

*Pearson Annual Review 2003*

PEARSON

The Pearson logo consists of the word "PEARSON" in a white, sans-serif, all-caps font. Below the text is a white, curved line that starts under the 'P', goes up to touch the 'A', dips down to touch the 'O', and then goes up to touch the 'N'.

## Financial highlights

	2003 £m	\$m	2002 £m	\$m	Change – underlying %	Change – constant currency %	Change – headline %
Sales	4,048	7,246	4,320	7,733	(4)	(2)	(6)
<b>Business performance*</b>							
Operating profit	490	877	493	882	0	5	(1)
Profit before tax	410	734	399	714		8	3
Adjusted earnings per share	32.0p	57.3¢	30.3p	54.2¢		11	6
Operating free cash flow	210	376	305	546			(31)
Free cash flow	192	344	215	385			(11)
Operating margin	12.1%		11.4%				
Return on invested capital	6.3%		6.0%				
<b>Statutory results</b>							
Operating profit	226	405	143	256			58
Profit/(loss) before tax	152	272	(25)	(45)			–
Basic earnings/(loss) per share	6.9p	12.4¢	(13.9)p	(24.9)¢			–
Dividends per share	24.2p	43.3¢	23.4p	41.9¢			3
Net borrowings	1,361	2,436	1,408	2,520			(3)

\* Continuing operations adjusted to exclude goodwill (2003: £(264)m; 2002: £(340)m), integration costs (2003: £nil; 2002: £(10)m), non-operating items (2003: £6m; 2002: £(37)m) and net finance costs (2003: £nil; 2002: £(37)m).

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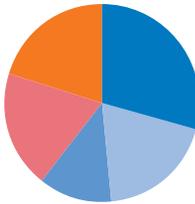
# PEARSON

At Pearson, we feed the mind and fire the imagination. We have world-leading businesses in education, consumer publishing and business information. Through our books, newspapers and online services, we educate, entertain and inform millions of people every day. In a world where people depend on knowledge and brain-power to succeed, we believe we're in a great business.

Sales: total £4,048m \$7,246m

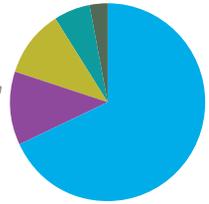
#### By sector

School: £1,176m (29%) \$2,105m
Higher Education: £772m (19%) \$1,382m
Professional: £503m (12%) \$900m
FT Group: £757m (19%) \$1,355m
Penguin: £840m (21%) \$1,504m



#### By geography

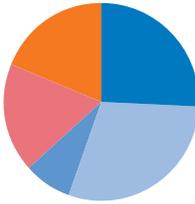
North America: £2,742m (68%) \$4,908m
United Kingdom: £474m (12%) \$848m
Continental Europe: £463m (11%) \$829m
Asia Pacific: £255m (6%) \$457m
Rest of the World: £114m (3%) \$204m



Operating profit: total £490m \$877m

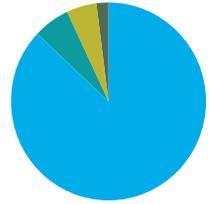
#### By sector

School: £127m (26%) \$227m
Higher Education: £148m (30%) \$265m
Professional: £38m (8%) \$68m
FT Group: £86m (17%) \$154m
Penguin: £91m (19%) \$163m



#### By geography

North America: £466m (87%) \$834m
Asia Pacific: £33m (6%) \$59m
Continental Europe: £29m (5%) \$52m
Rest of the World: £8m (2%) \$14m



Note: Adjusted operating profit, see note 2 below.

Note: United Kingdom operating loss excluded = £(46)m \$(82)m.

Throughout this report (unless otherwise stated):

- Growth rates are given on an underlying basis, excluding the impact of currency movements and portfolio changes. In 2003, portfolio changes increased revenues by £89m and profits by £24m, while currency movements reduced revenues by £181m and profits by £27m.
- Adjusted figures are presented as additional measures of business performance. They are stated before goodwill, integration costs and non-operating items. Goodwill is amortised over no more than 20 years. Business performance measures are non-GAAP measures for UK reporting. Reconciliations of operating profit, adjusted earnings per share and operating free cash flow to the equivalent statutory heading under UK GAAP are included in notes 2, 9 and 27.
- The value of the dollar has been translated at the year end rate; \$1.79: £1 sterling.

# Chairman's statement

Our transformation is beginning to pay off

Dear fellow shareholder,

It is now a little over seven years since we set off on our journey to transform Pearson from a wide-ranging conglomerate into a world-leading content company. At that time, like many of you, I invested in the shares, convinced that Pearson had the assets and plans to prosper in the long term.

So I shared your excitement when the exuberance of the late 1990s propelled them over £20, and your concern as the gloom of the early 21st Century brought them back down.

## Progress

Today I am more convinced than ever that this business is in good shape. In those seven years we've turned three companies in education, business information and consumer publishing into world leaders. We've put ourselves in pole position to benefit from a fundamental change in all our lives: the premium on skills and knowledge in a brain-powered world.

The past couple of years have been tough for many businesses, and some of ours have felt the chill. But the board is proud of what the company has achieved – and the way it has behaved – throughout this period. We have made no compromises in maintaining and improving the quality of our products, and Marjorie and the management team have continued to execute our well-defined long-term strategy.

Their determination to stick to that strategy while, at the same time, relentlessly taking the tough decisions to enable it to succeed is paying off. As Marjorie describes, we made progress on our financial and operating goals in 2003, despite the trading challenges. We think we'll make more progress in 2004, even though our markets still look tough.



**Dennis Stevenson** Chairman

And we are now at the point where we can look ahead and see many possibilities for rapid growth in 2005 and beyond. The trading conditions that made life tough for us in the past three years are beginning – *just* beginning – to move back in our favour.

#### Governance

We have put in a great deal of effort this year to implement the new Combined Code a year earlier than required. We summarise our approach to governance in the Directors' report. It has not changed a great deal since we are already fulfilling the vast majority of the Code provisions. Any shareholder who would like to see a full account of how we comply or explain can find it on our website ([www.pearson.com/investor/corpgov.htm](http://www.pearson.com/investor/corpgov.htm)) or by ringing our Company Secretarial department on +44 20 7010 2257 or 2253.

We along, I hope, with the majority of companies have taken a great deal of trouble to comply with the new Code and, in the few cases where we judge compliance to be against the shareholders' interest, to explain in a full way. While a supporter of the new Code, I have one lingering worry: a 'box-ticking' approach to compliance with the new Code on the part of a sufficient number of institutional investors would run the risk of undermining the entire effort.

If any shareholder has any questions or concerns about any aspect of our governance or compliance, please contact me directly on my personal e-mail address, [dennis68pm@aol.com](mailto:dennis68pm@aol.com).

#### People

As always, every step of our progress has come about through the efforts of more than 30,000 talented people all around Pearson. We thank them for their commitment to the company and we'd like you to read about some of the extraordinary things they have achieved on pages 16 to 19.

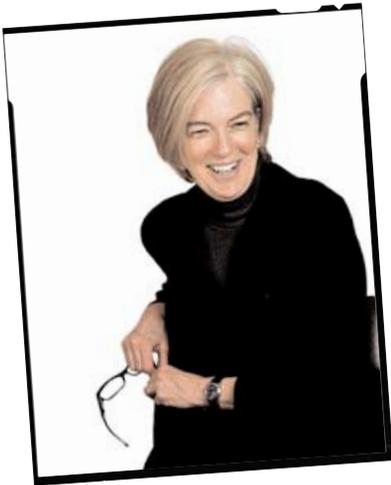
The vast majority of our people are shareholders in the company and I am as sure as I can be that they, like you, will have every reason to feel confident about their investment in Pearson over the coming years.



Dennis Stevenson, Chairman

# Chief executive's review

The value of knowledge



**Marjorie Scardino** Chief executive

What is the value of knowledge? In dark places, knowledge puts the light on. Knowledge makes economic systems work, countries prosper, people succeed. But knowledge isn't a universally available power source.

Today, only 30% of the people in the world can read. Only one in a hundred has a college education. Those who do can earn three times what someone who hasn't finished secondary school can. That's why an increasing number of children in the world's most populous countries are in school: more than 60% of children in China; 50% in India; more than 80% in Russia; and 95% in America. This worldwide yearning for knowledge will electrify our future.

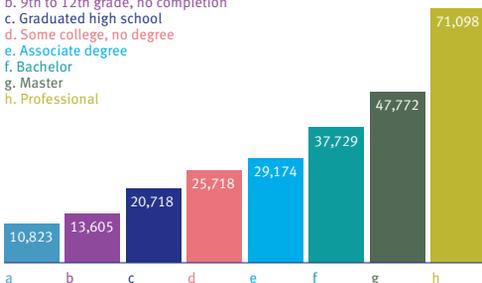
Since 1997 we've been working on building Pearson in an environment in which knowledge is power and we provide some of the fuel. The last few years have been hard on parts of our business, and on our shareholders. But in 2003 we made good headway and we're confident

## Average salary \$

By level of education, 2000

Source: US Department of Commerce

- a. Less than 9th grade
- b. 9th to 12th grade, no completion
- c. Graduated high school
- d. Some college, no degree
- e. Associate degree
- f. Bachelor
- g. Master
- h. Professional

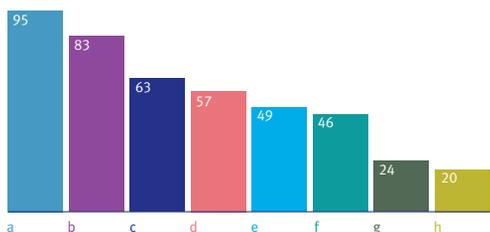


## Children in secondary education %

In the world's eight most populated countries

Source: DK/FT World Desk Reference

- a. US
- b. Russia
- c. China
- d. Indonesia
- e. India
- f. Bangladesh
- g. Pakistan
- h. Brazil



we'll do that in the years ahead, too. There are two qualities that we think will be crucial to our progress:

*1) A coherent company with one focus and one set of values* If you've been an investor in Pearson for very long (and many of us have), you know what we've been doing to change the company: adding and subtracting, planting and pruning until we had businesses that made sense together, that were more productive and innovative because they had things to share.

At the same time, we've been trying to give those businesses an environment that not only attracts the best people, but also makes their collaboration an everyday event.

That work takes a common set of goals and values. Our main aims relate to the larger world of what we do – teaching children to read; helping adults get new skills; providing the best business intelligence; helping citizens and governments function better; helping people acquire knowledge that consists of facts *and* understanding.

As you will have seen before, and as you'll see elsewhere in this annual report, we value three qualities above all: bravery, imagination and decency. To us, those aren't just run-of-the-mill words: they guide our decision-making and our behaviour.

But do they matter to our prosperity as a company? We believe so.

*2) A company that reaches its financial goals* We understand very well that our financial goals are the ones that make all the others attainable, and we see more and more evidence of that interplay.

Since 2000, the coherence of our set of businesses that share assets and systems and ideas has allowed us to reduce our costs significantly. About a quarter of our senior managers have worked for more than one Pearson business. Last year we sold more than £250m of products and services that were created by the combination of two or more parts of Pearson working together, and that collaboration is growing.

To continue to reach our financial goals, we need to get two seemingly simple things right: we need to make our operations more efficient, and we need to make and sell better products and services than our competitors. We've been working hard on both areas.

*More efficient operations* Over the past three years we've been steadily reducing costs, making better use of our working capital, assessing our investments with more rigour, improving our processes and discipline. In general, we've been getting better – leaner and more fit – at running the machinery of our company.

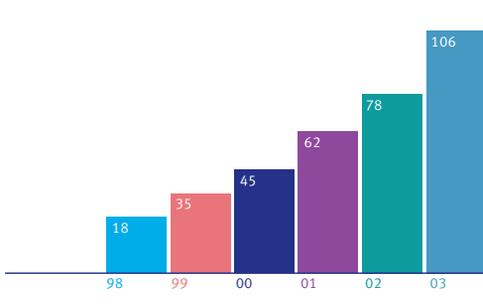
**Fatter margins** Operating margin %

Of course, our most urgent work has been on the fitness of our more cyclical businesses – the ones that have had the most challenges in the unforgiving business climate of the last three years. We've reduced costs in our newspapers, in the technology publishing businesses, and in digital learning by more than £200m altogether.

All around the company and all around the world, we've been taking out layers and trying to use the clout of our size and expertise to best advantage. We've combined our international book businesses, for instance, in Canada, Australia and India; and all have seen rising profits. We've integrated a lot of our distribution and warehousing; and in the past three years we've lowered inventory levels by a third. We've created more ways to share assets – design capability, brands, and content – both words and pictures. We've multiplied our capacity with technology, such as print on demand, which has allowed us to sell more backlist titles than ever without the expense of holding them in our warehouses.

**Stronger products and services** Being better operators has allowed us to allocate more capital to our brand of research and development, which in turn makes us even stronger. We spend a lot each year investigating, planning and producing new products and services; over the past three years we've invested almost £2bn that way.

