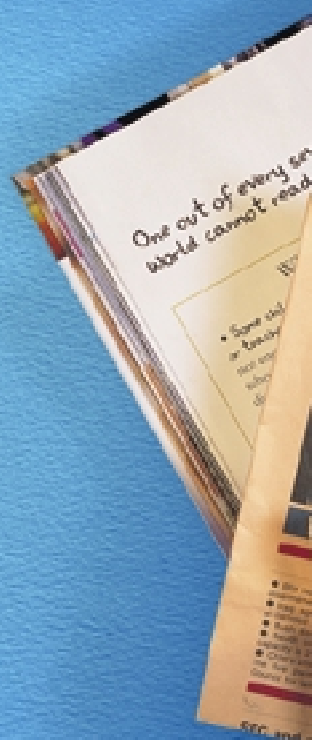
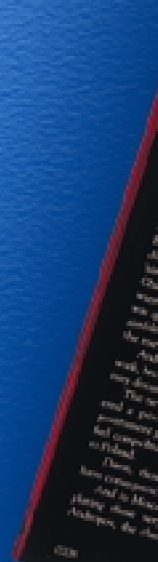


a little knowledge is never enough



PEARSON ANNUAL REVIEW 2002

In association with unicef
BERLIN
THE DOWNFALL 1945
ANTONY BEEVOR
SCOTT FORESMAN
FINANCIAL
MARTIN WOLF
The brave should confront the bear
KnowledgeBox at Home
Main
Welcome
to KnowledgeBox at Home
Main
KnowledgeBox
For Families
For Educators
Contact Us
Red Rabbit
Expansión
ECONOMÍA
Comienza la cuenta
ECONOMÍA FAMILIAR

A little knowledge is never enough. So we try to provide a little more. We educate, entertain and inform 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.

Contents

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.

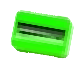
As I write this, the newspapers are full of headlines about prolonged economic and political uncertainty, stock market falls and international terrorism. Why, therefore, am I still confident about Pearson's future?

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

QUENTIN PEEL * FINANCIAL TIMES

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

Chief executive's review

If you're reading this, you're a Pearson shareholder, and you may be wondering how things *really* are in your company.

Our share price is at a low ebb; one of our finest brands, the *Financial Times*, is becalmed in the advertising doldrums; and the political and economic atmosphere we're working in doesn't look as if it's going to fill with sunshine any time soon.

But Pearson is, in the midst of this gloom, in fine shape. There is every reason for you to be very proud of your connection to the company and confident about your investment. Let me give you just ten:

1 ▸ **Our profits took a turn for the better in 2002 and we can make yearly progress hereafter.** From 1997 to 2000 we produced record sales, profits and cash, and a rising dividend. In 2001, the advertising slump began to be an advertising collapse, and our business newspapers' profits collapsed as well. We still made a profit and still maintained a rising dividend; but it wasn't anywhere near what we'd been used to.

So 2002 was a year when we had to fight back. And we did. We kept our promise of an earnings recovery in spite of a global economy and business climate that just got worse and worse.

2 ▸ **Each of our businesses is a leader in its field.** All of them have sustainable, best-in-class positions in their markets. They are not only leaders in size; they also have strong brands and franchises – something special in the products they make or the way they do things that sets them apart from their competitors.

3 ▸ **We are in 'knowledge' markets, good markets to be in when the world is moving from relying mostly on muscle power to relying mostly on brain power.** Those markets require news and information to run businesses or countries; education – cradle to grave, pre-school to professional; entertainment and elucidation – at least what can be found in books, one of the most cost-effective ways there is to have a good time. Our businesses use two methods to appeal to people's intellects: great publishing and the ability to mix that publishing with services to help customers use the words and data and ideas.

4 ▸ **Pearson is now an operating company rather than a holding company.** That means our businesses have enough in common that we can all work on the business at hand, not on *overseeing* disparate enterprises. Including management. We go out with salesmen and dig for new product ideas and talk to customers. We look for ways to do new things, or to do old things differently. We look for ways for the parts of the company to share talents and assets and costs inside the company.

Of course, you can only share things if you have a set of businesses that work together and help each other. And that's what we finally have. Our businesses all make sense together, and so they can work toward the same goals together. Collaboration is an everyday occurrence at Pearson.

5 ▸ **We are entirely reliant on the inventiveness and character of our people.** If tomorrow we didn't have offices, or warehouses, or we lost all our manuscripts

MARJORIE SCARDINO • CHIEF EXECUTIVE, PEARSON

and all our software code, we'd still be in business. We'd still have our major stock in trade – our people's ability to reinvent the business and their willingness to confront tough chores.

We've set our sights on being a great place to work, a place everyone *can* leave because they're in such demand, but no one *does* because this place is better. We do everything we can to make sure that we recruit the best people and then give them the training and career development they need to do their job... and the next job they're going to have. When they join us, they can expect to be paid fairly for doing their job and to receive rewards for extraordinary work. They can also expect to have a safe place to work, free from any kind of bullying or unfair pressures. And they can, on most days, expect to enjoy their work.

6 ▸ **We have a board of directors who understand that their job is to help the enterprise prosper, and who do just that.** These days boards face more rules to ensure they act responsibly and check up on management regularly. Our board has an informal and intimate frankness that ensures they do both without pulling any punches. They know management needs their help, and they give it generously. They know the shareholders count on them to make sure their investment is being well taken care of, and they do that uncompromisingly.

7 ▸ **We try to make it as easy as possible for people to understand our business and our performance.** In a world where companies have lost their way through a confusion of accounting rules and special purpose vehicles, and where business stories are told in jargon and pension details are covered with caveats, we try to tell our stories – including our strengths and weaknesses – in plain English and plain data. We think that will protect our shareholders and give us advantages.

8 ▸ **We believe corporations are risk-taking organisations whose aim is to become more valuable over time because they produce valuable products and services at a profit.** Our company doesn't discover miracle drugs or miracle technology. But we do discover and publish new ideas; make information available and understandable; strive to provide truly 'universal' education – that teaches *each* child. We in Pearson work because of that possibility, and believe that if we're able to change the world, our shareholders will profit as well.

9 ▸ **We count on the fact that culture and conduct – what beliefs we share and how we conduct business – have a great deal to do with success.** Like all companies, we say we are ethical and try to do our duty to society and our employees. But we've been saying our aims were to be 'brave, imaginative, and decent' so long now we've all begun to know what that means. And when we don't act that way, we know it and try to make sure that it doesn't happen again.

10 ▸ **We have a clear goal and a strategy for achieving it.** Our goal is outlined in the theme of this report. It is to add to people's knowledge to help them live and learn.

Pearson Education and Penguin US have partnered to create a new college book series: Penguin Academics. Ranging from anthologies of literature to history books, the series makes Penguin's unique backlist available in new forms to professors and students of literature.

KIYARA ALS * PENGUIN
LATOYA SIMS * PENGUIN

To entertain and enlighten them; to teach them new skills and inform them about their professions. We believe it's a good goal, and we've now got the company that can accomplish it. But the measure of whether we're accomplishing it is our financial performance.

So now our strategy for achieving it is not just getting the right pieces, as it has been for the last five or six years. It is having annual improvement in sales, profits and cash; and increasing our return on invested capital. It is exerting what Thomas Edison once said genius required: **1% inspiration and 99% perspiration.**

2002

Last year, to achieve the earnings rebound, we relied on all those attributes of Pearson to get the job done.

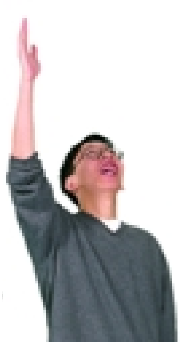
We were helped in our profit improvement by cost reductions, lower internet losses and lower interest charges (because we paid off some debt when we sold our television business). We were hurt by the weaker dollar, and, of course, by the advertising environment.

Since 1997 we have measured our success three ways – sales, margins and cash. In 2002, we began to work even harder on cash and, with a special emphasis on managing our working capital, we were able to increase our operating free cash flow by 29%.

Good competitive performances ▸ We gained significant shares in four of our biggest markets: higher education, consumer publishing, asset valuation and government services. We made modest gains in most of our other markets, too. The only market where we lost share slightly was in US schools, and that was because we decided to sit out of bidding for some school book opportunities we thought would be unprofitable for us.

Aggressive cost management and asset allocation ▸ We had to reduce spending across Pearson, especially in our business newspapers and in technology publishing, areas hit hard by the recession in advertising and in technology. We also began to see the early investment costs of new businesses come down, particularly those reliant on the internet. As we managed costs, we tried to balance the risks and the rewards. We did not treat people as sacrifices to be made for financial markets that wanted the short-term to be better.

Continued investment ▸ At the same time we cut costs, we invested. We put more than £250m into new product development, which will sustain our top-line in the future. And we spent £30m integrating our businesses and their shared functions in ways that will add to our bottom line in the years to come.



SCOTT CHAN ★ PENGUIN

2003

For this year, we're confident that, except in the most extreme political and economic conditions, we can deliver further significant earnings growth, even at current exchange rates, and also further cash and an increasing return on capital. And we're confident we can go on to sustain annual progress on all three measures, working hard, task by task, day by day. Where will we be exerting our 99% perspiration?

More investing ▸ We'll allocate our resources first to our markets that are growing the fastest: higher education, English language teaching, children's publishing, testing, governments as customers, investors who need our data and pricing help in an unpredictable market.

We'll also invest to take advantage of our franchise and market share where we see our competitors are weakened by the environment. This is especially true in our business newspapers. Of course we'll make these investments carefully, but no franchise can continue – even one a century old – without nourishment.

Growing our own ▸ Now that we have all the right parts in our company, we plan to rely more on our ingenuity than on acquisitions for new products and services. So we'll be working to create some for existing brands and to customise some. Customisation is already booming in our education business, where professors want their own unique books. It also works for FT.com subscribers who want their investments monitored, or their data fed to them their way. Organic investment means we will also have to be even more disciplined in our allocation of assets – not shying away from taking risks, but taking those with the most reliable and enduring returns.

