

Pearson PLC, 2013

www.pearson.com, PSORF or PSON (London exchange)

Headquartered in London, United Kingdom, Pearson is the largest education company and the largest book publisher in the world. Pearson is organized into three main business groupings: (1) Pearson Education (digital learning, education publishing and services including Poptropica and eCollege); (2) Financial Times (FT) Group (business information, including the *Financial Times* newspaper); and (3) Penguin Group (consumer publishing, including the Dorling Kindersley and Penguin Classics imprints). In late 2011, Pearson acquired Global Education and Technology Group. In 2012, Pearson acquired Certiport, Inc., Author Solutions, Inc. (ASI), and EmbanetCompass.

In late 2012, Pearson agreed to merge its Penguin Books division with Bertelsmann's Random House to create the world's biggest book publisher, a newly created joint venture named Penguin Random House. Bertelsmann will own 53 percent of the joint venture and Pearson will own 47 percent. The joint venture excludes Bertelsmann's trade publishing business in Germany and Pearson retains rights to use the Penguin brand in education markets worldwide. The newly formed company is subject to customary regulatory and other approvals but is expected to complete in the second half of 2013.

In October 2013, Harish Manwani joined the board of directors of Pearson. Harish is Chief Operating Officer of the global consumer products company Unilever. Harish is a graduate from Bombay University and holds a Masters degree in management studies. Pearson chairman Glen Moreno said: "Harish brings to Pearson a deep knowledge of emerging markets, an understanding of the rapidly growing middle class in those countries, and senior experience in a successful global organization. This background is very relevant to our transformation of Pearson into the world's leading learning company." Harish replaces Dr. Susan Fuhrman on the Pearson board; Susan is President of Teachers College, Columbia University. Pearson also recently announced another appointment to its board, Linda Lorimer, Vice President of Yale University.

History

Founded by Samuel Pearson in 1844, Pearson originally was a building and engineering firm operating under the name of *S. Pearson & Son*. In 1880, control passed to grandson Weetman Pearson, an engineer later known as Lord Cowdray, who in 1890 moved the business to London and turned it into one of the world's largest construction companies. Pearson was listed on the London Stock Exchange in 1969. Pearson acquired Penguin Books in 1970 and Ladybird Books in 1972.

During the 1990s, Pearson acquired a number of TV production and broadcasting assets and sold most of its nonmedia assets, under the leadership of future U.S. Congressman Bob Turner. Pearson acquired the education division of Simon & Schuster in 1998 from Viacom and merged with its own education unit, Addison-Wesley Longman, to form Pearson Education.

In 2000, Pearson acquired National Computer Systems and entered the educational assessment and school management systems market in the United States. That same year, Pearson acquired Dorling Kindersley, the illustrated reference publisher and integrated it within Penguin. In 2006, Pearson acquired National Evaluation Systems, Inc. (NES; Amherst, MA), a provider of customized state assessments for teacher certification in the USA. Pearson completed the acquisition of Harcourt Assessment in 2008, merging the acquired businesses into Pearson Assessment Information. In that same year, Pearson acquired eCollege, a digital learning technology group valued at \$477M. In 2011, Pearson created the Pearson College, a British degree provider based in London and Manchester. Also that year, Pearson acquired Connections Education.

In late 2012, Pearson acquired KEV Group, the North American leader in the management and accounting of school activity funds and online payments. KEV Group's *School Cash Suite* products manage all aspects of every dollar that comes into secondary schools. Whether cash, check or an online transaction, KEV's products help more than 4,000 schools reduce fraud