We're disciplined about that investment, financially and strategically, because gaining more share of the market is crucial to our future. Our aim is to do better than our competitors because what we do is more enticing, better value or just works better. And so far we're achieving that because we've been gaining market share every year for the past three. Here are some highlights:

**Custom publishing** Sales \$m

> *We've grown stronger in school textbook publishing, creating new programmes and increasing our audience in key subjects like reading and social studies. This market will grow rapidly in 2005 – and most of that growth will come in subjects where we're the market leader.*

> *In college publishing, we've grown faster than our competitors for five straight years, even though we're already the largest. We've published more classic, enduring texts than*

Stronger school publishing	Pearson position (total K-12 market)		Subject as % of total 04-06 new adoptions
	2003	1999	
Social Studies	#1	#3	24
Reading/Literature	#1/#2	#3	19
Math	#1	#1	18
Science	#2	#2/#3	13
Music/Art	#1	#1	7

Source: Pearson estimates

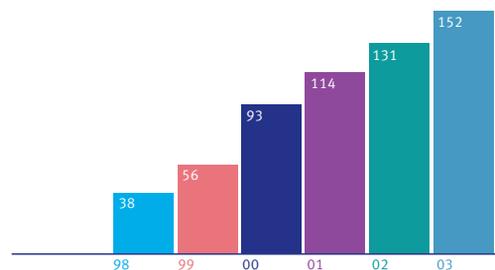
any other publisher, as well as more brand new books. We've pioneered the use of technology to enliven the learning process. And we've created a model of customised publishing to make bespoke books for individual professors. That business, which had sales of less than \$20m in 1998, topped \$100m last year.

> *Testing and certifying professionals – nurses or technology specialists or securities dealers, for instance – is a growing industry.* We provide these qualification services thanks to our educational pedigree, our testing experience, our technology and our service. That business, which had sales of \$100m last year, won \$600m of new, multi-year contracts.

> *Penguin's investment in its roster of established authors, new stars and its home-grown content, helped it gain share as well.* In a year in which it had more bestsellers than ever, the quality of its books also shone: its authors won a Nobel prize, a Pulitzer prize, a Whitbread and a Book of the Year award.

> *In six years Interactive Data, our financial information and pricing business, has grown from a \$140m to a \$440m company.* It has grown from the inside out, adding new services to a very enduring customer base, as well as by adding on some new companies. That steady growth enabled the FT Group to increase its profits last year in spite of the fact that advertising revenues continued to wait for a renewal of corporate confidence.

Interactive Data Corporation EBITDA \$m



> *And in spite of the advertising market, we've kept on investing in all our business newspapers.* These are premium brands and high-quality businesses, and they play a crucial

role in society. They require steadfast commitment, even in the toughest of times, and they'll recover strongly when economic conditions improve. We can be confident about that because the quality of our journalism is as high as ever. Last year *Financial Times* journalists were named the best for their business and finance reporting, their coverage of fund management, and their overall business journalism.

### 2004 and beyond

In 2003, our approach to improving our operations and products helped us overcome some situations we didn't create but had to confront. The business advertising climate remained grim; the weak dollar knocked £181m off our reported sales; and one of our biggest customers, a part of the US government, owes us on a large bill for work we completed in 2002. In spite of those challenges, we made good progress on our financial goals. We improved margins, increased earnings and our return on invested capital rose.

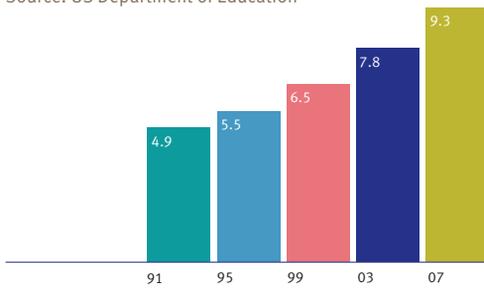
This year, we'll need to call on gravity-defying qualities again to achieve our goal of steady progress on earnings, cash and returns. Business advertising remains erratic (though we may be past the worst); we'll hit a low point in the five-year school textbook adoption calendar; and the US dollar continues to look weak.

Still, we expect to move ahead. And we expect to see underlying financial growth at the same time as we're investing heavily to prepare for some very good markets we see from next year and beyond. Our confidence stands on three solid pillars:

1. In US school publishing, we can predict a leap in our new business opportunities, which will help increase sales by at least 10% and profits even faster.
2. Our businesses which provide services on long-term contracts for financial institutions and schools and professionals and governments have more than \$1bn of new business under contract which mostly begins to flow next year; and they're adding more all the time.
3. The Pearson businesses that have been most affected by tough economic conditions are leaner than ever, and can rebound strongly when their markets recover.

#### US education: total school funding per pupil \$'000

Source: US Department of Education



#### Education required for newly created jobs

Average amount in years (estimated in 2000)

Source: Workforce 2000, US Department of Labor

# 13.5

#### International science and technology

Proportion of scientists worldwide reading in English

Source: British Council

# 2/3

### What is the value of Pearson's knowledge?

For Pearson, the value of knowledge is measured by our financial and market progress and by the broader progress of our customers toward satisfying their need for knowledge in this year and beyond.

There are times in business when faith is called for. This is not one of them. We have more concrete reasons to believe in our future. By making ourselves better at operating and more innovative at products and services, we'll make our market-leading positions stronger. That virtuous circle is our goal. In that way, we'll accomplish not only the kind of financial growth and durability our shareholders should expect, but we'll also accomplish the goals of our businesses – teaching children to read in a way that makes them readers all their lives; producing great books with great authors and with our own, home-grown talent; having the world's most informative business news and information sources; providing the services that help schools work better and citizens be more informed.

As we meet that basic human yearning for knowledge, we will build the long-term value of our company.



Marjorie Scardino, Chief executive



*Growing our own*



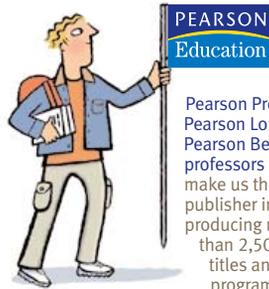
## Stand-out brands

All of our businesses are leaders in their markets

We're proud owners of some of the finest names in publishing. Over many years they've earned the trust of their readers and become marks of quality, accuracy and insight. They also stand for a special way of doing things – from the FT's perspective on the world of business, to Penguin's record for uncovering new writing talent, to Pearson Education's unique blend of textbooks and online services.

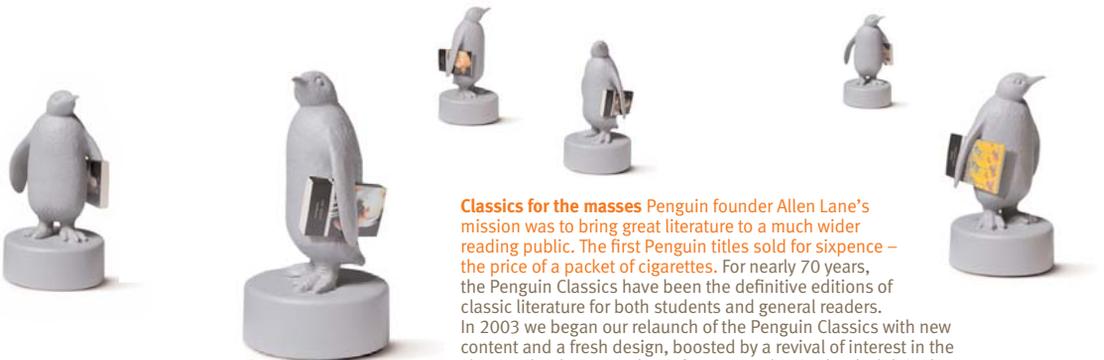
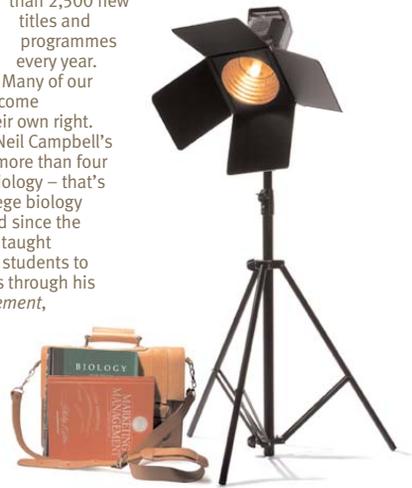


**The Penguin that flew** A flightless bird – the brainchild of Penguin founder Allen Lane's secretary – is the only book publishing brand recognised worldwide and one of the most famous names in the media industry. Penguin is today the mark of quality new writing and the definitive classics of literature. So much so that when Terry Waite was held hostage for four years in war-torn Beirut, he asked his captor for some good books to read by sketching a Penguin.



**First on campus** Our higher education publishing imprints Pearson Prentice Hall, Pearson Addison-Wesley, Pearson Longman, Pearson Allyn and Bacon and Pearson Benjamin Cummings are famous with professors and students alike. Combined they make us the number one higher education publisher in the US, producing more than 2,500 new titles and programmes every year.

Many of our college authors have become international stars in their own right. Over the past 16 years, Neil Campbell's textbooks have helped more than four million students learn biology – that's two-thirds of all the college biology students in America. And since the 1960s, Philip Kotler has taught generations of business students to focus on their customers through his book *Marketing Management*, which has been translated into 23 languages.



**Classics for the masses** Penguin founder Allen Lane's mission was to bring great literature to a much wider reading public. The first Penguin titles sold for sixpence – the price of a packet of cigarettes. For nearly 70 years, the Penguin Classics have been the definitive editions of classic literature for both students and general readers. In 2003 we began our relaunch of the Penguin Classics with new content and a fresh design, boosted by a revival of interest in the classics thanks to Oprah Winfrey's new classics book club in the US and the search for the UK's most popular books in the BBC's *Big Read*. 45 of the UK public's favourite 100 titles were Penguins.

**The ship that launched...** In 1755, 31 years after Thomas Longman founded the imprint bearing his name, he published the world's first comprehensive English dictionary. Almost three centuries on, the famous Longman ship has become the mark of quality in English language teaching all over the world. Today more than 40 million people are learning English as a second language with a Longman book or online study programme.



**On comprend mieux le monde à travers l'économie** Since its launch nearly 100 years ago, *Les Echos* has become France's leading business newspaper, read by more than 650,000 business leaders and

decision makers every day. Last year *Les Echos* unveiled a new look with a new format, new content including an 'Entreprises et Marchés' section based on the FT's 'Companies and Markets' and a fresher approach to editorial. In the months after the relaunch, *Les Echos*' circulation was up 4% in a declining French newspaper market.



**Pink is perkier** The FT has become much more than the world-famous newspaper: it is also a trusted brand for financial information, business publishing and new ventures. 49 of the world's 50 largest financial institutions rely

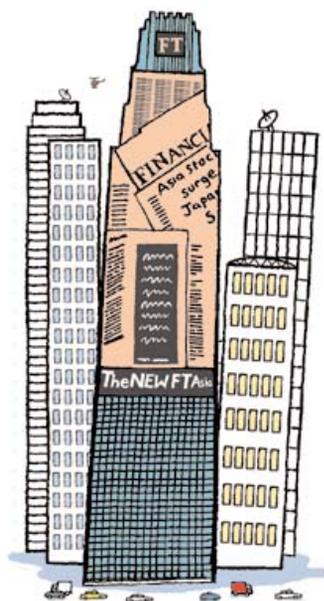
on essential pricing information from FT

Interactive Data, part of our Interactive Data Corporation, to value their funds. Business students and professionals look to FT Prentice Hall, a joint venture between the FT and our Higher Education publishing business, for the best books on management, finance and business. And Germany's Chancellor is just one of 92,000 readers of *FT Deutschland*, the first non-English language newspaper to carry the FT name.



**The fundamentals of learning** Around one in three elementary school children in the US learn the basics of reading, writing and mathematics with the help of a Pearson Scott Foresman textbook. From its humble beginnings as a publisher of high school Latin in 1889, generations of Americans have learned to read with our famous Dick and Jane stories. Today Pearson Scott Foresman is the world's premier elementary school publisher, with leading programmes in the key subjects of reading, mathematics, social studies, and science.

**Success reads success** The *Financial Times* was first published in 1888 as a daily newsletter for directors, brokers, investors and financiers in the City of London. Today, with individual editions for the UK, continental Europe, the US and Asia; correspondents in 70 countries; and readers in 140, it is the world's most international business newspaper. And with 3.3 million monthly users, the FT's online edition FT.com is the world's most popular audited business website. The FT's unique editorial perspective attracts an exclusive, hard-to-reach audience of influential people in finance, business and politics.





## Home-grown products

We're investing in new content and services

We're constantly re-creating our newspapers, books and online services – in some cases every minute of every day. At the same time, we're building their quality and value for the long term. Last year we invested around £700m in our research and development: improving each one of our businesses by investing in new areas of content, by pushing into new markets and by applying new technology and services to make the publishing more personal and more valuable.



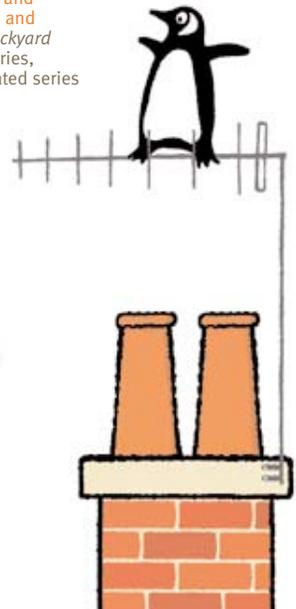
**Personal publishing** Five years ago, when college professors asked us for textbooks that could be tailored to their particular courses, we began to invest in a new model of textbook publishing. Our custom publishing business builds course materials to order around an individual professor's course objectives. The typical book includes chapters from our conventional textbooks; the course agenda, lecture notes and assignments for that particular class; and selected articles from newspapers, magazines and academic journals. This special way of delivering our content has grown five-fold in five years to top \$100m in sales in 2003.

