (10)        | (7)        |          | (4)          | (21)        |
| <b>Total cash flows</b>                                         |             | <b>1</b>   |          | <b>(12)</b>  | <b>(11)</b> |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

|                                                          | <b>Government</b>                | <b>2006<br/>Data</b> |                      | <b>Total</b> |
|----------------------------------------------------------|----------------------------------|----------------------|----------------------|--------------|
|                                                          | <b>Solutions</b>                 | <b>Management</b>    | <b>Les<br/>Echos</b> |              |
|                                                          | <b>All figures in £ millions</b> |                      |                      |              |
| Sales                                                    | 286                              | 61                   | 86                   | 433          |
| Operating profit                                         | 22                               | 13                   | 5                    | 40           |
| <b>Profit before tax</b>                                 | <b>22</b>                        | <b>13</b>            | <b>5</b>             | <b>40</b>    |
| Attributable tax expense                                 | (8)                              | (5)                  | (2)                  | (15)         |
| <b>Profit after tax</b>                                  | <b>14</b>                        | <b>8</b>             | <b>3</b>             | <b>25</b>    |
| Profit on disposal of discontinued operations before tax |                                  |                      |                      |              |
| Attributable tax (expense)/benefit                       |                                  |                      |                      |              |
| <b>Profit for the year from discontinued operations</b>  | <b>14</b>                        | <b>8</b>             | <b>3</b>             | <b>25</b>    |
| Operating cash flows                                     | 20                               | 9                    | 4                    | 33           |
| Investing cash flows                                     | (8)                              | (2)                  |                      | (10)         |
| Financing cash flows                                     | (1)                              | (7)                  | (7)                  | (15)         |
| <b>Total cash flows</b>                                  | <b>11</b>                        |                      | <b>(3)</b>           | <b>8</b>     |

**4. Operating expenses**

|                                   | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|-----------------------------------|----------------------------------|-------------|-------------|
|                                   | <b>All figures in £ millions</b> |             |             |
| <b>By function:</b>               |                                  |             |             |
| Cost of goods sold                | <b>2,174</b>                     | 1,910       | 1,841       |
| <b>Operating expenses</b>         |                                  |             |             |
| Distribution costs                | <b>198</b>                       | 202         | 232         |
| Administrative and other expenses | <b>1,890</b>                     | 1,600       | 1,518       |
| Other income                      | <b>(102)</b>                     | (101)       | (99)        |
| <b>Total operating expenses</b>   | <b>1,986</b>                     | 1,701       | 1,651       |
| <b>Total</b>                      | <b>4,160</b>                     | 3,611       | 3,492       |



**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

|                                                   | Notes | 2008         | 2007         | 2006         |
|---------------------------------------------------|-------|--------------|--------------|--------------|
| All figures in £ millions                         |       |              |              |              |
| <b>By nature:</b>                                 |       |              |              |              |
| Utilisation of inventory                          | 21    | 832          | 732          | 702          |
| Depreciation of property, plant and equipment     | 10    | 80           | 65           | 68           |
| Amortisation of intangible assets Pre-publication | 20    | 244          | 192          | 210          |
| Amortisation of intangible assets Other           | 11    | 116          | 70           | 48           |
| Employee benefit expense                          | 5     | 1,553        | 1,288        | 1,225        |
| Operating lease rentals                           |       | 134          | 129          | 122          |
| Other property costs                              |       | 116          | 122          | 121          |
| Royalties expensed                                |       | 415          | 365          | 360          |
| Advertising, promotion and marketing              |       | 244          | 195          | 190          |
| Information technology costs                      |       | 76           | 70           | 71           |
| Other costs                                       |       | 452          | 484          | 474          |
| Other income                                      |       | (102)        | (101)        | (99)         |
| <b>Total</b>                                      |       | <b>4,160</b> | <b>3,611</b> | <b>3,492</b> |

During the year the Group obtained the following services from the Group's auditor:

|                                                                                                             | 2008     | 2007     | 2006      |
|-------------------------------------------------------------------------------------------------------------|----------|----------|-----------|
| All figures in £ millions                                                                                   |          |          |           |
| Fees payable to the company's auditor for the audit of parent company and consolidated financial statements | 3        | 3        | 5         |
| The audit of the company's subsidiaries pursuant to legislation                                             | 2        | 1        | 4         |
| Tax services                                                                                                | 2        | 2        | 1         |
| Other services                                                                                              | 1        | 1        | 1         |
| <b>Total</b>                                                                                                | <b>8</b> | <b>7</b> | <b>11</b> |

Reconciliation between audit and non-audit service fees is shown below:

|                                                                                             | 2008 | 2007 | 2006 |
|---------------------------------------------------------------------------------------------|------|------|------|
| All figures in £ millions                                                                   |      |      |      |
| Group audit fees including fees for attestation under section 404 of the Sarbanes-Oxley Act | 5    | 4    | 9    |
| Non-audit fees                                                                              | 3    | 3    | 2    |

|              |          |          |           |
|--------------|----------|----------|-----------|
| <b>Total</b> | <b>8</b> | <b>7</b> | <b>11</b> |
|--------------|----------|----------|-----------|

Fees for attestation under section 404 of the Sarbanes-Oxley Act are allocated between fees payable for the audits of consolidated and subsidiary accounts.

Tax services include services related to tax planning and various other tax advisory matters.

Other services include due diligence on acquisitions and services related to the disposal of the Data Management business.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****5. Employee information**

|                                                                             | Notes | 2008         | 2007         | 2006         |
|-----------------------------------------------------------------------------|-------|--------------|--------------|--------------|
| All figures in £ millions                                                   |       |              |              |              |
| <b>Employee benefit expense</b>                                             |       |              |              |              |
| Wages and salaries (including termination benefits and restructuring costs) |       | 1,317        | 1,087        | 1,035        |
| Social security costs                                                       |       | 119          | 100          | 101          |
| Share-based payment costs                                                   | 26    | 33           | 30           | 25           |
| Pension costs – defined contribution plans                                  | 25    | 41           | 39           | 36           |
| Pension costs – defined benefit plans                                       | 25    | 37           | 31           | 29           |
| Other post-retirement benefits                                              | 25    | 6            | 1            | (1)          |
|                                                                             |       | <b>1,553</b> | <b>1,288</b> | <b>1,225</b> |

The details of the emoluments of the directors of Pearson plc are shown in the report on directors' remuneration.

|                                | 2008          | 2007          | 2006          |
|--------------------------------|---------------|---------------|---------------|
| Average number employed        |               |               |               |
| <b>Employee numbers</b>        |               |               |               |
| North American Education       | 15,412        | 14,327        | 12,710        |
| International Education        | 5,718         | 5,291         | 4,472         |
| Professional                   | 2,641         | 2,540         | 2,223         |
| FT Publishing                  | 2,379         | 2,083         | 1,766         |
| Interactive Data               | 2,413         | 2,300         | 2,200         |
| Penguin                        | 4,112         | 4,163         | 3,943         |
| Other                          | 909           | 918           | 900           |
| <b>Continuing operations</b>   | <b>33,584</b> | <b>31,622</b> | <b>28,214</b> |
| <b>Discontinued operations</b> | <b>96</b>     | <b>1,070</b>  | <b>6,127</b>  |
|                                | <b>33,680</b> | <b>32,692</b> | <b>34,341</b> |

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****6. Net finance costs**

|                                                                      | Notes | 2008         | 2007         | 2006         |
|----------------------------------------------------------------------|-------|--------------|--------------|--------------|
| All figures in £ millions                                            |       |              |              |              |
| Interest payable                                                     |       | (106)        | (114)        | (117)        |
| Net foreign exchange losses                                          |       | (11)         | (25)         | (2)          |
| Other losses on financial instruments in a hedging relationship:     |       |              |              |              |
| fair value hedges                                                    |       | (7)          | (1)          |              |
| net investment hedges                                                |       |              | (1)          | (2)          |
| Other losses on financial instruments not in a hedging relationship: |       |              |              |              |
| derivatives                                                          |       | (12)         | (9)          | (12)         |
| <b>Finance costs</b>                                                 |       | <b>(136)</b> | <b>(150)</b> | <b>(133)</b> |
| Interest receivable                                                  |       | 17           | 19           | 23           |
| Finance income in respect of employee benefits                       | 25    | 8            | 10           | 4            |
| Net foreign exchange gains                                           |       |              | 8            | 21           |
| Other gains on financial instruments in a hedging relationship:      |       |              |              |              |
| fair value hedges                                                    |       | 2            |              |              |
| net investment hedges                                                |       | 1            |              |              |
| Other gains on financial instruments not in a hedging relationship:  |       |              |              |              |
| amortisation of transitional adjustment on bonds                     |       | 1            | 1            | 8            |
| derivatives                                                          |       | 16           | 6            | 3            |
| <b>Finance income</b>                                                |       | <b>45</b>    | <b>44</b>    | <b>59</b>    |
| <b>Net finance costs</b>                                             |       | <b>(91)</b>  | <b>(106)</b> | <b>(74)</b>  |

The £5m (2007: £1m) net loss on fair value hedges comprises a £156m (2007: £20m) loss on the underlying bonds offset by a £151m (2007: £19m) gain on the related derivative financial instruments.

**7. Income tax**

|                                                       | Notes | 2008        | 2007        | 2006        |
|-------------------------------------------------------|-------|-------------|-------------|-------------|
| All figures in £ millions                             |       |             |             |             |
| <b>Current tax</b>                                    |       |             |             |             |
| Charge in respect of current year                     |       | (89)        | (71)        | (81)        |
| Recognition of previously unrecognised trading losses |       |             |             | 23          |
| Other adjustments in respect of prior years           |       | 10          | 27          | 35          |
| <b>Total current tax charge</b>                       |       | <b>(79)</b> | <b>(44)</b> | <b>(23)</b> |

|                                                       |    |       |       |      |
|-------------------------------------------------------|----|-------|-------|------|
| <b>Deferred tax</b>                                   |    |       |       |      |
| In respect of timing differences                      |    | (97)  | (96)  | (73) |
| Recognition of previously unrecognised capital losses |    |       |       | 76   |
| Recognition of previously unrecognised trading losses |    |       |       | 37   |
| Other adjustments in respect of prior years           |    | 4     | 9     | (21) |
| <b>Total deferred tax charge</b>                      | 13 | (93)  | (87)  | 19   |
| <b>Total tax charge</b>                               |    | (172) | (131) | (4)  |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the UK tax rate as follows:

|                                                        | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|--------------------------------------------------------|----------------------------------|-------------|-------------|
|                                                        | <b>All figures in £ millions</b> |             |             |
| Profit before tax                                      | <b>585</b>                       | 468         | 448         |
| Tax calculated at UK rate (2008: 28.5%, 2007: 30%)     | <b>(167)</b>                     | (141)       | (135)       |
| Effect of overseas tax rates                           | <b>(29)</b>                      | (25)        | (17)        |
| Joint venture and associate income reported net of tax | <b>7</b>                         | 7           | 7           |
| Net expense not deductible for tax purposes            | <b>(1)</b>                       | (9)         | (13)        |
| Utilisation of previously unrecognised tax losses      | <b>4</b>                         | 3           | 7           |
| Recognition of previously unrecognised tax losses      |                                  |             | 136         |
| Unutilised tax losses                                  |                                  | (2)         | (3)         |
| Prior year adjustments                                 | <b>14</b>                        | 36          | 14          |
| <b>Total tax charge</b>                                | <b>(172)</b>                     | (131)       | (4)         |
| UK                                                     | <b>(53)</b>                      | (42)        | (15)        |
| Overseas                                               | <b>(119)</b>                     | (89)        | 11          |
| <b>Total tax charge</b>                                | <b>(172)</b>                     | (131)       | (4)         |

The tax benefit on items charged to equity is as follows:

|                                                                   | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|-------------------------------------------------------------------|----------------------------------|-------------|-------------|
|                                                                   | <b>All figures in £ millions</b> |             |             |
| Share-based payments                                              | <b>(7)</b>                       | 7           | 2           |
| Pension contributions and actuarial gains and losses              | <b>10</b>                        | 28          | 9           |
| Net investment hedges and other foreign exchange gains and losses | <b>(1)</b>                       | (6)         | 1           |
|                                                                   | <b>2</b>                         | 29          | 12          |

**8. Earnings per share****Basic**

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the company and held as treasury shares.



**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****Diluted**

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares to take account of all dilutive potential ordinary shares and adjusting the profit attributable, if applicable, to account for any tax consequences that might arise from conversion of those shares.

|                                                                       | Notes | 2008           | 2007   | 2006  |
|-----------------------------------------------------------------------|-------|----------------|--------|-------|
| <b>All figures in £ millions</b>                                      |       |                |        |       |
| Profit for the year from continuing operations                        |       | <b>413</b>     | 337    | 444   |
| Minority interest                                                     |       | <b>(31)</b>    | (26)   | (23)  |
| <b>Earnings from continuing operations</b>                            |       | <b>382</b>     | 311    | 421   |
| (Loss)/profit for the year from discontinued operations               | 3     | <b>(90)</b>    | (27)   | 25    |
| <b>Earnings</b>                                                       |       | <b>292</b>     | 284    | 446   |
| Weighted average number of shares (millions)                          |       | <b>797.0</b>   | 796.8  | 798.4 |
| Effect of dilutive share options (millions)                           |       | <b>0.5</b>     | 1.3    | 1.5   |
| Weighted average number of shares (millions) for diluted earnings     |       | <b>797.5</b>   | 798.1  | 799.9 |
| <b>Earnings per share from continuing and discontinued operations</b> |       |                |        |       |
| Basic                                                                 |       | <b>36.6p</b>   | 35.6p  | 55.9p |
| Diluted                                                               |       | <b>36.6p</b>   | 35.6p  | 55.8p |
| <b>Earnings per share from continuing operations</b>                  |       |                |        |       |
| Basic                                                                 |       | <b>47.9p</b>   | 39.0p  | 52.7p |
| Diluted                                                               |       | <b>47.9p</b>   | 39.0p  | 52.6p |
| <b>Earnings per share from discontinued operations</b>                |       |                |        |       |
| Basic                                                                 |       | <b>(11.3p)</b> | (3.4p) | 3.2p  |

**9. Dividends**

|                                                                          | 2008 | 2007 | 2006 |
|--------------------------------------------------------------------------|------|------|------|
| <b>All figures in £ millions</b>                                         |      |      |      |
| Final paid in respect of prior year 20.5p (2007: 18.8p; 2006: 17p)       | 163  | 150  | 136  |
| Interim paid in respect of current year 11.8p (2007: 11.1p; 2006: 10.5p) | 94   | 88   | 84   |
|                                                                          | 257  | 238  | 220  |

The directors are proposing a final dividend in respect of the financial year ended 31 December 2008 of 22p per share which will absorb an estimated £176m of shareholders' funds. It will be paid on 8 May 2009 to shareholders who are on the register of members on 14 April 2009. These financial statements do not reflect this dividend.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****10. Property, plant and equipment**

|                                              | <b>Land<br/>and<br/>buildings</b> | <b>Plant and<br/>equipment</b> | <b>Assets in<br/>course of<br/>construction</b> | <b>Total</b> |
|----------------------------------------------|-----------------------------------|--------------------------------|-------------------------------------------------|--------------|
|                                              | <b>All figures in £ millions</b>  |                                |                                                 |              |
| <b>Cost</b>                                  |                                   |                                |                                                 |              |
| At 1 January 2007                            | 313                               | 631                            | 11                                              | 955          |
| Exchange differences                         | (2)                               |                                |                                                 | (2)          |
| Additions                                    | 20                                | 62                             | 11                                              | 93           |
| Disposals                                    | (24)                              | (65)                           |                                                 | (89)         |
| Acquisition through business combination     |                                   | 27                             |                                                 | 27           |
| Disposal through business disposal           | (1)                               | (25)                           |                                                 | (26)         |
| Reclassifications                            |                                   | 6                              | (6)                                             |              |
| Transfer to non-current assets held for sale | (8)                               | (14)                           |                                                 | (22)         |
| <b>At 31 December 2007</b>                   | <b>298</b>                        | <b>622</b>                     | <b>16</b>                                       | <b>936</b>   |
| Exchange differences                         | 54                                | 138                            | 6                                               | 198          |
| Additions                                    | 6                                 | 67                             | 6                                               | 79           |
| Disposals                                    | (7)                               | (38)                           |                                                 | (45)         |
| Acquisition through business combination     | 2                                 | 29                             | 2                                               | 33           |
| Reclassifications                            | 2                                 | 21                             | (23)                                            |              |
| <b>At 31 December 2008</b>                   | <b>355</b>                        | <b>839</b>                     | <b>7</b>                                        | <b>1,201</b> |

|                                              | <b>Land<br/>and<br/>buildings</b> | <b>Plant and<br/>equipment</b> | <b>Assets in<br/>course of<br/>construction</b> | <b>Total</b> |
|----------------------------------------------|-----------------------------------|--------------------------------|-------------------------------------------------|--------------|
|                                              | <b>All figures in £ millions</b>  |                                |                                                 |              |
| <b>Depreciation</b>                          |                                   |                                |                                                 |              |
| At 1 January 2007                            | (128)                             | (479)                          |                                                 | (607)        |
| Exchange differences                         |                                   | 1                              |                                                 | 1            |
| Charge for the year                          | (14)                              | (54)                           |                                                 | (68)         |
| Disposals                                    | 11                                | 63                             |                                                 | 74           |
| Acquisition through business combination     |                                   | (16)                           |                                                 | (16)         |
| Disposal through business disposal           |                                   | 20                             |                                                 | 20           |
| Transfer to non-current assets held for sale | 5                                 | 10                             |                                                 | 15           |
| <b>At 31 December 2007</b>                   | <b>(126)</b>                      | <b>(455)</b>                   |                                                 | <b>(581)</b> |

|                                          |              |              |          |              |
|------------------------------------------|--------------|--------------|----------|--------------|
| Exchange differences                     | (30)         | (102)        |          | (132)        |
| Charge for the year                      | (19)         | (61)         |          | (80)         |
| Disposals                                | 6            | 36           |          | 42           |
| Acquisition through business combination | (1)          | (26)         |          | (27)         |
| <b>At 31 December 2008</b>               | <b>(170)</b> | <b>(608)</b> |          | <b>(778)</b> |
| <b>Carrying amounts</b>                  |              |              |          |              |
| At 1 January 2007                        | 185          | 152          | 11       | 348          |
| At 31 December 2007                      | 172          | 167          | 16       | 355          |
| <b>At 31 December 2008</b>               | <b>185</b>   | <b>231</b>   | <b>7</b> | <b>423</b>   |

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

Depreciation expense of £12m (2007: £13m) has been included in the income statement in cost of goods sold, £6m (2007: £5m) in distribution expenses and £61m (2007: £50m) in administrative and other expenses. There was no depreciation expense relating to discontinued operations in 2008 (2007: £3m).