Streamlining operations ▸ We started on this last year. We've been pretty good at getting integration benefits from our acquisitions – we've always done better, faster than planned. Now we do that with our existing companies as well, sharing processes and back offices and efficiencies of all kinds; improving sales efforts and marketing ideas thanks to the expertise of one part of the company teaching another.

BEYOND 2003

Pearson was started by an entrepreneurial contractor in Yorkshire in 1844. Over the last century and a half its assets and its businesses have been built up by descendants of that adventurer and then by others they brought in as the enterprise grew. It has had its high periods and its low periods. It has gone through digging railroad tunnels and drilling for oil and starting airlines and providing lighting for the public monuments of Athens. It has made wine and fine china and amusements in wax. And for nearly a century it has been a devoted and courageous publisher.

But whatever it has done, its owners and managers have always prided themselves in the thought that the assets of the company were to be improved in value and passed on to the shareholders of the next day. And that is still our aim today.

We know that, in order to do our part for the enterprise, we have to make the decisions that will make the company more valuable as it passes down the line than it was when we took it over. That means we have to invest our capital in ventures that will bring in more value than they cost and that will endure. And that is what we aim to do in 2003 and well beyond.

Marjorie Scardino

In a year of tough commercial conditions, the FT set out to treat its readers and customers better than ever. In the UK and US, the FT conducted extensive market research, held an internal customer awareness seminar and put a customer service ranking system in place to raise the quality of customer service. As a result, overall satisfaction with the FT is now consistently 9 out of 10.

CHARLOTTE HOARE * FINANCIAL TIMES
OLIVIER FLEUROT * MANAGING DIRECTOR, FT GROUP
MARK RUBIN * FINANCIAL TIMES
SASA SAVIC * FT CUSTOMER
JACK BRABIN * FINANCIAL TIMES
CHRIS COTNOIR * FINANCIAL TIMES

The Pearson goals

For the past five years, Pearson's performance measures have been central to the way we manage our business. With our portfolio transformation now largely complete, we have refined our approach.

Our six measures provide clarity, internally and externally, about the most tangible and relevant measures of our financial performance. We use our operating goals – sales growth, margins and cash conversion – to set targets for our businesses and as the basis of incentive plans across Pearson. We use our financial benchmarks – free cash flow, EBITDA and adjusted earnings per share – to align management with the interests of our shareholders. These financial benchmarks, and increasingly our share price itself, form the basis of our senior management incentive plans.

While these performance measures have served us well, with our portfolio transformation largely complete we have taken the opportunity to refine our approach. We think it's important that we continue to look at a range of measures that give a balanced view of our business, rather than an excessive focus on any single one. We also believe that our current operating goals meet our objective of being simple, measurable, stretching and consistent, and that our financial benchmarks do align our actions with the interests of our owners.

However, we are making some modest adjustments to our goals as Pearson enters this new phase in its evolution. A key objective will be to deliver returns above our cost of capital. We are therefore introducing return on invested capital as one of our financial benchmarks in place of EBITDA. (EBITDA is largely covered by our targets on cash conversion and free cash flow. For the record, EBITDA was £615m in 2002, up from £588m in 2001.)

Our operating goals already largely focus on the levers we have to improve ROIC. We will continue to measure our performance against the goals which drive operating profit: sales growth (at constant exchange rates) and operating margins. We are also retaining our cash focus and continue to aim to convert at least 80% of our operating profits into cash in any one year. We are adding a through-the-year measure of capital efficiency – an annual improvement in the average ratio of working capital to sales. We introduced this measure in 2002 at Penguin and Pearson Education, where we currently tie up an average of some £1bn in stock, debtors and creditors. The FT Group is a net contributor of working capital.

Naturally, we alter the weighting of these metrics across our company depending on the nature of the business involved and its operating environment. It is also important to note that the goals set out here do not reflect the full range of measures, both financial and non-financial, that we use to drive performance in our operating companies.

Finally, although we have always striven to communicate our financial performance openly and clearly, the radical changes in our portfolio have not made it easy to compare our performance year-on-year. Many of these complexities – which were explained in the notes to our accounts – will naturally fall away as our portfolio becomes more settled. However, we will seek to provide additional reconciliation in our accounts wherever they aid a better understanding of our business.

In 2002 we reduced the average working capital tied up in our book publishing businesses by £53m – even as we increased investment in new authors, titles and programmes – by being more efficient with our inventory.

RONA FAIRHEAD * CHIEF FINANCIAL OFFICER, PEARSON

UNDERLYING SALES GROWTH

Pearson's underlying sales grew 6% in 2002. We calculate underlying sales growth by excluding the effect of acquisitions or disposals on the one hand and currency movements on the other. As our business portfolio is now more stable, the 'underlying' impact in 2002 is primarily currency movements.

We believe that we now have a mix of companies that can deliver long-term through-the-cycle growth. However, in 2001, our book publishing businesses were unable to protect us from the downturn in our more cyclical newspaper publishing operations. In 2002 we delivered a return to growth even though sales in our newspaper and technology businesses continued to decline.

In 2003, with the outlook for our advertising-related and technology publishing businesses still difficult, we expect only modest sales growth. Looking further ahead, we expect sales growth to pick up again.

TRADING MARGIN

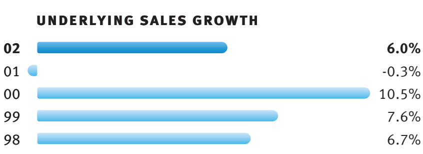
Trading margin represents our ability to turn our sales into profit. Our aim is to ensure that all our businesses generate 'best-in-class' margins, relative to their industries.

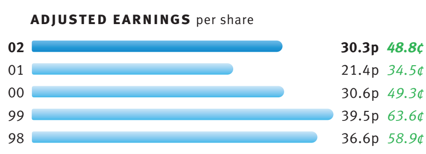
In 2002, our trading margins improved to 11.4% (from 10.5% in 2001). We benefited from lower internet losses and actions taken in 2001 to reduce our cost base. This more than offset the continued business advertising and technology publishing downturn and a change in the revenue mix at Pearson Education (where we saw a very big increase in the sales contribution from our lower-margin professional operations). Throughout 2002 we continued to take cost actions, which we expect to help improve margins in future years. These included ongoing business restructuring costs (which we expense as operating costs) and a £30m investment in back office integration and systems rationalisations.

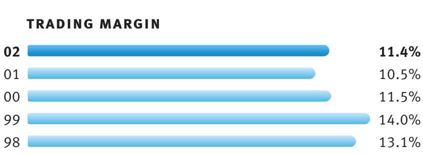
Looking ahead to 2003, we expect to reduce internet losses and the costs of our business integration investment to fall to £20m. This investment spend will disappear in 2004 and we aim to generate some £20m of annual cost savings from 2005 onwards.

ADJUSTED EARNINGS PER SHARE

We report our adjusted earnings after normal business restructuring costs, which we treat as operating expenses, but before specific non-recurring costs, primarily the integration costs relating to significant acquisitions and before







TAMMY MAN * PEARSON EDUCATION, HONG KONG
ANDREA CROZIER * PENGUIN, CANADA
JULIE GIBBS * PENGUIN, AUSTRALIA

JEFFREY ATKINSON * PENGUIN, NEW ZEALAND
SAUL MATTHEW IRELAND * PENGUIN, NEW ZEALAND
MICHAEL CAMPBELL * PEARSON EDUCATION, CANADA

We are the world's biggest book publisher and we are beginning to make that scale count in our favour. We have combined our book businesses in Australia and Canada and we are moving to share back office operations such as warehousing and distribution in the UK and New Zealand.

UDI KORE * ZEDDRICK WHITE * PEARSON

certain non-cash items – principally goodwill amortisation. Non-recurring costs were integration charges of £10m in 2002 (against £74m in 2001) and a £37m charge for the cancellation of certain swap contracts following the RTL disposal. The total goodwill charge was £340m down from £436m in 2001 with an average remaining life of goodwill of 15 years.

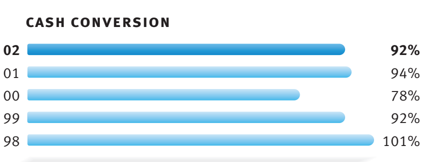
Our adjusted earnings per share fell back in 2001, driven by the sharp cyclical downturn in business advertising. In 2002, despite the continued advertising downturn and a weaker dollar exchange rate, we delivered earnings growth of 42%.

In 2003, we expect to continue to grow earnings in double-digits at constant exchange rates, as we benefit from a further steep decline in internet losses and some modest improvements from our business integrations.

Looking further out, we should benefit from our leading positions in growth markets and our ability to harness the benefits of sharing our assets and our processes. Our aim will be to deliver strong annual earnings improvement at constant exchange rates.

CASH CONVERSION

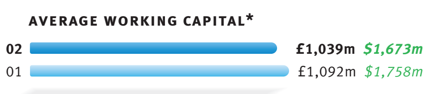
Our newspaper businesses typically convert almost all their operating profit into operating cash flow,

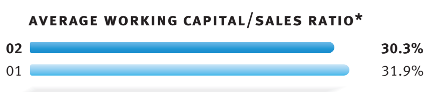


but, if they are to grow, our book publishing businesses need to absorb capital – in the form of authors' advances, pre-publication costs, inventory and receivables. We do not as a result, seek to convert 100% of our operating profit into cash, although we set ourselves a minimum target of 80% cash conversion for any year.

We achieved that target again last year with a strong performance in both cash collection and inventory management.

working capital ▸ Of our £1bn of working capital in 2002, 53% represents our investment in future growth – the advances that Penguin pays its authors before they deliver their manuscripts; and the new product development (or 'pre-publication costs') at Dorling Kindersley and Pearson Education.