EXHIBIT 2 Pearson's Segment

All figures in £ millions	2012						
	North American Education	International Education	Professional	FT Group	Corporate	Discontinued operations	Group
Continuing operations							
Sales (external)	2,658	1,568	390	443	—	—	5,059
Sales (inter-segment)	5	1	12	—	—	—	18
Adjusted operating profit	536	216	37	49	—	—	838
Intangible charges	(66)	(73)	(37)	(4)	—	—	(180)
Acquisition costs	(7)	(8)	(1)	(4)	—	—	(20)
Other net gains and losses	—	—	(123)	—	—	—	(123)
Operating profit	463	135	(124)	41	—	—	515
All figures in £ millions	2011						
	North American Education	International Education	Professional Education	FT Group	Corporate	Discontinued Operations	Group
Continuing operations							
Sales (external)	2,584	1,424	382	427	—	—	4,817
Sales (inter-segment)	3	—	9	—	—	—	12
Adjusted operating profit	493	196	66	76	—	—	831
Intangible charges	(57)	(60)	(11)	(8)	—	—	(136)
Acquisition costs	(2)	(9)	—	(1)	—	—	(12)
Other net gains and losses	29	(6)	—	412	—	—	435
Operating profit	463	121	55	479	—	—	1,118

million were from North America, £1.568 billion from International, £390 million were from Professional, and £443 million from Financial Times (FT) Group—as indicated in Exhibit 2. Note in Exhibit 3 that Pearson had 2012 revenue declines in three regions, but sales were up in the USA slightly.

Pearson Education

Pearson Education provides textbooks and digital technologies to teachers and students across all ages. Pearson's education brands include Bug Club, Edexcel, Financial Times Publishing, Pearson, MyEnglishLab, and BBC Active. Pearson's education brands in North America include College, Poptropica, FT Press, MyLabs/Mastering, SAMS Publishing, and Que Publishing. Pearson generates about 60 percent of its education sales in North America but operates in more than 70 countries. Pearson publishes across the curriculum under a range of brand names including Scott Foresman, Prentice Hall, Addison-Wesley, Allyn and Bacon, Benjamin Cummings, and Longman.

Pearson's Prentice Hall division is the market leader in higher education publishing across all discipline areas; Pearson's Addison Wesley and Benjamin Cummings are premier publishers in computing, economics, finance, mathematics, science, and statistics; Pearson's Longman focuses on materials in English, history, philosophy, political science, and religion; and Allyn and Bacon focuses on the social sciences, humanities, and education disciplines.

In 2013, Pearson Education reorganized into three main divisions: Pearson International Education, Pearson North American Education, and Professional Education. Pearson International Education is headquartered in London, with offices across Europe, Asia, and South America. Pearson North American Education is headquartered in Upper Saddle River, New Jersey, with major business units based

and significantly decrease their workload. Limiting cash in a school system and increasing transparency of cash that does come in decreases the risk of bullying, reduces classroom distractions, and ensures maximum efficiency for all users.

Internal Issues

Vision and Mission

Pearson has no clearly stated vision or mission statement. However, there is a statement at the Pearson website, under the Strategy icon, that may be the firm's mission statement. It reads: "Pearson's goal is to help people make progress in their lives through learning. We aim to be the world's leading learning company, serving the citizens of a brain-based economy wherever and whenever they are learning."

Strategy

Pearson's strategy, as stated on the company website, consists of four initiatives, paraphrased as follows to focus on:

1. Long-term organic investment in content,
2. Digital products and services businesses—Add services to our content, usually enabled by technology; Pearson's digital revenues were £2bn or 33 percent of total sales.
3. International expansion—Pearson sells in more than 70 countries, but desires new particular emphasis on fast-growing markets in China, India, Africa and Latin America. In 2011, Pearson generated \$1bn of revenue in developing markets for the first time, accounting for 11 percent of total sales and 22 percent of employees.
4. Efficiency—Pearson profit margins have increased to 16.1 percent and the ratio of average working capital to sales has improved from 20.1 percent to 16.9 percent.