**A print run of one** Dorling Kindersley, renowned for its unique, beautifully illustrated reference books, is pioneering personal publishing. In 2003 DK published *America 24/7*, a photographic collection of a week in America taken from more than one million photos submitted online. DK made publishing history by offering readers the chance to order a customised book jacket, complete with their own favourite photograph.

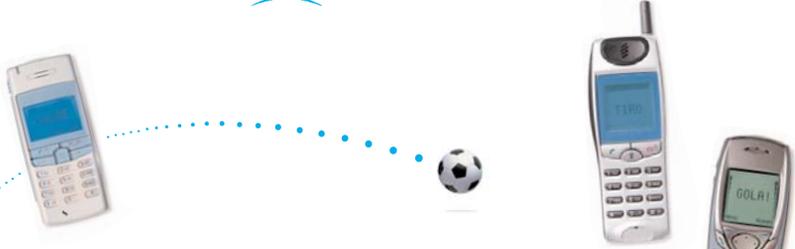


**Above:** Katie Bradshaw, Cathy Melnicki, Jeannie Guman, Connie Carson. Dorling Kindersley, US.

**Stars of page and screen** In 2003 we extended the power of the Penguin brand to the screen when we launched Penguin Television. It commissions factual and children's programming based on Penguin and DK books. Current programmes include *Backyard Science*, a 52-part live-action children's series, and *The Way Things Work*, a 26-part animated series and a Gold World Award winner for best children's programme at the New York Festival's Television Programming and Promotion Awards.



**Have it your way** Our expansion of the *Financial Times* around the world and online has transformed the *FT* into a 24-hour global news service. FT.com, the newspaper's internet edition, has some 3.3 million unique monthly users and in 2002 we began converting them into paying customers by launching a range of subscription services. Today 74,000 people subscribe for real-time and customised services such as live Lex notes throughout the day, personalised news alerts and tools to track their investments.



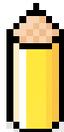
# PASS

**Scoring in testing** Our school testing business, Pearson Educational Measurement, dates back to the 1920s when E F Lindquist, a professor at the University of Iowa, developed standardised tests to measure student achievement. Since then, we have been at the forefront of the industry, developing and using state-of-the-art technologies from optical scanning to complex data management and enterprise application software. We won \$300m of new US testing contracts in 2003 and are applying these skills in new markets including Australia and the UK through our partnership with examination board Edexcel.



**Learning online** More than two million college students are studying online through a Pearson programme. We provide professors

with online tools they use to customise learning materials by combining our content with their own; conduct online assessments; and access a range of resources and communication tools. At the touch of a button, professors can make their own course available to their students online.



**Social climbing** When Pearson bought Simon & Schuster's education businesses back in 1998, we combined two of America's most famous names in elementary school publishing: Scott Foresman and Silver Burdett Ginn. Since then, we've been investing to build a leadership position across all key disciplines including reading, math, science and music. In 2003, our new elementary social studies programme swept the market, winning more than half of all available adoption opportunities.

**Real time alerts** Over the past six years, we've turned our financial information business IDC from a \$140m to an \$440m company. We've steadily built IDC's base business of providing essential pricing data to financial institutions. And at the same time, we've invested in buying a series of smaller companies which extend the services that IDC can provide its customers. The most recent acquisition was Comstock in 2003, which provides real-time data from more than 180 stock exchanges and other sources worldwide.



**Measuring up** We're applying the skills we've learnt in testing school students to professional customers. We're part-way through an investment of some £15m in more than 400 Pearson professional testing centres around the world. Those centres are becoming the destinations for software engineers certifying their IT skills; nurses taking their medical exams; drivers sitting their licence theory test; and aspiring business school students taking the world-famous Graduate Management Admissions Test.



## Unsung heroes

*We're nothing without our people*

30,000 minds fuel our business: publishers, editors, journalists, designers, educators, marketers, sales people, technology professionals, operations and distributions experts. Here are just a few who did something special last year.



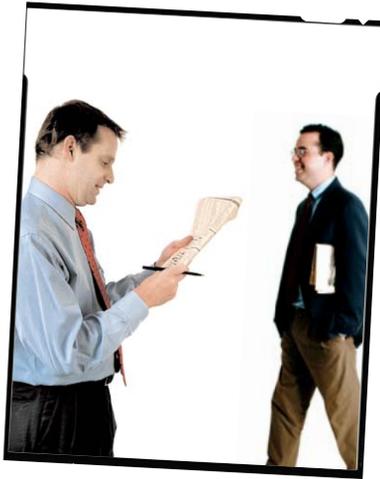
**Left:** Richard Tomkins, Business Journalist of the Year (Business Journalist of the Year Awards).

**Below centre:** Lucy Warwick-Ching, Best Newcomer to Pension and Investment (Aon Consulting Awards).

**In 2003 the *Financial Times* won more than 30 awards.**

**Above:** Kate Burgess, National Journalist of the Year (Bradford & Bingley Personal Finance Media Awards).

**Right:** Adrian Michaels and Peter Spiegel, Business and Finance Reporters of the Year (British Press Awards) for their coverage of US accounting scandals.



**Below:** FT.com editor Tracey Corrigan (far right) with team members Paul Solman, Lisa Rohumaa, Eoin Callan and Emma Jacobs. FT.com was honoured with seven awards in 2003 including Best Global Markets Site (Barron's Awards), Media Prize for Subscription Services and Best Consumer Site (New Media Age), which described FT.com as 'a monster of a site'.

**Above left:** Martin Wolf, Decade of Excellence Award (Business Journalist of the Year Awards).

**Above right:** Philip Coggan, Fund Management Journalist of the Year (State Street Global Advisers Annual Award).



**Right:** Gene Smith from Addison Wesley. Our Higher Education business in the US grew faster than the market for a fifth straight year helped by the strength and quality of our sales teams.

**Right:** Chris Marchant, Franco Ziccardi, Gary Francis and Alan Shaw are part of our new distribution team in Rugby in the UK. Our new state-of-the-art warehouse, shared by Penguin and Pearson Education, opens for business in March 2004.



**Left:** Susan Petersen Kennedy, President of Penguin Group (US), was named the 2004 Matrix Award Honoree in the Books category. These prestigious annual awards recognise exceptional women who have distinguished themselves in the communications field.



**Above:** Wendy Craven is editor to bestselling author, Philip Kotler, who has published with Pearson Prentice Hall for more than 30 years. In that time, his classic textbook *Marketing Management* has sold more than two million copies and been translated into 23 languages.



**Above:** John Ridding, Su-Mei Thompson and Jen Cheng are part of the team who launched the Asia edition of the *Financial Times* and [www.zhongwen.ft.com](http://www.zhongwen.ft.com), a Chinese language version of FT.com, in 2003.



**Left:** Lyn Fraser (Australia), Mandy Suhr (UK) and Mariann Donato and **below** Marilyn Ducksworth, senior vice president, Corporate Communications (US) helped Penguin to make publishing history with the publication of *The English Roses*, the first of five children's books by Madonna. This was the biggest simultaneous worldwide release ever in more than 30 languages and 100 countries including Australia, the UK and the US.



When Oprah Winfrey picked John Steinbeck's *East of Eden* for her TV book club, an old classic began to fly off the bookstore shelves. In six months it sold more than 1.5 million copies – more than it had sold since publication in 1952 – made possible by an extraordinary effort by our production and distribution teams.



Walter Bagdzinski

Nancy Dominioni

Larry Kennison



**Above:** Don Redpath, Norman Lidofsky, Julie Shiroishi, Ken Kaye, Hank Cochrane, Richard Adamonis, Mary Margaret Callahan, Ernie Petrillo, Patrick Nolan, Michael Yarmark.



Lisa Pascarello

Beth Blank



**Left:** Rosie Glaisher, publicity director for Penguin Press, led the team behind a huge UK publicity campaign that helped propel Michael Moore's *Stupid White Men* to the top of the bestseller charts. It has sold more than a million copies and won Book of the Year at the 2003 British Book Awards.

**Below (clockwise from top):** Doris Linka, Brian Moelling, Helene Dennery, Pascale Pernet, Antoine Cheret, David Fayerman, Christian Schneider, Paula Parrish, Andy Peart, Janey Webb, Tom Sigel.

We hold regular international gatherings for our people to share best practice and ideas. This group of Higher Education people from across Europe met for an editorial masterclass on how to grow our local language Higher Education operations.



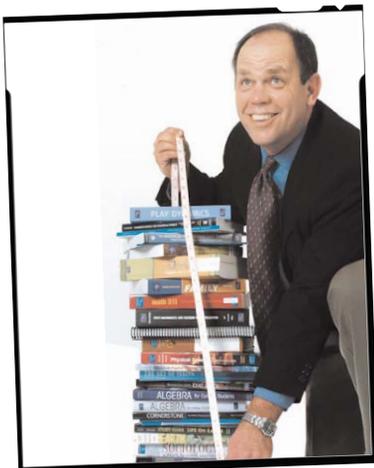
**Right:** DK is famous around the world for its beautiful design and "category killer" books. In 2001 we published the first of a series of major reference works, *Animal*, which has sold more than a million copies to date. In 2003 we published *Earth* and will follow up with four more books over the next three years. Jonathan Metcalf, publishing director for DK's family reference books, is part of the team making this happen.

Gloria Horner

Raymond Ward



**Below:** Don Kilburn heads our Higher Education custom publishing business. It has grown from an \$18m business to more than \$100m in five years and in 2003 grew by 35%.



**Left:** Bob Whelan heads our US professional testing business which won \$600m of new contracts in 2003. These include testing learner drivers for the UK's Driving Standards Agency, business school applicants for the Graduate Management Admissions Test and securities professionals for the National Association of Securities Dealers.

**Below:** Kathryn Court president and publisher at Penguin Books US has been editor to J M Coetzee since 1982, when we published his second novel *Waiting for the Barbarians*. In 2003, he was awarded The Nobel Prize for Literature.





**Above:** Tony Lacey is editor to Penguin author Claire Tomalin. She won the Whitbread Book of the Year for *Samuel Pepys: The Unequalled Self*, her biography of Samuel Pepys, which has now sold 330,000 copies, unprecedented for an historical biography.

**Below:** Jim Stoddart is the art director behind the 2003 relaunch of the Penguin Classics with new content and a fresh design. 19 Penguin Classics made the top 100 in a UK national poll to find the public's favourite books, showing that they are just as popular today as they were on their launch in 1936.



Aurelio Rivera, Barb Watters, Pepe Del Valle

Mark Spears, Rowena Vargas, Steve Kiecker

Kathy Bretz, Camille Salerno, Ray Chew

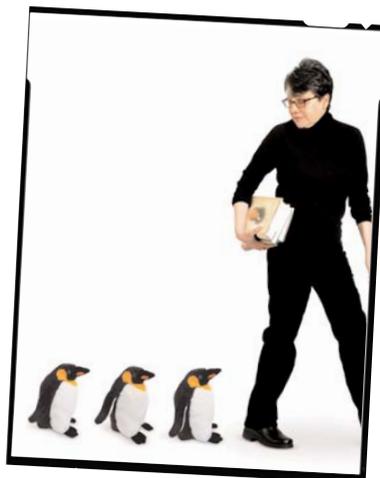
Janet Hill, Janell Jones and Thom Van der Doef

Chris Roy and Lori Holloway

**Left, above and right:** In 2003 we launched our new elementary social studies programme and won more than half of all available school adoption opportunities, including a 60% market share in Indiana and Texas.



Richard Loftin and Eugennie Chang



**Above:** Publisher Ann Godoff joined Penguin in 2003 bringing more than 30 authors with her. Her new imprint, the Penguin Press, now has a stable of more than 90 authors and will publish 32 books in 2004.



**Left:** Penguin editor Pam Dorman spotted the potential of debut author Sue Monk-Kidd. Her first novel, *The Secret Life of Bees*, has sold more than two million copies and been on the *New York Times* bestseller list for more than a year.

**Below:** Simon Ng, Cynthia Lam and Kenneth Ma from Longman Hong Kong didn't let SARS interfere with their crucial selling time and, in fact, increased their sales by more than 100%. The team created a range of online sales tools and held seminars for more than 400 teachers.



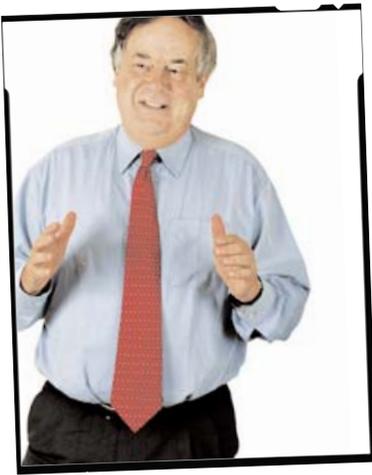


Standing up



## Standing up

*In all we do, we aim to be brave, imaginative and decent*



**David Bell** Director for people

For the first time this year we've included a special section on corporate social responsibility in our annual report. This is not because we have just discovered it. Weetman Pearson, who led the company more than a century ago, had a reputation as one of the most enlightened employers of his time.

We have tried ever since to set the highest possible standards in the way we treat our people, our customers and the wider world in which we operate. This section focuses on the progress we are making with all three groups.

More than 30,000 people now work for Pearson in 62 countries. In the past year we have made good progress towards the goal we set ourselves some years ago. This is to be a brave, imaginative and decent company, a place where people want to work, where they treat people as they want to be treated themselves – in short one of the best employers in the world.

It goes without saying that it is our people who create the products we sell. Their strong sense of responsibility and integrity is at the heart of everything we do and all the products we make. You see this when you meet our education experts who produce teaching materials, our journalists who report and analyse the world or our editors and publishers who make the most entertaining and informative books. Pearson could not succeed without their very high standards and a deep-rooted and unswerving commitment to accuracy, independence and learning.