* *Pearson Education and Penguin only*

We'll continue to make these investments, so long as we can see adequate returns. The rest of our working capital represents cash tied up in our processes, and here we see potential to become more efficient.

In our book publishing businesses we targeted and delivered a 5% improvement – some £53m – in the absolute level of average working capital, based on constant sales.

Marca, Spain's leading sports newspaper, has raised its game in the face of tough competition. A successful redesign and an aggressive marketing campaign helped *Marca* bounce back to growth.

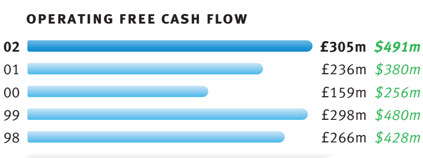
PILAR TRUCIOS * RECOLETOS

GASPAR GONZALEZ PALENZUELA * RECOLETOS
JOSE MARIA PAJARES * RECOLETOS

Improving our average working capital to sales in 2003 and 2004 will be extremely challenging as, at our education business in particular, we'll be ramping up new product investment ahead of very strong expected sales in 2005. However, we will seek to deliver continued efficiency gains and yearly progress on this measure.

FREE CASH FLOW

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 in the form of dividends or for re-investment in our business. The proceeds of disposals and the cost of acquisitions, together with any substantial integration costs associated with them, are excluded from the calculation.



Pearson's total free cash flow has been depressed in recent years by a high level of investment, particularly in the internet operations, but also in our print businesses. We believe that these investments will generate future growth, but we also need to ensure that dividends to shareholders can be paid from the cash generated by our businesses. In 2002, our focus on working capital and capital expenditure helped us to deliver a 29% improvement in free cash flow – even as we continued to invest in our businesses.

Looking ahead, we expect to deliver steady progress in cash generation, although we recognise that free cash flow in any one year may be affected by individual investment programmes. In the short term, we expect cash flow generation to be strongly positive.

RETURN ON INVESTED CAPITAL

Over the last few years, the transformation of Pearson has significantly increased the capital invested in the business (in the form of goodwill associated with the acquisitions necessary to build our market-leading businesses) and required substantial cash investment to integrate those acquisitions and to deliver an increasing proportion of our publishing and services online. With that transformation now largely complete, we are in a strong position to improve, each year, our return on invested capital.

We define ROIC as operating profit less cash tax as a percentage of our net operating assets plus total goodwill (that is, before goodwill amortisation). In 2002, our ROIC was 6%, up from 4.6% in 2001. Our cost of capital is a little lower than 8%. Our goal is to generate returns on invested capital above the cost of our capital as soon as possible.

RETURN ON INVESTED CAPITAL	2002		2001	
RETURN (OPERATING PROFIT LESS CASH TAX)	£419m	$675m	£394m	$634m
TOTAL INVESTED CAPITAL	£6,976m	$11,231m	£8,584m	$13,820m
RETURN ON INVESTED CAPITAL	6.0%		4.6%	

Going forward, we have two main levers to improve returns: increasing operating profit and reducing the level of operating assets. How quickly we can generate returns above our cost of capital will be dependent on a number of factors such as the business advertising environment.

ELISE SEE TAI * SIÂN WILLIAMS * CATHERINE GOLDSMITH * RACHAEL FOSTER * DK DESIGNS LYNN TREPICCHIO * BETSY NILES * SUZANNE KEEZER * CELIA ARGIRIOU * PEARSON EDUCATION

For the first time, children in the US, UK, Australia and Canada will learn to read from the same series of books thanks to an ambitious collaboration between Pearson Education and Dorling Kindersley. The Four Corners reading programme consists of 140 books which combine Pearson Education's mastery of content with DK's design magic.

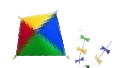
From business to education to books, our products last a lifetime.

In a world where the prosperity of individuals and countries increasingly depends on their knowledge and skills, our products matter more than ever.

1 **We're a publishing company:** whether data or images on paper or screens; whether in real time or from another century. Our customers trust us to make the right calls on which authors to sign up, which news stories to put up front, or how best to illustrate a science experiment. That takes good judgement in thousands of decisions about what's true, what's important, what's entertaining and what's inspiring.

2 **We mix services with our publishing to make the content more valuable and introduce us to new markets.** We combine textbooks with tests, so a teacher can diagnose how a child is learning, and prescribe an individual programme to help him along. We blend today's company news and analysis with historic data, so an investor has the information he needs to manage his money.

3 **We're one company.** Our special mix of assets is generating some wonderful opportunities – both to save costs and to grow revenues. We're realising the scale advantages of being the world's biggest book publisher, and we're creating new products that are more useful and more appealing because our businesses are working together.



4 **Our most important advantage is our people.** Everything we create – ideas, stories, newspapers, images, books, websites – is only as good as their minds and imaginations. They're responsible for helping children learn and for testing them to check that they have; for helping business people to make the right choices; for telling stories that help people understand the world or bring a smile to their face. So our company extends beyond newsrooms, design studios and warehouses and into classrooms, colleges, businesses, trading floors and homes.

Pearson is one of the world's great publishers. We publish more books than any other company and our news and analysis reach millions of people every day, in print and online. Over many years our publishing brands – Penguin, the Financial Times, Scott Foresman, Dorling Kindersley, Prentice Hall, Longman and many others – have earned the trust of readers because of their commitment to accuracy, integrity, and independence of thought. Our journalists, authors and editors are constantly seeking out the next scoop, blockbuster author, compelling story, innovative format or distinctive design.

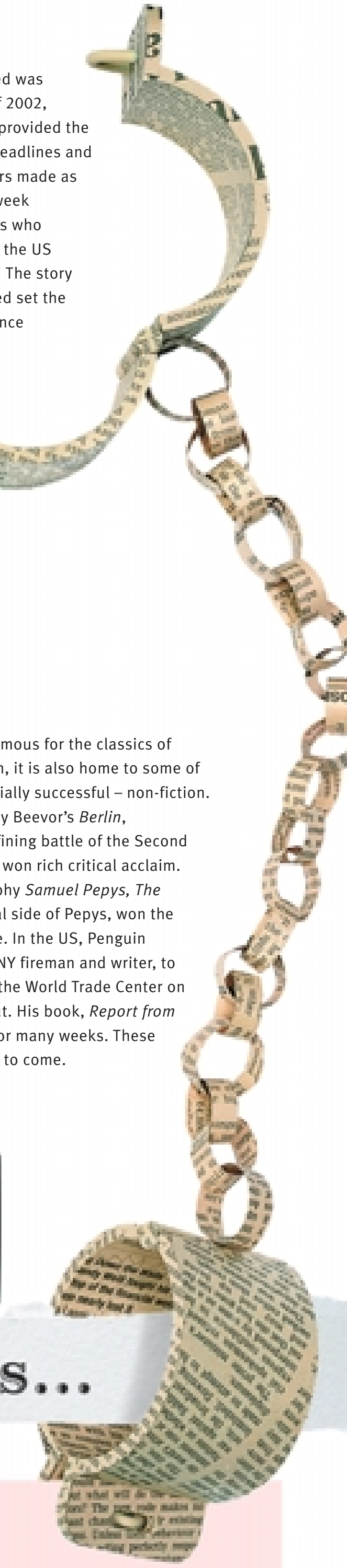
A publishing revolution: For many years, Dorling Kindersley's unique style of illustrated reference books has brought learning to life. Acquired by Pearson in 2000, DK has been working hard to turn around its commercial performance and unlock its creative magic. Those efforts paid off in 2002, as DK returned to profit and to its publishing best with a new generation of beautiful books including Bill Wyman's *Rolling with the Stones* and Judith Miller's *Antiques Guide*. DK's progress is set to continue in 2003 as it strengthens its partnerships with world-renowned institutions including The Smithsonian and The Royal Horticultural Society and prepares to publish new titles from leading experts such as Peter Ackroyd in history, Monty Don in gardening and Tom Peters in business.

Penguin's best Christmas: In a year when the global consumer publishing industry was flat, Penguin grew its underlying revenues by 5%. Much of that performance was down to our strongest publishing schedule yet. Penguin topped the Christmas bestseller lists on both sides of the Atlantic, thanks to authors like Jamie Oliver, Roy Keane, Zadie Smith, William Trevor, Tom Clancy, Patricia Cornwell, Nora Roberts and Jan Karon.

Rethinking the Classics: For more than 50 years, the Penguin Classics have provided the most authoritative and informative editions of classic literature for students and general readers. Launched in 1946 with a paperback translation of Homer's *The Odyssey*, the Classics were described as 'the greatest educative force of the Twentieth Century'. This year we're relaunching the entire list of 1,000 Classics, with new introductions and prefaces, up-to-date suggestions for further reading and a fresh new design.

The web of life: In colleges and schools across the US, we are moving our teaching materials from pure textbooks to a blend of printed and online content. Working with leading biology expert, Neil Campbell, Pearson Education applied content and technology from its college business to develop a slimmed-down core school textbook. We moved much of the detailed content online, enhancing lessons with tests, simulations, experiments and rich data.

Barons of Bankruptcy: Corporate greed was among the biggest business stories of 2002, and executives being led away in handcuffs provided the defining images. The *FT* looked behind the headlines and analysed how much money company directors made as their companies went bankrupt. After a six-week investigation, the *FT* revealed that executives who presided over the 25 largest bankruptcies in the US amassed personal fortunes totalling $3.3bn. The story touched a popular nerve in the US and helped set the agenda for the debate on corporate governance that followed.



Head of the class: It's statistically impossible to graduate from college in the US without studying one of our textbooks. Our college authors define the way future generations view the world, and many are the world's leading authorities on their subjects. They include Philip Kotler in marketing, Neil Campbell in biology, James Watson in microbiology, Robin Bade and Michael Parkin in economics, X J Kennedy in literature and Donald Knuth in computer programming.