The Group leases certain equipment under a number of finance lease agreements. The net carrying amount of leased plant and equipment included within property, plant and equipment was £7m (2007: £6m).

**11. Intangible assets**

|                                              | Goodwill                  | Software    | Acquired<br>customer<br>lists &<br>relationships<br>&<br>brands | Acquired<br>trademarks<br>&<br>publishing<br>rights | Other<br>intangibles<br>acquired | Total        |
|----------------------------------------------|---------------------------|-------------|-----------------------------------------------------------------|-----------------------------------------------------|----------------------------------|--------------|
|                                              | All figures in £ millions |             |                                                                 |                                                     |                                  |              |
| <b>Cost</b>                                  |                           |             |                                                                 |                                                     |                                  |              |
| At 1 January 2007                            | 3,271                     | 201         | 113                                                             | 26                                                  | 96                               | 3,760        |
| Exchange differences                         | (4)                       | (2)         |                                                                 | 1                                                   | 3                                | (2)          |
| Additions internal development               |                           | 20          |                                                                 |                                                     |                                  | 20           |
| Additions purchased                          |                           | 13          |                                                                 |                                                     |                                  | 13           |
| Disposals                                    | (34)                      | (19)        | (2)                                                             |                                                     | (3)                              | (56)         |
| Acquisition through business combination     | 304                       | 4           | 76                                                              | 35                                                  | 40                               | 503          |
| Transfer to non-current assets held for sale | (194)                     |             |                                                                 |                                                     |                                  | (194)        |
| <b>At 31 December 2007</b>                   | <b>3,343</b>              | <b>217</b>  | <b>187</b>                                                      | <b>62</b>                                           | <b>136</b>                       | <b>4,044</b> |
| Exchange differences                         | <b>1,082</b>              | <b>71</b>   | <b>77</b>                                                       | <b>24</b>                                           | <b>31</b>                        | <b>1,347</b> |
| Additions internal development               |                           | <b>29</b>   |                                                                 |                                                     |                                  | <b>29</b>    |
| Additions purchased                          |                           | <b>16</b>   |                                                                 |                                                     |                                  | <b>16</b>    |
| Disposals                                    | <b>(8)</b>                | <b>(27)</b> |                                                                 |                                                     |                                  | <b>(35)</b>  |
| Acquisition through business combination     | <b>153</b>                | <b>17</b>   | <b>77</b>                                                       | <b>42</b>                                           | <b>97</b>                        | <b>386</b>   |
| Disposal through business disposal           |                           | <b>(1)</b>  |                                                                 |                                                     | <b>(2)</b>                       | <b>(3)</b>   |
| Transfer to Pre-publication                  |                           | <b>(12)</b> |                                                                 |                                                     |                                  | <b>(12)</b>  |
| <b>At 31 December 2008</b>                   | <b>4,570</b>              | <b>310</b>  | <b>341</b>                                                      | <b>128</b>                                          | <b>165</b>                       | <b>5,772</b> |

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

|                                              | <b>Goodwill</b> | <b>Software</b> | <b>Acquired customer lists &amp; relationships</b> | <b>Acquired trademarks &amp; brands</b> | <b>Acquired publishing rights</b> | <b>Other intangibles acquired</b> | <b>Total</b> |
|----------------------------------------------|-----------------|-----------------|----------------------------------------------------|-----------------------------------------|-----------------------------------|-----------------------------------|--------------|
| <b>Amortisation</b>                          |                 |                 |                                                    |                                         |                                   |                                   |              |
| At 1 January 2007                            |                 | (135)           | (15)                                               | (1)                                     | (15)                              | (13)                              | (179)        |
| Exchange differences                         |                 | 1               |                                                    |                                         |                                   | 1                                 | 2            |
| Charge for the year                          |                 | (25)            | (13)                                               | (3)                                     | (17)                              | (12)                              | (70)         |
| Disposals                                    |                 | 19              |                                                    |                                         |                                   |                                   | 19           |
| Acquisition through business combination     |                 | (2)             |                                                    |                                         |                                   |                                   | (2)          |
| Transfer to non-current assets held for sale |                 |                 |                                                    |                                         |                                   |                                   |              |
| <b>At 31 December 2007</b>                   |                 | <b>(142)</b>    | <b>(28)</b>                                        | <b>(4)</b>                              | <b>(32)</b>                       | <b>(24)</b>                       | <b>(230)</b> |
| Exchange differences                         |                 | <b>(50)</b>     | <b>(15)</b>                                        | <b>(3)</b>                              | <b>(13)</b>                       | <b>(12)</b>                       | <b>(93)</b>  |
| Charge for the year                          |                 | <b>(30)</b>     | <b>(24)</b>                                        | <b>(10)</b>                             | <b>(25)</b>                       | <b>(27)</b>                       | <b>(116)</b> |
| Disposals                                    |                 | <b>27</b>       |                                                    |                                         |                                   |                                   | <b>27</b>    |
| Acquisition through business combination     |                 | <b>(13)</b>     |                                                    |                                         |                                   |                                   | <b>(13)</b>  |
| Disposal through business disposal           |                 | <b>1</b>        |                                                    |                                         | <b>1</b>                          |                                   | <b>2</b>     |
| Transfer to Pre-publication                  |                 | <b>4</b>        |                                                    |                                         |                                   |                                   | <b>4</b>     |
| <b>At 31 December 2008</b>                   |                 | <b>(203)</b>    | <b>(67)</b>                                        | <b>(17)</b>                             | <b>(69)</b>                       | <b>(63)</b>                       | <b>(419)</b> |
| <b>Carrying amounts</b>                      |                 |                 |                                                    |                                         |                                   |                                   |              |
| At 1 January 2007                            | 3,271           | 66              | 98                                                 | 25                                      | 81                                | 40                                | 3,581        |
| At 31 December 2007                          | 3,343           | 75              | 159                                                | 58                                      | 104                               | 75                                | 3,814        |
| <b>At 31 December 2008</b>                   | <b>4,570</b>    | <b>107</b>      | <b>274</b>                                         | <b>111</b>                              | <b>96</b>                         | <b>195</b>                        | <b>5,353</b> |

**Goodwill**

The goodwill carrying value of £4,570m relates to acquisitions completed after 1 January 1998. Prior to 1 January 1998 all goodwill was written off to reserves on the date of acquisition. £3,309m of the carrying value relates to acquisitions completed between 1 January 1998 and 31 December 2002 and £1,261m relates to acquisitions completed after 1 January 2003 (the date of transition to IFRS).

For acquisitions completed between 1 January 1998 and 31 December 2002 no value was ascribed to intangibles other than goodwill and the goodwill on each acquisition was amortised over a period of up to 20 years. On adoption of IFRS on 1 January 2003, the Group chose not to restate the goodwill balance and at that date the balance was frozen



(i.e. amortisation ceased). If goodwill had been restated then a significant value would have been ascribed to other intangible assets, which would be subject to amortisation, and the carrying value of goodwill would be significantly lower.

For acquisitions completed after 1 January 2003 value has been ascribed to other intangible assets, which are amortised, with only the remaining difference between the purchase price and the fair value of net assets acquired being allocated to goodwill.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****Other intangible assets**

Other intangibles acquired include content, technology and software rights. Amortisation of £5m (2007: £3m) is included in the income statement in cost of goods sold and £111m (2007: £67m) in administrative and other expenses.

Impairment tests for cash-generating units containing goodwill Impairment tests have been carried out where appropriate as described below. The recoverable amount for each unit tested exceeds its carrying value.

Goodwill is allocated to 14 cash-generating units (CGUs) within the business segments as follows:

|                                                | Notes | 2008                         | 2007         |
|------------------------------------------------|-------|------------------------------|--------------|
|                                                |       | All figures in<br>£ millions |              |
| US School Curriculum                           |       | 937                          | 677          |
| US School Assessment and Information           |       | 722                          | 414          |
| US Higher Education                            |       | 1,164                        | 839          |
| Canada                                         |       | 173                          | 155          |
| International Education Publishing             |       | 315                          | 270          |
| International Education Assessment and Testing |       | 241                          | 194          |
| Professional Publishing                        |       | 15                           | 10           |
| Professional Assessment and Testing            |       | 254                          | 181          |
| <b>Pearson Education total</b>                 |       | <b>3,821</b>                 | <b>2,740</b> |
| Financial Times                                |       | 46                           | 12           |
| Mergermarket                                   |       | 130                          | 126          |
| Interactive Data                               |       | 208                          | 147          |
| FT Group total                                 |       | 384                          | 285          |
| Penguin US                                     |       | 216                          | 155          |
| Penguin UK                                     |       | 95                           | 111          |
| Pearson Australia                              |       | 54                           | 52           |
| <b>Penguin total</b>                           |       | <b>365</b>                   | <b>318</b>   |
| <b>Total goodwill continuing operations</b>    |       | <b>4,570</b>                 | <b>3,343</b> |
| Goodwill held for sale                         | 31    |                              | 96           |
| <b>Total goodwill</b>                          |       | <b>4,570</b>                 | <b>3,439</b> |

During 2008, after the change in organisational structure the CGUs were reorganised and goodwill reallocated to the units affected. The recoverable amount of each CGU is based on value in use calculations. Goodwill is tested for impairment annually. Other than goodwill there are no intangible assets with indefinite lives. The goodwill is generally denominated in the currency of the relevant cash flows and therefore the impairment review is not materially

sensitive to exchange rate fluctuations.

**Key assumptions**

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five-year period. The key assumptions used by management in the value in use calculations were:

***Discount rate*** The discount rate is based on the risk-free rate for government bonds, adjusted for a risk premium to reflect the increased risk in investing in equities. The risk premium adjustment is assessed for each specific CGU. The average pre-tax discount rates used are in the range of 10.2% to 11.7% for the Pearson

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

Education businesses (2007: 10.5% to 12.0%), 10.8% to 20.5% for the FT Group businesses (2007: 10.4% to 17.2%) and 8.8% to 10.4% for the Penguin businesses (2007: 8.9% to 11.7%).

**Perpetuity growth rates** The cash flows subsequent to the approved budget period are based upon the long-term historic growth rates of the underlying territories in which the CGU operates and reflect the long-term growth prospects of the sectors in which the CGU operates. A perpetuity growth rate of 2.0% was used for all CGUs in 2008 (a range from 2.5% to 3.5% in 2007). The perpetuity growth rates are consistent with appropriate external sources for the relevant markets.

**Cash flow growth rates** The cash flow growth rates are derived from management's latest estimates of forecast sales taking into consideration past experience of operating margins achieved in the CGU. Historically, such forecasts have been reasonably accurate.

**Sensitivities**

The Group's impairment review is sensitive to a change in the key assumptions used, most notably the discount rates, the perpetuity growth rates and expected future cash flows. Based on the Group's sensitivity analysis, a reasonably possible change in the discount rate or perpetuity growth rate could cause an impairment in either the US School Curriculum or Penguin UK CGUs.

The fair value of US School Curriculum is 8% or approximately £77m above its carrying value, but an increase of 0.5 percentage points in the discount rate or a reduction of 0.6 percentage points in the perpetuity growth rate would cause the value in use to fall below the carrying value.

The fair value of Penguin UK is 24% or approximately £44m above its carrying value, but an increase of 1.4 percentage points in the discount rate or a reduction of 1.7 percentage points in the perpetuity growth rate would cause the value in use to fall below the carrying value.

**12. Investments in joint ventures and associates****Joint ventures**

|                                  | 2008                         | 2007      |
|----------------------------------|------------------------------|-----------|
|                                  | All figures in<br>£ millions |           |
| At beginning of year             | 11                           | 12        |
| Exchange differences             | (4)                          |           |
| Share of profit after tax        | 6                            | 4         |
| Dividends                        | (5)                          | (8)       |
| Additions and further investment | 5                            | 3         |
| <b>At end of year</b>            | <b>13</b>                    | <b>11</b> |

Investments in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost.

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The aggregate of the Group's share in its joint ventures, none of which are individually significant, are as follows:

|                                | <b>2008</b>                          | <b>2007</b> |
|--------------------------------|--------------------------------------|-------------|
|                                | <b>All figures in £<br/>millions</b> |             |
| <b>Assets</b>                  |                                      |             |
| Non-current assets             | <b>6</b>                             | 3           |
| Current assets                 | <b>21</b>                            | 23          |
| <b>Liabilities</b>             |                                      |             |
| Current liabilities            | <b>(14)</b>                          | (15)        |
| <b>Net assets</b>              | <b>13</b>                            | 11          |
| Income                         | <b>36</b>                            | 61          |
| Expenses                       | <b>(30)</b>                          | (57)        |
| <b>Profit after income tax</b> | <b>6</b>                             | 4           |

**Associates**

|                                                         | <b>2008</b>                          | <b>2007</b> |
|---------------------------------------------------------|--------------------------------------|-------------|
|                                                         | <b>All figures in £<br/>millions</b> |             |
| At beginning of year                                    | <b>9</b>                             | 8           |
| Exchange differences                                    | <b>(5)</b>                           | (1)         |
| Share of profit after tax                               | <b>19</b>                            | 19          |
| Dividends                                               | <b>(16)</b>                          | (24)        |
| Additions                                               |                                      | 1           |
| Distribution from associate in excess of carrying value | <b>6</b>                             | 6           |
| Actuarial losses on retirement benefit obligations      | <b>(3)</b>                           |             |
| <b>At end of year</b>                                   | <b>10</b>                            | 9           |

Investments in associates are accounted for using the equity method of accounting. There is no acquisition goodwill relating to the Group's investments in associates.