But that is not enough. We also want all our external 'customers' – investors, authors, readers, teachers, printers, distributors, retailers – to judge us by the same high standards. As the world's biggest publisher nothing is more important to us than that we meet these standards.

Of course we have a way to go. But we are making good progress. Opposite are some highlights of our progress so far and some of our plans for 2004.

We very much welcome comments, observations and suggestions which can be sent to me at [david.bell@pearson.com](mailto:david.bell@pearson.com).

A handwritten signature in blue ink, appearing to read 'David Bell'.

**David Bell**, Director for people

### Our progress

1. Founding signatory of the UN Global Compact, which sets ethical and environmental standards for the corporate sector.
2. Completed a thorough review of our environmental impact, and put in place targets for annual progress.
3. Advised 16,000 suppliers of our commitments and expectations under the UN Global Compact.
4. Published a Pearson-wide Code of Business Conduct, and set up a regular process to verify compliance.
5. Implemented a company-wide framework for career appraisals.
6. Launched a four-year diversity strategy, to ensure that our company reflects the societies in which we operate.
7. Established a programme to support Pearson people who volunteer in their communities including a company award scheme and payroll giving.
8. Set up a major partnership with US not-for-profit Jumpstart, to encourage talented college students to become teachers and to support disadvantaged pre-school children.
9. Named the media sector leader in the Dow Jones World Index for corporate sustainability.

### Our plans for 2004

1. Maintain or improve our ratings in key indices of corporate sustainability.
2. Introduce business targets and milestones for our diversity strategy.
3. Work with UK book production companies to develop industry guidelines on labour standards and human rights in the supply chain.
4. Assess key printers and paper suppliers against UN Global Compact standards.
5. Continue to invest in scientific research-based education products.
6. Extend the reach of our management development programmes to more countries and parts of the business.
7. Reduce energy use in key buildings and review packaging and office waste.
8. Develop strategic community partnership for key markets outside the US.

**Our products** Our most significant social impacts arise directly from our core purpose as an education and information company. Our products play an important part in helping people to learn and get on in their lives.

In our education business in particular, we are developing a growing base of research into the educational value of our products. Here are some examples.

**Learning to read and count** We have partnered with the Waterford Institute, a not-for-profit organisation, to deliver the *Waterford Early Reading* programme. This unique computer-based instruction, based upon

a decade of intensive study by top educators, adapts to an individual user's learning pace, regardless of primary language or pre-literacy exposure. Each level provides daily instructional activities, as well as a library of take-home materials. It requires just 15 minutes each day and students are provided with immediate feedback to help direct and motivate them.

The programme has been formally assessed in schools and districts and studies show it is extremely effective in preparing young children to learn to read. Most notably, the programme brings the lowest performers in a class to

reading competency and is highly effective in helping non-English speaking children assimilate the English language more quickly.

We have recently launched the *Waterford Math and Science* programme which mirrors the proven approach of the reading programme.

**More info:** [www.pearsondigital.com](http://www.pearsondigital.com)

**Read Together, Talk Together** Research shows that children show greater language gains when they actively participate in the reading experience. In partnership with the US National Center for Learning Disabilities, we have developed *Read Together, Talk Together*, a reading programme which encourages integrated dialogue between adult and child. The programme includes picture books designed by Dorling Kindersley, classic children's books from Penguin and teacher and parent training materials including videos and prompt cards.

**More info:** [www.pearsonearlylearning.com](http://www.pearsonearlylearning.com)

**Measuring success** For over 30 years, educators in the US have been using our SuccessMaker courseware to increase student achievement. There is an increasing demand for accountability and results reflected by President Bush's 'No Child Left Behind' education act. SuccessMaker provides elementary courseware in reading, arts, maths and English language and bilingual development available online. The courseware is aligned to district and national standards and teachers can measure student achievement through reports and performance data.

**More info:** [www.pearsondigital.com/successmaker](http://www.pearsondigital.com/successmaker)

**LessonLab** In 2003 we extended our commitment to teacher professional development when we acquired LessonLab, a pioneer in education research and technology. LessonLab was founded by Dr James Stigler, director of the Third International Mathematics and Science Study, which videotaped and analysed teaching practices in more than 1,000 classrooms around the world. Through LessonLab's software, teachers can apply this research base to their own teaching methods.

**More info:** [www.lessonlab.com](http://www.lessonlab.com)

**Our publishing** As the world's largest publishing company, our editorial judgements – whether it's the comment and analysis in our newspapers and online or the authors and stories that we publish – can have a big impact. Editorial independence is a central part of our culture and we separate editorial and commercial decisions.

We are proud that Penguin has long been a champion of free speech and that its founding mission was to make literature more widely available. This goes back beyond the 1960s when Penguin published the first unabridged version of *Lady Chatterley's Lover* and continues today.

*The Financial Times* has an equally strong reputation for incisive and objective news reporting and analysis.

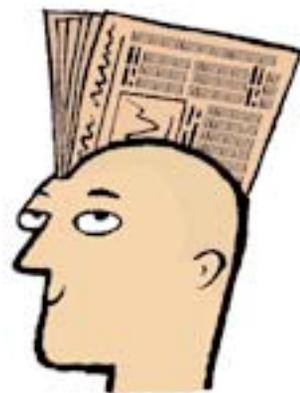
Our newspapers and online sites are an important channel for helping to shape the debate on key social issues and have been publishing indices of corporate responsibility and environmental management for a number of years. For the past 10 years, the FT has supported campaigning organisations such as Business in the Community and the International Prince of Wales Business Leaders Forum to bring their work to a wider audience. The FT has also teamed up with Dorling Kindersley to publish *Everybody's Business*, a practical handbook that helps managers to put corporate social responsibility on the mainstream business agenda.

Dorling Kindersley has also developed a special relationship with the United Nations Children's Fund (UNICEF) publishing books to raise awareness of the UN's Convention of the Rights of the Child. Our recent publication, *A Life like Mine*, explores the Rights of the Child through the eyes of 20 children around the world.

Through our Longman brand, our education business is very active in HIV and AIDS awareness. Since 1997 Longman has published a range of books for a spectrum of age groups which tackle HIV/AIDS and the issues surrounding it in an open and compelling way.

The programme includes the Sara series, the product of a major research project undertaken by UNICEF on the empowerment of the girl-child in Africa. These materials not only address the cultural and economic real-life issues that affect adolescents in Africa, but also focus on developing critical life skills.

**More info:** [www.mml.co.za](http://www.mml.co.za)



**Our communities** We have focused our community support around education and literacy. In 2003 we invested £2.1m in education-focused community programmes around the world and gave additional in-kind support such as book donations, publishing expertise and staff time. Our total cash and in-kind support was more than £6m in 2002.

**Inspiring the next generation of teachers** Looking to address the critical need for pre-school teachers in low-income communities, Pearson teamed up with the US non-profit group Jumpstart in 2001 to inspire talented university graduates to join the teaching profession. The Jumpstart programme pairs college students to work one-to-one with underprivileged pre-schoolers to develop their literacy and social skills. The Pearson Teacher Fellowship builds on that college experience, providing a structured training programme for Jumpstart alumni to become teachers in early learning centres serving the most needy children.

**Research indicates that children who participate in the Jumpstart programme show a 17% gain in literacy and language skills compared to their non-Jumpstart counterparts.**

Funded with an initial three-year commitment of \$2.5m, there are now 40 Pearson Teacher Fellows in 15 low-income communities across the US, with an additional 30 Fellows due to start the two-year programme in the spring 2004. Pearson Teacher Fellows receive a stipend, intensive teacher training, ongoing professional development and support, and each Fellow is partnered with a Pearson mentor to provide advice and guidance. A number of the current Pearson Fellows are now teaching in the same centres where they first worked with the Jumpstart programme, with plans to continue with post-graduate studies. And Pearson employees all around the US are adopting pre-schools so they can help Jumpstart and the Pearson Teacher Fellows succeed in their goal of preparing these at-risk children for success in school and life.

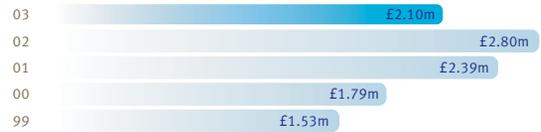
 **More info:** [www.pearson.com/community](http://www.pearson.com/community)

**Spotting new talent in China** In 2003 Pearson embarked on a significant expansion in Asia including the launch of an Asia edition of the *FT*. Alongside this the *FT*, in partnership with Beijing University, launched a financial journalism training programme. Four journalists from the programme will be awarded scholarships from the Laura Cha Fellowship and placements at the *FT* offices in London and Hong Kong.

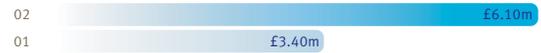


**Left: Carol Leslie, Pearson Education** In 2003 we awarded six Pearson Community Awards to employees to recognise outstanding work in their local communities. Each winner was awarded \$2,000 for their chosen charity, including Carol Leslie for her work with The Therapeutic Nursery, a pre-school programme in New Jersey for children with autism.

#### Pearson cash charitable giving



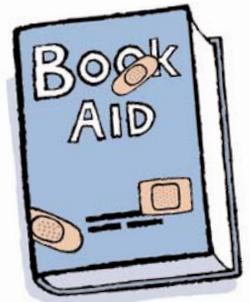
#### Pearson cash and in-kind charitable giving\*



\*Note: Per Cent Club submissions. 2003 numbers to be reported in September 2004.

**The power of books** We have a long association with Book Aid, an international development agency that works in partnership with schools and libraries in the developing world to make books available to readers of all ages. Book Aid is also working towards a sustainable solution to the problem of book shortages through a range of projects including training and networking opportunities for fledgling African publishing and bookselling firms.

We share the Book Aid vision and over the years we have lent financial and in-kind support. In 2003 projects included an international reading project based on Dorling Kindersley's book *A Life Like Mine* and Pearson Education's sponsorship to support World Book Day. In February 2004 Puffin published a collection of short stories for children, *Eating Words for Breakfast*, in celebration of Book Aid's 50th anniversary.



**Our employees** It is important to us that we encourage and support our employees to be active in their local communities and we are proud of the contribution that they make. We do this by providing them with time, money and products. For example, in the UK, we run a payroll giving scheme where employees can make tax-free donations to their favourite charities and we will match these donations up to £500 a year. Each year we recognise their commitment through the Pearson Community Awards. In 2003 we received more than 350 applications and awarded six employees from around the world with \$2,000 each for their chosen charity.

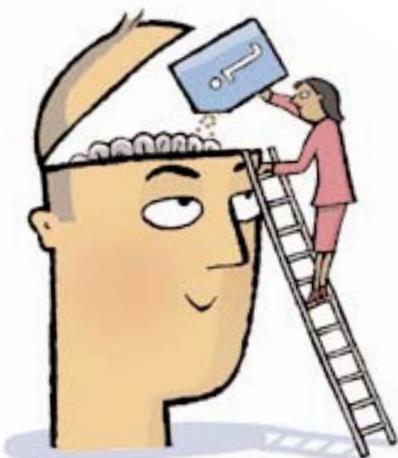


**Our people** Our business is about brains and brands so we rely heavily on the skills and talents of our 30,000 people. Last year we conducted an employee survey across Pearson. The feedback shaped our action plan for last year and here's some of our progress:

**Performance reviews** We've put in place a framework for performance reviews across the entire company and trained managers on how to conduct them;

**Internal promotion** We remain committed to promoting internally rather than hiring from outside where that's possible – in fact, over 22% of our senior managers have worked in more than one country, division or function within Pearson. We introduced career discussions across Pearson and relaunched Pearson Partners, a website which gives details of all the vacancies across the Pearson businesses worldwide;

**Staff roadshows** Once a year we run a series of staff roadshows where our management team meet our employees and update them on the business. In 2004 we will run these in 50 locations around the world. We also post regular messages and announcements on our intranets and Marjorie e-mails everyone through the year with important news. Staff are encouraged to e-mail her with their comments and questions;



**Code of Business Conduct** In 2003 we launched our new Code of Business Conduct. A confidential hot line allows employees to raise any issue covered in it in complete privacy. Each year we will e-mail our employees to confirm that they are happy with the way we are operating it. Any breaches or concerns are followed up by our group control team and reported to the audit committee;

**Job benefits** We offer a range of benefits tailored to location and we've worked hard to make them even easier to understand – over 80% of our people can now go online to our new My Pay and Benefits site.

**Management leadership evaluations** We have introduced the Pearson leadership profile which sets out the most important attributes for leadership in Pearson. We use this to evaluate the performance and potential of our senior management and aspiring leaders and it forms the basis of our new leadership programme launched in August 2003. More than 25% of senior managers have gone through this in less than five months and by the end of 2004, all our senior managers will have attended.

**Functional forums** Over 350 of our people have come together cross-company and cross-region in functional or learning forums to share information and best practice. These forums have been held in finance, HR, technology, design, marketing, communications and editorial. We also hold an annual meeting of over 100 of our talented managers across Pearson to listen to their ideas and for them to hear more about the businesses we're in.

**Diversity and the future** Last year we launched a four year diversity programme to make sure diversity is at the centre of everything we do. We are not in favour of setting specific targets for recruitment, retention or promotion. But our goal is clear: we want to be at least the best in our industry for diversity.

Our plan falls into three phases:

**Phase 1** The first phase, now complete, involved a systematic analysis of our workforce by gender, age and ethnicity. The headline results of this are set out here and we have benchmarked our performance in the key areas of the US and the UK where we operate.