Making history: Though Penguin is famous for the classics of literature and for contemporary fiction, it is also home to some of the most critically acclaimed – and commercially successful – non-fiction. Three history titles stood out in 2002. Antony Beevor's *Berlin*, with its story of the human misery of the defining battle of the Second World War, topped the bestseller charts and won rich critical acclaim. Claire Tomalin's funny and irreverent biography *Samuel Pepys, The Unequalled Self,* which revealed the personal side of Pepys, won the prestigious Whitbread Book of the Year prize. In the US, Penguin editors approached Dennis Smith, a retired NY fireman and writer, to tell the story of his colleagues who ran into the World Trade Center on September 11, when others were running out. His book, *Report from Ground Zero*, stayed on the bestsellers list for many weeks. These books will inform and inspire for a long time to come.

entertains and informs...

Playing to win: When *Marca,* Spain's leading sports newspaper, was faced with a tough competitor who began to reduce its cover price sharply, it was faced with a dilemma: fight a price war, as many newspapers have in Europe, or compete on the quality of the product. It opted for publishing quality – supporting the editorial team, investing in the brand and expanding into new media formats. As a result *Marca* gained share during the year, despite the price competition, with its circulation bouncing back to growth.

English lessons: There are more than a billion people worldwide learning English as a second language. Through the world-famous Longman imprint, we teach more than 40 million of them every year.

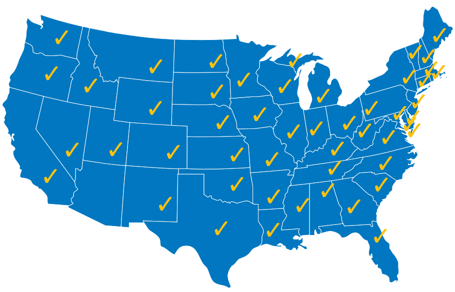
Award-winning journalism: The *Financial Times* stole the show at the World Leadership Forum's Business Journalist of the Year Awards:

- Decade of Excellence Award: Martin Wolf.
- Business Journalist of the Year Award: Richard Tomkins.
- Management and Business Education Award: John-Paul Flintoff.
- Service Industry Award: Juliette Jowitt.

Great publishing isn't just about great ideas and stories. It's also about making them available in the way customers want them and making the content special and useful. Much of our future depends upon being able to customise the things we make. Our books, newspapers and websites all have mass audiences, but our customers often want something unique, too.

Our customer may be a teacher who wants to give one student special practice to get his reading skills up to speed with the rest of the class. He may be a college professor who wants to build an economics course out of his own notes, lectures, assignments and tests, and deliver them online to his students. She may be an investor who wants to track the news and share price performance of her own unique portfolio of stocks.

Making its mark: Millions of students depend on Pearson as they sit their school tests and exams. In 2002, our educational testing business renewed two of its largest statewide contracts – California and Ohio – and won six new state contracts and the Department of Education's nationwide test of student progress. This business is poised to benefit further as the US Government has passed a law requiring all 50 states to test every 8-13 year-old in reading and maths every year.



Adding up: Pearson's Higher Education publishing business took the emergence of the internet as an opportunity to extend its leadership and attack one of its big competitors – the market for second-hand textbooks. *My Math Lab,* an online learning environment dedicated to improving student performance in mathematics, is a good example. It provides homework in multi-media instructions for 66 of our Higher Education maths titles and we're adding more. Students are able to log on using access codes, which they only receive when they buy a new textbook. Professors use the site to tailor material to their particular teaching needs. This leading-edge technology helped the Higher Education publishing business to grow well ahead of its market. We're launching similar products in economics, psychology, anatomy and physiology in 2003.

A fair deal for investors: The *FT*'s asset pricing business, IDC, is set to benefit from one of its most exciting new products. IDC discovered that a structural inefficiency within US mutual funds was costing the funds $4bn a year. Their investments in overseas markets like Japan were valued at the end-of-day prices – even though there were circumstances in which, if stock markets elsewhere in the world rose sharply while Japan was sleeping, it was a statistical certainty that Japan would re-open higher too. Arbitrageurs were taking advantage of these 'stale' prices and making significant profits.

So IDC created a service called Fair Value Pricing – to come up with more accurate values for overseas securities. The product is being trialled with 50 of the world's largest financial institutions and we're helping the industry solve a problem that they weren't even aware of. We're now developing a range of follow-on products and ideas that our methodology can be applied to.

Working for the government: NCS Pearson's Government Solutions business was Pearson's fastest-growing division in 2002, winning more than $500m of new US Government contracts. The US federal Government is keen to outsource non-core operations to private companies, and NCS is using its expertise in testing, training, HR support and data management to take advantage of the opportunity.

In March NCS Pearson was hired by the Transportation Security Administration to help it recruit and train 64,000 security personnel for US airports, in the biggest recruitment drive in US peacetime history.

We're also providing an online college education for US Navy personnel onboard ships and submarines; processing student grant applications for the Department of Education; helping the US Army, Navy and Air Force to administer their HR systems; and operating a national customer service centre for the US Department of Justice.

The fourth edition: FT.com, the online expression of the *Financial Times*, is the world's most popular audited business website. Since its launch in 2000, we've been steadily growing its audience – now a record 3.5 million users every month – and earning revenues through the sale of advertising and content. In 2002 FT.com took another big step forward as it launched a new range of services and began to convert those users into paying customers.

We re-designed the site and added new content, making the most of the *FT*'s unique comment and analysis. Paid-for services such as Lex Live and the Brussels Briefing are among the most popular areas of the site. By the end of 2002 we had 45,000 paying subscribers, helping FT.com to break even. It's now well established as the leader in online business journalism and is set fair to pay its way as the newspaper's fourth edition.

Testing the professionals: This year, 200 Pearson professional testing centres opened for business across the US. Each year 150,000 aspiring nurses will take their professional examinations in our centres, which provide an accessible and secure environment for online testing. Now the centres are open, we're aiming to make them the testing home for many other professions.

Made-to-order: In colleges up and down America, we're helping professors to create their own unique textbooks. We custom-build books and online programmes for a professor's individual course – taking in his own course plan and lecture notes, chapters from our books, newspaper articles, and tests and assignments he wants his students to take along the way.

So now we can make a curriculum that teaches his course the way he wants it. This business has trebled in size over the past three years, and is a model of personalised publishing that many other parts of Pearson can follow.

Over the past few years we've spent a lot of time and effort transforming Pearson from a disparate group into a more coherent company. We are a large family of businesses that are a lot alike and all share the same aim – to help our customers get on in, and make the most of, their lives. Pearson is the world's leading publisher and we want to make the most of it. Where it makes sense to share assets – such as intellectual property, content, design, brands and back offices – we are doing it more and more. Collaboration across Pearson isn't just about reducing costs, it's also helping us to create new products with some fantastic results.

…A FAMILY OF BUSINESSES THAT SHARES BRANDS.

Four corners: For the first time, children in the world's largest English-language markets – Australia, Canada, the US and UK – will learn to read from the same series of books in a new collaborative production between Pearson Education and Dorling Kindersley. An international team of researchers, designers and editors from across the two companies have been working since 2001 to create 2,400 pages and 140 books to be launched at the end of 2003.

Each book has been compiled to match curriculum standards in each of the four countries and written locally to reflect cultural differences. They will look dramatically different from any other reading book with beautiful DK designs that bring the pages to life. This collaboration is one of a number of cross-Pearson projects spearheaded by a new division, DK Designs, created specifically to spread DK's design magic across the company.

Painting campuses pink: Our college publisher Prentice Hall has sales teams on the campus of every business school and every college across America. With the *FT*, we're now offering business, finance and economics professors a weekly online service from the *FT*'s top writers. They report and analyse the major business and economics stories, and highlight the big issues to look out for in the week ahead. Professors use this commentary to prepare topical lessons and assignments. The partnership is helping our college business sell more books, and introducing the *FT* to its next generation of readers.

Sharing assets: As the world's largest publisher, we own millions of digital assets. We've pooled these resources to create the Pearson Asset Library. Not only is this saving costs on image licensing fees but it is also streamlining our production processes across the company. In 2002 we combined our two biggest libraries – 2.7 million images from our commercial DK image library and more than 800,000 from Pearson Education. The *Financial Times* photo library, a vast collection of news photographs and images, will be added in 2003.

The power of one: Together, Pearson Education and Penguin are the world's largest book publisher. We are starting to make that scale count in our favour.

Last year, we combined these book publishing businesses into single companies in Australia and Canada. They already shared many customers in the form of the major bookstores, and they now share warehouses, distribution centres, technology, salesforces and back office functions, too. In the UK, we are combining Penguin's and Pearson Education's warehousing and distribution into a new centre.

These are big investments – we plan to spend a total of £50m in 2002 and 2003 combined – but we expect to save £20m a year from 2005 and provide a better service to our customers.

The books business: The *FT* is trusted the world over for its authoritative business news and analysis. Now it's our brand for business books, too.

The FT and Prentice Hall, one of our imprints for college students and business people, have joined forces to publish the best titles in management, finance and business.

Recent titles include the history of telecommunications giant Nokia; a biography of Bernard Arnault, head of the LVMH luxury goods empire; and the *Financial Times* guides to marketing, investment and strategy.

A Texas-sized opportunity: In 2003 the state of Texas plans to buy new social studies textbooks for all its school children. Pearson Education expects to take a decent share of that opportunity as it launches a new social studies programme.

The new programme consists of 27 books, some in English, some in Spanish and some for advanced study, all aligned to the state's specific standards. The elementary texts feature specially designed spreads from Dorling Kindersley that radically transform the traditional look and feel of a social studies textbook. And scanners from our education testing business will enable teachers, for the first time, to test their students on-the-spot to see if they've learned the lessons the state requires them to.

We publish educational programmes that help teachers teach and students learn; news and analysis that help business people, politicians and investors make decisions; and fiction and non-fiction books that entertain and inform.

In all that publishing, we are unusually dependent on our people: the reporters, authors, designers, editors, educators and sales people who create our products and make them successful. Our work is underpinned by some basic principles. They are about being a company that is brave, imaginative and decent; about being committed to education in the broadest sense of the word; and about having a fundamental commitment to editorial integrity and freedom of speech.