The Group's interests in its principal associates, all of which are unlisted, are as follows:

%

| <b>2008</b>                 | <b>Country of<br/>incorporation</b> | <b>Interest<br/>held</b> | <b>Assets</b>                    | <b>Liabilities</b> | <b>Revenues</b> | <b>Profit</b> |
|-----------------------------|-------------------------------------|--------------------------|----------------------------------|--------------------|-----------------|---------------|
|                             |                                     |                          | <b>All figures in £ millions</b> |                    |                 |               |
| The Economist Newspaper Ltd | England                             | <b>50</b>                | <b>86</b>                        | <b>(86)</b>        | <b>149</b>      | <b>16</b>     |
| Other                       |                                     |                          | <b>35</b>                        | <b>(25)</b>        | <b>42</b>       | <b>3</b>      |
| <b>Total</b>                |                                     |                          | <b>121</b>                       | <b>(111)</b>       | <b>191</b>      | <b>19</b>     |

| <b>2007</b>                 | <b>Country of<br/>incorporation</b> | <b>%<br/>Interest<br/>held</b> | <b>Assets</b>                    | <b>Liabilities</b> | <b>Revenues</b> | <b>Profit</b> |
|-----------------------------|-------------------------------------|--------------------------------|----------------------------------|--------------------|-----------------|---------------|
|                             |                                     |                                | <b>All figures in £ millions</b> |                    |                 |               |
| The Economist Newspaper Ltd | England                             | 50                             | 63                               | (63)               | 131             | 15            |
| Other                       |                                     |                                | 30                               | (21)               | 56              | 4             |
| <b>Total</b>                |                                     |                                | 93                               | (84)               | 187             | 19            |

The interest held in associates is equivalent to voting rights.

Table of Contents**Notes to the Consolidated Financial Statements (Continued)****13. Deferred income tax**

|                                                                         | <b>2008</b>                          | <b>2007</b> |
|-------------------------------------------------------------------------|--------------------------------------|-------------|
|                                                                         | <b>All figures in<br/>£ millions</b> |             |
| <b>Deferred income tax assets</b>                                       |                                      |             |
| Deferred income tax assets to be recovered after more than 12 months    | <b>341</b>                           | 262         |
| Deferred income tax assets to be recovered within 12 months             | <b>31</b>                            | 66          |
|                                                                         | <b>372</b>                           | 328         |
| <b>Deferred income tax liabilities</b>                                  |                                      |             |
| Deferred income tax liabilities to be settled after more than 12 months | <b>(447)</b>                         | (287)       |
| Deferred income tax liabilities to be settled within 12 months          |                                      |             |
|                                                                         | <b>(447)</b>                         | (287)       |
| <b>Net deferred income tax</b>                                          | <b>(75)</b>                          | 41          |

Deferred income tax assets to be recovered within 12 months relate to the utilisation of losses in the US.

Deferred income tax assets and liabilities may be offset when there is a legally enforceable right to offset current tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The Group has unrecognised deferred income tax assets at 31 December 2008 in respect of UK losses of £28m (2007: £34m). None of these unrecognised deferred income tax assets have expiry dates associated with them.

The recognition of the deferred income tax assets is supported by management's forecasts of the future profitability of the relevant business units.

The movement on the net deferred income tax account is as follows:

|                                          | <b>Notes</b> | <b>2008</b>                          | <b>2007</b> |
|------------------------------------------|--------------|--------------------------------------|-------------|
|                                          |              | <b>All figures in £<br/>millions</b> |             |
| At beginning of year                     |              | <b>41</b>                            | 172         |
| Exchange differences                     |              | <b>(12)</b>                          | (4)         |
| Income statement charge                  | 7            | <b>(93)</b>                          | (87)        |
| Acquisition through business combination | 30           | <b>(4)</b>                           | (45)        |
| Disposal through business disposal       | 32           |                                      | 2           |
| Tax (charge)/benefit to equity           |              | <b>(7)</b>                           | 3           |
| <b>At end of year</b>                    |              | <b>(75)</b>                          | 41          |
| Table of Contents                        |              |                                      | 200         |





**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The movement in deferred income tax assets and liabilities during the year is as follows:

|                                          | <b>Capital<br/>losses</b> | <b>Trading<br/>losses</b> | <b>Goodwill<br/>and<br/>intangibles<br/>All figures in £ millions</b> | <b>Returns<br/>provisions</b> | <b>Other</b> | <b>Total</b> |
|------------------------------------------|---------------------------|---------------------------|-----------------------------------------------------------------------|-------------------------------|--------------|--------------|
| <b>Deferred income tax assets</b>        |                           |                           |                                                                       |                               |              |              |
| At 1 January 2007                        | 76                        | 129                       | 25                                                                    | 66                            | 121          | 417          |
| Exchange differences                     |                           | (5)                       |                                                                       | (1)                           | (2)          | (8)          |
| Acquisition through business combination |                           | 10                        |                                                                       |                               | 1            | 11           |
| Income statement (charge)/benefit        | (76)                      | (47)                      | (5)                                                                   | 14                            | 19           | (95)         |
| Tax benefit to equity                    |                           |                           |                                                                       |                               | 3            | 3            |
| <b>At 31 December 2007</b>               |                           | <b>87</b>                 | <b>20</b>                                                             | <b>79</b>                     | <b>142</b>   | <b>328</b>   |
| Exchange differences                     |                           | <b>19</b>                 | <b>6</b>                                                              | <b>28</b>                     | <b>40</b>    | <b>93</b>    |
| Acquisition through business combination |                           | <b>2</b>                  |                                                                       |                               |              | <b>2</b>     |
| Income statement charge                  |                           | <b>(35)</b>               | <b>(6)</b>                                                            | <b>(1)</b>                    | <b>(3)</b>   | <b>(45)</b>  |
| Tax charge to equity                     |                           |                           |                                                                       |                               | <b>(6)</b>   | <b>(6)</b>   |
| <b>At 31 December 2008</b>               |                           | <b>73</b>                 | <b>20</b>                                                             | <b>106</b>                    | <b>173</b>   | <b>372</b>   |

Other deferred income tax assets include temporary differences on share-based payments, inventory, retirement benefit obligations and other provisions.

|                                          | <b>Goodwill<br/>and<br/>intangibles</b> | <b>Other</b> | <b>Total</b> |
|------------------------------------------|-----------------------------------------|--------------|--------------|
|                                          | <b>All figures in £ millions</b>        |              |              |
| <b>Deferred income tax liabilities</b>   |                                         |              |              |
| At 1 January 2007                        | (149)                                   | (96)         | (245)        |
| Exchange differences                     | 3                                       | 1            | 4            |
| Acquisition through business combination | (56)                                    |              | (56)         |
| Disposal through business disposal       |                                         | 2            | 2            |
| Income statement (charge)/benefit        | (12)                                    | 20           | 8            |
| Tax benefit to equity                    |                                         |              |              |
| <b>At 31 December 2007</b>               | <b>(214)</b>                            | <b>(73)</b>  | <b>(287)</b> |
| Exchange differences                     | <b>(73)</b>                             | <b>(32)</b>  | <b>(105)</b> |
| Acquisition through business combination | <b>(5)</b>                              | <b>(1)</b>   | <b>(6)</b>   |
| Income statement charge                  | <b>(26)</b>                             | <b>(22)</b>  | <b>(48)</b>  |

|                            |              |              |              |
|----------------------------|--------------|--------------|--------------|
| Tax charge to equity       |              | (1)          | (1)          |
| <b>At 31 December 2008</b> | <b>(318)</b> | <b>(129)</b> | <b>(447)</b> |

Other deferred income tax liabilities include temporary differences in respect of depreciation and royalty advances.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****14. Classification of financial instruments**

The accounting classification of each class of the Group's financial assets and financial liabilities, together with their fair values, is as follows:

|                                         | Notes | Fair value         |                                     |                                      | 2008                                 |                   | Total carrying value | Total market value |
|-----------------------------------------|-------|--------------------|-------------------------------------|--------------------------------------|--------------------------------------|-------------------|----------------------|--------------------|
|                                         |       | Available for sale | Derivatives deemed held for trading | Derivatives in hedging relationships | Amortised cost Loans and receivables | Other liabilities |                      |                    |
| All figures in £ millions               |       |                    |                                     |                                      |                                      |                   |                      |                    |
| Investments in unlisted securities      | 15    | 63                 |                                     |                                      |                                      |                   | 63                   | 63                 |
| Cash and cash equivalents               | 17    |                    |                                     |                                      | 685                                  |                   | 685                  | 685                |
| Marketable securities                   |       | 54                 |                                     |                                      |                                      |                   | 54                   | 54                 |
| Derivative financial instruments        | 16    |                    | 23                                  | 161                                  |                                      |                   | 184                  | 184                |
| Trade receivables                       | 22    |                    |                                     |                                      | 1,030                                |                   | 1,030                | 1,030              |
| <b>Total financial assets</b>           |       | <b>117</b>         | <b>23</b>                           | <b>161</b>                           | <b>1,715</b>                         |                   | <b>2,016</b>         | <b>2,016</b>       |
| Derivative financial instruments        | 16    |                    | (20)                                |                                      |                                      |                   | (20)                 | (20)               |
| Trade payables                          | 24    |                    |                                     |                                      |                                      | (450)             | (450)                | (450)              |
| Bank loans and overdrafts               | 18    |                    |                                     |                                      |                                      | (228)             | (228)                | (228)              |
| Borrowings due within one year          | 18    |                    |                                     |                                      |                                      | (248)             | (248)                | (247)              |
| Borrowings due after more than one year | 18    |                    |                                     |                                      |                                      | (1,887)           | (1,887)              | (1,620)            |
| <b>Total financial liabilities</b>      |       |                    | <b>(20)</b>                         |                                      |                                      | <b>(2,813)</b>    | <b>(2,833)</b>       | <b>(2,565)</b>     |

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

|                                         | Notes | 2007                     |                                                               |                                               |                                               | Total<br>carrying<br>value | Total<br>market<br>value |
|-----------------------------------------|-------|--------------------------|---------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------|----------------------------|--------------------------|
|                                         |       | Available<br>for<br>sale | Fair value<br>Derivatives<br>deemed<br>held<br>for<br>trading | Derivatives<br>in<br>hedging<br>relationships | Amortised cost<br>Loans<br>and<br>receivables |                            |                          |
| All figures in £ millions               |       |                          |                                                               |                                               |                                               |                            |                          |
| Investments in unlisted securities      | 15    | 52                       |                                                               |                                               |                                               | 52                         | 52                       |
| Cash and cash equivalents               | 17    |                          |                                                               |                                               | 560                                           | 560                        | 560                      |
| Marketable securities                   |       | 40                       |                                                               |                                               |                                               | 40                         | 40                       |
| Derivative financial instruments        | 16    |                          | 16                                                            | 35                                            |                                               | 51                         | 51                       |
| Trade receivables                       | 22    |                          |                                                               |                                               | 750                                           | 750                        | 750                      |
| <b>Total financial assets</b>           |       | 92                       | 16                                                            | 35                                            | 1,310                                         | 1,453                      | 1,453                    |
| Derivative financial instruments        | 16    |                          | (8)                                                           | (8)                                           |                                               | (16)                       | (16)                     |
| Trade payables                          | 24    |                          |                                                               |                                               |                                               | (342)                      | (342)                    |
| Bank loans and overdrafts               | 18    |                          |                                                               |                                               |                                               | (444)                      | (444)                    |
| Borrowings due within one year          | 18    |                          |                                                               |                                               |                                               | (115)                      | (112)                    |
| Borrowings due after more than one year | 18    |                          |                                                               |                                               |                                               | (1,049)                    | (1,046)                  |
| <b>Total financial liabilities</b>      |       |                          | (8)                                                           | (8)                                           |                                               | (1,950)                    | (1,960)                  |

Certain of the Group's derivative financial instruments are deemed to be held for trading either as they do not meet the hedge accounting criteria specified in IAS 39 or the Group has chosen not to seek hedge accounting for these instruments. None of these derivatives are held for speculative trading purposes. Transactions in derivative financial instruments are only undertaken to manage risks arising from underlying business activity, in accordance with the Group's treasury policy as described in note 19.

The Group designates certain qualifying derivative financial instruments as hedges of the fair value of its bonds (fair value hedges). Changes in the fair value of these derivative financial instruments are recorded in the income statement, together with any change in the fair value of the hedged liability attributable to the hedged risk.

The Group also designates certain of its borrowings and derivative financial instruments as hedges of its investments in foreign operations (net investment hedges). Movements in the fair value of these financial instruments (to the extent they are effective) are recognised in equity.

None of the Group's financial assets or liabilities are designated at fair value through the income statement upon initial recognition.

More detail on the Group's accounting for financial instruments is included in the Group's accounting policies. The Group's approach to managing risks in relation to financial instruments is included in note 19: Financial instruments and risk management.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****15. Other financial assets**

|                                                          | <b>2008</b>                          | <b>2007</b> |
|----------------------------------------------------------|--------------------------------------|-------------|
|                                                          | <b>All figures in<br/>£ millions</b> |             |
| At beginning of year                                     | <b>52</b>                            | 17          |
| Exchange differences                                     | <b>18</b>                            |             |
| Acquisition of investments                               | <b>1</b>                             |             |
| Disposal of investments                                  | <b>(8)</b>                           |             |
| Equity interest received on sale of Government Solutions |                                      | 35          |
| <b>At end of year</b>                                    | <b>63</b>                            | 52          |

Other financial assets comprise non-current unlisted securities.

**16. Derivative financial instruments**

The Group's approach to the management of financial risks is set out in note 19. The Group's outstanding derivative financial instruments are as follows:

|                                                                           | <b>2008</b>                           |               |                    | <b>2007</b>                           |               |                    |
|---------------------------------------------------------------------------|---------------------------------------|---------------|--------------------|---------------------------------------|---------------|--------------------|
|                                                                           | <b>Gross<br/>notional<br/>amounts</b> | <b>Assets</b> | <b>Liabilities</b> | <b>Gross<br/>notional<br/>amounts</b> | <b>Assets</b> | <b>Liabilities</b> |
|                                                                           | <b>All figures in £ millions</b>      |               |                    |                                       |               |                    |
| Interest rate derivatives in a fair value<br>hedge relationship           | <b>1,232</b>                          | <b>161</b>    |                    | 522                                   | 18            | (8)                |
| Interest rate derivatives not in a hedge<br>relationship                  | <b>1,033</b>                          | <b>23</b>     | <b>(20)</b>        | 796                                   | 7             | (8)                |
| Cross currency rate derivatives in a net<br>investment hedge relationship |                                       |               |                    | 100                                   | 17            |                    |
| Cross currency rate derivatives not in a<br>hedge relationship            |                                       |               |                    | 50                                    | 9             |                    |
| <b>Total</b>                                                              | <b>2,265</b>                          | <b>184</b>    | <b>(20)</b>        | 1,468                                 | 51            | (16)               |
| <b>Analysed as expiring:</b>                                              |                                       |               |                    |                                       |               |                    |
| In less than one year                                                     | <b>487</b>                            | <b>3</b>      | <b>(5)</b>         | 320                                   | 28            |                    |
| Later than one year and not later than<br>five years                      | <b>859</b>                            | <b>47</b>     | <b>(15)</b>        | 796                                   | 13            | (8)                |
| Later than five years                                                     | <b>919</b>                            | <b>134</b>    |                    | 352                                   | 10            | (8)                |

|              |              |            |             |       |    |      |
|--------------|--------------|------------|-------------|-------|----|------|
| <b>Total</b> | <b>2,265</b> | <b>184</b> | <b>(20)</b> | 1,468 | 51 | (16) |
|--------------|--------------|------------|-------------|-------|----|------|

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models.

At the end of 2008, the currency split of the mark-to-market values of rate derivatives, including the exchange of principal on cross currency rate derivatives, was US dollar £161m and sterling £3m (2007: US dollar £(119)m and sterling £154m).

The fixed interest rates on outstanding rate derivative contracts at the end of 2008 range from 4.45% to 7.0% (2007: 4.45% to 7.00%) and the floating rates are based on LIBOR in US dollar and sterling.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The Group's portfolio of rate derivatives is diversified by maturity, counterparty and type. Natural offsets between transactions within the portfolio and the designation of certain derivatives as hedges significantly reduce the risk of income statement volatility. The sensitivity of the portfolio to changes in market rates is set out in note 19.

Counterparty exposure from all derivatives is managed, together with that from deposits and bank account balances, within credit limits that reflect published credit ratings and by reference to other market measures (e.g. market prices for credit default swaps) to ensure that there is no significant risk to any one counterparty. No single derivative transaction had a market value (positive or negative) at the balance sheet date that exceeded 3% of the Group's consolidated total equity.

In accordance with IAS 39 Financial Instruments: Recognition and Measurement, the Group has reviewed all of its material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements, and has concluded that there are no material embedded derivatives.

**17. Cash and cash equivalents (excluding overdrafts)**

|                          | <b>2008</b>                      | <b>2007</b> |
|--------------------------|----------------------------------|-------------|
|                          | <b>All figures in £ millions</b> |             |
| Cash at bank and in hand | <b>528</b>                       | 439         |
| Short-term bank deposits | <b>157</b>                       | 121         |
|                          | <b>685</b>                       | 560         |

Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates.

