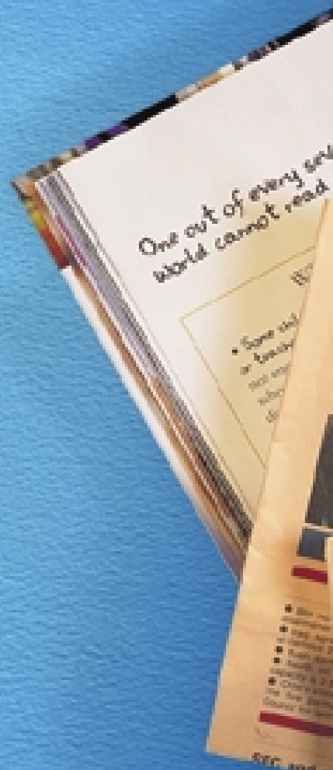
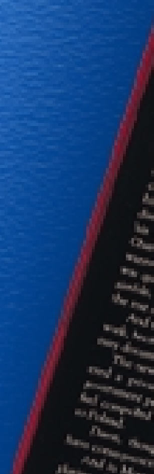
a little knowledge is never enough





PEARSON ANNUAL REPORT 2002

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A little knowledge is never enough. So we try to provide a little more. We educate PEARSON Education, entertain and inform FT millions around the world every day. Through our publishing and our services, we help people live and learn.

Financial highlights	2002		2001		headline % change	underlying % change
Sales*	**£4,320m**	*$6,955m*	£4,225m	*$6,802m*	2	6
Business performance						
Operating profit*	**£493m**	*$794m*	£426m	*$686m*	16	18
Profit before tax*	**£399m**	*$642m*	£294m	*$473m*	36	
Adjusted earnings per share	**30.3p**	*48.8¢*	21.4p	*34.5¢*	42	
Operating free cash flow	**£305m**	*$491m*	£236m	*$380m*	29	
Statutory results						
Operating profit/(loss)	**£143m**	*$230m*	£(47)m	*$(76)m*	–	
Loss before tax	**£(25)m**	*$(40)m*	£(436)m	*$(702)m*	–	
Loss per share	**(13.9)p**	*(22.4)¢*	(53.2)p	*(85.7)¢*	–	
Dividend per share	**23.4p**	*37.7¢*	22.3p	*35.9¢*	5	
Net borrowings	**£1,408m**	*$2,267m*	£2,379m	*$3,830m*	41	

* continuing operations before goodwill, integration costs and non-operating items. Profit before tax includes discontinued operations.

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notes ▸ Throughout this report (unless otherwise stated):

1. Growth rates are given on an underlying basis, excluding the impact of acquisitions, disposals and currency movements. In 2002, portfolio changes increased revenues by £10m and reduced profits by £26m;
2. Adjusted figures are presented as additional measures, to provide a better indicator of business performance. They are stated before goodwill, integration costs and non-operating items. Goodwill is amortised over no more than 20 years;
3. Figures are reported after internet enterprises;
4. 2001 numbers and all prior year numbers have been restated for FRS 19, the new accounting standard for deferred tax;
5. The value of the dollar has been translated at the year-end rate; $1.61: £1 sterling.

Dear fellow shareholders,

A year ago today, I wrote to you about my confidence that you would see a strong earnings recovery from Pearson in 2002, even in uncertain times.

I am pleased to say that we have kept that promise – in spite of the fact that the drought in business advertising has proved more severe and more enduring than any of us could have imagined. However, as a shareholder in Pearson myself, I am painfully aware that our share price has dropped dramatically over the past 24 months. It is little consolation that most of our media peers have experienced similar declines.

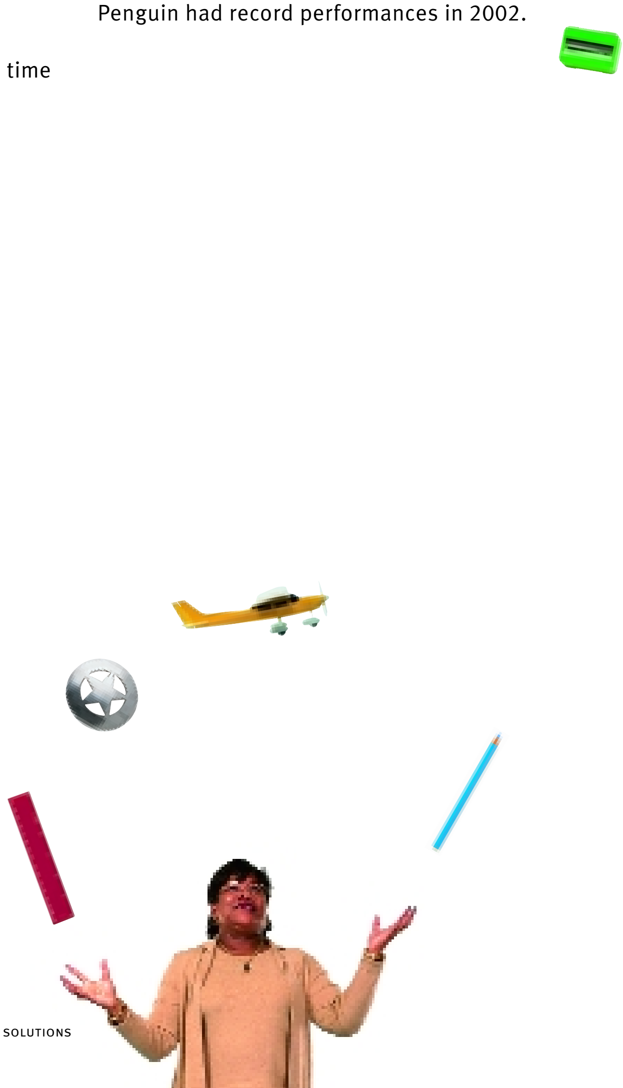
As I write this, the newspapers are full of headlines about prolonged economic and political uncertainty, stock market falls and international terrorism. Why, therefore, am I still confident about Pearson's future?