...a company that is entirely reliant on our people and counts on the

a great place to work

Everything we create – ideas, stories, newspapers, images, books, websites – depends on the minds and imagination of our people. We're home to some of the best in the business, and we've set ourselves the goal of being the best place to work in the world. Of course we're nowhere near there yet, but that's where we're aiming.

Employee survey: This year we completed our first company-wide employee survey, and compared our results with 6,000 other companies. Pearson scored reasonably well as a place to work. We enjoy our work, we're happy with our working conditions, we think we have good benefits, we like to think we help each other. More than 60% of us think that being part of Pearson is important, and more than 80% think we're doing a good job of communicating what Pearson is about. But there are also real concerns over job security, stress and lack of opportunity for promotion. These are concerns that you expect at this stage in the economic cycle and we take them seriously. We're making a big effort to improve the feedback and career planning we provide to everyone at Pearson, and to improve the information we give people about their benefits. We'll repeat the survey this year, too, so we can see how we're doing.

Code of conduct: One of our basic principles is to be a decent company, that does the right thing by its people, its customers, its shareholders and everyone we do business with. This year we published a code of business conduct, setting out what that means to us – and really putting down on paper the standards of what we already believe and do.

Pearson careers: Across Pearson, we run a series of programmes to develop our people at all stages of their careers. Each of our businesses runs training programmes for graduates, exposing them to various roles across different functions and countries. Every year, we hold forums for managers from around the world to focus on company strategy and generating new ideas. And in 2002 we introduced a Pearson-wide placement programme to give people the chance to work for a short period with colleagues in other businesses or another country.

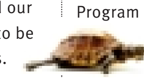
Diversity: We aim to be a diverse and inclusive company. We've appointed people in each of our businesses to spearhead our diversity programme and this is going to be a priority for us over the next few years.

our products

We provide education in the broadest sense of the word. Our products help children to succeed at school or adults to succeed at work; they help politicians consider different points of view or business people to divine markets; they inspire people to take a fresh look at the world. In 2002, we invested some £250m on new products and services.

Learning to read at your own speed: A great deal of scientific research suggests that very young children who aren't read to at home enter school at a significant disadvantage.

After nearly a decade of intensive study by top educators and researchers, the Waterford Early Reading Program was developed by the Waterford Institute, a non-profit organisation whose mission is to deliver superior education through technology. The programme, sold across the US by Pearson Education, has a unique computer-based instruction that adapts to an individual user's learning pace, regardless of primary language or pre-literacy exposure. It gives each child 15 minutes of individual attention and assistance each day, with a rich multi-media mix of books, poems, songs and other literacy activities.



The programme has been formally assessed, comparing the achievements of students who used the programme with those who did not. The research shows the programme to be very effective in preparing young children to read, with particular strength in bringing the lowest performers in a class to

DAVID BELL * DIRECTOR FOR PEOPLE, PEARSON

fact that culture and conduct have a great deal to do with success...

reading competency and helping non-English speaking children to assimilate English language skills more quickly.

We've recently launched the Waterford Early Maths and Science programmes, using the same innovative self-paced software to provide students with a solid foundation in basic maths skills, science content and creative problem-solving.

MORE ABOUT THE WATERFORD PROGRAMME AND THE RESEARCH FINDINGS AT *www.pearsondigital.com*

Leaving no child behind: Teachers and schools getting ready for America's most sweeping education reforms for 25 years now have a helping hand. Concert, a new online application, will allow teachers to tailor learning for each student and help schools to monitor and report their students' performance. These are new requirements for schools as part of President Bush's 'No Child Left Behind' education act.

MORE INFORMATION AT *www.pearsonedtech.com*

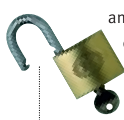
Putting reading first: The US federal Government has created a $1bn annual budget to boost literacy levels for young children. The money can only be spent on programmes that are scientifically proven to boost language and literacy skills.

Pearson Education has partnered with eminent researchers to bring their work in scientifically-based reading instruction to benefit young children across America. Teaming up with the National Center for Learning Disabilities, Pearson Early Learning published their research-based screening tool, *Get Ready to Read!*, which helps parents and teachers know if a child is ready to learn how to read. To engage parent, child, and teacher in the active development of reading skills, we published their scientifically-based programme *Read Together, Talk Together*. It is founded on the principle that children gain dramatic growth in reading and language skills when there is an integrated dialogue between the adult and the child who is learning to read. The programme includes new picture books designed by Dorling Kindersley, classic children's books from Penguin, and support materials for teachers and parents designed to stimulate conversations with children about books.

publishing power

Our editorial judgements – what authors we publish, the stories we feature, the comment we make – can have a big impact on both broad social issues and specific community organisations. That's why we employ the best authors, editors and journalists, and vigorously protect their editorial integrity and freedom.

Editorial integrity: Freedom of speech and editorial independence are fundamental principles of our publishing. Penguin has long championed these causes. Over the years, it has been the publisher (and defender in the courts) of controversial titles and the *Financial Times* has an equally strong reputation for incisive and objective news and analysis.



Corporate ethics and responsibility: While our newspapers have helped to shape the debate on corporate ethics and responsibility, our book publishers are creating the leading practical guides for business schools and companies.

Our higher education imprint Prentice Hall leads the publishing market in business ethics – a market which is growing rapidly as more college and MBA students choose business ethics courses as one of their electives towards a degree in business.

Everybody's Business: For the past ten years, the *FT* has been lending its publishing skills to campaigning organisations such as Business in the Community and The Prince of Wales Business Leaders Forum, bringing their publications to a much wider audience of business leaders and publishing indices of corporate responsibility and environmental management. Last year the *FT* teamed up with Dorling Kindersley to publish *Everybody's Business*, a handbook for companies who are trying to meet changing expectations from customers, employees, communities and investors.

A life like mine: In 2002 Dorling Kindersley and the United Nations Childrens Fund (UNICEF) extended a long-term publishing partnership that gives a unique insight into the lives children lead around the world. Nearly 11 million children under five die each year, mostly from preventable diseases, and more than 100 million children aged 5-14 are in full-time or dangerous work. The UN's Convention on the Rights of the Child sets out what every child needs, from the basics of food, water and shelter, through education and health care and protection from wars, abuse and exploitation. To celebrate the anniversary of the UN Convention, DK and UNICEF published *A life like mine*, exploring the Rights of the Child through the eyes of twenty children from all corners of the world.

…in everything we do, we aspire to be brave, imaginative and decent.

community programmes

We've focused our business on helping people of all ages get on in their lives and we've focused our community support around organisations that help them do that too.

In 2002, we invested some £2.8m in community programmes. That investment is centred on two things. We want to support our employees who are active in their communities, providing them with time, money and products that encourage and extend their commitment. And we want to forge long-term partnerships with a small number of not-for-profit organisations that make a sustainable difference to education, teachers and literacy.

A jump-start for pre-schoolers: In 2001 we made a $2.5m, three-year commitment to Jumpstart, a US non-profit organisation. Jumpstart recruits and trains college students to work one-to-one with disadvantaged pre-school children. The process can measurably improve the children's performance, and often inspires the college students to take up careers as pre-school teachers. This year, the Pearson Teacher Fellowship is sponsoring 28 Jumpstart alumni to become full-time early education teachers. Pearson Teacher Fellows receive stipends, on-going training, plus individual mentoring from our employees to support them in the first two years of their teaching careers. Our US businesses are using their expertise and resources creatively to further assist the Jumpstart programme with books, technology and staff time. We plan to launch a flagship UK community programme during 2003.

MORE INFORMATION AT
www.jstart.org

Employee volunteering: We encourage employees to offer their services as volunteers – to read to children in local primary schools, paint classrooms or tidy up playgrounds.

We run a matching scheme for employee fundraising so that they can double the money they raise for their chosen organisations. Our payroll-giving schemes make it easier for employees to make tax-free donations to their favourite causes.

Spreading the word: We partner with various organisations which promote literacy and increase access to books. Our children's publisher Puffin works with Bookstart in the UK, which provides every baby in the country with a pack of free books and learning materials for parents. In the US, Penguin has partnered with Literacy Partners, which focuses on adult and family literacy programmes.

We also work closely with Book Aid International, which helps schools and libraries in the developing world to make books and educational materials available where they are most needed.

our policies

Environment: Every day, our people travel to work and for business, use electricity to keep warm or cool and to power their computers and consume water. Our books and newspapers use paper and ink and are packaged around the world. While most of our products are based on intellectual property, we recognise that our day to day operations have an effect on the world around us and that we have a responsibility to manage and measure this impact.

Efficiency is not just about capital. It is also about making sure that we and our supplier partners do not use up more natural resources than we really need to.

BILL BARKE * CHAIRMAN AND CEO ADDISON WESLEY HIGHER EDUCATION GROUP, JUMPSTART BOARD MEMBER

Pearson has had an environmental policy since 1992. We reviewed this policy in 2000 and put a benchmarking procedure in place in 2001 to measure our progress. We have now surveyed all of our wholly owned businesses. We have set targets and report on our performance on our website. There is more to do, but we are committed to continue this work.

MORE INFORMATION AT
www.pearson.com/community/envr.htm

Labour standards and human rights: A commitment to labour standards and human rights is one of the basic building blocks on what being a good corporate citizen means to us.

We realise that these are not always easy issues. One practical way to make real our concern for labour standards and human rights was by becoming a founder signatory to the United Nations Global Compact. The Compact sets out nine principles in the areas of human rights, labour standards and the environment. Its purpose is to provide a framework for companies to consider and manage their impact on global society and the environment – ideal for an international company with customers all over the world.

In our 2000 Annual Report and Accounts, we codified the UN principles into a series of guidelines that formed the key commitments against which we would judge ourselves. Each year, we report in our Annual Report and Accounts and on our website on the progress made against our guidelines.