At the end of 2008 the currency split of cash and cash equivalents was US dollars 36% (2007: 37%), sterling 22% (2007: 29%), euros 20% (2007: 16%) and other 22% (2007: 18%).

Cash and cash equivalents have fair values that approximate to their carrying amounts due to their short-term nature.

Cash and cash equivalents include the following for the purpose of the cash flow statement:

|                           | <b>2008</b>                      | <b>2007</b> |
|---------------------------|----------------------------------|-------------|
|                           | <b>All figures in £ millions</b> |             |
| Cash and cash equivalents | <b>685</b>                       | 560         |
| Bank overdrafts           | <b>(96)</b>                      | (68)        |
|                           | <b>589</b>                       | 492         |



**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****18. Financial liabilities Borrowings**

The Group's current and non-current borrowings are as follows:

|                                                        | <b>2008</b>                          | <b>2007</b> |
|--------------------------------------------------------|--------------------------------------|-------------|
|                                                        | <b>All figures in<br/>£ millions</b> |             |
| <b>Non-current</b>                                     |                                      |             |
| Bank loans and overdrafts                              | <b>132</b>                           |             |
| 4.7% US Dollar Bonds 2009 (nominal amount \$350m)      |                                      | 176         |
| 7% Global Dollar Bonds 2011 (nominal amount \$500m)    | <b>368</b>                           | 264         |
| 5.5% Global Dollar Bonds 2013 (nominal amount \$350m)  | <b>258</b>                           |             |
| 5.7% US Dollar Bonds 2014 (nominal amount \$400m)      | <b>322</b>                           | 211         |
| 7% Sterling Bonds 2014 (nominal amount £250m)          | <b>254</b>                           | 251         |
| 6.25% Global Dollar Bonds 2018 (nominal amount \$550m) | <b>445</b>                           |             |
| 4.625% US Dollar notes 2018 (nominal amount \$300m)    | <b>237</b>                           | 143         |
| Finance lease liabilities                              | <b>3</b>                             | 4           |
|                                                        | <b>2,019</b>                         | 1,049       |
| <b>Current</b>                                         |                                      |             |
| <b>Due within one year or on demand:</b>               |                                      |             |
| Bank loans and overdrafts                              | <b>96</b>                            | 444         |
| 10.5% Sterling Bonds 2008 (nominal amount £100m)       |                                      | 105         |
| 4.7% US Dollar Bonds 2009 (nominal amount \$350m)      | <b>244</b>                           |             |
| Loan notes                                             |                                      | 8           |
| Finance lease liabilities                              | <b>4</b>                             | 2           |
|                                                        | <b>344</b>                           | 559         |
| <b>Total borrowings</b>                                | <b>2,363</b>                         | 1,608       |

Included in the non-current borrowings above is £12m of accrued interest (2007: £6m). Included in the current borrowings above is £1m of accrued interest (2007: £7m).

The maturity of the Group's non-current borrowing is as follows:

|                            | <b>2008</b>                          | <b>2007</b> |
|----------------------------|--------------------------------------|-------------|
|                            | <b>All figures in<br/>£ millions</b> |             |
| Between one and two years  | <b>2</b>                             | 178         |
| Between two and five years | <b>759</b>                           | 266         |

|                 |              |       |
|-----------------|--------------|-------|
| Over five years | <b>1,258</b> | 605   |
|                 | <b>2,019</b> | 1,049 |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The carrying amounts and market values of borrowings are as follows:

|                                |                         | 2008           |              | 2007           |              |
|--------------------------------|-------------------------|----------------|--------------|----------------|--------------|
|                                | Effective interest rate | Carrying value | Market value | Carrying value | Market value |
| Bank loans and overdrafts      | n/a                     | 228            | 228          | 444            | 444          |
| Loan notes                     | n/a                     |                |              | 8              | 8            |
| 10.5% Sterling Bonds 2008      | 10.53%                  |                |              | 105            | 102          |
| 4.7% US Dollar Bonds 2009      | 4.86%                   | 244            | 243          | 176            | 176          |
| 7% Global Dollar Bonds 2011    | 7.16%                   | 368            | 349          | 264            | 267          |
| 5.5% Global Dollar Bonds 2013  | 5.76%                   | 258            | 227          |                |              |
| 5.7% US Dollar Bonds 2014      | 5.88%                   | 322            | 262          | 211            | 203          |
| 7% Sterling Bonds 2014         | 7.20%                   | 254            | 258          | 251            | 261          |
| 6.25% Global Dollar Bonds 2018 | 6.46%                   | 445            | 352          |                |              |
| 4.625% US Dollar notes 2018    | 4.69%                   | 237            | 169          | 143            | 135          |
| Finance lease liabilities      | n/a                     | 7              | 7            | 6              | 6            |
|                                |                         | <b>2,363</b>   | <b>2,095</b> | 1,608          | 1,602        |

The market values are based on clean market prices at the year end or, where these are not available, on the quoted market prices of comparable debt issued by other companies. The effective interest rates above relate to the underlying debt instruments.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

|           | 2008                      | 2007  |
|-----------|---------------------------|-------|
|           | All figures in £ millions |       |
| US dollar | 2,081                     | 1,251 |
| Sterling  | 277                       | 357   |
| Euro      | 5                         |       |
|           | <b>2,363</b>              | 1,608 |

The Group has the following undrawn capacity on its committed borrowing facilities as at 31 December:

| 2008                      | 2007 |
|---------------------------|------|
| All figures in £ millions |      |

**Floating rate**

expiring within one year  
expiring beyond one year

**1,085** 1,007

**1,085** 1,007

In addition to the above facilities, there are a number of short-term facilities that are utilised in the normal course of business.

All of the Group's borrowings are unsecured. In respect of finance lease obligations, the rights to the leased asset revert to the lessor in the event of default.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****18. Financial liabilities Borrowings continued**

The maturity of the Group's finance lease obligations is as follows:

|                                                           | <b>2008</b>                          | <b>2007</b> |
|-----------------------------------------------------------|--------------------------------------|-------------|
|                                                           | <b>All figures in<br/>£ millions</b> |             |
| <b>Finance lease liabilities – minimum lease payments</b> |                                      |             |
| Not later than one year                                   | 4                                    | 2           |
| Later than one year and not later than two years          | 2                                    | 2           |
| Later than two years and not later than three years       | 1                                    | 1           |
| Later than three years and not later than four years      |                                      | 1           |
| Later than four years and not later than five years       |                                      |             |
| Later than five years                                     |                                      |             |
| Future finance charges on finance leases                  |                                      |             |
| Present value of finance lease liabilities                | 7                                    | 6           |

The present value of finance lease liabilities is as follows:

|                                                   | <b>2008</b>                          | <b>2007</b> |
|---------------------------------------------------|--------------------------------------|-------------|
|                                                   | <b>All figures in<br/>£ millions</b> |             |
| Not later than one year                           | 4                                    | 2           |
| Later than one year and not later than five years | 3                                    | 4           |
| Later than five years                             |                                      |             |
|                                                   | 7                                    | 6           |

The carrying amounts of the Group's lease obligations approximate their fair value.

**19. Financial risk management**

The Group's approach to the management of financial risks together with sensitivity analyses is set out below.

***Treasury policy***

The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. 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. The Group borrows principally in US dollars and sterling, at both floating

and fixed rates of interest, using derivative financial instruments ( derivatives ), where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally rate swaps, rate caps and collars, currency rate swaps and forward foreign exchange contracts. The main risks arising from the Group s financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the board, which are summarised below. All the treasury policies remained unchanged throughout 2008, with the exception of a change to the foreign exchange hedging policy made with effect from October 2008, which is explained later in this note. Some minor updates will also be made to treasury policies for 2009, largely to reflect current financial market conditions.

The audit committee and a group of external treasury advisers receives reports on the Group s treasury activities, policies and procedures. The treasury department is not a profit centre and its activities are subject to regular internal audit.



**Table of Contents****Notes to the Consolidated Financial Statements (Continued)*****Interest rate risk management***

The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into rate swaps, rate caps and forward rate agreements. The Group's policy objective has continued to be to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt and before certain adjustments for IAS 39) to be hedged (i.e. fixed or capped at the year end) over the next four years, subject to a maximum of 65% and a minimum that starts at 40% and falls by 10% at each year end. At the end of 2008 the hedging ratio, on the above basis, was approximately 49%. A simultaneous 1% change on 1 January in the Group's variable interest rates in US dollar and sterling, taking into account forecast seasonal debt, would have a £10m effect on profit before tax.

***Use of interest rate derivatives***

The policy described in the section above creates a group of derivatives, under which the Group is a payer of fixed rates and a receiver of floating rates. The Group also aims to avoid undue exposure to a single interest rate setting. Reflecting this objective, the Group has swapped its fixed rate bond issues to floating rate at their launch. This creates a second group of derivatives, under which the Group is a receiver of fixed rates and a payer of floating rates. The Group's accounting objective in its use of interest rate derivatives is to minimise the impact on the income statement of changes in the mark-to-market value of its derivative portfolio as a whole. It uses duration calculations to estimate the sensitivity of the derivatives to movements in market rates. The Group also identifies which derivatives are eligible for fair value hedge accounting (which reduces sharply the income statement impact of changes in the market value of a derivative). The Group then balances the total portfolio between hedge-accounted and pooled segments, so that the expected movement on the pooled segment is minimal.

***Liquidity and refinancing risk management***

The Group's objective is to secure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. At the end of 2008 the average maturity of gross borrowings was 5.0 years of which bonds represented 90% of these borrowings (up from 4.6 years and up from 72% respectively at the beginning of the year).

The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. All of 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. The Group will also continue to use internally a range of ratios to monitor and manage its finances. These include interest cover, net debt to operating profit and cash flow to debt measures. The Group also maintains undrawn committed borrowing facilities. At the end of 2008 the committed facilities amounted to £1,217m and their weighted average maturity was 3.4 years.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)*****Analysis of Group debt, including the impact of derivatives***

The following tables analyse the Group's sources of funding and the impact of derivatives on the Group's debt instruments.

The Group's net debt position is set out below:

|                                       | <b>2008</b>                          | <b>2007</b> |
|---------------------------------------|--------------------------------------|-------------|
|                                       | <b>All figures in £<br/>millions</b> |             |
| Cash and cash equivalents             | <b>685</b>                           | 560         |
| Marketable securities                 | <b>54</b>                            | 40          |
| Derivative financial instruments      | <b>164</b>                           | 35          |
| Bank loans, overdrafts and loan notes | <b>(228)</b>                         | (452)       |
| Bonds                                 | <b>(2,128)</b>                       | (1,150)     |
| Finance lease liabilities             | <b>(7)</b>                           | (6)         |
| <b>Net debt</b>                       | <b>(1,460)</b>                       | (973)       |

The split of net debt between fixed and floating rate, stated after the impact of rate derivatives, is as follows:

|               | <b>2008</b>                          | <b>2007</b> |
|---------------|--------------------------------------|-------------|
|               | <b>All figures in £<br/>millions</b> |             |
| Fixed rate    | <b>781</b>                           | 567         |
| Floating rate | <b>679</b>                           | 406         |
| <b>Total</b>  | <b>1,460</b>                         | 973         |

Gross borrowings, after the impact of cross-currency rate derivatives, analysed by currency are as follows:

|              | <b>2008</b>                          | <b>2007</b> |
|--------------|--------------------------------------|-------------|
|              | <b>All figures in £<br/>millions</b> |             |
| US dollar    | <b>2,081</b>                         | 1,401       |
| Sterling     | <b>277</b>                           | 207         |
| Euro         | <b>5</b>                             |             |
| <b>Total</b> | <b>2,363</b>                         | 1,608       |

As at 31 December 2008 there were no outstanding cross-currency rate derivatives.

As at 31 December 2008 the exposure of the borrowings of the Group to interest rate changes when the borrowings re-price is as follows:

|                                  | <b>Less<br/>than<br/>one<br/>year</b> | <b>One to<br/>five years</b> | <b>More than<br/>five years</b> | <b>Total</b> |
|----------------------------------|---------------------------------------|------------------------------|---------------------------------|--------------|
|                                  | <b>All figures in £ millions</b>      |                              |                                 |              |
| Re-pricing profile of borrowings | 476                                   | 629                          | 1,258                           | 2,363        |
| Effect of rate derivatives       | 1,173                                 | (254)                        | (919)                           |              |
| <b>Total</b>                     | <b>1,649</b>                          | <b>375</b>                   | <b>339</b>                      | <b>2,363</b> |

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Table of Contents**Notes to the Consolidated Financial Statements (Continued)**

The maturity of contracted cash flows on the Group's borrowings and all of its derivative financial instruments are as follows:

|                                                   | 2008                      |            |     |              |
|---------------------------------------------------|---------------------------|------------|-----|--------------|
|                                                   | USD                       | GBP        | EUR | Total        |
|                                                   | All figures in £ millions |            |     |              |
| Not later than one year                           | 311                       | 17         |     | 328          |
| Later than one year and not later than five years | 884                       | 65         |     | 949          |
| Later than five years                             | 954                       | 266        |     | 1,220        |
| <b>Total</b>                                      | <b>2,149</b>              | <b>348</b> |     | <b>2,497</b> |
| Analysed as:                                      |                           |            |     |              |
| Revolving credit facilities and commercial paper  | 141                       |            |     | 141          |
| Bonds                                             | 2,237                     | 355        |     | 2,592        |
| Rate derivatives inflows                          | (392)                     | (21)       |     | (413)        |
| Rate derivatives outflows                         | 163                       | 14         |     | 177          |
| <b>Total</b>                                      | <b>2,149</b>              | <b>348</b> |     | <b>2,497</b> |

|                                                   | 2007                      |            |     |              |
|---------------------------------------------------|---------------------------|------------|-----|--------------|
|                                                   | USD                       | GBP        | EUR | Total        |
|                                                   | All figures in £ millions |            |     |              |
| Not later than one year                           | 153                       | (30)       |     | 123          |
| Later than one year and not later than five years | 966                       | 70         |     | 1,036        |
| Later than five years                             | 420                       | 285        |     | 705          |
| <b>Total</b>                                      | <b>1,539</b>              | <b>325</b> |     | <b>1,864</b> |
| Analysed as:                                      |                           |            |     |              |
| Revolving credit facilities and commercial paper  | 429                       |            |     | 429          |
| Bonds                                             | 1,017                     | 483        |     | 1,500        |
| Rate derivatives inflows                          | (268)                     | (160)      |     | (428)        |
| Rate derivatives outflows                         | 361                       | 2          |     | 363          |
| <b>Total</b>                                      | <b>1,539</b>              | <b>325</b> |     | <b>1,864</b> |

All cash flow projections shown above are on an undiscounted basis. Any cash flows based on a floating rate are calculated using interest rates as set at the date of the last rate reset. Where this is not possible, floating rates are based on interest rates prevailing at 31 December in the relevant year. All derivative amounts are shown gross, although the company net settles these amounts wherever possible.

Amounts drawn under revolving credit facilities and commercial paper are assumed to mature at the maturity date of the relevant facility, with interest calculated as payable in each calendar year up to and including the date of maturity of the facility.

***Financial counterparty risk management***

Counterparty credit limits, which take published credit rating and other factors into account, are set to cover our total aggregate exposure to a single financial institution. The limits applicable to published credit ratings bands are approved by the chief financial officer within guidelines approved by the board. Exposures and limits applicable to each financial institution are reviewed on a regular basis.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)*****Foreign currency risk management***

Although the Group is based in the UK, it has its most significant investment in overseas operations. The most significant currency for the Group is the US dollar. The Group's policy on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remains that these should be transacted at the relevant spot exchange rate. The majority of the Group's operations are domestic within their country of operation. No unremitted profits are hedged with foreign exchange contracts, as the company judges it inappropriate to hedge non-cash flow translational exposure with cash flow instruments. However, the Group does seek to create a natural hedge of this exposure through its policy of aligning approximately the currency composition of its core net borrowings with its forecast operating profit before depreciation and amortisation. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. The policy above applies only to currencies that account for more than 15% of Group operating profit before depreciation and amortisation, which currently are only the US dollar and sterling. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. In addition, our policy does not require existing currency debt to be terminated to match declines in that currency's share of Group operating profit before depreciation and amortisation. Following the board's approval of a policy change in October 2008, currencies that account for less than 15% of Group operating profit before depreciation and amortisation may now be included in the above hedging process at the request of the chief financial officer. At the balance sheet date, no hedging transactions had been undertaken under that authority.

Included within year end net debt, the net borrowings/(cash) in the two principal currencies above (taking into account the effect of cross currency swaps) were: US dollar £1,777m and sterling £127m.