**Phase 2** In the second phase we are concentrating on external recruitment and on removing any perceived obstacles to advancement. As a result:

- › We have designed a pilot programme to focus in depth on 'hidden' issues which may be perceived to hinder promotion. The first focus groups under this programme will be held in spring 2004;
- › We have made it a condition of being on our preferred supplier list that recruitment agencies send us diverse lists of candidates and we are monitoring the performance of each agency;
- › We are tripling the size of our internship programmes and working hard to increase awareness of them in ethnic minority communities. Working with INROADS in the US, and setting up our own programmes in the UK, we plan to offer work experience to at least 60 people this year;
- › The proportion of ethnic minority recruits onto our business graduate training programme in the UK has increased from 12% in 2002 to 50% in 2003;
- › To increase diversity, we are holding special days in key cities in the UK and US to introduce Pearson and to encourage applicants.

**Phase 3** The third phase of the plan, which we have already begun, is to focus on the pipeline of people already in the organisation and to make sure that they thrive within Pearson. To this end we:

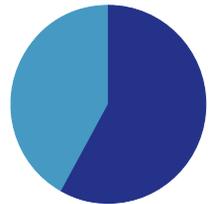
- › Have embarked on a programme of management training from the executive directors downwards;
- › Have instituted training for new recruits and also for recruiters;
- › Are building a mentoring programme;
- › Have adjusted Pearson's Senior Leadership Profile to reflect this new emphasis;
- › Plan to tie part of the bonus of each senior manager to diversity from 2005 onwards;
- › Are monitoring the number of women and ethnic minorities who go through our development programmes, and it is our aim that the numbers remain constant or improve year-on-year;

- › Will continue to work with our recruitment agencies to ensure that the proportion of our entry level recruits from diverse backgrounds remains constant or improves year-on-year;
- › Will begin focusing on more senior levels and working with various organisations to encourage more diverse applicants.

This is how our company looks today:

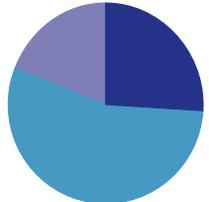
#### Our employees by gender

■ Female = 58%  
■ Male = 42%



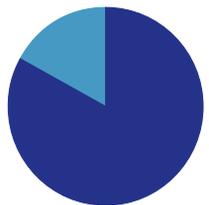
#### Our employees by age

■ 30 or under = 26%  
■ 30 to 50 = 55%  
■ 50 plus = 19%



#### Our employees by ethnicity\*

■ White = 85%  
■ Ethnic minority = 15%



\*US and UK only.

## The UN Global Compact

Pearson was a founder signatory of the UN Global Compact which sets out worldwide standards for the corporate sector. The nine principles of the UN Global Compact are:

## Human rights:

1. **Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence; and**
2. **make sure that they are not complicit in human rights abuses.**

**Environment** As a business based on ideas, our direct environmental impact is limited, but we are committed to understanding the effect we have and to setting targets for managing and reducing our impact.

**Reducing our impact** Where we do have a more significant impact is in the production and distribution of our books, magazines and newspapers. These products use paper and inks and are packaged for transportation around the world. We recognise that we must work with the suppliers who provide us with the paper, production services and the distribution capacity we need to get our ideas into the hands of our customers.

Our most visible environmental impact is through our use of paper and was, therefore, a particular priority for us during 2003. Following consultation with many of our paper buyers, paper suppliers and other groups, Pearson adopted a policy statement that sets out the guidelines we follow when purchasing paper. We started a programme of review visits with key suppliers and developed an approach to help us better understand the source and origin of the wood used. As part of this focus, Pearson has become a member of the WWF 95+ Group, a partnership between businesses and the conservation organisation WWF working together on the issue of responsible purchasing policy for paper. As a member of the group, Pearson will have access to information and practical guidance on responsible paper sourcing issues.

**Environment Policy** Our Environment Policy was adopted in 1992. It was fully rewritten in 2000 and will be further reviewed this year to reflect our increased focus on supply chain issues. The Pearson Environmental Review 2003 is published on the company website. This now covers 95 of our buildings (up from 69 in 2002) and ranges over 14 countries where we have a significant presence (12 in 2002). The environment review covered 85% of our workforce (71% in 2002).

The usage of electricity and gas per employee fell by 4% and per square metre by 8% in 2003, compared to our targeted reduction of 5%. We also met our commitment to remove all halon from buildings in our European operations by the end of 2003. The company's air travel was reduced by 17% compared to 2002.

More information on Pearson environmental impacts, targets and commitments are available at:

 [www.pearson.com/community/envr.htm](http://www.pearson.com/community/envr.htm)

**Labour standards and human rights** Pearson spends around £2bn each year with our suppliers across the world. This places a responsibility on us to encourage our supply chain partners to share our commitments and respect for human rights.

This is not an easy task as all our companies must be sensitive to the diverse cultures in which they operate. To help clarify our priorities, Pearson became a founder signatory to the United Nations Global Compact in 2000. The Global Compact sets out a series of nine principles in the areas of labour standards, human rights and environmental management and provides companies with a framework for managing these responsibilities. Pearson interpreted these principles into a series of guidelines which we use to assess and report on our performance.

We recognise that our first responsibility is through the businesses we directly own across the world. In 2001, we introduced an annual survey of our workforce concerning labour standards and human rights to ensure that we live up to the commitments in our guidelines. The 2003 survey covers 83 business operations in 37 countries. As a result, we are confident that we meet our guidelines with regard to equal opportunities, employment conditions, dignity at work, fair pay and human rights.

Last year, we extended our survey to include our major subcontractors. We prepared the ground in 2002 by consulting with 16,000 of our suppliers around the world, to advise them of the commitments we made under the Global Compact. As key contracts came up for renewal or new contracts were negotiated, particularly those relating to paper supply, printing and distribution, we introduced contractual commitments relating to the Global Compact. These commitments are now included in many agreements. This will rise further this year.

In 2003, we began a programme of supplier visits to discuss our commitments and to review supplier performance. As a pilot, a Pearson team including the executive responsible for environmental issues and others from the Group's production departments visited a number of our printing subcontractors in China.

**Labour standards:**

3. **Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; and**
4. **the elimination of all forms of forced and compulsory labour; and**
5. **the effective abolition of child labour; and**
6. **eliminate discrimination in respect of employment and occupation.**

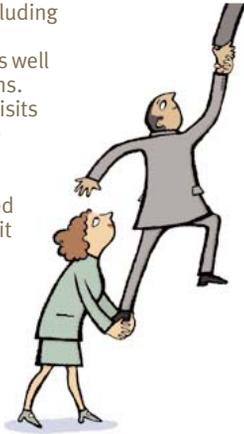
**Environment:**

7. **Businesses should support a precautionary approach to environmental challenges; and**
8. **undertake initiatives to promote greater environmental responsibility; and**
9. **encourage the development and diffusion of environmentally friendly technologies**

The team discussed issues including health and safety, fair pay, environmental management as well as working and living conditions. Issues identified through the visits have been highlighted and are being followed up through our commercial relationships. Another production team raised similar issues in a separate visit to printers in India.

As well as looking at our own supply chain, we try to play our part in working towards an industry-wide commitment. Pearson, along with other major book publishing companies in the UK, is working to further develop industry standards and we will seek to replicate such a scheme in the US.

In addition to the direct environmental commitments outlined above we also plan a rolling programme to assess how our top printers and paper suppliers perform against our commitments under the Global Compact.



ethical procedures and code of conduct to ensure they are of the highest possible standards. Specifically the FT editorial team has reviewed and reissued all its policies and procedures covering journalistic standards of conduct to ensure compliance with PCC guidelines and best practice.

**Rating our performance** In 2003 we participated in a range of industry wide performance surveys.

Dow Jones rated Pearson as media sector leader for the second year in both the DJSI World Index for corporate sustainability and the DJSI STOXX index of European sustainable investments. EIRIS (the Ethical Investment Research Service) considered that our environmental policy and management systems were good but felt that further improvement in our performance and reporting was possible. We will address this in 2004. Pearson was recognised as a Top 100 company in the Business in Community CR Index.

Pearson submitted a Communication on Progress to the UN. This annual report describes our performance against the nine principles that form the Global Compact.

View in full at:

[www.pearson.com/community/ethics/progresscommunication.htm](http://www.pearson.com/community/ethics/progresscommunication.htm)

**Managing our risks** Managing our risks, particularly reputational risks, is very important to us. As we reported last year, we regularly review our social, environmental and ethical (SEE) risks as part of our normal risk management processes. Semi-annually each business formally reviews and reports on these risks to our group control function, who provides a regular update on SEE matters, via the audit committee, to the board.

As described, we believe we are proactively managing our SEE risks. We consider the most important to be compliance with the UN Global Compact (both for ourselves and our suppliers), the environmental impact of our products and our ethical standards.

Our 2003 risk reviews did not identify any significant issues that the Group was not managing.

We pride ourselves on the integrity and quality of our journalistic reporting. In the light of recent well documented failings in journalistic standards and reporting elsewhere, we paid special attention to our

**How others rated our performance in 2003**

**Dow Jones DJSI World Index for corporate sustainability in media sector:** Leader

**Dow Jones DJSI STOXX Index of European sustainable investments in Media sector:** Leader

**FTSE4 Good:** Member

**Business in the Community CR Index:** Top 100 company



*Getting stronger*



# Getting stronger

## Operating and financial review



**Rona Fairhead** Chief financial officer

We've set ourselves the goal of achieving annual progress on earnings, cash and return on invested capital. We made good progress in tough markets in 2003, and you can see how we performed against each of our measures on the facing page.

### 2003 overview

In 2003 our sales declined by 4%. Our book businesses performed very strongly but could not make up for the absence of the one-off TSA contract, which contributed some £250m to our sales in 2002, and tough trading conditions for our advertising and technology-related businesses. We mitigated the impact of the £272m sales decline with significant cost reductions, so that operating profit was £3m lower at £490m and profit before tax improved to £410m (£399m in 2002). Our operating margins improved from 11.4% to 12.1%, helping adjusted earnings per share to grow to 32.0p, an increase of 6%.

On a statutory basis, we reported a profit before tax for the year of £152m (a £25m loss in 2002) and generated earnings per share of 6.9p (a loss per share of 13.9p in 2002). Our net borrowings were a further 3% lower, ending the year at £1,361m.

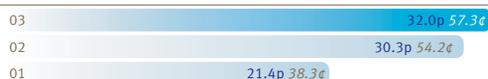
### Looking ahead

We are expecting further underlying progress on earnings, cash and returns this year, despite a weak adoption calendar for our school business and investments we are making to support organic growth. Looking further ahead to 2005 and beyond, we expect our performance on all three financial goals to accelerate, with the strengthening of the US School industry, \$1bn of contract wins in 2003 and lower costs in our advertising and technology-related businesses.

Earnings, cash and returns are the bedrock of incentive plans throughout Pearson. The annual bonuses of our directors and our senior managers are based either directly on these three measures or on the elements of them which they control. For example, targets for our businesses and managers include underlying sales growth and trading margin – which are key drivers of adjusted earnings per share – as well as cash conversion and working capital – which underpin progress on cash flow and return on invested capital.

## Our financial goals

### Adjusted earnings per share



**The measure** We report our adjusted earnings per share (eps) after restructuring charges relating to our continuing businesses. These charges are reported within the operating results of our businesses, and included £20m in 2003 relating to the integration of our book publishing operations in Australia, Canada and the UK.

We exclude from our calculation of adjusted eps the non-cash goodwill charge, costs relating to the integration of major acquisitions and other non operating items. In 2003, we reported a goodwill charge of £264m (down from £340m in 2002), a non operating gain of £6m and no integration costs. This compares with a non operating loss of £37m and integration costs of £10m in 2002.

**Our progress** In 2003 we increased our adjusted eps by 6% (or 11% at constant currency).

In 2004, we expect to show further earnings growth in constant currency as good progress in the FT Group and further cost savings help us to offset the weaker dollar and a slow year for the US School publishing industry.

Looking further ahead, we expect a sharp acceleration in our earnings growth in 2005 and beyond as a rebound in the US School adoption cycle and a potential recovery in our cyclical advertising businesses combine with the cost reductions we've been making for the past three years.

### Free cash flow



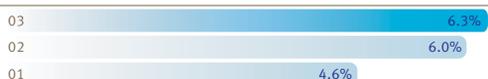
**The measure** Free cash flow is the measure of the cash that is available from our business operations, after the payment of interest and tax, for distribution to shareholders in the form of dividends or for reinvestment to grow our business. We monitor both operating free cash flow, which measures the cash performance of our businesses, and total free cash flow, which includes tax and finance charges and any non operating items.

We exclude proceeds of disposals and the cost of acquisitions from both these calculations.

**Our progress** Operating free cash flow was £210m (£305m in 2002) and free cash flow was £192m (£215m in 2002). Two major factors, both timing-related, masked an otherwise strong performance. Penguin's publishing schedule was particularly concentrated in the fourth quarter, pushing collections into 2004, and the TSA has not yet paid some \$151m relating to the 2002 contract.

We expect our free cash flow to be ahead in 2004. Looking further ahead, we expect steady progress in cash generation.

### Return on invested capital



**The measure** Return on invested capital is our operating profit less tax expressed as a percentage of gross invested capital. Over the past few years, the transformation of Pearson has significantly increased the capital invested in the business (in the form of goodwill associated with acquisitions) and required substantial cash investment to integrate those acquisitions. With our portfolio largely in the shape we want, our goal is to meet and then exceed our cost of capital which is approximately 7.5%–8.0%.