In 2001 we began a process to ensure that we live up to these commitments by surveying our workforce. We completed this process in 2002 and the survey now covers 82 business operations in 41 countries. We are confident that for all the businesses that we own we meet or exceed the standards we have set ourselves on equal employment opportunities and conditions. In 2003 we plan to extend our survey to include our major sub-contractors.

MORE INFORMATION AT
www.pearson.com/community/ethics.htm

JOSÉ LUIS MORALES * PAULO ROVAI * PEARSON EDUCATION

Operating review

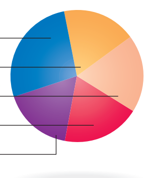
In 2002, sales increased by 6% to £4,320m and operating profit from continuing operations improved by £67m to £493m, an increase of 18%. Adjusted earnings per share grew to 30.3p, a headline increase of 42%. Operating free cash flow improved by £69m to £305m. Average use of working capital improved by £53m in our book publishing businesses, even as we increased investment in new authors, titles and programmes.

On a statutory basis, Pearson reported a loss before tax for the year of £25m (a £436m loss in 2001) and generated a loss per share of 13.9p (a loss per share of 53.2p in 2001). The loss includes a (non-cash) goodwill charge of £340m. Net borrowings fell by £971m to end the year at £1,408m. The board is recommending a 5% increase in the dividend to 23.4p per share.

SALES total £4,320m *$6,955m*

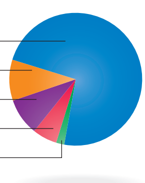
sector analysis

27% SCHOOL EDUCATION £1,151m *$1,853m*
18% HIGHER EDUCATION £775m *$1,248m*
19% PROFESSIONAL EDUCATION £830m *$1,336m*
19% THE PENGUIN GROUP £838m *$1,349m*
17% THE FT GROUP £726m *$1,169m*



geographical analysis

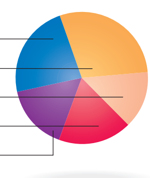
73% NORTH AMERICA £3,139m *$5,054m*
10% CONTINENTAL EUROPE £419m *$675m*
9% UNITED KINGDOM £411m *$661m*
6% ASIA PACIFIC £249m *$401m*
2% REST OF WORLD £102m *$164m*



OPERATING PROFIT* total £493m *$794m*

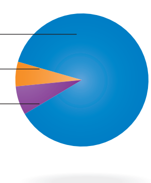
sector analysis

23% SCHOOL EDUCATION £115m *$185m*
29% HIGHER EDUCATION £142m *$229m*
14% PROFESSIONAL EDUCATION £69m *$111m*
18% THE PENGUIN GROUP £87m *$140m*
16% THE FT GROUP £80m *$129m*



geographical analysis

87% NORTH AMERICA £495m *$797m*
7% CONTINENTAL EUROPE £40m *$64m*
6% ASIA PACIFIC £31m *$50m*
REST OF WORLD £(1)m *$(2)m*
UNITED KINGDOM £(72)m *$(116)m*



* continuing operations before goodwill and exceptional items.

In 2002, Pearson launched its first ever corporate advertising campaign. While our publishing imprints are known the world over, research suggests that there is little awareness that names like Scott Foresman, Prentice Hall, Penguin and The Financial Times are all part of the Pearson family. The campaign – which only runs in our own publications – aims to show how all of our businesses help people 'live and learn'.

JOHN FALLON * CEO, PEARSON EDUCATION, EUROPE, MIDDLE EAST AND AFRICA
PAMELA MUSICK * PEARSON EDUCATION

The Financial Times Group

The Financial Times Group is a network of some of the world's finest newspapers and a fast-growing web of online services. Built around the *Financial Times* newspaper – a unique voice on the key financial, economic and business issues of the day – we are the most international source of business news and analysis in the world.

- *The Financial Times* is the most international business newspaper in the world. It is printed in 20 cities across the globe with a daily circulation of over 470,000 and a readership of more than 1.6m people in 140 countries.
- FT.com, the newspaper's internet partner, combines agenda-setting editorial and financial data with a broad range of business tools, including the most extensive business news search function on the internet. FT.com attracts 3.5m unique monthly visitors and has a growing subscriber base of 45,000.
- Our pan-European network includes the leading business newspapers and websites in France (*Les Echos* and lesechos.fr) and Spain (*Expansión* and expansiondirecto.es). In 2000 we launched a new German language newspaper, *FT Deutschland*, a joint venture with Gruner + Jahr, which has built a circulation of 90,000 in just three years.
- Our Interactive Data Corporation (NYSE: IDC) is a leading provider of financial data to institutional and retail investors. IDC collects, maintains and models data on more than 3.5m securities for its customers which include 49 of the world's top 50 financial institutions.
- FT Business produces specialist information on the retail, personal and institutional finance industries including *Investors Chronicle* and the UK's premier finance magazine, *The Banker*.
- The FT Group has a 50% stake in the Economist Group, which publishes the world's leading weekly business and current affairs journal.
- The FT also has a stake in a number of joint ventures, including FTSE International, a joint venture with the London Stock Exchange; *Vedomosti*, Russia's leading business newspaper and a partnership venture with Dow Jones and Independent Media; and a 50% stake in BDFM, publishers of South Africa's leading financial newspapers and websites.

The FT Group saw revenues fall £75m (8%) as the global economic downturn continued to hit advertising revenues and, to a much lesser extent, newsstand sales. Despite the revenue decline, operating profits increased 8% to £80m due to double digit profit growth at IDC and Recoletos (the FT Group's two businesses least affected by the downturn), successful cost reduction programmes across the Group, and sharply lower internet losses of £34m (down from £60m in 2001).

The *Financial Times* newspaper and its internet partner, FT.com, are now fully integrated. A 14% reduction in their combined cost base mitigated – but could not offset – a sharp reduction in advertising revenues at the newspaper. A further advertising deterioration in the second half, together with some one-off costs, meant that, although the newspaper remained in profit for the full year, it operated at a loss in the second half. Industry conditions remained tough for the *FT*'s major advertising categories,

SALES

02	£726m	$1,169m
01	£801m	$1,290m
00	£844m	$1,359m

OPERATING PROFIT

02	£80m	$129m
01	£72m	$116m
00	£98m	$158m

FT YEAR END CIRCULATION

02	473,587
01	501,258
00	485,103
99	440,381
98	385,578

source: ABC

In 2002 FT.com launched a new range of services and began to convert loyal users into paying customers. The entire site was redesigned, offering an improved user experience and new value-added services. Subscribers enjoy complete access to specialist FT comment and analysis including Lex Live and in-depth data on over 18,000 listed companies worldwide. This helped FT.com reach its target of break-even in the fourth quarter of 2002. And it added a new revenue stream (alongside advertising & content sales) with 45,000 subscribers signing up by the end of the year.

CLARE PAYNE * FINANCIAL TIMES

including financial services, technology and business-to-business. Advertising volumes fell by 24% (on top of a 29% fall in 2001) and advertising revenues by 23% (after a 20% decline in 2001). The newspaper ended the year with average daily circulation of 473,587, a decline of 6% on the previous year primarily due to lower sales in the UK.

FT.com broke even in the fourth quarter of 2002. Revenues were up 9% to £25m. Despite the introduction of paid-for elements of the site, FT.com's popularity continued to grow, up 30% to a record 3.5m unique monthly users in January 2003.

Les Echos made a profit of £7m (down 34% on 2001) as advertising revenues fell sharply. Average daily circulation was 121,000, a 6% decline, but well ahead of its market. **FT Business** delivered double digit margins as its major titles – *Investors Chronicle, The Banker* and *Financial Adviser* – all strengthened their market positions.

Losses from the FT's **associates and joint ventures** were less than half the level of the previous year due to continued progress at ***FT Deutschland***, our joint venture with Gruner + Jahr. Despite the tough German advertising market, *FT Deutschland* grew its advertising revenues slightly and increased its circulation by 14% to 89,000 at the end of the year. **The Economist Group** also contributed to the improvement, offsetting falling advertising revenues with tight cost controls. *The Economist's* worldwide weekly circulation grew by 6% to 881,259.

Recoletos (Bolsa Madrid: REC), our Spanish media group, increased profits by 21%, benefiting from actions taken in 2001 to reduce costs. After a successful re-launch *Marca*, Spain's leading sports newspaper, grew its circulation by 2% to 382,000 and increased advertising revenues and profits. Circulation at business newspaper *Expansion* was 9% lower and advertising revenues 25% lower.

Interactive Data Corporation (NYSE: IDC), our 60%-owned asset pricing business, increased revenues by 7% as contract renewal rates in its institutional business – which accounts for 90% of revenues – continued to run at 95%. IDC also benefited from the launch of several new products and the integration of Merrill Lynch's Securities Pricing business, the latest in a series of successful bolt-on acquisitions. In January 2003, IDC announced the acquisition of S&P Comstock, which adds real-time pricing to IDC's existing end-of-day services.

SALES	2002		2001		UNDERLYING % CHANGE
FT NEWSPAPER	£202m	*$326m*	£250m	*$403m*	(19)
OTHER FT PUBLISHING*	£102m	*$164m*	£138m	*$222m*	(14)
INTERNET ENTERPRISES**	£48m	*$77m*	£51m	*$82m*	(5)
RECOLETOS	£148m	*$238m*	£150m	*$242m*	(4)
IDC	£226m	*$364m*	£212m	*$341m*	7
TOTAL	**£726m**	***$1,169m***	**£801m**	***$1,290m***	**(8)**

OPERATING PROFIT	2002		2001		UNDERLYING % CHANGE
FT NEWSPAPER	£1m	*$2m*	£31m	*$50m*	(92)
OTHER FT PUBLISHING*	£13m	*$21m*	£21m	*$34m*	(39)
ASSOCIATES AND JOINT VENTURES	£(3)m	*$(5)m*	£(10)m	*$(16)m*	65
INTERNET ENTERPRISES**	£(34)m	*$(55)m*	£(60)m	*$(97)m*	46
RECOLETOS	£29m	*$47m*	£23m	*$37m*	21
IDC	£74m	*$119m*	£67m	*$108m*	12
TOTAL	**£80m**	***$129m***	**£72m**	***$116m***	**8**

* *Les Echos and FT Business*

** *The FT Group's internet enterprises include online businesses related to the FT, Les Echos, Recoletos, FT Deutschland, The Economist, IDC and CBSMarketWatch.*

JON MCMANUS * FINANCIAL TIMES

The Penguin Group

CELESTE BROWN • PENGUIN

Penguin is one of the world's great names in consumer publishing. From literary prize winners to commercial blockbusters; from a child's first picture book to the classics of literature; from fantastic fiction to beautiful reference works, Penguin publishes an unrivalled range of books in 100 countries. Penguin is the world's pre-eminent English language publisher – number one or two in the US, UK, Australia, New Zealand, India and Canada.