***Use of currency debt and currency derivatives***

The Group uses both currency denominated debt and derivative instruments to implement the above policy. Its intention is that gains/losses on the derivatives and debt offset the losses/gains on the foreign currency assets and income. Each quarter the value of hedging instruments is monitored against the assets in the relevant currency and, where practical, a decision is made whether to treat the debt or derivative as a net investment hedge (permitting foreign exchange movements on it to be taken to reserves) for the purposes of IAS 39.

***Financial instruments sensitivity analysis***

As at 31 December 2008 the sensitivity of the Group's financial instruments to fluctuations in interest rates and exchange rates is as follows:

|                                    | Carrying   | Impact of                        | Impact of                     | Impact of                     | Impact of                 |
|------------------------------------|------------|----------------------------------|-------------------------------|-------------------------------|---------------------------|
|                                    | value      | 1% increase in interest rates    | 1% decrease in interest rates | 10% strengthening in sterling | 10% weakening in sterling |
|                                    |            | <b>All figures in £ millions</b> |                               |                               |                           |
| Investments in unlisted securities | <b>63</b>  |                                  |                               | <b>(2)</b>                    | <b>3</b>                  |
| Cash and cash equivalents          | <b>685</b> |                                  |                               | <b>(41)</b>                   | <b>50</b>                 |

|                                  |                |             |             |             |              |
|----------------------------------|----------------|-------------|-------------|-------------|--------------|
| Marketable securities            | <b>54</b>      |             |             | <b>(5)</b>  | <b>6</b>     |
| Derivative financial instruments | <b>164</b>     | <b>(80)</b> | <b>88</b>   | <b>(15)</b> | <b>18</b>    |
| Bonds                            | <b>(2,128)</b> | <b>77</b>   | <b>(84)</b> | <b>155</b>  | <b>(189)</b> |
| Other borrowings                 | <b>(235)</b>   |             |             | <b>19</b>   | <b>(24)</b>  |
| Other net financial assets       | <b>580</b>     |             |             | <b>(46)</b> | <b>57</b>    |
| Total financial instruments      | <b>(817)</b>   | <b>(3)</b>  | <b>4</b>    | <b>65</b>   | <b>(79)</b>  |

The table shows the sensitivities of the fair values of each class of financial instruments to an isolated change in either interest rates or foreign exchange rates. The class Other net financial assets comprises trade assets less trade liabilities.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The sensitivities of derivative instruments are calculated using established estimation techniques such as discounted cash flow and option valuation models. Where modelling an interest rate decrease of 1% led to negative interest rates, these points on the yield curve were adjusted to 0%. A large proportion of the movements shown above would impact equity rather than the income statement, depending on the location and functional currency of the entity in which they arise and the availability of net investment hedge treatment. The changes in valuations are estimates of the impact of changes in market variables and are not a prediction of future events or anticipated gains or losses.

**20. Intangible assets Pre-publication**

|                                              | <b>2008</b>                          | <b>2007</b> |
|----------------------------------------------|--------------------------------------|-------------|
|                                              | <b>All figures in £<br/>millions</b> |             |
| <b>Cost</b>                                  |                                      |             |
| At beginning of year                         | <b>1,264</b>                         | 1,152       |
| Exchange differences                         | <b>494</b>                           | (7)         |
| Additions                                    | <b>297</b>                           | 230         |
| Disposals                                    | <b>(345)</b>                         | (125)       |
| Acquisition through business combination     | <b>78</b>                            | 19          |
| Transfer from software                       | <b>12</b>                            |             |
| Transfer to non-current assets held for sale |                                      | (5)         |
| <b>At end of year</b>                        | <b>1,800</b>                         | 1,264       |
| <b>Amortisation</b>                          |                                      |             |
| At beginning of year                         | <b>(814)</b>                         | (750)       |
| Exchange differences                         | <b>(337)</b>                         | 1           |
| Charge for the year                          | <b>(244)</b>                         | (192)       |
| Disposals                                    | <b>345</b>                           | 125         |
| Acquisition through business combination     | <b>(51)</b>                          | (1)         |
| Transfer from software                       | <b>(4)</b>                           |             |
| Transfer to non-current assets held for sale |                                      | 3           |
| <b>At end of year</b>                        | <b>(1,105)</b>                       | (814)       |
| Carrying amounts                             |                                      |             |
| <b>At end of year</b>                        | <b>695</b>                           | 450         |

Included in the above are pre-publication assets amounting to £462m (2007: £292m) which will be realised in more than 12 months.

Amortisation is included in the income statement in cost of goods sold. There was no amortisation relating to discontinued operations in 2008 and 2007.





**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****21. Inventories**

|                  | <b>2008</b>                          | <b>2007</b> |
|------------------|--------------------------------------|-------------|
|                  | <b>All figures in £<br/>millions</b> |             |
| Raw materials    | <b>31</b>                            | 24          |
| Work in progress | <b>29</b>                            | 30          |
| Finished goods   | <b>441</b>                           | 314         |
|                  | <b>501</b>                           | 368         |

The cost of inventories relating to continuing operations recognised as an expense and included in the income statement in cost of goods sold amounted to £832m (2007: £732m). In 2008 £56m (2007: £47m) of inventory provisions was charged in the income statement. None of the inventory is pledged as security.

**22. Trade and other receivables**

|                                  | <b>2008</b>                          | <b>2007</b> |
|----------------------------------|--------------------------------------|-------------|
|                                  | <b>All figures in £<br/>millions</b> |             |
| <b>Current</b>                   |                                      |             |
| Trade receivables                | <b>1,030</b>                         | 750         |
| Royalty advances                 | <b>111</b>                           | 84          |
| Prepayments and accrued income   | <b>62</b>                            | 48          |
| Other receivables                | <b>135</b>                           | 59          |
| Receivables from related parties | <b>4</b>                             | 5           |
|                                  | <b>1,342</b>                         | 946         |
| <b>Non-current</b>               |                                      |             |
| Royalty advances                 | <b>102</b>                           | 68          |
| Prepayments and accrued income   | <b>3</b>                             | 4           |
| Other receivables                | <b>47</b>                            | 57          |
|                                  | <b>152</b>                           | 129         |

Trade receivables are stated at fair value, net of provisions for bad and doubtful debts and anticipated future sales returns.

The movements on the provision for bad and doubtful debts are as follows:

|                                          | <b>2008</b>                          | <b>2007</b> |
|------------------------------------------|--------------------------------------|-------------|
|                                          | <b>All figures in £<br/>millions</b> |             |
| At beginning of year                     | <b>(52)</b>                          | (46)        |
| Exchange differences                     | <b>(18)</b>                          | (1)         |
| Income statement movements               | <b>(27)</b>                          | (19)        |
| Utilised                                 | <b>27</b>                            | 15          |
| Acquisition through business combination | <b>(2)</b>                           | (3)         |
| Disposal through business disposal       |                                      | 2           |
| <b>At end of year</b>                    | <b>(72)</b>                          | (52)        |

Concentrations of credit risk with respect to trade receivables are limited due to the Group's large number of customers, who are internationally dispersed.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The ageing of the Group's trade receivables is as follows:

|                                              | <b>2008</b>                      | <b>2007</b> |
|----------------------------------------------|----------------------------------|-------------|
|                                              | <b>All figures in £ millions</b> |             |
| Within due date                              | <b>1,110</b>                     | 819         |
| Up to three months past due date             | <b>248</b>                       | 171         |
| Three to six months past due date            | <b>60</b>                        | 51          |
| Six to nine months past due date             | <b>21</b>                        | 12          |
| Nine to 12 months past due date              | <b>15</b>                        | 19          |
| More than 12 months past due date            | <b>20</b>                        | 19          |
| <b>Total trade receivables</b>               | <b>1,474</b>                     | 1,091       |
| Less: provision for bad and doubtful debts   | <b>(72)</b>                      | (52)        |
| Less: provision for sales returns            | <b>(372)</b>                     | (281)       |
| Transfer to non-current assets held for sale |                                  | (8)         |
| <b>Net trade receivables</b>                 | <b>1,030</b>                     | 750         |

The Group reviews its bad debt provision at least twice a year following a detailed review of receivable balances and historic payment profiles. Management believe all the remaining receivable balances are fully recoverable.

**23. Provisions for other liabilities and charges**

|                                                                 | <b>Deferred consideration</b>    | <b>Leases</b> | <b>Other</b> | <b>Total</b> |
|-----------------------------------------------------------------|----------------------------------|---------------|--------------|--------------|
|                                                                 | <b>All figures in £ millions</b> |               |              |              |
| At 1 January 2008                                               | 37                               | 9             | 21           | 67           |
| Exchange differences                                            | 5                                | 2             | 9            | 16           |
| Charged to income statement                                     | 2                                |               | 7            | 9            |
| Released to income statement                                    |                                  | (1)           | (5)          | (6)          |
| Acquisition through business combination current year           | 3                                |               | 16           | 19           |
| Acquisition through business combination prior year adjustments | (4)                              |               | 7            | 3            |
| Utilised                                                        |                                  | (2)           | (17)         | (19)         |
| At 31 December 2008                                             | <b>43</b>                        | <b>8</b>      | <b>38</b>    | <b>89</b>    |
|                                                                 |                                  |               | <b>2008</b>  | <b>2007</b>  |

|                        | <b>All figures in<br/>£ millions</b> |    |
|------------------------|--------------------------------------|----|
| Analysis of provisions |                                      |    |
| Non-current            | <b>33</b>                            | 44 |
| Current                | <b>56</b>                            | 23 |
|                        | <b>89</b>                            | 67 |

Deferred consideration primarily relates to the acquisition of Mergermarket in 2006. These amounts are payable in 2009.

Lease commitments relate primarily to onerous lease contracts, acquired through business combinations, which have various expiry dates up to 2017. The provision is based on current occupancy estimates.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****24. Trade and other liabilities**

|                                        | <b>2008</b>                          | <b>2007</b> |
|----------------------------------------|--------------------------------------|-------------|
|                                        | <b>All figures in £<br/>millions</b> |             |
| Trade payables                         | <b>450</b>                           | 342         |
| Social security and other taxes        | <b>35</b>                            | 23          |
| Accruals                               | <b>501</b>                           | 402         |
| Deferred income                        | <b>444</b>                           | 290         |
| Interest payable                       | <b>10</b>                            |             |
| Dividends payable to minority interest | <b>5</b>                             | 12          |
| Other liabilities                      | <b>205</b>                           | 171         |
|                                        | <b>1,650</b>                         | 1,240       |
| <b>Less: non-current portion</b>       |                                      |             |
| Accruals                               | <b>42</b>                            | 30          |
| Deferred income                        | <b>87</b>                            | 58          |
| Interest payable                       | <b>1</b>                             |             |
| Other liabilities                      | <b>91</b>                            | 102         |
|                                        | <b>221</b>                           | 190         |
| <b>Current portion</b>                 | <b>1,429</b>                         | 1,050       |

The carrying value of the Group's payables approximates its fair value.

The deferred income balances comprise:

multi-year obligations to deliver workbooks to adoption customers in school businesses;

advance payments in assessment and testing businesses;

subscription income in school, newspaper and market pricing businesses;

advertising income relating to future publishing days in newspaper businesses; and

obligations to deliver digital content in future periods.

**25. Retirement benefit and other post-retirement obligations*****Background***

The Group operates a number of defined benefit and defined contribution retirement plans throughout the world. For the defined benefit plans, benefits are based on employees' length of service and final pensionable pay. Defined

contribution benefits are based on the amount of contributions paid in respect of an individual member, the investment returns earned and the amount of pension this money will buy when a member retires.

The largest plan is the Pearson Group Pension Plan ( UK Group plan ) with both defined benefit and defined contribution sections. From 1 November 2006, all sections of the UK Group plan were closed to new members with the exception of a defined contribution section that was opened in 2003. This section is available to all new employees of participating companies. The other major defined benefit plans are based in the US.

Other defined contribution plans are operated principally overseas with the largest plan being in the US. The specific features of these plans vary in accordance with the regulations of the country in which employees are located.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

Pearson also has several post-retirement medical benefit plans (PRMBs), principally in the US. PRMBs are unfunded but are accounted for and valued similarly to defined benefit pension plans.

***Assumptions***

The principal assumptions used for the UK Group plan and the US PRMB are shown below. Weighted average assumptions have been shown for the other plans, which primarily relate to US pension plans.

|                                                                         | 2008                |             |             | 2007          |             |      | 2006          |             |       |
|-------------------------------------------------------------------------|---------------------|-------------|-------------|---------------|-------------|------|---------------|-------------|-------|
|                                                                         | UK Group plan       | Other plans | PRMB        | UK Group plan | Other plans | PRMB | UK Group plan | Other plans | PRMB  |
| %                                                                       |                     |             |             |               |             |      |               |             |       |
| Inflation Rate used to discount plan liabilities                        | <b>2.80</b>         | <b>2.80</b> | <b>2.80</b> | 3.30          | 2.93        | 3.00 | 3.00          | 2.91        | 3.00  |
| Expected return on assets                                               | <b>6.40</b>         | <b>6.25</b> | <b>6.25</b> | 5.80          | 6.01        | 6.05 | 5.20          | 5.70        | 5.85  |
| Expected rate of increase in salaries                                   | <b>6.33</b>         | <b>7.60</b> |             | 6.50          | 7.27        |      | 6.40          | 7.18        |       |
| Expected rate of increase for pensions in payment and deferred pensions | <b>4.30</b>         | <b>4.50</b> |             | 5.00          | 4.36        |      | 4.70          | 4.37        |       |
| Initial rate of increase in healthcare rate                             | <b>2.30 to 4.20</b> |             |             | 2.50 to 4.30  |             |      | 2.10 to 4.60  |             |       |
| Ultimate rate of increase in healthcare rate                            |                     |             | <b>9.00</b> |               |             | 9.50 |               |             | 10.00 |
|                                                                         |                     |             | <b>5.00</b> |               |             | 5.00 |               |             | 5.00  |



The UK discount rate is based on the annualised yield on the iBoxx over 15-year AA-rated corporate bond index, adjusted to reflect the duration of our liabilities. The US discount rate is set by reference to a US bond portfolio matching model. The expected return on assets is based on market expectations of long-term asset returns for the defined portfolio at the end of the year.

The expected rates of return on categories of plan assets are determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio.

The UK mortality assumptions have been derived by adjusting standard mortality tables (PMFA 92 tables projected forward with medium cohort improvement factors). The Group changed its mortality assumptions in the UK in 2007 to reflect an assumed increased life expectancy of pensioners by adding a 1% floor to the medium cohort projections.

For the US plans, the assumptions used were based on standard US mortality tables. In 2007 GAM94 was used, and in 2008 this was updated to RP2000 to reflect the mortality assumption now more prevalent in the US.