**Our progress** Return on invested capital (ROIC) rose from 6.0% in 2002 to 6.3% in 2003. On this measure we were helped by currency movements – stripping out the exchange rate benefit our ROIC would have been 6.1%. We expect ROIC to be the toughest measure to improve in 2004, but expect significant progress in 2005 and 2006.

**Note:** Adjusted figures are presented as additional measures of business performance. They are stated before goodwill, integration costs and non operating items. Goodwill is amortised over no more than 20 years. Business performance measures are non-GAAP measures for UK reporting. Reconciliations of operating profit, adjusted earnings per share and operating free cash flow to the equivalent statutory heading under UK GAAP are included in notes 2, 9 and 27.

# Pearson Education

Taking share in school and college publishing

Educating 100 million people every year, we are the world's leading publisher of textbooks and electronic learning tools for students of all ages from pre-school to college and on into their professional lives. We are the world's leading company in testing students and professionals and in software that helps teachers teach and schools to manage information about student performance. We provide all these products both in the US and around the world, where we are also the world's leading publisher of English language teaching materials.

## Sales

03	£2,451m	\$4,387m
02	£2,756m	\$4,933m
01	£2,604m	\$4,661m
00	£2,090m	\$3,741m
99	£1,725m	\$3,088m

## Operating profit

03	£313m	\$560m
02	£326m	\$584m
01	£274m	\$490m
00	£237m	\$424m
99	£254m	\$455m

Sales at Pearson Education were 6% lower than in 2002, as good growth in our School and Higher Education businesses could not fill the gap left by the absence of the £250m TSA contract. Profits were 2% lower, as progress in School and Higher Education largely offset a 51% decline in our Professional operations. Margins improved as we benefited from sales growth, operating efficiencies and the 2002 disposal of FT Knowledge.

In our **School** business, sales were 1% higher and operating profits up 13%. In the US, our textbook publishing business grew 2% as our basal imprints, Pearson Scott Foresman and Pearson Prentice Hall, increased revenues by 4% against basal market growth of some 1%. Our new elementary social studies programme took a market share of more than 50% in adoption states, helping Pearson to take the leading position in new adoptions with a share of approximately 29%.



**Peter Jovanovich** Chief executive,  
Pearson Education

Sales at our supplemental publishing business were lower than in 2002 as we discontinued some unprofitable product lines and were affected by industry-wide weakness in state budgets. Although the same pressures reduced sales at our School digital learning business, strong cost management enabled it to return to a small profit. In School testing 2003 revenues were a little ahead of the previous year and we won more than \$300m worth of new multi-year contracts which will boost sales from 2005, when the Federal Government's No Child Left Behind accountability measures become mandatory.

Outside the US, revenues were up 7% with good growth in English Language Teaching and in our School publishing operations in Hong Kong, South Africa, the UK and the Middle East. Our UK testing business, London Qualifications, contributed revenues of £89m.

Our **Higher Education** business increased revenues by 6% and operating profits by 11%. In the US the Higher Education publishing business grew its revenues by 6%. Excluding

	2003 £m	2003 \$m	2002 £m	2002 \$m	Change – underlying %	Change – constant currency %	Change – headline %
<b>Sales</b>							
School	1,176	2,105	1,151	2,060	1	8	2
Higher Education	772	1,382	775	1,387	6	6	0
Professional	503	900	784	1,403	(30)	(32)	(36)
FT Knowledge	–	–	46	83	–	–	–
Pearson Education	2,451	4,387	2,756	4,933	(6)	(5)	(11)
<b>Operating profit</b>							
School	127	227	115	206	13	17	10
Higher Education	148	265	142	254	11	11	4
Professional	38	68	81	145	(51)	(52)	(53)
FT Knowledge	–	–	(12)	(21)	–	–	–
Pearson Education	313	560	326	584	(2)	2	(4)

Pearson, the market grew by 3%. This comes on top of 14% revenue growth in 2002 and marks our fifth straight year of market share gains. Though industry growth slowed a little in 2003, the long-term fundamentals of growing enrolments, a boom in community colleges and a strong demand for post-secondary qualifications more than offset the impact of state budget weaknesses and rising tuition fees.

Our business benefited from a strong schedule of first editions including Faigley's *Penguin Handbook* in English Composition, Wood & Wood's *Mastering World Psychology* and Jones & Wood's *Created Equal* in American History. The use of technology continues to distinguish our learning programmes, with almost one million students now following their courses through our paid-for online sites, an increase of 30% on last year, and a further 1.4 million using our free online services. Our market-leading custom publishing business, which creates personalised textbooks and online packages for individual professors and faculties, grew revenues by 35%, with sales exceeding \$100m for the first time.

Outside the US, our Higher Education imprints grew 7%, helped by strong growth in key markets including Europe and Canada, solid local publishing and the introduction of our custom publishing model.

Revenues and profits were significantly lower in our **Professional** business, caused by both the absence of the TSA contract and the associated close-out costs. The \$151m receivable from the TSA remains outstanding and we are discussing with the TSA the post-contract audit and payment. We expect this process to be completed in 2004, and that we will receive payment of the amount due, although the timing of the receipt remains uncertain.

TSA apart, our Government Solutions business grew by 39%, benefiting from new contracts with the Department of Health and the USAC. The Professional Testing business won more than \$600m of new long-term contracts. These include testing learner drivers for the UK's Driving Standards Agency, business school applicants for the Graduate Management Admissions Test and securities professionals for the National Association of Securities Dealers.

Our worldwide technology publishing operations maintained margins despite a 12% drop in revenues. After a severe three-year technology recession, in which our publishing revenues have fallen by 36%, the rate of decline now appears to be slowing, particularly in the US.

# The Financial Times Group

Increasing profits despite weak advertising markets

The FT Group includes many of the world's most respected business information brands. Through the leading global business newspaper and online service, the pre-eminent national titles in many countries and a trusted provider of financial data and analysis, we reach a worldwide audience of 10 million people every day.

## Sales

03	£757m \$1,355m
02	£726m \$1,300m
01	£801m \$1,434m
00	£844m \$1,511m
99	£687m \$1,230m

## Operating profit

03	£86m \$154m
02	£80m \$143m
01	£72m \$129m
00	£98m \$175m
99	£114m \$204m

The Financial Times Group increased profits by 8% despite a 3% revenue decline as Interactive Data (IDC), our asset pricing business, posted an 18% profit increase. For our business newspapers, 2003 was the third year of a savage corporate advertising recession which has seen advertising volumes at the *Financial Times* fall almost two-thirds since their peak in 2000. Over the same period, we have reduced the FT's cost base by more than £100m.

Losses at the *Financial Times* were £9m higher than in 2002 as advertising revenues fell by £23m and we invested some £10m in the newspaper's continued expansion around the world.



**Olivier Fleurot** Chief executive officer,  
The Financial Times Group

Advertising revenues were down 15% as industry conditions remained tough for the FT's key advertising categories of corporate finance, technology and business-to-business. The advertising declines were significantly worse immediately before and during the war in Iraq, but the rate of decline began to narrow towards the end of the year, helped by growth in US, online and recruitment advertising. The newspaper's circulation in the six months to January 2004 was 433,000, 4% lower than in the same period last year, although FT.com's subscribers are some 50% higher at 74,000. The launch of our Asia edition in September completed the FT's global network of four regional newspaper editions, backed up by a single editorial, commercial and technology infrastructure and by FT.com.

	2003 £m	2003 \$m	2002 £m	2002 \$m	Change – underlying %	Change – constant currency %	Change – headline %
<b>Sales</b>							
Financial Times	203	363	224	401	(9)	(9)	(9)
Other FT publishing	112	200	105	188	(7)	0	7
Recoletos	169	303	148	265	4	4	14
IDC	273	489	249	446	2	15	10
<b>Total</b>	<b>757</b>	<b>1,355</b>	<b>726</b>	<b>1,300</b>	<b>(3)</b>	<b>3</b>	<b>4</b>
	2003 £m	2003 \$m	2002 £m	2002 \$m	Change – underlying %	Change – constant currency %	Change – headline %
<b>Operating profit/(loss)</b>							
Financial Times	(32)	(57)	(23)	(41)	(37)	(37)	(39)
Other FT publishing	6	11	10	18	(42)	(45)	(40)
Associates & Joint Ventures	3	5	(6)	(11)	–	–	–
Recoletos	28	50	29	52	(11)	(11)	(3)
IDC	81	145	70	125	18	24	16
<b>Total</b>	<b>86</b>	<b>154</b>	<b>80</b>	<b>143</b>	<b>8</b>	<b>13</b>	<b>8</b>

Profits at *Les Echos* were behind last year, reflecting continuing declines in advertising revenues and investment in the newspaper's relaunch. Average circulation for the year was down 4% to 116,400, but the September relaunch generated a positive response, with newsstand sales in the final quarter up 4% against a market decline of 6%. Despite a continued decline in the advertising market, *FT Business* posted profit growth, due to tight cost management.

The FT's associates and joint ventures returned to profit (£6m loss in 2002) with good progress at *FT Deutschland*, our joint venture with Gruner + Jahr, and at the Economist Group, in which Pearson owns a 50% interest. *FT Deutschland's* average circulation for 2003 was 92,000, an increase of 9% on the previous year and advertising revenues increased in a declining market. *The Economist Group* increased its operating profit despite further revenue declines, reflecting additional measures to reduce costs. *The Economist's* circulation growth continued, with average weekly circulation 3% higher at 908,000.

Revenues at *Recoletos* (Bolsa Madrid: REC), our 79%-owned Spanish media group, were up 4% as its consumer titles including sports newspaper *Marca* performed strongly, more than offsetting further advertising revenue decline at business newspaper *Expansión*. Profits were 11% lower as Recoletos invested in existing and new titles. Average circulation at *Marca* increased 3% to 391,000, and at *Expansión* fell 3% to 46,000.

*Interactive Data Corporation* (NYSE: IDC), our 61%-owned asset pricing business, grew its underlying revenues in a declining market for the fourth consecutive year. Revenues increased by 2% and profits by 18%, despite continuing weakness in the market for financial services as institutions focused on containing costs. It was helped by strong institutional renewal rates, which continue to run at more than 95%, the addition of new asset classes to its core pricing services, and the successful launch of our Fair Value Pricing service, which is now installed in 35 leading institutions. IDC continued to extend its range of services through new products such as e-Finance Solutions, enhancements of existing products such as BondEdge and eSignal and bolt-on acquisitions including Comstock, a real-time financial data service, and Hyperfeed Technologies.

# The Penguin Group

Breaking records with strongest ever publishing

Penguin is the most famous name in book publishing and a leader in all of the world's major English language markets. We publish some 3,500 books every year, for adults and children, in fiction and non-fiction, from timeless classics to the hottest bestsellers.

## Sales

03	£840m \$1,504m
02	£838m \$1,500m
01	£820m \$1,468m
00	£755m \$1,351m
99	£565m \$1,011m

## Operating profit

03	£91m \$163m
02	£87m \$156m
01	£80m \$143m
00	£79m \$141m
99	£65m \$116m

Penguin increased revenues and profits by 2%. In the US, our largest market, accounting for around two-thirds of sales, our best ever schedule of new titles enabled Penguin to grow ahead of the industry despite tough conditions for backlist publishing. In the UK our backlist performed well, helped by the relaunch of Penguin Classics and the BBC's *The Big Read*.

Penguin's best-selling books included:

- > Sue Monk Kidd's debut novel *The Secret Life of Bees* (2.3 million copies sold)
- > John Steinbeck's *East of Eden* (1.5 million)
- > Al Franken's *Lies and the Lying Liars Who Tell Them* (1.1 million)
- > Scott Berg's *Kate Remembered* (0.5 million)
- > Paul Burrell's *A Royal Duty* (0.9 million)
- > Madonna's *The English Roses* and *Mr Peabody's Apples* (1.2 million) and
- > Michael Moore's *Stupid White Men* (0.8 million).

Dorling Kindersley faced a tough backlist market but benefited from three major new titles:

- > *America 24/7*
- > Tom Peters' *Re-Imagine!* and
- > *e-Encyclopaedia* published in association with Google™.

We increased spending on authors' advances as we invested in a number of new imprints including Portfolio (business books), Gotham (non-fiction), and The Penguin Press (non-fiction), which has already signed over 90 authors, including Alexandra Fuller,

	2003 £m	2003 \$m	2002 £m	2002 \$m	Change – underlying %	Change – constant currency %	Change – headline %
<b>Sales</b>	<b>840</b>	<b>1,504</b>	<b>838</b>	<b>1,500</b>	2	4	0
<b>Operating profit</b>	<b>91</b>	<b>163</b>	<b>87</b>	<b>156</b>	2	8	5

**Note** At the beginning of 2003 we transferred our Alpha consumer technology publishing business from Pearson Education's Professional division to Penguin. Our calculation of Penguin's underlying growth includes Alpha for both 2002 and 2003.

Ron Chernow and John Berendt. We signed new multi-book deals with a number of our most successful authors including Catherine Coulter and Nora Roberts, whose books have spent a total of 71 weeks at number one on the *New York Times* bestseller list.

In the year ahead we will also be investing in channel initiatives to build the Penguin and DK brands and to reach new consumers. These include Penguin TV, which will commission non-fiction and children's programmes based on DK and Penguin books, and a pilot direct selling programme in the US.