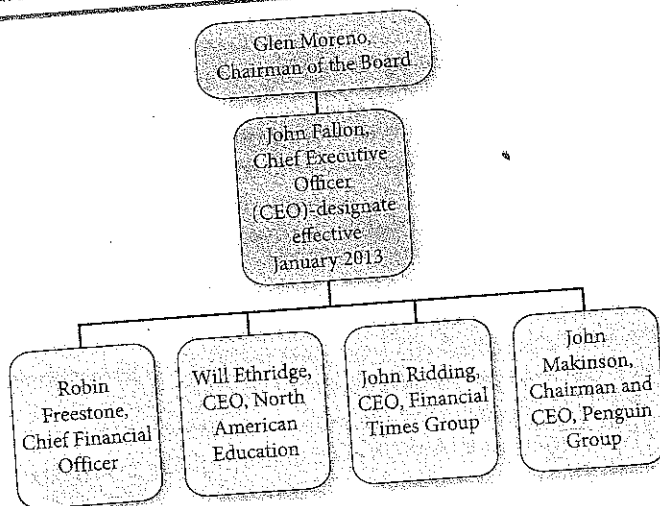
Organizational Structure

On the Pearson website, the top management team is listed under the Board of Directors icon. Pearson's organizational chart is provided in Exhibit 1. Chief executive officer (CEO) John Fallon replaced CEO Marjorie Scardino on January 1, 2013.

Segments

Pearson is organized into four main business groupings: (1) Pearson International Education, (2) Pearson North American Education, and (3) Professional Education and FT Group. In 2012 Pearson generated total revenues of £5.059 billion, as indicated in Exhibit 2. £2.63

EXHIBIT 1 Pearson's Organizational Structure



Source: Based on company documents.

EXHIBIT 2 F

All figures in
£ millions

Continuing

Sales (extern

Sales (inter-

Adjusted op

Intangible c

Acquisition

Other net g

Operating

All figure
£ million

Continui

Sales (ex

Sales (in

Adjusted

Intangib

Acquisi

Other n

Opera

billion

Profes

Note: 1

the U

Pears

Pear

all a

Pro

Co

Pear

man

ing

an

all

Co

Pear

man

ing

an

EXHIBIT 3 Pearson's Revenues By Region

All figures in £ millions	Sales	
	2012	2011
Continuing operations		
UK	705	713
Other European countries	391	394
USA	2,800	2,707
Canada	145	150
Asia Pacific	647	514
Other countries	371	339
Total continuing	5,059	4,817
Discontinued operations		
UK	160	152
Other European countries	78	77
USA	603	606
Canada	56	59
Asia Pacific	139	132
Other countries	17	19
Total discontinued	1,053	1,045
Total	6,112	5,862

in San Francisco, Boston, Columbus, Indianapolis, and Chandler (Arizona). In 2012, Pearson International Education had revenues of £1,568 million, Pearson North American Education had revenues of £2,658 million, and Professional Education had revenues of £443 million.

The North American segment had 2012 operating profits of £536 million. Student registration for MyLab grew 11 percent to almost 10 million. Student registrations in 2012 at Pearson's eCollege grew 3 percent to 8.7 million. Also in North America, Pearson's Connection Education, which operates online K-12 schools in 22 states, served more than 43,000 students up 31 percent from 2011.

Pearson's International Education segment reported 2012 operating profits of £216 million, partly due to student enrollments in China at Wall Street English (WSE), increasing 15 percent to 61,000. WSE is Pearson's worldwide chain of English language centers for professionals with 11 new WSE centers opened in 2012. Pearson did especially well in 2012 in India with its TutorVista program and in Mexico with the launch of UTEL, a new university enabling Mexicans to enroll in online business courses. Also in the International segment, Pearson VUE test volumes grew 7 percent in 2012 to almost 8 million.

Financial Times Group

The FT Group provides business and financial news, data, comment, and analysis in print and online. FT Publishing includes: the *Financial Times* newspaper and FT.com website; a range of specialist financial magazines and online services; and Mergermarket, a financial data vendor. The FT Group also has shareholdings in *Business Day* and *Financial Mail* (BDFM) of South Africa (50 percent stake) and *The Economist* (50 percent stake). Pearson's FT group reported 2012 operating profits of £49 million, with digital subscriptions increasing 18 percent to almost 316,000 and with 3.5 million FT web app users. The *Economist* (50% owned by Pearson) reported in 2012 a 2 percent increase in worldwide printed digital circulation.

Penguin Group

Penguin Group is an international consumer publisher, which includes imprints such as Allen Lane, Avery, Berkley Books, dial, Dutton, Dorling Kindersley, Grosset & Dunlap, Hamish Hamilton, Ladybird, Plume, Puffin, Penguin, Putnam, Michael Joseph, Riverhead, and Viking. Penguin publishes around 4,000 titles every year and its range of titles

includes classics, merge Penguin Group book publisher—own 47 percent. £98 million. E-book revenue.