Using the above tables, the remaining average life expectancy in years of a pensioner retiring at age 65 on the balance sheet date for the UK and US Group plans is as follows:

|        | UK          |      | US          |      |
|--------|-------------|------|-------------|------|
|        | 2008        | 2007 | 2008        | 2007 |
| Male   | <b>21.5</b> | 21.3 | <b>17.6</b> | 17.9 |
| Female | <b>21.8</b> | 21.6 | <b>20.2</b> | 21.3 |

The remaining average life expectancy in years of a pensioner retiring at age 65, 20 years after the balance sheet date, for the UK and US Group plans is as follows:

|        | UK          |      | US          |      |
|--------|-------------|------|-------------|------|
|        | 2008        | 2007 | 2008        | 2007 |
| Male   | <b>23.3</b> | 23.1 | <b>17.6</b> | 17.9 |
| Female | <b>23.8</b> | 23.6 | <b>20.2</b> | 21.3 |

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)*****Financial statement information***

The amounts recognised in the income statement are as follows:

|                                            | 2008                |                             |              |                         |          | Total        |
|--------------------------------------------|---------------------|-----------------------------|--------------|-------------------------|----------|--------------|
|                                            | UK<br>Group<br>plan | Defined<br>benefit<br>other | Sub-total    | Defined<br>contribution | PRMB     |              |
|                                            |                     |                             |              |                         |          |              |
| Current service cost                       | 33                  | 3                           | 36           | 41                      | 1        | 78           |
| Past service cost                          |                     | 1                           | 1            |                         | 5        | 6            |
| <b>Total operating expense</b>             | <b>33</b>           | <b>4</b>                    | <b>37</b>    | <b>41</b>               | <b>6</b> | <b>84</b>    |
| Expected return on plan assets             | (104)               | (7)                         | (111)        |                         |          | (111)        |
| Interest on plan liabilities               | 93                  | 7                           | 100          |                         | 3        | 103          |
| <b>Net finance (income)/expense</b>        | <b>(11)</b>         |                             | <b>(11)</b>  |                         | <b>3</b> | <b>(8)</b>   |
| <b>Net income statement charge</b>         | <b>22</b>           | <b>4</b>                    | <b>26</b>    | <b>41</b>               | <b>9</b> | <b>76</b>    |
| <b>Actual (loss)/return on plan assets</b> | <b>(130)</b>        | <b>(27)</b>                 | <b>(157)</b> |                         |          | <b>(157)</b> |

|                                            | 2007                |                             |             |                         |          | Total       |
|--------------------------------------------|---------------------|-----------------------------|-------------|-------------------------|----------|-------------|
|                                            | UK<br>Group<br>plan | Defined<br>benefit<br>other | Sub-total   | Defined<br>contribution | PRMB     |             |
|                                            |                     |                             |             |                         |          |             |
| Current service cost                       | 29                  | 2                           | 31          | 39                      | 1        | 71          |
| <b>Total operating expense</b>             | <b>29</b>           | <b>2</b>                    | <b>31</b>   | <b>39</b>               | <b>1</b> | <b>71</b>   |
| Expected return on plan assets             | (96)                | (7)                         | (103)       |                         |          | (103)       |
| Interest on plan liabilities               | 84                  | 7                           | 91          |                         | 2        | 93          |
| <b>Net finance (income)/expense</b>        | <b>(12)</b>         |                             | <b>(12)</b> |                         | <b>2</b> | <b>(10)</b> |
| <b>Net income statement charge</b>         | <b>17</b>           | <b>2</b>                    | <b>19</b>   | <b>39</b>               | <b>3</b> | <b>61</b>   |
| <b>Actual (loss)/return on plan assets</b> | <b>128</b>          | <b>4</b>                    | <b>132</b>  |                         |          | <b>132</b>  |

|                                            | 2006                      |                             |           |                         |      |       |
|--------------------------------------------|---------------------------|-----------------------------|-----------|-------------------------|------|-------|
|                                            | UK<br>Group<br>plan       | Defined<br>benefit<br>other | Sub-total | Defined<br>contribution | PRMB | Total |
|                                            | All figures in £ millions |                             |           |                         |      |       |
| Current service cost                       | 27                        | 2                           | 29        | 36                      | 1    | 66    |
| Past service cost                          |                           |                             |           |                         | (2)  | (2)   |
| <b>Total operating expense</b>             | 27                        | 2                           | 29        | 36                      | (1)  | 64    |
| Expected return on plan assets             | (85)                      | (7)                         | (92)      |                         |      | (92)  |
| Interest on plan liabilities               | 78                        | 7                           | 85        |                         | 3    | 88    |
| <b>Net finance (income)/expense</b>        | (7)                       |                             | (7)       |                         | 3    | (4)   |
| <b>Net income statement charge</b>         | 20                        | 2                           | 22        | 36                      | 2    | 60    |
| <b>Actual (loss)/return on plan assets</b> | 153                       | 13                          | 166       |                         |      | 166   |

The total operating charge is included in administrative and other expenses. The UK Group plan current service cost includes £14m (2007: £10m) relating to defined contribution sections.

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The amounts recognised in the balance sheet are as follows:

|                                                  | 2008                      |                          |                            | Total        | 2007                |                          |                            | Total       |
|--------------------------------------------------|---------------------------|--------------------------|----------------------------|--------------|---------------------|--------------------------|----------------------------|-------------|
|                                                  | UK<br>Group<br>plan       | Other<br>funded<br>plans | Other<br>unfunded<br>plans |              | UK<br>Group<br>plan | Other<br>funded<br>plans | Other<br>unfunded<br>plans |             |
|                                                  | All figures in £ millions |                          |                            |              |                     |                          |                            |             |
| Fair value of plan assets                        | 1,478                     | 100                      |                            | 1,578        | 1,744               | 109                      |                            | 1,853       |
| Present value of defined benefit obligation      | (1,429)                   | (149)                    | (16)                       | (1,594)      | (1,682)             | (117)                    | (12)                       | (1,811)     |
| <b>Net pension (liability)/asset</b>             | <b>49</b>                 | <b>(49)</b>              | <b>(16)</b>                | <b>(16)</b>  | <b>62</b>           | <b>(8)</b>               | <b>(12)</b>                | <b>42</b>   |
| Other post-retirement medical benefit obligation |                           |                          |                            | (68)         |                     |                          |                            | (47)        |
| Other pension accruals                           |                           |                          |                            | (34)         |                     |                          |                            | (28)        |
| <b>Net retirement benefit obligations</b>        |                           |                          |                            | <b>(118)</b> |                     |                          |                            | <b>(33)</b> |
| <b>Analysed as:</b>                              |                           |                          |                            |              |                     |                          |                            |             |
| <b>Retirement benefit assets</b>                 |                           |                          |                            | <b>49</b>    |                     |                          |                            | <b>62</b>   |
| <b>Retirement benefit obligations</b>            |                           |                          |                            | <b>(167)</b> |                     |                          |                            | <b>(95)</b> |

The following (losses)/gains have been recognised in the statement of recognised income and expense:

|                                                              | 2008                      | 2007       | 2006       |
|--------------------------------------------------------------|---------------------------|------------|------------|
|                                                              | All figures in £ millions |            |            |
| Amounts recognised for defined benefit plans                 | (74)                      | 79         | 102        |
| Amounts recognised for post-retirement medical benefit plans | 3                         | 1          | 5          |
| <b>Total recognised in year</b>                              | <b>(71)</b>               | <b>80</b>  | <b>107</b> |
| <b>Cumulative amounts recognised</b>                         | <b>53</b>                 | <b>124</b> | <b>44</b>  |

The fair value of plan assets comprises the following:

|            | <b>UK<br/>Group<br/>plan</b> | <b>2008<br/>Other<br/>funded<br/>plans</b> | <b>Total</b> | <b>UK<br/>Group<br/>plan</b> | <b>2007<br/>Other<br/>funded<br/>plans</b> | <b>Total</b> |
|------------|------------------------------|--------------------------------------------|--------------|------------------------------|--------------------------------------------|--------------|
|            |                              |                                            | %            |                              |                                            |              |
| Equities   | <b>28.0</b>                  | <b>3.1</b>                                 | <b>31.1</b>  | 34.3                         | 3.4                                        | 37.7         |
| Bonds      | <b>40.8</b>                  | <b>2.2</b>                                 | <b>43.0</b>  | 34.9                         | 2.0                                        | 36.9         |
| Properties | <b>7.4</b>                   | <b>0.1</b>                                 | <b>7.5</b>   | 7.7                          |                                            | 7.7          |
| Other      | <b>17.5</b>                  | <b>0.9</b>                                 | <b>18.4</b>  | 17.2                         | 0.5                                        | 17.7         |

The plan assets do not include any of the Group's own financial instruments, or any property occupied by the Group.

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Changes in the values of plan assets and liabilities of the retirement benefit plans are as follows:

|                                                    | 2008                |                | 2007                             |                | Total |         |
|----------------------------------------------------|---------------------|----------------|----------------------------------|----------------|-------|---------|
|                                                    | UK<br>Group<br>plan | Other<br>plans | UK<br>Group<br>plan              | Other<br>plans |       |         |
|                                                    |                     |                |                                  |                |       |         |
|                                                    |                     |                | <b>Total</b>                     |                |       |         |
|                                                    |                     |                | <b>All figures in £ millions</b> |                |       |         |
| <b>Fair value of plan assets</b>                   |                     |                |                                  |                |       |         |
| Opening fair value of plan assets                  | 1,744               | 109            | 1,853                            | 1,528          | 105   | 1,633   |
| Exchange differences                               |                     | 23             | 23                               |                | 1     | 1       |
| Expected return on plan assets                     | 104                 | 7              | 111                              | 96             | 7     | 103     |
| Actuarial gains and (losses)                       | (234)               | (34)           | (268)                            | 32             | (3)   | 29      |
| Contributions by employer                          | 54                  | 3              | 57                               | 152            | 5     | 157     |
| Contributions by employee                          | 9                   |                | 9                                | 8              |       | 8       |
| Benefits paid                                      | (72)                | (8)            | (80)                             | (72)           | (6)   | (78)    |
| Other movements                                    | (127)               |                | (127)                            |                |       |         |
| <b>Closing fair value of plan assets</b>           | <b>1,478</b>        | <b>100</b>     | <b>1,578</b>                     | 1,744          | 109   | 1,853   |
| <b>Present value of defined benefit obligation</b> |                     |                |                                  |                |       |         |
| Opening defined benefit obligation                 | (1,682)             | (129)          | (1,811)                          | (1,683)        | (127) | (1,810) |
| Exchange differences                               |                     | (38)           | (38)                             |                | 1     | 1       |
| Current service cost                               | (33)                | (3)            | (36)                             | (29)           | (2)   | (31)    |
| Past service cost                                  |                     | (1)            | (1)                              |                |       |         |
| Interest cost                                      | (93)                | (7)            | (100)                            | (84)           | (7)   | (91)    |
| Actuarial gains and (losses)                       | 189                 | 5              | 194                              | 50             |       | 50      |
| Contributions by employee                          | (9)                 |                | (9)                              | (8)            |       | (8)     |
| Benefits paid                                      | 72                  | 8              | 80                               | 72             | 6     | 78      |
| Other movements                                    | 127                 |                | 127                              |                |       |         |
| <b>Closing defined benefit obligation</b>          | <b>(1,429)</b>      | <b>(165)</b>   | <b>(1,594)</b>                   | (1,682)        | (129) | (1,811) |

During 2008 changes made to the administration of the plan assets has enabled assets relating to the defined contribution sections of the UK Group plan to be identified separately from those of the defined benefit section, for accounting purposes. Defined contribution assets will no longer be disclosed as part of the UK Group plan assets. The other movements in both the change in value of plan assets and liabilities over the year represent the separation out of these defined contribution assets.

Changes in the value of the US PRMB are as follows:

2008      2007

|                                           | <b>All figures in £<br/>millions</b> |      |
|-------------------------------------------|--------------------------------------|------|
| Opening defined benefit obligation        | <b>(47)</b>                          | (48) |
| Exchange differences                      | <b>(19)</b>                          |      |
| Current service cost                      | <b>(1)</b>                           | (1)  |
| Past service cost                         | <b>(5)</b>                           |      |
| Interest cost                             | <b>(3)</b>                           | (2)  |
| Actuarial gains and (losses)              | <b>3</b>                             | 1    |
| Benefits paid                             | <b>4</b>                             | 3    |
| <b>Closing defined benefit obligation</b> | <b>(68)</b>                          | (47) |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The history of the defined benefit plans is as follows:

|                                             | 2008                      | 2007    | 2006    | 2005    | 2004    |
|---------------------------------------------|---------------------------|---------|---------|---------|---------|
|                                             | All figures in £ millions |         |         |         |         |
| Fair value of plan assets                   | 1,578                     | 1,853   | 1,633   | 1,500   | 1,280   |
| Present value of defined benefit obligation | (1,594)                   | (1,811) | (1,810) | (1,803) | (1,615) |
| <b>Net pension asset/(liability)</b>        | <b>(16)</b>               | 42      | (177)   | (303)   | (335)   |
| Experience adjustments on plan assets       | (268)                     | 29      | 74      | 140     | 67      |
| Experience adjustments on plan liabilities  | 194                       | 50      | 28      | (119)   | (127)   |

**Funding**

The UK Group plan is self-administered with the plan's assets being held independently of the Group. The trustees of the plan are required to act in the best interest of the plan's beneficiaries. The most recently completed triennial actuarial valuation for funding purposes was completed as at 1 January 2006 and revealed a funding shortfall. The Group has agreed that the funding shortfall will be eliminated by 31 December 2014. In 2008 the Group contributed £21m (2007: £121m including a special contribution of £100m) and has agreed to contribute £21.9m per annum thereafter in excess of an estimated £30m of regular contributions.

The Group expects to contribute \$92m in 2009 and \$86m in 2010 to its US pension plans.

**Sensitivities**

The net retirement benefit obligations are calculated using a number of assumptions, the most significant being the discount rate used to calculate the defined benefit obligation. The effect of a one percentage point increase and decrease in the discount rate on the defined benefit obligation and the total pension expense is as follows:

|                                                                                  | 2008                      |             |
|----------------------------------------------------------------------------------|---------------------------|-------------|
|                                                                                  | 1%<br>increase            | 1% decrease |
|                                                                                  | All figures in £ millions |             |
| <b>Effect on:</b>                                                                |                           |             |
| (Decrease)/increase in defined benefit obligation UK Group plan                  | (180.1)                   | 209.6       |
| (Decrease)/increase of aggregate of service cost and interest cost UK Group plan | (2.2)                     | 1.1         |
| (Decrease)/increase in defined benefit obligation US plan                        | (12.2)                    | 14.5        |

The effect of a one percentage point increase and decrease in the assumed medical cost trend rates is as follows:

2008  
1% decrease



**1%**  
**increase**  
**All figures in £ millions**

**Effect on:**

|                                                                    |            |              |
|--------------------------------------------------------------------|------------|--------------|
| Increase/(decrease) in post-retirement medical benefit obligation  | <b>3.3</b> | <b>(2.9)</b> |
| Increase/(decrease) of aggregate of service cost and interest cost | <b>0.2</b> | <b>(0.1)</b> |

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****26. Share-based payments**

The Group recognised the following charges in the income statement in respect of its equity-settled share-based payment plans:

|                                        | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|----------------------------------------|----------------------------------|-------------|-------------|
|                                        | <b>All figures in £ millions</b> |             |             |
| Pearson plans                          | <b>25</b>                        | 23          | 18          |
| Interactive Data plans                 | <b>8</b>                         | 7           | 7           |
| <b>Total share-based payment costs</b> | <b>33</b>                        | 30          | 25          |

The Group operates the following equity-settled employee option and share plans:

**Worldwide Save for Shares Plan** Since 1994, the Group has operated a Save-As-You-Earn plan for UK employees. In 1998, the Group introduced a Worldwide Save for Shares Plan. Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equal to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the end of the savings period lapse unconditionally.

**Employee Stock Purchase Plan** In 2000, the Group established an Employee Stock Purchase Plan which allows all employees in the US to save a portion of their monthly salary over six month periods. At the end of the period, the employee has the option to purchase ADRs with their accumulated funds at a purchase price equal to 85% of the lower of the market price prevailing at the beginning or end of the period.

**Long-Term Incentive Plan** This plan was introduced in 2001 and renewed in 2006 and consists of two parts: share options and/or restricted shares.

Options were granted under this plan in 2001 based on a pre-grant earnings per share growth test and are not subject to further performance conditions on exercise. The options became exercisable in tranches and lapse if they remain unexercised at the tenth anniversary of the date of grant.

The vesting of restricted shares is normally dependent on continuing service over a three to five-year period, and in the case of senior management upon the satisfaction of corporate performance targets over a three year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in July 2007, March 2008 and July 2008, vest dependent on relative shareholder return, return on invested capital and earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2007 and 2008 vest depending on continuing service over a three-year period.

**Annual Bonus Share Matching Plan** This plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Group meets an earnings per share growth target, the company will match them on a gross basis of up to one share for every one held.

In addition to the above, share options remain outstanding under Executive Share Option, Reward and Special Share Option Plans. These are legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001.

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The number and weighted average exercise prices of share options granted under the Group's plans are as follows:

|                                           | 2008          |              | 2007          |              |
|-------------------------------------------|---------------|--------------|---------------|--------------|
|                                           | Number        | Weighted     | Number        | Weighted     |
|                                           | of            | average      | of            | average      |
|                                           | share         | exercise     | share         | exercise     |
|                                           | options       | price        | options       | price        |
|                                           | 000s          | £            | 000s          | £            |
| Outstanding at beginning of year          | 16,781        | 13.15        | 18,861        | 13.36        |
| Granted during the year                   | 1,437         | 5.35         | 773           | 6.90         |
| Exercised during the year                 | (683)         | 4.85         | (1,326)       | 5.80         |
| Forfeited during the year                 | (3,082)       | 11.56        | (1,434)       | 19.63        |
| Expired during the year                   | (74)          | 6.06         | (93)          | 7.68         |
| <b>Outstanding at end of year</b>         | <b>14,379</b> | <b>13.14</b> | <b>16,781</b> | <b>13.15</b> |
| <b>Options exercisable at end of year</b> | <b>11,527</b> | <b>14.97</b> | <b>13,999</b> | <b>14.63</b> |

Options were exercised regularly throughout the year. The weighted average share price during the year was £6.44 (2007: £8.02). Early exercises arising from redundancy, retirement or death are treated as an acceleration of vesting and the Group therefore recognises in the income statement the amount that otherwise would have been recognised for services received over the remainder of the original vesting period.