Pearson is the world's largest book publisher and last year we continued to integrate our book publishing operations around the world. In Australia and Canada, the first two markets where we combined Penguin and Pearson Education into one company, profits were up 17% and 12% respectively. In the UK, we have moved the two businesses to a single shared warehousing and distribution centre and in the US we have begun to consolidate central functions. The costs of these integration moves were absorbed in the operating profits of Pearson Education and Penguin in 2002 and 2003, and we continue to expect them to deliver some £20m of annual cost savings from 2005.



**John Makinson** Chairman and Chief executive, Penguin Group

## Financial review

**Profit before tax** In 2003 we report a profit before tax of £152m against a loss of £25m in 2002 as acquisition integration charges ceased and the goodwill amortisation charge reduced.

**Goodwill amortisation** Goodwill is a balance sheet item which represents the difference between the price paid for acquisitions and the fair value of the assets acquired. Pearson amortises goodwill to the profit and loss account over whichever is the shorter of the estimated useful life of the acquisition and a period of 20 years. The goodwill amortisation charge fell by £66m last year to £264m, mainly due to Family Education Network and CBS Marketwatch, where the final amortisation charges were incurred in the first half of 2003.

**Goodwill impairment** Goodwill is subject to an impairment review at the end of the first full year following an acquisition and at any other time if events or changes in circumstances indicate that the carrying value may not be recoverable. In 2003 no impairment charges were necessary.

**Integration costs** Integration costs are the one-off costs of integrating significant recent acquisitions into our existing businesses. The last of these significant acquisitions occurred in 2000 and the final costs of integration were incurred in 2002. In 2003 there were no integration charges and all other restructuring and related costs have been expensed through the profit and loss account as part of the ongoing operations of our businesses.

**Non operating items** Non operating items relate to gains and losses on the sale or closure of businesses and on the sale of fixed assets. In 2003 we had an overall profit on non operating items of £6m, mainly relating to the sale of an associate investment in Unidesa by Recoletos.

**Interest** Net operating interest fell by £14m to £80m, with average net debt decreasing by £157m. Interest was further reduced by the effect of a general fall in interest rates during the year. The weighted average three month LIBOR rate, reflecting the Group's borrowings in US dollars, euros, and sterling, fell by 75 basis points, or 0.75%. The impact of these falls was dampened by our treasury policy of having 40%–65% of net debt at fixed interest rates. As a result, the Group's net interest rate payable averaged approximately 4.6%, improving from 5.0% in the previous year.

**Taxation** The tax charge for the year was £75m. As in previous years, this high rate of tax has come about mainly because there is only very limited tax relief available for the goodwill amortisation charged in the accounts. The total tax charge of £75m includes credits of £56m relating to prior year items; these reflect a combination of settlements with Revenue authorities and changes to deferred tax balances.

The tax rate on adjusted earnings fell from 32.8% in 2002 to 31.2% in 2003. This decline reflects the factors above, the impact of the dollar exchange rate, and a more favourable mix of profits between higher and lower tax rate jurisdictions.

*Minority interests* Minority interests include a 39% minority share in IDC and a 21% minority share in Recoletos.

*Dividends* The dividend payment of £192m which we are recommending in respect of 2003 represents 24.2p per share – a 3.4% increase on 2002. The dividend is covered 1.3 times by adjusted earnings, and 1.1 times by operating free cash flow. The company seeks to maintain a balance between the requirements of our shareholders, including our many private shareholders, for a rising stream of dividend income and the reinvestment opportunities that we see across the Group. This balance has been expressed in recent years as a commitment to increase our annual dividend faster than the prevailing rate of inflation while progressively reinvesting a higher proportion of our distributable earnings in our business.

*Pensions* Pearson operates a variety of pension schemes. Our UK fund is by far the largest and we also have some smaller defined benefit funds in the US and Canada. Outside the UK, most of our people operate 401K (essentially defined contribution) plans. Our most recent full valuation of the UK Pension Fund was in 2001 and the next full valuation will be completed during 2004. The pension funding level is kept under regular review by the company and the Fund trustees. After an informal indication in 2002, and taking account of current stock market conditions, the company increased contributions by £5m to £25m in 2003 and has taken an additional £6m charge to the profit and loss account, ahead of the full valuation in 2004. The additional contributions were designed to keep the scheme fully funded and bridge the gap between the 2001 valuation and current expectations.

*Summary financial statement* This summary financial statement, including the summary directors' report, was approved by the board on 27 February 2004. It does not contain sufficient information to allow for a full understanding of the results and state of affairs of the Pearson Group. For further information, the annual report of Pearson plc should be consulted. If you have not received the full annual report, but wish to do so, please return the request form attached to your proxy form for the annual general meeting. If, however, you are happy to receive the summary report only (which does include a summary financial statement) you need take no action. The auditors have issued an unqualified report on the financial statements containing no statement under sections 237(2) or 237(3) of the Companies Act 1985.



Governance and financial statements



## Profit and loss account year ended 31 December 2003

All figures in £ millions	2003			2002		
	Results from operations	Other items	Total	Results from operations	Other items	Total
Sales	4,048	–	4,048	4,320	–	4,320
Total operating profit	490	(264)	226	493	(350)	143
Non operating items	–	6	6	–	(37)	(37)
Net finance costs	(80)	–	(80)	(94)	(37)	(131)
Profit/(loss) before taxation	410	(258)	152	399	(424)	(25)
Taxation	(128)	53	(75)	(131)	67	(64)
Profit/(loss) after taxation	282	(205)	77	268	(357)	(89)
Equity minority interests	(28)	6	(22)	(27)	5	(22)
Profit/(loss) for the financial year	254	(199)	55	241	(352)	(111)
Dividends on equity shares			(192)			(187)
Loss retained			(137)			(298)
Adjusted earnings per share			32.0p			30.3p
Basic earnings/(loss) per share			6.9p			(13.9)p
Diluted earnings/(loss) per share			6.9p			(13.9)p
Dividends per share			24.2p			23.4p

## Cash flow statement year ended 31 December 2003

All figures in £ millions	2003	2002
Operating profit*	490	493
Working capital and other operating movements	(181)	(36)
Net operating expenditure on fixed assets	11	(2)
Operating cash flow	320	455
Integration costs	(8)	(44)
Interest, taxation and dividends	(327)	(378)
Net movement of funds from operations	(15)	33
Acquisitions and disposals	(60)	806
Other non operating movements including new equity	5	1
Net movement of funds	(70)	840
Net debt at beginning of the year	(1,408)	(2,379)
Exchange differences on net debt	117	131
Net debt at end of the year	(1,361)	(1,408)

\* Before goodwill amortisation and integration costs. Net debt excludes finance leases.

## Balance sheet as at 31 December 2003

All figures in £ millions	2003	2002
Intangible assets	3,260	3,610
Other fixed assets	612	700
Current assets	2,523	2,542
Creditors – amounts falling due within one year	(1,704)	(1,363)
<b>Net current assets</b>	<b>819</b>	<b>1,179</b>
<b>Total assets less current liabilities</b>	<b>4,691</b>	<b>5,489</b>
Creditors – amounts falling due after more than one year	(1,392)	(1,794)
Provisions for liabilities and charges	(152)	(165)
<b>Net assets</b>	<b>3,147</b>	<b>3,530</b>
Equity shareholders' funds	2,952	3,338
Equity minority interests	195	192
	<b>3,147</b>	<b>3,530</b>

The financial statements were approved by the board of directors on 27 February 2004 and signed on its behalf by Dennis Stevenson and Rona Fairhead.

### Independent auditors' statement to the members of Pearson plc

We have examined the summary financial statement of Pearson plc.

#### Respective responsibilities of directors and auditors –

The directors are responsible for preparing the Pearson annual review in accordance with applicable law. Our responsibility is to report to you our opinion on the consistency of the summary financial statement within the Pearson annual review with the annual financial statements, the directors' report and the report on directors' remuneration, and its compliance with the relevant requirements of Section 251 of the United Kingdom Companies Act 1985 and the regulations made thereunder. We also read the other information contained in the Pearson annual review and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the summary financial statement.

This statement, including the opinion, has been prepared for and only for, the company's members as a body in accordance with Section 251 of the Companies Act 1985 and for no other purpose.

We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**Basis of opinion** – We conducted our work in accordance with Bulletin 1999/6, 'The auditors' statement on the summary financial statement' issued by the Auditing Practices Board for use in the United Kingdom.

**Opinion** – In our opinion the summary financial statement is consistent with the annual financial statements, the directors' report and the report on directors' remuneration of Pearson plc for the year ended 31 December 2003 and complies with the applicable requirements of Section 251 of the Companies Act 1985 and the regulations made thereunder.

**PricewaterhouseCoopers LLP – Chartered Accountants and Registered Auditors**  
London, 27 February 2004

## Summary directors' report

The full directors' report is set out on pages 49 to 54 of the annual report of Pearson plc. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 12 to 40 of the annual report and on pages 12 to 40 of this summary review and financial statement.

**Results and dividend** – The profit for the financial year ended 31 December 2003 was £55m (2002: £111m loss). The loss retained for the year was £137m (2002: £298m loss) and has been transferred to reserves. A final dividend of 14.8p per share is recommended for the year ended 31 December 2003. This, together with the interim dividend already paid, makes a total for the year of 24.2p (2002: 23.4p). The final dividend will be paid on 7 May 2004 to shareholders on the register at the close of business on 13 April 2004, the record date.

**Directors** – The present members of the board, together with their biographical details, are shown on page 50. Four directors, Dennis Stevenson, John Makinson, Reuben Mark and Vernon Sankey will retire by rotation at the AGM on 30 April 2004 and will stand for re-election. Vernon Sankey and Reuben Mark as non-executive directors of the company, do not have service contracts.

**Corporate governance** – The full directors' report, including the report on directors' remuneration which has been considered and adopted by the board, is contained in the annual report, copies of which are obtainable from the company. These reports describe how the company has applied the principles and complied with the provisions of the Combined Code on corporate governance, as well as giving reasons for any non-compliance. The company also complies with the best practice provisions on remuneration matters prescribed in Schedule A of the Combined Code on corporate governance, and has done so throughout the year ended 31 December 2003. The tables on page 48 and 49 give information on directors' remuneration, pension positions and interests in Pearson shares.

For the full directors' report go to pearson annual report 2003 at [www.pearson.com](http://www.pearson.com).

**Annual general meeting (AGM)** – The notice convening the AGM to be held at 12 noon on Friday, 30 April 2004 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 25 March 2004.

**Philip Hoffman** – secretary  
27 February 2004

## Summary report on directors' remuneration

This is a summary of the full report on directors' remuneration as set out on pages 55 to 69 of the Annual Report 2003.

### The personnel committee

Reuben Mark chairs the personnel committee; the other members of the committee during 2003 were Terry Burns and Rana Talwar. All three members of the committee are independent non-executive directors. All members attended all five meetings of the committee held during 2003.

### Remuneration policy

Pearson seeks to generate a performance culture by developing programmes that support its business goals and rewarding their achievement. It is the company's policy that total remuneration (base compensation plus short-term 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.

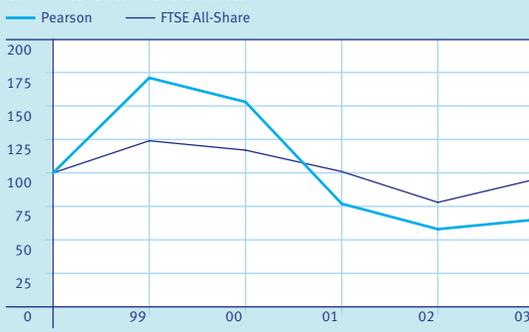
The company's policy is that base compensation should provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets and business sectors and geographic regions. Benefit programmes should ensure that Pearson retains a competitive recruiting advantage.

Share ownership is encouraged throughout the company. Equity-based reward programmes align the interests of directors, and employees in general, with those of shareholders by linking rewards with Pearson's financial success.

### Performance

We set out below Pearson's total shareholder return relative to the FTSE All-Share index (of which Pearson is a constituent) on an annual basis over the five-year period 1998 to 2003. We have chosen this index on the basis that it is a recognisable reference point and appropriate comparator for the majority of our investors.

#### Total shareholder return



### Remuneration

Total remuneration is made up of fixed and performance-linked elements. Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual bonus, bonus share matching and long-term incentives.

### Base salary

Our policy is that the base salaries of the executive directors should be competitive with those of directors and executives in similar positions in comparable companies. We use a range of companies of comparable size and global reach in different sectors including the media sector in the UK and selected media companies in North America to make this comparison. 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 salaries were not competitive.

Our policy is to review salaries annually.

### Other emoluments

It is the company's policy that its benefit programmes should be competitive in the context of the local labour market, but as an international company we recognise the requirements, circumstances and mobility of individual executives.

### Annual bonus

The committee establishes the annual bonus plans for the executive directors, chief executives of the company's principal operating companies and other members of the Pearson Management Committee, including performance measures and targets and the amount of bonus that can be earned.

The performance targets relate to the company's main drivers of business performance at both the corporate and operating company level. Performance is measured separately for each item.

Although at the date of publication of this report no decisions had been made, for 2004 the performance measures for Pearson plc are likely to be drawn from those in previous years, namely growth in underlying sales and adjusted earnings per share, operating cash conversion and working capital as a ratio to sales, and return on invested capital. For subsequent years, the measures will be set at the time.

Following the committee's review of executive remuneration and the increase in annual bonus opportunities described to shareholders in the 2003 report, for 2004 the target annual bonus opportunity for executive directors and other members of the Pearson Management Committee is 75% of salary. Individuals may receive up to twice their target bonus (i.e. a maximum of 150% of salary) based on performance in excess of target.

The committee may award individual discretionary bonuses.