Pearson now in 2012, Penguin

Finance

Note in the income statement profits in 2012. Pearson balance

External

Total U.S. college publishing market (AAP). AAP also

Competitor

The world of publishing is avoiding books

EXHIBIT 4

All figures in

Sales

Cost of goods

Gross profit

Operating ex

Profit on sale

Loss on clos

Share of res

Operating pr

Finance cost

Finance inc

Profit before

Income tax

Profit for th

Profit for th

Profit for th

Profit for th

Attributabl

Equity hol

Non-cont

Earnings

and dis

equity

expenses

Income

Statement

includes classics, reference volumes, and children's titles. In October 2012, Pearson agreed to merge Penguin Group with Bertelsmann's Random House to create the world's biggest trade book publisher—Penguin Random House. Bertelsmann will own 53 percent and Pearson will own 47 percent. Penguin reported 2012 revenue of £1,053 million and operating profits of £98 million. E-book revenue grew strongly and accounted for 17 percent of Penguin's global revenue.

Pearson now owns 47 percent of the new Penguin/Random House publishing company. In 2012, Penguin published 255 *New York Times* bestsellers.

Finance

Note in the income statements in Exhibit 4 that Pearson reported increasing revenues but declining profits in 2012. The decline in earnings resulted in a decline in 2012 retained earnings on the Pearson balance sheets, as shown in Exhibit 5.

External

Total U.S. college enrollments declined 2 percent in 2012 while the overall higher education publishing market declined 6 percent, according to the Association of American Publishers (AAP). AAP also reported a 15 percent decline in the textbook publishing market in 2012.

Competitors

The world of book publishing is changing rapidly as e-books, renting books, sharing books, avoiding books, photocopying books, scanning books, creating custom books, using e-readers

EXHIBIT 4 Pearson's Income Statements

Year ended 31 December 2012		
All figures in £ millions	2012	2011
Sales	5,059	4,817
Cost of goods sold	(2,224)	(2,072)
Gross profit	2,835	2,745
Operating expenses	(2,216)	(2,072)
Profit on sale of associate	—	412
Loss on closure of subsidiary	(113)	—
Share of results of joint ventures and associates	9	33
Operating profit	515	1,118
Finance costs	(113)	(96)
Finance income	32	25
Profit before tax	434	1,047
Income tax	(148)	(162)
Profit for the year from continuing operations	286	885
Profit for the year from discontinued operations	43	71
Profit for the year	329	956
Attributable to:		
Equity holders of the company	326	957
Non-controlling interest	3	(1)
Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)		
Basic	40.5p	119.6p
Diluted	40.5p	119.3p

EXHIBIT 5 Pearson's Balance Sheets

As of 31 December 2012		
All figures in £ millions	2012	2011
Assets		
Non-current assets		
Property, plant and equipment	327	383
Intangible assets	6,218	6,342
Investments in joint ventures and associates	15	32
Deferred income tax assets	229	287
Financial assets—Derivative financial instruments	174	177
Retirement benefit assets	—	25
Other financial assets	31	26
Trade and other receivables	79	151
	7,073	7,423
Current assets		
Intangible assets—Pre-publication	666	650
Inventories	261	407
Trade and other receivables	1,104	1,386
Financial assets—Derivative financial instruments	4	—
Financial assets—Marketable securities	6	9
Cash and cash equivalents (excluding overdrafts)	1,062	1,369
	3,103	3,821
Assets classified as held for sale	1,172	—
Total assets	11,348	11,244
Liabilities		
Non-current liabilities		
Financial liabilities—Borrowings	(2,010)	(1,964)
Financial liabilities—Derivative financial instruments	—	(2)
Deferred income tax liabilities	(601)	(620)
Retirement benefit obligations	(172)	(166)
Provisions for other liabilities and charges	(110)	(115)
Other liabilities	(282)	(325)
	(3,175)	(3,192)
Current liabilities		
Trade and other liabilities	(1,556)	(1,741)
Financial liabilities—Borrowings	(262)	(87)
Financial liabilities—Derivative financial instruments	—	(1)
Current income tax liabilities	(291)	(213)
Provisions for other liabilities and charges	(38)	(48)
	(2,147)	(2,090)
Liabilities directly associated with assets classified as held for sale	(316)	—
Total liabilities	(5,638)	(5,282)
Net assets	5,710	5,962