The options outstanding at the end of the year have weighted average remaining contractual lives and exercise prices as follows:

|                          | 2008          |             | 2007          |             |
|--------------------------|---------------|-------------|---------------|-------------|
|                          | Number        | Weighted    | Number        | Weighted    |
|                          | of            | average     | of            | average     |
|                          | share         | contractual | share         | contractual |
|                          | options       | life        | options       | life        |
|                          | 000s          | Years       | 000s          | Years       |
| Range of exercise prices |               |             |               |             |
| £                        |               |             |               |             |
| 0 - 5                    | 453           | 1.23        | 930           | 1.56        |
| 5 - 10                   | 5,113         | 2.84        | 4,909         | 3.22        |
| 10 - 15                  | 5,481         | 1.97        | 7,257         | 2.62        |
| 15 - 20                  | 908           | 0.84        | 980           | 1.85        |
| 20 - 25                  | 350           | 1.19        | 400           | 2.19        |
| >25                      | 2,074         | 1.19        | 2,305         | 2.19        |
|                          | <b>14,379</b> | <b>2.05</b> | <b>16,781</b> | <b>2.62</b> |

In 2008 and 2007 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

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The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

|                                 | <b>2008<br/>Weighted<br/>average</b> | <b>2007<br/>Weighted<br/>average</b> |
|---------------------------------|--------------------------------------|--------------------------------------|
| Fair value                      | <b>£1.67</b>                         | £2.53                                |
| Weighted average share price    | <b>£6.96</b>                         | £8.91                                |
| Weighted average exercise price | <b>£5.35</b>                         | £6.90                                |
| Expected volatility             | <b>21.41%</b>                        | 19.72%                               |
| Expected life                   | <b>4.1 years</b>                     | 4.0 years                            |
| Risk free rate                  | <b>4.28%</b>                         | 5.34%                                |
| Expected dividend yield         | <b>4.54%</b>                         | 3.29%                                |
| Forfeiture rate                 | <b>3.6%</b>                          | 3.5%                                 |

The expected volatility is based on the historic volatility of the company's share price over the previous three to seven years depending on the vesting term of the options.

The following shares were granted under restricted share arrangements:

|                                  | <b>2008<br/>Number<br/>of<br/>shares<br/>000s</b> | <b>2008<br/>Weighted<br/>average<br/>fair value<br/>£</b> | <b>2007<br/>Number<br/>of<br/>shares<br/>000s</b> | <b>2007<br/>Weighted<br/>average<br/>fair value<br/>£</b> |
|----------------------------------|---------------------------------------------------|-----------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------|
| Annual Bonus Share Matching Plan | <b>253</b>                                        | <b>6.73</b>                                               | 143                                               | 7.67                                                      |
| Long-Term Incentive Plan         | <b>4,152</b>                                      | <b>5.78</b>                                               | 3,377                                             | 7.12                                                      |

Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Until 31 December 2007, they were discounted by the dividend yield (2007: 3.26%) to take into account any dividends foregone. From 2008, shares granted include the entitlement to dividends during the vesting period and therefore the share price is not discounted. The fair value of shares granted under the Long-Term Incentive Plan that vest unconditionally is determined using the share price at the date of grant. Participants of the Long-Term Incentive Plan are entitled to dividends during the vesting period. The number of shares to vest has been adjusted, based on historical experience, to account for any potential forfeitures.

Restricted shares with a market performance condition were valued by an independent actuary using a Monte Carlo model. Restricted shares with a non-market performance condition were fair valued based on the share price at the date of grant. Non-market performance conditions were considered by adjusting the number of shares expected to vest based on the most likely outcome of the relevant performance criteria.

**Subsidiary share option plans**

Interactive Data, a 62% subsidiary of the Group, operates the following share-based payment plans:

***2001 Employee Stock Purchase Plan***

The 2001 Employee Stock Purchase Plan allows all eligible employees worldwide to purchase stock at a discounted price at specific times.

***2000 Long-Term Incentive Plan***

Under this plan, the Compensation Committee of the Board of Directors can grant share-based awards representing up to 20% of the total number of shares of common stock outstanding at the date of grant. The plan provides for the discretionary issuance of share-based awards to directors, officers and employees of Interactive Data, as well as persons who provide consulting or other services to Interactive Data. The exercise price for all options granted to date has been equal to the market price of the underlying shares at the date of

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grant. Options expire ten years from the date of grant and generally vest over a three to four-year period without any performance criteria attached.

In addition, grants of restricted stock can be made to certain executives and members of the Board of Directors of Interactive Data. The awarded shares are available for distribution, at no cost, at the end of a three-year vesting period. No performance criteria are attached to shares granted under this plan.

Interactive Data employees purchased 183,318 shares (2007: 186,343) under the 2001 Employee Stock Purchase Plan at an average share price of \$22.95 (£15.96) (2007: \$17.77; £8.93). The weighted average fair value at the date of grant was \$6.59 (£4.58) (2007: \$4.76; £2.39).

The number and weighted average exercise prices of share options granted under the 2000 Long-Term Incentive Plan are as follows:

|                                           | <b>2008</b>     | <b>2008</b>     | <b>2007</b>     | <b>2007</b>     | <b>2007</b>     | <b>2007</b>     |
|-------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                           | <b>Number</b>   | <b>Weighted</b> | <b>Weighted</b> | <b>Number</b>   | <b>Weighted</b> | <b>Weighted</b> |
|                                           | <b>of share</b> | <b>average</b>  | <b>average</b>  | <b>of share</b> | <b>average</b>  | <b>average</b>  |
|                                           | <b>options</b>  | <b>exercise</b> | <b>exercise</b> | <b>options</b>  | <b>exercise</b> | <b>exercise</b> |
|                                           | <b>000s</b>     | <b>price</b>    | <b>price</b>    | <b>000s</b>     | <b>price</b>    | <b>price</b>    |
|                                           |                 | <b>\$</b>       | <b>£</b>        |                 | <b>\$</b>       | <b>£</b>        |
| Outstanding at beginning of year          | 9,827           | 18.21           | 9.15            | 10,506          | 16.33           | 8.34            |
| Granted during the year                   | 1,449           | 24.95           | 17.35           | 1,560           | 27.17           | 13.65           |
| Exercised during the year                 | (895)           | 15.37           | 10.69           | (1,935)         | 14.88           | 7.48            |
| Forfeited during the year                 | (99)            | 22.05           | 15.34           | (293)           | 20.38           | 10.24           |
| Expired during the year                   | (18)            | 12.17           | 8.46            | (11)            | 18.12           | 9.10            |
| <b>Outstanding at end of year</b>         | <b>10,264</b>   | <b>19.38</b>    | <b>13.48</b>    | <b>9,827</b>    | <b>18.21</b>    | <b>9.15</b>     |
| <b>Options exercisable at end of year</b> | <b>6,865</b>    | <b>16.89</b>    | <b>11.75</b>    | <b>6,199</b>    | <b>15.27</b>    | <b>7.67</b>     |

The options outstanding at the end of the year have a weighted average remaining contractual life and exercise price as follows:

|                                 | <b>2008</b>        | <b>2007</b>        |
|---------------------------------|--------------------|--------------------|
|                                 | <b>Number</b>      | <b>Number</b>      |
|                                 | <b>of share</b>    | <b>of share</b>    |
|                                 | <b>options</b>     | <b>options</b>     |
|                                 | <b>000s</b>        | <b>000s</b>        |
|                                 | <b>Weighted</b>    | <b>Weighted</b>    |
|                                 | <b>average</b>     | <b>average</b>     |
|                                 | <b>contractual</b> | <b>contractual</b> |
|                                 | <b>life</b>        | <b>life</b>        |
|                                 | <b>Years</b>       | <b>Years</b>       |
| <b>Range of exercise prices</b> |                    |                    |
| <b>\$</b>                       |                    |                    |

0 4.4



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|      |     |               |            |       |     |
|------|-----|---------------|------------|-------|-----|
| 4.4  | 7.5 | <b>47</b>     | <b>1.3</b> | 72    | 2.1 |
| 7.5  | 12  | <b>1,502</b>  | <b>2.4</b> | 1,745 | 3.4 |
| 12   | 20  | <b>2,987</b>  | <b>4.6</b> | 3,464 | 5.6 |
| > 20 |     | <b>5,728</b>  | <b>8.0</b> | 4,546 | 8.5 |
|      |     | <b>10,264</b> | <b>6.2</b> | 9,827 | 6.6 |

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The fair value of the options granted under the Long-Term Incentive Plan and of the shares awarded under the 2001 Employee Stock Purchase Plan was estimated using a Black-Scholes option pricing model. The weighted average estimated fair values and the inputs into the Black-Scholes model are as follows:

|                                 | <b>Long-Term Incentive Plan</b> |                         | <b>Employee Stock Purchase Plan</b> |                         |
|---------------------------------|---------------------------------|-------------------------|-------------------------------------|-------------------------|
|                                 | <b>2008</b>                     | <b>2007</b>             | <b>2008</b>                         | <b>2007</b>             |
|                                 | <b>Weighted average</b>         | <b>Weighted average</b> | <b>Weighted average</b>             | <b>Weighted average</b> |
| Fair value                      | <b>\$ 5.58</b>                  | \$ 6.60                 | <b>\$ 6.59</b>                      | \$ 4.76                 |
| Weighted average share price    | <b>\$24.95</b>                  | \$27.17                 | <b>\$22.95</b>                      | \$17.77                 |
| Weighted average exercise price | <b>\$24.95</b>                  | \$27.17                 | <b>\$22.95</b>                      | \$17.77                 |
| Expected volatility             | <b>24.20%</b>                   | 23.40%                  | <b>33.70%</b>                       | 20.50%                  |
| Expected life                   | <b>5.7 years</b>                | 5.0 years               | <b>0.5 years</b>                    | 0.5 years               |
| Risk free rate                  | <b>1.5% to 3.5%</b>             | 4.2% to 4.9%            | <b>2.0% to 2.4%</b>                 | 4.3% to 5.1%            |
| Expected dividend yield         | <b>2.2%</b>                     | 1.9%                    | <b>2.1%</b>                         | 2.0%                    |
| Forfeiture rate                 | <b>0.0%</b>                     | 0.0%                    | <b>0.0%</b>                         | 0.0%                    |

The expected volatility is based on the historic volatility of Interactive Data's share price over the vesting term of the options.

During the year Interactive Data granted the following shares under restricted share arrangements:

|                               | <b>2008</b>                  | <b>Weighted</b>              | <b>Weighted</b>             | <b>2007</b>                  | <b>Weighted</b>              | <b>Weighted</b>             |
|-------------------------------|------------------------------|------------------------------|-----------------------------|------------------------------|------------------------------|-----------------------------|
|                               | <b>Number of shares 000s</b> | <b>average fair value \$</b> | <b>average fair value £</b> | <b>Number of shares 000s</b> | <b>average fair value \$</b> | <b>average fair value £</b> |
| 2000 Long-Term Incentive Plan | <b>194</b>                   | <b>25.43</b>                 | <b>17.69</b>                | 185                          | 27.07                        | 13.60                       |

Shares awarded under the 2000 Long-Term Incentive Plan were valued based on the share price prevailing at the date of grant.

**27. Share capital and share premium**

|                                                 | <b>Number of shares 000s</b> | <b>Ordinary shares £m</b> | <b>Share premium £m</b> |
|-------------------------------------------------|------------------------------|---------------------------|-------------------------|
| At 1 January 2007                               | 806,109                      | 202                       | 2,487                   |
| Issue of ordinary shares – share option schemes | 1,919                        |                           | 12                      |

|                            |                |            |              |
|----------------------------|----------------|------------|--------------|
| At 31 December 2007        | 808,028        | 202        | 2,499        |
| Issue of ordinary shares   |                |            |              |
| share option schemes       | 1,248          |            | 6            |
| <b>At 31 December 2008</b> | <b>809,276</b> | <b>202</b> | <b>2,505</b> |

The total authorised number of ordinary shares is 1,198m shares (2007: 1,194m shares) with a par value of 25p per share (2007: 25p per share). All issued shares are fully paid. All shares have the same rights.

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of debt (see note 18), cash and cash equivalents (see note 17) and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings (see notes 27, 28 and 29).

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The Group reviews its capital structure on a regular basis and will balance its overall capital structure through payments of dividends, new share issues as well as the issue of new debt or the redemption of existing debt in line with the financial risk policies outlined in note 19.

**28. Treasury shares**

|                             | Pearson plc                    |             | Interactive Data               |            | Total       |
|-----------------------------|--------------------------------|-------------|--------------------------------|------------|-------------|
|                             | Number<br>of<br>shares<br>000s | £m          | Number<br>of<br>shares<br>000s | £m         | £m          |
| At 1 January 2007           | 8,761                          | 130         | 6,052                          | 59         | 189         |
| Purchase of treasury shares | 4,900                          | 40          | 1,177                          | 16         | 56          |
| Release of treasury shares  | (1,900)                        | (29)        |                                |            | (29)        |
| At 31 December 2007         | 11,761                         | 141         | 7,229                          | 75         | 216         |
| Purchase of treasury shares | <b>2,028</b>                   | <b>12</b>   | <b>1,976</b>                   | <b>35</b>  | <b>47</b>   |
| Release of treasury shares  | <b>(3,341)</b>                 | <b>(41)</b> |                                |            | <b>(41)</b> |
| <b>At 31 December 2008</b>  | <b>10,448</b>                  | <b>112</b>  | <b>9,205</b>                   | <b>110</b> | <b>222</b>  |

The Group holds Pearson plc shares in trust to satisfy its obligations under its restricted share plans (see note 26). These shares, representing 1.3% (2007: 1.5%) of called-up share capital, are treated as treasury shares for accounting purposes and have a par value of 25p per share.

Interactive Data hold their own shares in respect of share buy-back programmes. These shares are held as treasury shares and have a par value of \$0.01.

The nominal value of Pearson plc treasury shares amounts to £2.6m (2007: £2.9m). The nominal value of Interactive Data treasury shares amounts to £0.06m (2007: £0.04m).

At 31 December 2008 the market value of Pearson plc treasury shares was £67.0m (2007: £86.1m) and the market value of Interactive Data treasury shares was £157.9m (2007: £119.9m).

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## Notes to the Consolidated Financial Statements (Continued)

## 29. Other reserves and retained earnings

|                                                                   | Notes | Translation<br>reserve | Fair<br>value<br>reserve | Total<br>other<br>reserves | Retained<br>earnings |
|-------------------------------------------------------------------|-------|------------------------|--------------------------|----------------------------|----------------------|
| All figures in £ millions                                         |       |                        |                          |                            |                      |
| At 1 January 2007                                                 |       | (592)                  |                          | (592)                      | 1,568                |
| Net exchange differences on translation of foreign operations     |       | 25                     |                          | 25                         |                      |
| Cumulative translation adjustment disposed subsidiaries           | 32    | 53                     |                          | 53                         |                      |
| Profit for the year attributable to equity holders of the company |       |                        |                          |                            | 284                  |
| Dividends paid to equity holders of the company                   | 9     |                        |                          |                            | (238)                |
| Equity settled transactions                                       | 26    |                        |                          |                            | 30                   |
| Actuarial gains on retirement benefit obligations Group           | 25    |                        |                          |                            | 80                   |
| Treasury shares released under employee share plans               | 28    |                        |                          |                            | (29)                 |
| Taxation on items charged to equity                               | 7     |                        |                          |                            | 29                   |
| <b>At 31 December 2007</b>                                        |       | <b>(514)</b>           |                          | <b>(514)</b>               | <b>1,724</b>         |
| Net exchange differences on translation of foreign operations     |       | <b>1,050</b>           |                          | <b>1,050</b>               |                      |
| Cumulative translation adjustment disposed subsidiaries           | 32    | <b>49</b>              |                          | <b>49</b>                  |                      |
| Cumulative translation adjustment disposed joint venture          |       | <b>1</b>               |                          | <b>1</b>                   |                      |
| Profit for the year attributable to equity holders of the company |       |                        |                          |                            | <b>292</b>           |
| Dividends paid to equity holders of the company                   | 9     |                        |                          |                            | <b>(257)</b>         |
| Equity settled transactions                                       | 26    |                        |                          |                            | <b>33</b>            |
| Actuarial losses on retirement benefit obligations Group          | 25    |                        |                          |                            | <b>(71)</b>          |
| Actuarial losses on retirement benefit obligations associate      |       |                        |                          |                            | <b>(3)</b>           |
| Treasury shares released under employee share plans               | 28    |                        |                          |                            | <b>(41)</b>          |
| Taxation on items charged to equity                               | 7     |                        |                          |                            | <b>2</b>             |
| <b>At 31 December 2008</b>                                        |       | <b>586</b>             |                          | <b>586</b>                 | <b>1,679</b>         |

The translation reserve includes exchange differences arising from the translation of the net investment in foreign operations and of borrowings and other currency instruments designated as hedges of such investments. Included in the translation reserve in 2007 was a £49m loss relating to net assets classified as held for sale.