Actual pay-outs for 2003 averaged 31% of salary.

### Bonus share matching

The company encourages executive directors and other senior executives to hold Pearson shares.

The annual bonus share matching plan permits executive directors and senior executives around the company to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the company's adjusted earnings per share increase in real terms by at least 3% per annum, the company will match them on a gross basis of one share for every two held after three years, and another one for two originally held (i.e. a total of one-for-one) after five years.

## Summary report on directors' remuneration continued

### Long-term incentives

Executive directors, senior and other executives and managers are eligible to participate in Pearson's long-term incentive plan introduced in 2001. The plan consists of two parts: stock options and/or restricted stock. 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. The principles underlying it are as follows:

- › the committee uses an accepted economic valuation model to determine the impact of any performance conditions and calculate the relative value of both stock options and restricted stock;
- › based on these values, the committee establishes guidelines each year for the expected value of awards i.e. their net present value after taking into account all the conditions and in particular, the probability that any performance conditions will be met;
- › the maximum expected value of awards for executive directors is based on an assessment of market practice for comparable companies. Current policy is for annual long-term incentive awards with maximum expected values of 300% of salary for the CEO and 200% of salary for the other executive directors. Actual awards for 2003 were below these maximum policy levels;
- › no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans in any 10-year period commencing in January 1997;
- › awards of restricted stock are satisfied using existing shares.

### Service agreements

Executive directors have rolling service agreements with one or more group companies. Other than by termination in accordance with the terms of these agreements, employment continues until retirement.

In accordance with policy, with the exception of Peter Jovanovich, all executive directors have service agreements under which the company may terminate these agreements by giving 12 months' notice and which specify the compensation payable by way of liquidated damages in circumstances where the company terminates the agreements without notice or cause. We feel that these notice periods and provisions for liquidated damages are adequate, but not excessive, compensation for loss of office.

In the case of Peter Jovanovich, his service agreement provides for compensation on termination of employment by the company without cause of 200% of annual salary plus target bonus reflecting US employment practice and the terms agreed with him in October 2000 before his appointment as a director of the company.

In 2003, the chairman of the board wrote to institutional investors on the matter of Peter Jovanovich's severance terms. He said that we were completely supportive of 12 months being the longest period of notice in directors' contracts. We intend that after a further period this arrangement will fall in line with those for the other executive directors. Discussions with Peter Jovanovich have been held up by his absence on ill-health grounds, but will resume on his return.

### Directors' remuneration was as follows:

	2003 Salaries/ fees £000	2003 Bonus £000	2003 Other† £000	2003 Total £000	2002* Total £000
<b>Chairman</b>					
Dennis Stevenson	275	–	–	275	275
<b>Executive directors</b>					
Marjorie Scardino	625	200	54	879	852
David Bell	360	115	16	491	487
Rona Fairhead (appointed 1 June 2002)	363	116	14	493	496
Peter Jovanovich (appointed 1 June 2002)	530	156	9	695	978
John Makinson	450	127	232	809	855
<b>Non-executive directors</b>					
Terry Burns	35	–	–	35	35
Patrick Cescau (appointed 1 April 2002)	35	–	–	35	26
Reuben Mark	47	–	–	47	47
Vernon Sankey	40	–	–	40	40
Rana Talwar	35	–	–	35	35
<b>Total</b>	<b>2,795</b>	<b>714</b>	<b>325</b>	<b>3,834</b>	<b>4,126</b>
<b>Total 2002</b>	<b>2,230</b>	<b>1,053</b>	<b>240</b>	<b>–</b>	<b>4,126</b>

† Other emoluments exclude pension contributions and include £37,030 in respect of housing costs for Marjorie Scardino and a location and market premium of £206,586 for John Makinson.

\*Includes remuneration for Rona Fairhead and Peter Jovanovich prior to their appointment as directors on 1 June 2002.

## Summary report on directors' interests

### The interests of directors were as follows:

	Ordinary shares at 1 Jan 03	Ordinary shares at 31 Dec 03	Restricted shares at 1 Jan 03	Restricted shares at 31 Dec 03	Share options 1 Jan 03	Share options 31 Dec 03
Dennis Stevenson	161,894	163,268	–	–	2,512	2,512
Marjorie Scardino	86,121	93,733	532,571	643,566	574,953	540,194
David Bell	50,939	56,492	233,313	326,095	199,430	181,188
Terry Burns	1,712	3,133	–	–	–	–
Patrick Cescau	0	0	–	–	–	–
Rona Fairhead	560	9,622	165,611	279,594	60,000	60,000
Peter Jovanovich	54,986	56,450	365,818	453,587	493,252	459,724
John Makinson	29,333	39,214	299,634	393,894	426,951	409,773
Reuben Mark	11,837	13,561	–	–	–	–
Vernon Sankey	1,666	2,992	–	–	–	–
Rana Talwar	5,935	4,346	–	–	–	–

**Note 1** Ordinary shares includes both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals under the annual bonus share matching plan.

**Note 2** Restricted shares comprise awards made under the reward, annual bonus share matching and long-term incentive plans. The number of shares shown represents the maximum number of shares that may vest, subject to any performance conditions being met.

**Note 3** Executive directors of the company, as possible beneficiaries, are also deemed to be interested in the Pearson Employee Share Trust and the Pearson Employee Share Ownership Trust, the trustees of which held 206,769 and 7,371,290 Pearson ordinary shares of 25p each respectively at 31 December 2003 and also at 1 March 2004.

**Note 4** With effect from 1 March 2004, Marjorie Scardino will be deemed to be interested in a further number of shares under her unfunded pension arrangement.

**Note 5** At 31 December 2003, Marjorie Scardino, John Makinson and David Bell each held 1,000 shares in Recoletos Grupo de Comunicación S.A. Dennis Stevenson held 8,660 shares. John Makinson held 1,000 shares in Interactive Data Corporation.

## Board of directors

### Chairman

**Dennis Stevenson**<sup>•▲</sup> – chairman, aged 58, was appointed a non-executive director of Pearson in 1986 and became chairman in 1997. He is also chairman of HBOS plc and a non-executive director of Manpower Inc. in the US.

### Executive directors

**Marjorie Scardino**<sup>•</sup> – chief executive, aged 57, joined the Pearson board in January 1997. She trained and practised as a lawyer, and was chief executive of The Economist Group from 1993 until joining Pearson. She is also a non-executive director of Nokia Corporation.

**David Bell**<sup>•</sup> – director for people, aged 57, became a director of Pearson in March 1996. He is chairman of the Financial Times Group, having been chief executive of the Financial Times from 1993 to 1998. In July 1998 he was appointed Pearson's director for people with responsibility for the recruitment, motivation, development and reward of employees across the Pearson Group. He is also a non-executive director of VITEC Group plc and chairman of the International Youth Foundation.

**John Makinson**<sup>•</sup> – chairman and chief executive officer of The Penguin Group, aged 49, joined the Pearson board in March 1996 and was finance director until June 2002. From 1994 to 1996 he was managing director of the Financial Times, and prior to that he founded and managed the investor relations firm Makinson Cowell. He was appointed chairman of The Penguin Group in May 2001. He is also chairman of Interactive Data Corporation in the US and a non-executive director of George Weston Limited in Canada.

**Rona Fairhead**<sup>▲•</sup> – chief financial officer, aged 42, joined the Pearson board and became chief financial officer in June 2002. She also served as deputy finance director from October 2001. From 1996 until 2001, she worked at ICI, where she served as executive vice president, group control and strategy. Prior to that, she worked for Bombardier Inc. in finance, strategy and operational roles. She is also a non-executive director of HSBC Holdings plc, and of Harvard Business School Publishing in the US.

**Peter Jovanovich**<sup>•</sup> – chief executive of Pearson Education, aged 55, joined the Pearson board in June 2002. He became chief executive of Pearson Education in 1998. Prior to this he was president of the McGraw-Hill Educational and Professional Group and chairman and CEO of Harcourt Brace Jovanovich. He also serves on the boards of the Association of American Publishers and the Alfred Harcourt Foundation.

### Non-executive directors

**Terry Burns**<sup>\*†•</sup> – aged 59, was the UK government's chief economic adviser from 1980 until 1991 and Permanent Secretary of HM Treasury from 1991 until 1998. He is non-executive chairman of Abbey National plc and Glas Cymru Limited, and a non-executive director of The British Land Company PLC. He was appointed a non-executive director of Pearson in May 1999, and our senior independent director in February this year.

**Reuben Mark**<sup>\*†•</sup> – aged 65, is chairman and chief executive of the Colgate-Palmolive Company and a non-executive director of Time Warner Inc. He became a non-executive director of Pearson in 1988.

**Vernon Sankey**<sup>\*▲</sup> – aged 54, was previously chief executive of Reckitt & Colman plc and is deputy chairman of Photo-Me International plc and Beltpacker plc. He is also a non-executive director of Taylor Woodrow plc, Zurich Financial Services AG and a board member of the UK's Food Standards Agency. He became a non-executive director of Pearson in 1993.

**Rana Talwar**<sup>†▲</sup> – aged 55, was previously group chief executive of Standard Chartered plc. He became a non-executive director of Pearson in March 2000.

**Patrick Cescau**<sup>•</sup> – aged 55, is a director of Unilever plc and Unilever NV. He will become chairman of Unilever plc and vice chairman of Unilever NV with effect from 30 September 2004. He became a non-executive director of Pearson in April 2002.

\* a member of the audit committee.

† a member of the personnel committee.

• a member of the nomination committee.

▲ a member of the treasury committee.

## Shareholder information

### Payment of dividends to mandated accounts

Where shareholders have given instruction for payment to be made direct into a bank or building society, this is done through the Bankers Automated Clearing System (BACS), with the associated tax voucher showing the tax credit attributable to the dividend payment sent direct to the shareholder at the address shown on our register. If you wish the tax voucher to be sent to your bank or building society, please inform our registrar, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 0870 600 3986 or, for those shareholders with hearing difficulties, textphone number 0870 600 3950.

### Dividend reinvestment plan (DRIP)

The plan provides the benefit of giving shareholders the right to buy the company's shares on the London stock market with the cash dividend. If you would like further information about the DRIP, please contact Lloyds TSB Registrars. Telephone 0870 241 3018.

### Personal Equity Plans (PEPs) and Individual Savings Accounts (ISAs)

The government no longer permits investment to be made in PEPs, although existing PEPs may be continued. Existing Corporate PEP and Single Company PEP holders who require further information about their PEPs should ring the HBOS helpline on 0870 606 6417. Lloyds TSB Registrars offer ISAs in Pearson shares. They can be contacted for information on 0870 242 4244.

### Low cost share dealing facilities

A telephone and internet dealing service has been arranged through Lloyds TSB Registrars which provides a simple way of selling Pearson shares. Commission is 0.5% with a minimum charge of £20 for telephone dealing and £17.50 for internet dealing. For telephone sales call 0870 850 0852 between 8.30 am and 4.30 pm, Monday to Friday, and for internet sales log on to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing). You will need your shareholder reference number shown on your share certificate.

A postal facility, which provides a simple, low cost way of buying and selling Pearson shares, is available through the company's stockbroker, Cazenove & Co. Limited, 12 Tokenhouse Yard, London EC2R 7AN. Telephone 020 7588 2828. An alternative weekly postal dealing service is available through our registrars, telephone 0870 242 4244 for details.

### ShareGift

The Orr Mackintosh Foundation operates a charity share donation scheme for shareholders with small holdings of shares, whose value makes them uneconomic to sell. Details can be obtained from the ShareGift website at [www.sharegift.org](http://www.sharegift.org) or by telephoning 020 7337 0501.

### Shareholder information on-line

Lloyds TSB Registrars provide a range of shareholder information on-line. You can check your holding and find practical help on transferring shares or updating your details at [www.shareview.co.uk](http://www.shareview.co.uk). Lloyds TSB Registrars can be contacted for information on 0870 600 3970.

### Information about the Pearson share price

The current price of Pearson ordinary shares can be obtained from the company's website, [www.pearson.com](http://www.pearson.com), from FT.com or from Financial Times CityLine (telephone 0906 843 3620).

### American Depositary Receipts (ADRs)

Pearson's ordinary shares are listed on the New York Stock Exchange in the form of ADRs and traded under the symbol PSO. Each ADR represents one ordinary share. All enquiries regarding registered ADR holder accounts and payment of dividends should be directed to The Bank of New York, the authorised depository bank for Pearson's ADR programme, at The Bank of New York, Investor Services, P.O. Box 11258, Church Street Station, New York, NY 10286-1258, telephone 1-888 BNY ADRs (toll free within the US) or (1) 610 382 7836 (outside the US), or email [shareowners@bankofny.com](mailto:shareowners@bankofny.com), or sign-in at [www.stockbny.com](http://www.stockbny.com). Voting rights for registered ADR holders can be exercised through The Bank of New York, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a report on Form 20-F that will contain a US GAAP reconciliation.

### Advisers

**Auditors** PricewaterhouseCoopers LLP

**Bankers** HSBC Bank Plc

**Brokers** Cazenove & Co. Limited, Citigroup

**Financial advisers** Lazard Brothers & Co. Limited, J. Henry Schroder & Co. Limited

**Solicitors** Freshfields Bruckhaus Deringer, Herbert Smith and Morgan, Lewis & Bockius

### Financial calendar for 2004

Ex-dividend date	7 April
Record date	13 April
Last date for dividend reinvestment election	22 April
Annual general meeting	30 April
Payment date for dividend and share purchase date for dividend reinvestment	7 May
Interim results	26 July
Interim dividend	24 September

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