EXHIBIT 5 Co

All figures in £

Equity

Share capital
Share premium
Treasury shares
Translation reserve
Retained earnings
Total equity at the company
Non-controlling interest
Total equity
Total Liabilities

permeate today's
climatic size b
changing enviro
The situat
e-commerce, r
ers. A few of
Wiley, Hough
Universe are
publisher, whi
imitating their
that can be ex
A financ
view of each f
McGraw-Hill

McGraw-Hill
Headquarters
and related
through McG
credit ratings
Commodities
and Aviation

EXHIBIT 6

Sales (\$)
Net Income
Profit Margin
Return to Equity
EPS (\$)
Market Cap
Number of
EPS Earnings
Base

EXHIBIT 5 Continued

All figures in £ millions	2012	2011
Equity		
Share capital	204	204
Share premium	2,555	2,544
Treasury shares	(103)	(149)
Translation reserve	128	364
Retained earnings	2,902	2,980
Total equity attributable to equity holders of the company	5,686	5,943
Non-controlling interest	24	19
Total equity	5,710	5,962
Total Liabilities and Equity	11,348	11,244

permeate today's publishing landscape. The historical day of students carrying around encyclopedic size books is drawing to an end. Although great news for students and customers, this changing environment makes book publishing much more risky for both publishers and authors.

The situation described leads to increased competition daily on many fronts such as price, e-commerce, new entrants, ancillary offerings, acquisitions, divestitures, and weakened players. A few of Pearson's major rivals in this turbulent environment are McGraw-Hill, John Wiley, Houghton Mifflin, and Thomson Reuters, but even online book publishers such as iUniverse are attacking from new directions. Pearson is the largest and most profitable book publisher, which in a sense makes Pearson most vulnerable to competitor's duplicating and imitating their product offerings, and continually examining Pearson for potential weaknesses that can be exploited.

A financial comparison of each rival firm is provided in Exhibit 6, followed by a brief overview of each firm. Note in Exhibit 4 that Pearson's earnings per share (EPS) is lower than both McGraw-Hill and John Wiley.

McGraw-Hill Companies, Inc. (NYSE: MPH)

Headquartered in New York City, McGraw-Hill is a leading producer of textbooks, tests, and related materials, serving the elementary, secondary, and higher education markets through McGraw-Hill Education (MHE). Other businesses include S&P Ratings (indexes and credit ratings); S&P Capital IQ and S&P Indices (financial and business information); and Commodities and Commercial (Platts, J.D. Power and Associates, McGraw-Hill Construction, and Aviation Week).

EXHIBIT 6 A Comparison of Publishers

	Pearson	McGraw-Hill	John Wiley	Thomson Reuters
Sales (\$)	5.09B£	6.35B	1.75B	13.45B
Net Income (\$)	329M£	789M	190M	-877M
Profit Margin (%)	6.46	13.01	10.89	-6.45
Debt-to-Equity Ratio	0.41	0.67	0.64	0.43
EPS (\$)	0.40£	3.03	3.14	-1.06
Market Capitalization (\$)	10.6B£	14.97B	2.27B	23.83B
Number of Shares Out	817M	277M	60.15M	826M

EPS, earnings per share.

Source: Based on company documents.

McGraw-Hill announced in late 2012 that it is divesting its education division for \$2.5 billion to Apollo Global Management LLC (APO). McGraw-Hill's education division had been reporting shrinking revenues over recent years, partly as a result of reduced spending on textbooks by the government (and students). Also, McGraw-Hill was facing difficulty with its plans to develop its education division into a subscription-based model through digital delivery. The new McGraw-Hill, without the education division, is being renamed McGraw-Hill Financial and will primarily focus on capital and commodities markets and include iconic brands like S&P Ratings, S&P Capital IQ, and S&P Indices. McGraw-Hill Companies expected revenues of approximately \$4.4 billion from McGraw-Hill Financial in 2012, with approximately 40 percent of it coming from international avenues.