› Over the last four years, Penguin has doubled its presence on the bestseller lists in the US and UK thanks to writers such as Tom Clancy, Patricia Cornwell, Jan Karon, Nora Roberts, Nick Hornby and Jamie Oliver.

› We are the world's leading children's publisher, helping characters such as Peter Rabbit, The Little Engine That Could and Spot capture the imagination of children all over the world through imprints such as Puffin, Grosset & Dunlap and Ladybird.

› Dorling Kindersley's beautifully illustrated reference books help children and adults of all ages to learn about the world around them in more than 90 countries and 40 languages.

› Penguin is working hard to discover the writing stars of tomorrow. In 2002 our debut authors included Hari Kunzru and Jonathan Safran Foer, winner of the *Guardian* First Book Award, in the UK, and Gary Shteyngart, winner of the Stephen Crane First Fiction Award, and Sue Monk Kidd in the US.

› In 2003 we relaunched the Penguin Classics range which includes more than 1,000 titles from Homer's *The Odyssey* to George Orwell's *Nineteen Eighty Four*.

› People discover the world using our travel guides. Together, our Rough Guides and Dorling Kindersley's *Eyewitness* Guides, have sold more than 15 million copies worldwide.

SALES

02	**£838m**	***$1,349m***
01	£820m	*$1,320m*
00	£755m	*$1,216m*

OPERATING PROFIT

02	**£87m**	***$140m***
01	£80m	*$129m*
00	£79m	*$127m*

The Penguin Group increased sales by 5% and operating profits by 11%, in spite of Penguin's £10m share of our £30m investment in new back office systems and processes.

In the US, Penguin published 24 titles that became *New York Times* number one bestsellers, more than any other publisher and a 25% increase on 2001. In the UK, Penguin posted its best performance on the bestseller lists for a decade as 45 titles reached the Neilsen Bookscan top 15, a 10% increase on 2001. This strong performance enabled Penguin to gain share in both the US and the UK.

Dorling Kindersley increased sales by 8% and profits by £15m as it benefited from its integration within Penguin, the revitalisation of DK's creative style and our investment in a stronger frontlist of key titles.

Pearson is now, by some distance, the world's largest book publisher and Pearson Education and Penguin are working on a number of initiatives to maximise the scale advantages that this brings.

	2002		2001		UNDERLYING % CHANGE
SALES	£838m	*$1,349m*	£820m	*$1,320m*	5
OPERATING PROFIT	£87m	*$140m*	£80m	*$129m*	11

JOHN MAKINSON • CHAIRMAN AND CHIEF EXECUTIVE, PENGUIN GROUP

Pearson Education

JOE SMALL * PEARSON EDUCATION

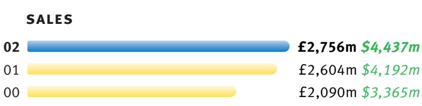
Pearson Education is the world's leading education company. We serve every age and level of student from early learning right through to professional life. We offer the broadest range of publishing and services from the most comprehensive list of textbooks, to leadership in testing, assessment and enterprise software and the very best in online consumer and professional learning.

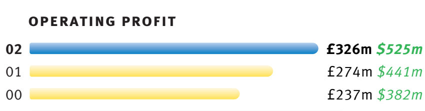
- Through our Scott Foresman and Prentice Hall School imprints, one in three American schoolchildren studies English or Maths with one of our textbooks.
- We are America's leading test scoring and reporting company, scoring and processing 40 million student tests across the US every year.
- More than 40,000 schools in the US use at least one of our online programmes and more than 14 million parents, students and teachers connect to our learning tools from home using the internet.
- We are the largest college publisher in the world, with imprints such as Prentice Hall, Addison Wesley, Longman, Allyn & Bacon and Benjamin Cummings. These publishers represent around one in three of all the text and online programmes studied on US campuses.
- Our professional and technology group publishes leading computer and business titles through imprints such as Addison-Wesley Professional, Peachpit Press, Prentice Hall PTR and Cisco Press.
- Pearson Government Solutions is our fastest-growing business providing data management information and education-related services to the US federal Government.
- We teach more people English as a second language than any other company in the world – 40 million of them. We're also the leading education company outside the US, operating in 55 countries and 17 languages.

Underlying sales at Pearson Education increased 11% and profits 22%. Profits were helped by a £52m reduction in internet losses but offset by Pearson Education's £20m share of investment in new back-office systems and processes and an £11m increase in pension contributions. **NCS Pearson** is now an integral part of Pearson Education. On a standalone basis, revenues increased 42% to £843m and profits increased 46% to £92m.

In our **School** business sales were down 5% and operating profits down 15%. In the US, our School business includes publishing, testing and software operations. School publishing revenues were down 6% due to the slower adoption cycle* and our decision to compete for just 65% of the available new adoption dollars. Our school imprints, Scott Foresman and Prentice Hall, took a 23% share of the total new adoption market and a 36% share of the adoptions in which we participated. Overall, our share of the US School publishing market was 24% (24.5% in 2001).

* In the US, 21 'adoption' states buy textbooks and related programmes to a planned contract schedule, which means the level of spending varies from year to year according to this schedule. The 'open territory' states are those that buy textbooks on an as-needed basis rather than on a published adoption schedule.





SALES	2002		2001		UNDERLYING % CHANGE
SCHOOL	£1,151m	*$1,853m*	£1,266m	*$2,038m*	(5)
HIGHER EDUCATION	£775m	*$1,248m*	£721m	*$1,161m*	13
PROFESSIONAL	£784m	*$1,262m*	£558m	*$898m*	48
FT KNOWLEDGE	£46m	*$74m*	£59m	*$95m*	(18)
TOTAL	**£2,756m**	***$4,437m***	**£2,604m**	*$4,192m*	**11**

OPERATING PROFIT	2002		2001		UNDERLYING % CHANGE
SCHOOL	£140m	*$225m*	£167m	*$269m*	(15)
HIGHER EDUCATION	£142m	*$229m*	£127m	*$204m*	17
PROFESSIONAL	£81m	*$130m*	£80m	*$129m*	8
INTERNET	£(25)m	*$(40)m*	£(77)m	*$(124)m*	–
FT KNOWLEDGE	£(12)m	*$(19)m*	£(23)m	*$(37)m*	–
TOTAL	**£326m**	***$525m***	**£274m**	***$441m***	**22**

We are the number one educational testing company in the US, and in 2002 we extended that lead as we won several new state testing contracts. We plan to use that experience to build our testing business outside the US.

MICHAEL KAYSER * NCS PEARSON
CLAUDINE O'LEARY * NCS PEARSON

After 13% growth in 2001, our school testing business grew by a further 3%. It renewed and expanded two of its largest multi-year statewide contracts – California and Ohio – as well as the National Assessment of Educational Progress contract from the US Department of Education. It won new contracts in California and six other states that will start to contribute to revenues in 2003. Revenues were down at our school software business, primarily due to the deferral of a number of contracts into 2003, but losses fell as we outsourced more of our software development needs.

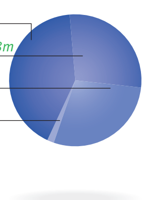
Outside the US, our school publishing businesses performed strongly in Hong Kong, Japan, Singapore and Spain. Strong growth in English Language Teaching sales in Europe and Asia was partially offset by some weakness in US and Latin American markets.

Our **Higher Education** business increased revenues by 13% and operating profits by 17%. In the US the Higher Education publishing business grew its revenues by 14%, ahead of market growth of 10% (8% excluding Pearson). The business benefited from a booming college population, its publishing and salesforce strength and its lead in making online services an integral part of its products. Our custom publishing business, which produces text books and course materials custom-made for individual college professors, continued its rapid growth, with sales up 50% in the year (and 300% over the past three years). Around the world, our Higher Education operations benefited from the same trends we saw in the US, with a particularly strong performance in Europe where revenues were up in double digits.

The **Professional** business increased sales by 48% and profits by 8%. A major investment in 200 professional certification centres across the US, along with a change in business mix and a further decline in our higher-margin technology publishing businesses, and double digit growth in the lower margin Government Solutions division, meant that profits grew considerably slower than revenues. In the US, we helped the newly-formed Transportation Security Administration to recruit 64,000 security personnel for US airports, a one-year contract worth more than $300m in revenues to our Government Solutions business. A series of smaller, longer-term contract wins – with the Immigration and Naturalization Service, the Department of Health and Human Services and the US Department of Defense – gives the business a strong pipeline for 2003 and future years. With IT and technology markets continuing to be bleak, sales at our technology publishing arm were down 12% in the US (following a 20% fall in 2001) and margins declined, although due to further cost actions they were still in double digits. In Europe, where technology publishing sales were down more than 20% in 2002, we have taken similar actions to reduce costs.