**30. Business combinations**

On 2 January 2008 the Group acquired 100% of Money-Media, a US based company offering online news and commentary for the money management industry. On 30 January 2008 the Group completed its acquisition of 100% of Harcourt Assessment after receiving clearance from the US Department of Justice.

**Table of Contents****Notes to the Consolidated Financial Statements (Continued)**

The provisional assets and liabilities arising from acquisitions are as follows:

|                                                        | Notes | 2008                                    |                           |                        | 2007                   |
|--------------------------------------------------------|-------|-----------------------------------------|---------------------------|------------------------|------------------------|
|                                                        |       | Harcourt<br>Assessment<br>Fair<br>value | Money-Media<br>Fair value | Other<br>Fair<br>value | Total<br>Fair<br>value |
| All figures in £ millions                              |       |                                         |                           |                        |                        |
| Property, plant and equipment                          | 10    | 6                                       |                           |                        | 11                     |
| Intangible assets                                      | 11    | 174                                     | 10                        | 36                     | 197                    |
| Intangible assets – Pre-publication                    | 20    | 27                                      |                           |                        | 18                     |
| Inventories                                            |       | 7                                       |                           |                        | 15                     |
| Trade and other receivables                            |       | 48                                      | 2                         | 4                      | 28                     |
| Cash and cash equivalents                              |       | 5                                       |                           | 11                     | 16                     |
| Trade and other liabilities                            |       | (40)                                    | (4)                       | (8)                    | (38)                   |
| Financial liabilities – Borrowings                     |       |                                         |                           |                        | (1)                    |
| Current income tax liabilities                         |       |                                         |                           | (3)                    | 4                      |
| Net deferred income tax liabilities                    | 13    |                                         |                           | (4)                    | (45)                   |
| Provisions for other liabilities and charges           | 23    | (19)                                    |                           | (7)                    | (2)                    |
| Minority interest                                      |       |                                         |                           | (2)                    |                        |
| Assets held for sale                                   |       | 3                                       |                           |                        | 3                      |
| <b>Net assets acquired at fair value</b>               |       | <b>211</b>                              | <b>8</b>                  | <b>27</b>              | <b>187</b>             |
| <b>Goodwill</b>                                        | 11    | <b>113</b>                              | <b>25</b>                 | <b>15</b>              | <b>304</b>             |
| <b>Total</b>                                           |       | <b>324</b>                              | <b>33</b>                 | <b>42</b>              | <b>491</b>             |
| Satisfied by:                                          |       |                                         |                           |                        |                        |
| Cash                                                   |       | (321)                                   | (33)                      | (40)                   | (468)                  |
| Deferred consideration                                 |       |                                         |                           |                        | (12)                   |
| Net prior year adjustments                             |       | (3)                                     |                           | (2)                    | (11)                   |
| <b>Total consideration</b>                             |       | <b>(324)</b>                            | <b>(33)</b>               | <b>(42)</b>            | <b>(491)</b>           |
| Carrying value of net assets/(liabilities)<br>acquired |       | 81                                      | (2)                       | (1)                    | 41                     |
| Fair value adjustments                                 |       | 130                                     | 10                        | 28                     | 146                    |
| <b>Fair value</b>                                      |       | <b>211</b>                              | <b>8</b>                  | <b>27</b>              | <b>187</b>             |

The goodwill arising on the acquisition of Harcourt Assessment and Money-Media results from substantial cost and revenue synergies and from benefits that cannot be separately recognised, such as the assembled workforce.

The fair value adjustments relating to these acquisitions were finalised during 2008.

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|                                              | <b>Harcourt Assessment</b>       |                   |                   |
|----------------------------------------------|----------------------------------|-------------------|-------------------|
|                                              | <b>Carrying</b>                  | <b>Fair</b>       |                   |
|                                              | <b>value</b>                     | <b>value adjs</b> | <b>Fair value</b> |
|                                              | <b>All figures in £ millions</b> |                   |                   |
| Property, plant and equipment                | 7                                | (1)               | 6                 |
| Intangible assets                            | 10                               | 164               | 174               |
| Intangible assets Pre-publication            | 35                               | (8)               | 27                |
| Inventories                                  | 8                                | (1)               | 7                 |
| Trade and other receivables                  | 50                               | (2)               | 48                |
| Cash and cash equivalents                    | 5                                |                   | 5                 |
| Trade and other liabilities                  | (39)                             | (1)               | (40)              |
| Provisions for other liabilities and charges | (3)                              | (16)              | (19)              |
| Assets held for sale                         | 8                                | (5)               | 3                 |
| <b>Net assets acquired at fair value</b>     | <b>81</b>                        | <b>130</b>        | <b>211</b>        |
| <b>Goodwill</b>                              |                                  |                   | <b>113</b>        |
| <b>Total</b>                                 |                                  |                   | <b>324</b>        |

|                                          | <b>Money-Media</b>               |                   |                   |
|------------------------------------------|----------------------------------|-------------------|-------------------|
|                                          | <b>Carrying</b>                  | <b>Fair</b>       |                   |
|                                          | <b>value</b>                     | <b>value adjs</b> | <b>Fair value</b> |
|                                          | <b>All figures in £ millions</b> |                   |                   |
| Intangible assets                        |                                  | 10                | 10                |
| Trade and other receivables              | 2                                |                   | 2                 |
| Trade and other liabilities              | (4)                              |                   | (4)               |
| <b>Net assets acquired at fair value</b> | <b>(2)</b>                       | <b>10</b>         | <b>8</b>          |
| <b>Goodwill</b>                          |                                  |                   | <b>25</b>         |
| <b>Total</b>                             |                                  |                   | <b>33</b>         |

**Net cash outflow on acquisition:**

|                                | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|--------------------------------|----------------------------------|-------------|-------------|
|                                | <b>All figures in £ millions</b> |             |             |
| Cash Current year acquisitions | (394)                            | (468)       | (382)       |

|                                                               |              |              |              |
|---------------------------------------------------------------|--------------|--------------|--------------|
| Cash Acquisitions yet to complete                             | (12)         |              |              |
| Deferred payments for prior year acquisitions and other items | (5)          | (4)          | (9)          |
| Cash and cash equivalents acquired                            | 16           |              | 28           |
| <b>Cash outflow on acquisition</b>                            | <b>(395)</b> | <b>(472)</b> | <b>(363)</b> |

Harcourt Assessment contributed £150m of sales and £25m to the Group's profit before tax between the date of acquisition and the balance sheet date. Money-Media contributed £9m of sales and £4m to the Group's profit before tax between the date of acquisition and the balance sheet date. Other businesses acquired contributed £2m to the Group's sales and £1m to the Group's profit before tax between the date of acquisition and the balance sheet date.

If the acquisitions had been completed on 1 January 2008, the Group estimates that sales for the period would have been £4,826m and profit before tax would have been £587m.

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**Table of Contents****Notes to the Consolidated Financial Statements (Continued)****31. Non-current assets classified as held for sale**

In 2007, assets classified as held for sale related to Data Management. The Group recognised an impairment on the goodwill allocated to the Data Management business in anticipation of the loss on disposal (see note 3). There are no assets or liabilities classified as held for sale at the 2008 balance sheet date.

|                                                                                            | Notes | 2008 | 2007       |
|--------------------------------------------------------------------------------------------|-------|------|------------|
| Property, plant and equipment                                                              | 10    |      | 7          |
| Intangible assets – Goodwill                                                               |       |      | 96         |
| Intangible assets – Pre-publication                                                        | 20    |      | 2          |
| Inventories                                                                                |       |      | 4          |
| Trade and other receivables                                                                |       |      | 8          |
| <b>Non-current assets classified as held for sale</b>                                      |       |      | <b>117</b> |
| Other liabilities                                                                          |       |      | (9)        |
| <b>Liabilities directly associated with non-current assets classified as held for sale</b> |       |      | <b>(9)</b> |
| <b>Net assets classified as held for sale</b>                                              |       |      | <b>108</b> |

**32. Disposals**

|                                              | 2008                      |       | 2007  | 2006  |
|----------------------------------------------|---------------------------|-------|-------|-------|
|                                              | Data<br>Management        | Other | Total | Total |
|                                              | All figures in £ millions |       |       |       |
| <b>Disposal of subsidiaries</b>              |                           |       |       |       |
| Property, plant and equipment                | (7)                       |       | (7)   | (16)  |
| Intangible assets                            | (1)                       |       | (1)   | (6)   |
| Intangible assets – Pre-publication          | (2)                       |       | (2)   |       |
| Inventories                                  | (4)                       | (3)   | (7)   | (1)   |
| Trade and other receivables                  | (8)                       |       | (8)   | (95)  |
| Cash and cash equivalents                    |                           |       |       | (14)  |
| Net deferred income tax liabilities          |                           |       |       | 2     |
| Trade and other liabilities                  | 9                         |       | 9     | 73    |
| Retirement benefit obligations               |                           |       |       | 3     |
| Provisions for other liabilities and charges |                           |       |       | 1     |
| Minority interest                            |                           | (5)   | (5)   | (8)   |
| Attributable goodwill                        | (98)                      | (8)   | (106) | (250) |
| Cumulative translation adjustment            | (49)                      |       | (49)  | (53)  |

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|                              |              |             |              |       |      |
|------------------------------|--------------|-------------|--------------|-------|------|
| <b>Net assets disposed</b>   | <b>(160)</b> | <b>(16)</b> | <b>(176)</b> | (364) | (10) |
| Cash received                | <b>111</b>   | <b>15</b>   | <b>126</b>   | 495   | 10   |
| Deferred receipts            |              | <b>2</b>    | <b>2</b>     |       |      |
| Other proceeds received      |              |             |              | 35    |      |
| Costs                        | <b>(4)</b>   | <b>(1)</b>  | <b>(5)</b>   | (20)  |      |
| <b>(Loss)/profit on sale</b> | <b>(53)</b>  |             | <b>(53)</b>  | 146   |      |

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|                                    | 2008       | 2007 | 2006 |
|------------------------------------|------------|------|------|
| <b>Cash flow from disposals</b>    |            |      |      |
| Cash Current year disposals        | 126        | 495  | 10   |
| Costs paid                         | (15)       | (12) |      |
| Cash and cash equivalents disposed |            | (14) |      |
| <b>Net cash inflow</b>             | <b>111</b> | 469  | 10   |

Further details of the Data Management business disposal are shown in note 3.

**33. Cash generated from operations**

|                                                           | Notes | 2008       | 2007  | 2006 |
|-----------------------------------------------------------|-------|------------|-------|------|
| All figures in £ millions                                 |       |            |       |      |
| Net profit                                                |       | 323        | 310   | 469  |
| <b>Adjustments for:</b>                                   |       |            |       |      |
| Income tax                                                |       | 209        | 222   | 19   |
| Depreciation                                              | 10    | 80         | 68    | 77   |
| Amortisation of purchased intangible assets               | 11    | 86         | 45    | 28   |
| Adjustment on recognition of pre-acquisition deferred tax |       |            |       | 7    |
| Amortisation of other intangible assets                   | 11    | 30         | 25    | 23   |
| Loss on sale of property, plant and equipment             |       | 1          | 1     | 2    |
| Net finance costs                                         | 6     | 91         | 106   | 74   |
| Share of results of joint ventures and associates         | 12    | (25)       | (23)  | (24) |
| Loss/(profit) on sale of discontinued operations          | 3     | 53         | (146) |      |
| Goodwill impairment of discontinued operation             | 3     |            | 97    |      |
| Net foreign exchange adjustment from transactions         |       | 105        | 11    | (37) |
| Share-based payment costs                                 | 26    | 33         | 30    | 25   |
| Pre-publication                                           |       | (58)       | (38)  | (3)  |
| Inventories                                               |       | (12)       | (1)   | (16) |
| Trade and other receivables                               |       | (81)       | (5)   | (60) |
| Trade and other liabilities                               |       | 82         | 80    | 54   |
| Retirement benefit obligations                            |       | (14)       | (126) | (17) |
| Provisions for other liabilities and charges              |       | (9)        | 3     |      |
| <b>Net cash generated from operations</b>                 |       | <b>894</b> | 659   | 621  |

Net cash generated from operations is translated at an exchange rate approximating to the rate at the date of cash flow. In 2008 the difference between this rate and the average rate used to translate profit gives rise to a large currency adjustment in the reconciliation between net profit and net cash generated from operations. This adjustment reflects the timing difference between recognition of profit and the related cash receipts or payments.

Included in net cash generated from operations is an amount of £nil (2007: £7m; 2006: £33m) relating to discontinued operations.

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In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

|                                                            | <b>2008</b>                      | <b>2007</b> | <b>2006</b> |
|------------------------------------------------------------|----------------------------------|-------------|-------------|
|                                                            | <b>All figures in £ millions</b> |             |             |
| Net book amount                                            | <b>3</b>                         | 15          | 10          |
| Loss on sale of property, plant and equipment              | <b>(1)</b>                       | (1)         | (2)         |
| <b>Proceeds from sale of property, plant and equipment</b> | <b>2</b>                         | 14          | 8           |

The principal other non-cash transactions are movements in finance lease obligations of £2m (2007: £4m; 2006: £4m).

**34. Contingencies**

There are contingent Group liabilities that arise in the normal course of business in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities of the Group in respect of legal claims. None of these claims are expected to result in a material gain or loss to the Group.

**35. Commitments****Capital commitments**

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

|                               | <b>2008</b>                      | <b>2007</b> |
|-------------------------------|----------------------------------|-------------|
|                               | <b>All figures in £ millions</b> |             |
| Property, plant and equipment |                                  | 3           |

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms and renewal rights. The Group also leases various plant and equipment under operating lease agreements, also with varying terms. The lease expenditure charged to the income statement during the year is disclosed in note 4.

The future aggregate minimum lease payments in respect of operating leases are as follows:

|                         | <b>2008</b>                      | <b>2007</b> |
|-------------------------|----------------------------------|-------------|
|                         | <b>All figures in £ millions</b> |             |
| Not later than one year | <b>149</b>                       | 123         |
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|                                                      |              |       |
|------------------------------------------------------|--------------|-------|
| Later than one year and not later than two years     | <b>138</b>   | 116   |
| Later than two years and not later than three years  | <b>129</b>   | 102   |
| Later than three years and not later than four years | <b>118</b>   | 93    |
| Later than four years and not later than five years  | <b>108</b>   | 85    |
| Later than five years                                | <b>970</b>   | 834   |
|                                                      | <b>1,612</b> | 1,353 |

### **36. Related party transactions**

***Joint ventures and associates*** Amounts advanced to joint ventures and associates during the year and at the balance sheet date are set out in note 12. Amounts falling due from joint ventures and associates are set out in note 22.

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*Key management personnel* are deemed to be the members of the board of directors of Pearson plc. It is this board which has responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the directors' remuneration report.

There were no other material related party transactions.

No guarantees have been provided to related parties.

**37. Events after the balance sheet date**

During 2008 Pearson's International Education business announced its intention to increase its stakes in Longman Nigeria from 29% to 51% for £9m and Maskew Miller Longman (MML), its South African publishing business, from 50% to 85%.

Under the terms of the MML agreement, Pearson intends to create a new Southern Africa business and in return for the increased stake in MML our current joint venture partner will receive £46m in cash and a 15% interest in Pearson's Heinemann and Edexcel businesses in that region.

In addition Pearson's International Education business also announced the acquisition of Fronter, a European online learning company based in Oslo, for £16m.

The Longman Nigeria acquisition completed in early January 2009 and the Fronter acquisition in February 2009. The MML transaction is expected to complete in the second quarter of 2009 following regulatory approval.

**SIGNATURES**

The registrant hereby certifies that it meets the requirements for filing on Form 20-F and that it has caused and authorized the undersigned to sign this annual report on its behalf.

Pearson plc

/s/ Robin Freestone  
Robin Freestone  
Chief Financial Officer

Date: March 26, 2009

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