1. We are now in three fundamentally strong long-term businesses.

As you read this annual report, you will see that each of our businesses provides 'education' in the broadest sense of the word. The judgement we made a few years ago was that in economies dependent more than ever on knowledge and knowledge-based services, governments, companies and individuals would spend more time and money on education and information.

In the past two years we have seen many signs that that was the right judgement: more people going to college or learning English around the world than ever before; a US President who has made education reform the cornerstone of his domestic policy; all of us needing to take a more active interest in managing our pensions and investments. Pearson's businesses will prosper in this brain-powered world.

If we have to be in very treacherous economic waters, it is reassuring that we get the majority of our profits from education and consumer publishing. These areas are not immune to the recession – no sector is – but they do have some fundamental characteristics that are well suited for the times we are in. Stock markets may have plunged and, as I write this, we may be on the verge of a war, but children are still going to school, governments are still spending on education and bookworms are still feeding their excellent habit. As a result, Pearson Education and Penguin had record performances in 2002.



PAMELA WALKER * PEARSON GOVERNMENT SOLUTIONS

Despite the very fine results at those businesses, Pearson's overall performance was muted by a precipitous advertising-led decline in revenues in the business publications of the FT Group. The financial institutions, the technology companies and the other major corporations that have accounted for most of the advertising in our newspapers have been battered by falling earnings, plunging stock markets and the crisis of confidence in the corporate world.

Despite the appalling economic conditions, the *FT* and its sister titles continue to provide some of the best business and financial information and insight in the world. Their management and journalists deserve all our congratulations for the way they have produced news, comment and analysis of the highest quality. Your board is confident that the FT Group is blessed with people, products and brands of huge value, whose time will come again when advertising recovers, as it always has.

2. The governance of Pearson is in good health.

Pearson practised good corporate governance long before it became fashionable – based on some common sense rules but more fundamentally on the integrity and the values of the board and everyone working in Pearson. We have never slavishly followed the various codes on corporate governance but have always endeavoured to explain where and why we have not ticked the boxes. In that spirit, we welcome Derek Higgs' invitation for companies to 'comply or explain' their attitude to the new UK combined code recommendations.

We already comply with the majority of the proposals made in the Higgs and Smith reports in the UK and the Sarbanes-Oxley Act in the US. We have carried out a complete review of all our corporate governance procedures and we will implement several changes which we believe will improve our governance. There are several recommendations on which we will seek to explain why we believe they will not make us better or serve our shareholders well.

The revised Combined Code will not be finalised until July this year, and we will report on our compliance with it in the annual report next year. However, the board outlines its initial thinking about the implications of new governance proposals in the directors' report.

Over the next few years the US federal government will transfer 850,000 jobs to private companies and our government solutions business is making the most of that opportunity. In 2002 we worked with the new Transportation and Security Administration to help it recruit, qualify and hire more than 64,000 security personnel for US airports – the largest peace time recruitment drive in US history.

3. Pearson’s work is done by many, many bright, energetic and totally committed people.

There are outstanding people all around Pearson. All of them have the admiration and gratitude of me and of the board – whether they are celebrating a record year in 2002 or hoping that their markets will begin to recover in 2003. I would like to extend the same gratitude to our independent directors. We have a small number of independent directors who are a strength in themselves and have been a source of support, constructive criticism and sanity.

Marjorie and the team have continued to do a wonderful job of protecting the company from the worst effects of the downturn while doing nothing in the short term that could prejudice Pearson’s long-term growth. At a time when there is much debate about the appropriate relationship between non-executive and executive directors it is worth saying that they feel enormously fortunate to have a board of non-executives who are supportive and challenging in equal measure.

We have set about 2003 with confidence and determination. We tried not to be distracted by irrational exuberance as the markets boomed, and we won’t be deflected by irrational pessimism on the way down. We’re keeping our eyes firmly fixed on the big picture – which is that we have three world-class businesses, better managed than ever before, with leading positions in long-term attractive markets. That’s a powerful combination that will ensure that Pearson will continue to make good progress this year and for many years to come.

DENNIS STEVENSON * CHAIRMAN, PEARSON