John Wiley & Sons (NYSE: JW-A)

Headquartered in Hoboken, New Jersey, John Wiley publishes scientific, technical, and medical works, including journals and reference works such as *Current Protocols* and *Kirk-Othmer Encyclopedia of Chemical Technology*. Wiley publishes more than 1,600 journal titles, produces professional and nonfiction trade books, and is a publisher of college textbooks. Wiley also publishes the *For Dummies* how-to series, the travel guide brand Frommer's, and CliffsNotes study guides, as well. Wiley has publishing, marketing, and distribution centers on four continents: North America, Europe, Asia, and Australia. For second quarter of 2012 that ended October 31, 2012, Wiley reported a slight decline in revenue compared to the same period in the previous fiscal year, and a 15-percent decrease in net income. Wiley has a market capitalization of \$2.3 billion.

Houghton Mifflin Harcourt Publishing Company

Headquartered in Boston Massachusetts, Houghton Mifflin is a publisher of pre-K through grade 12 educational material, as well as textbooks and printed materials. The company provides digital content online and via CD-ROM and publishes fiction (including J. R. R. Tolkien's *The Lord of the Rings* series), as well as nonfiction titles and reference materials, and offers professional resources and educational services to teachers. Although founded back in 1831, Houghton Mifflin today is owned by private-equity concerns, including hedge fund Paulson & Co. The company filed for bankruptcy in 2012.

Thomson Reuters (NYSE: TRI)

Headquartered in New York City, Thomson Reuters is the market leader in financial data (ahead of rival information provider Bloomberg), providing electronic information and services to businesses and professionals worldwide, serving the financial services, media, legal, tax and accounting, and science markets. Nearly all Thomson Reuters' revenues come from subscription sales to its plethora of offerings.

For the third quarter of 2012, Thomson Reuters reported revenues of \$3.2 billion, a 7-percent decline from the same period last year. Its net profit rose, however, by 24 percent to \$474 million. Thomson Reuters' best performing division is tax and accounting, but the firm reports flat or declining revenues in all its other divisions. Rumors circulated in 2012 that Thomson Reuters was maneuvering to buy Pearson's *Financial Times* newspaper.

The Future

The digital world is rapidly eroding Pearson's traditional book publishing business model. Luyen Chou, chief product officer for Pearson's K-12 technology group, summed it up best when he recently said: "Pearson needs to become an 'Electronic Arts' [EA] for education. To keep up with the changing environment, we can't just digitize the static textbooks of the past; we need to excel at producing high-quality, interactive digital learning experiences and get them into the hands of students. That includes digital studios, animators, illustrators, producers, and 3-D artists. We need to build that capacity from within and we need the whole supply chain to take that from the studio to the actual users. The folks that have done that well are the Electronic Arts type companies of the world, digital studios. That's not a core competency for companies like Pearson. We have to make sure that we're complementing our data and platform with high-quality interactive learning content."

In late 2012, Blackboard Inc. and Pearson reached an agreement to expand the availability of Pearson's leading learning solution—MyLab & Mastering—with Blackboard Learn, the market-leading learning management system (LMS). Previously available in North America, the integration is now available in most markets worldwide.

The systems integration includes state-of-the-art web services that enable instructors to find and access MyLab & Mastering within their Blackboard learning system. For example, faculty can synchronize grade books, transfer information and create corresponding links in both systems, and customize courses by choosing content and rearranging items in the content area and course navigation bar. For example, Dr. Salim M. Salim, head of the Mathematics Department at Qatar University said: "The integration of MyLab & Mastering and Blackboard Learn has created not only a more enriched teaching and learning experience, but it also makes my job much more convenient. The single sign on, grade book synchronization, personalized study paths and real-time evaluations allow me and my students to easily benefit from the powerful tools both systems offer."

Given the changing world of textbook publishing and publishing in general, Pearson is engaged in a competitive fight with rival McGraw-Hill for market share in the USA and indeed globally. McGraw-Hill's Connect software competes fiercely with Pearson's MyLab. Prepare a three-year strategic plan for Pearson.