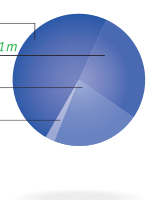
SALES ANALYSIS total £2,756m *$4,437m* **2002**

42% SCHOOL £1,151m *$1,853m*
28% HIGHER EDUCATION £775m *$1,248m*
28% PROFESSIONAL £784m *$1,262m*
2% FT KNOWLEDGE £46m *$74m*



SALES ANALYSIS total £2,604m *$4,192m* 2001

49% SCHOOL £1,266m *$2,038m*
28% HIGHER EDUCATION £721m *$1,161m*
21% PROFESSIONAL £558m *$898m*
2% FT KNOWLEDGE £59m *$95m*



Pearson Broadband has partnered with Pearson Education to develop KnowledgeBox, a digital learning system that helps teachers create multimedia lessons in reading, maths, science and social studies. It contains over 1,500 digital resources and material from leading publishers including Longman, Puffin, Penguin and Dorling Kindersley. KnowledgeBox is being used by schools in 21 states across the US and was launched in the UK in early 2003.

KELLIE LANE * **LAURA JONES** * **WENDY KERR** * **ROBIN GAY** * PEARSON BROADBAND

Financial review

EMMA JAMES * DK, PENGUIN

The sale of our 22% share in the RTL Group was concluded at the end of January 2002 allowing us to pay down our debt to under £1.5bn and marking the beginning of a period of portfolio stability. This also results in the Pearson profit and loss account becoming more straight forward as our significant acquisition and disposal activity and our start-up internet investments are largely behind us. 2002 also marks the end of the integration of our major acquisitions, and the goodwill amortisation arising from those acquisitions will be more predictable.

Our operating profits from continuing operations in 2002 increased from 2001 by 18% to £493m. However, almost entirely as a result of our (non-cash) goodwill amortisation charge, we still show an overall loss for the financial year.

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 the estimated useful life of the acquisition, or a period of 20 years, whichever is the shorter. The goodwill amortisation charge fell by £45m last year to £330m, mainly due to the disposal of the RTL Group.

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 2002, we took a £10m impairment charge relating to a subsidiary of Recoletos in Argentina.

integration costs ▸ Integration costs are the one-off costs of integrating significant recent acquisitions into our existing businesses. In 2002, £3m was incurred in integrating Dorling Kindersley into the Penguin Group (compared to £45m in 2001) and £7m related to the integration of NCS into Pearson Education (compared to £29m in 2001). This expenditure was in line with our forecasts at the time of the transactions and there will be no further charges in respect of these acquisitions in 2003. All other restructuring and related costs are expensed through the P&L as part of the ongoing operations of our businesses.

non operating items ▸ In 2002, we took a charge of £37m for non-operating items relating to losses on the sale or closure of businesses and fixed assets. The principal items are a profit of £18m relating to the completion of the sale of the RTL Group in January 2002 and a provision of £40m for the loss on sale of our Forum business, which completed in January 2003. This provision largely relates to unamortised goodwill at the balance sheet date. Other items include a loss on sale of PH Direct of £8m, a profit of £3m on finalisation of the sale of *Journal of Commerce* by the Economist and various smaller losses on investments and property.

amounts written off investments ▸ In 2002, we continued to review our fixed asset investments and concluded that there have been no further material impairments. This compares to a charge of £92m taken in 2001 relating to the carrying value of Pearson shares held to secure employee share option plans and equity investments in a number of internet businesses.

We're combining forces to grow our bilingual publishing programme. In just four years we've become the leading publisher of bilingual materials for the US elementary school market. We've taken the market-leading position in elementary Spanish reading and we hope to do the same in social studies.

JOANNE DRESNER * PRESIDENT, ELT, PEARSON EDUCATION
DEBRA HOPKINS * BILINGUAL PRODUCT MANAGER, PEARSON EDUCATION
MERCEDES MURATORIO * SPANISH PUBLISHING CO-ORDINATOR, PEARSON EDUCATION

interest ‣ Net interest charges fell by £75m to £94m, with average net debt decreasing by £748m following the receipt of proceeds from the RTL disposal. 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 160 basis points, or 1.6%. The effect of these falls was mitigated by our existing portfolio of interest rate swaps, which converted over half our variable rate commercial paper and bank debt to a fixed rate basis. As a result, the Group's net interest rate payable averaged approximately 5.0%, falling 1.4% from the previous year. During 2002, we took an additional one-off charge of £37m for cancellation of certain swap contracts and the early repayment of debt following rebalancing of the Group's debt portfolio on the receipt of the RTL proceeds.

taxation ‣ The Group recorded a total pre-tax loss of £25m in 2002 but there was a tax charge for the year of £64m. This situation reflects the fact that there is only limited tax relief available for the goodwill amortisation charged in the accounts. The total tax charge was in fact reduced by a non-operating credit of £45m attributable to the resolution of the tax position on the disposal of the Group's remaining interest in BSkyB.

The tax charge reflects the adoption of FRS 19 'Deferred Tax'. FRS 19 requires full provisioning for deferred tax and this has had a significant effect on Pearson's effective tax rate. This is mainly because Pearson has recognised a deferred tax asset in respect of US tax losses and other timing differences. Previously the tax benefit of US tax losses was accounted for as the losses were utilised. FRS 19 has been adopted in these accounts and the comparative figures have been restated.

The tax rate on adjusted earnings, after restating for FRS 19, decreased from 34.0% to 32.8%. The decrease was attributable to two main factors. There was a more favourable mix of profits between higher and lower tax regimes than in 2001; in addition there was a benefit from prior year adjustments.

dividends ‣ The dividend payment of £187m which we are recommending in respect of 2002 represents 23.4p per share – a 5% increase on 2001. The dividend is covered 1.3 times by adjusted earnings, and 1.6 times by operating free cash flow.

summary financial statement ‣ This summary financial statement, including the summary directors' report, was approved by the board on 3 March 2003. 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.

Every Monday, 80,000 business, economic and finance professors across the US receive a briefing, the *Week Ahead*, from the *Financial Times* US managing editor, Andrew Hill. The professors, customers of our college imprint Prentice Hall, use the *FT*'s analysis of the key events to enliven their teaching. The *FT* benefits from the scale and reach of Prentice Hall's large sales and marketing team and from its experience in managing online curriculum content.

ANDREW HILL ⋆ FINANCIAL TIMES
ANNIE TODD ⋆ PEARSON EDUCATION

ALEX KIRKHAM * DK, PENGUIN

Profit and loss account

year ended 31 Dec 2002

all figures in £ millions	2002 RESULTS FROM OPERATIONS	2002 OTHER ITEMS	2002 TOTAL	2001 RESTATED RESULTS FROM OPERATIONS	2001 RESTATED OTHER ITEMS	2001 RESTATED TOTAL
Sales	4,320	–	4,320	4,225	–	4,225
Total operating profit/(loss)	493	(350)	143	463	(510)	(47)
Non operating items	–	(37)	(37)	–	(128)	(128)
Amounts written off investments	–	–	–	–	(92)	(92)
Net finance costs	(94)	(37)	(131)	(169)	–	(169)
(Loss)/profit before taxation	399	(424)	(25)	294	(730)	(436)
Taxation	(131)	67	(64)	(100)	133	33
(Loss)/profit after taxation	268	(357)	(89)	194	(597)	(403)
Minority interests	(27)	5	(22)	(24)	4	(20)
(Loss)/profit for the financial year	241	(352)	(111)	170	(593)	(423)
Dividends on equity shares			(187)			(177)
Loss retained			(298)			(600)
Adjusted earnings per share			30.3p			21.4p
Loss per share			(13.9)p			(53.2)p
Diluted loss per share			(13.9)p			(53.2)p
Dividends per share			23.4p			22.3p

Cash flow statement

year ended 31 Dec 2002

all figures in £ millions	2002	2001 RESTATED
Operating profit*	**493**	463
Working capital and other operating movements	**(36)**	(4)
Net operating expenditure on fixed assets	**(2)**	(22)
Operating cash flow	**455**	437
Integration costs	**(44)**	(69)
Interest, taxation and dividends	**(378)**	(411)
Net movement of funds from operations	**33**	(43)
Acquisitions and disposals	**806**	(23)
Other non-operating movements including new equity	**1**	12
Net movement of funds	**840**	(54)
Net debt at beginning of the year	**(2,379)**	(2,301)
Exchange differences on net debt	**131**	(24)
Net debt at end of the year	**(1,408)**	(2,379)

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

Balance sheet

as at 31 Dec 2002

all figures in £ millions	**2002**	2001 RESTATED
Intangible assets	**3,610**	4,193
Other fixed assets	**700**	1,526
Current assets	**2,542**	2,522
Creditors due within one year	**(1,363)**	(1,368)
Net current assets	**1,179**	1,154
Total assets less current liabilities	**5,489**	6,873
Creditors due after more than one year	**(1,794)**	(2,661)
Provisions for liabilities and charges	**(165)**	(239)
Net assets	**3,530**	3,973
Equity shareholders' funds	**3,338**	3,797
Equity minority interests	**192**	176
	3,530	3,973

The financial statements were approved by the board of directors on 3 March 2003 and signed on its behalf by

DENNIS STEVENSON ‣ 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 2002 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, 3 MARCH 2003

Notes

The maintenance and integrity of the Pearson Plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Summary directors' report

The full directors' report is set out on pages 35 to 45 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 9 to 28 of the annual report and on pages 9 to 28 of this summary review and financial statement.

Results and dividend ‣ The loss for the financial year ended 31 December 2002 was £111m (2001: £423m loss). The loss retained for the year was £298m (2001: £600m loss) and has been transferred to reserves. A final dividend of 14.3p per share is recommended for the year ended 31 December 2002. This, together with the interim dividend already paid, makes a total for the year of 23.4p (2001: 22.3p). The final dividend will be paid on 9 May 2003 to shareholders on the register at the close of business on 14 March 2003, the record date.

Directors ‣ The present members of the board, together with their biographical details, are shown on page 36. Patrick Cescau was appointed a non-executive director on 1 April 2002, and both Rona Fairhead and Peter Jovanovich were appointed directors on 1 June 2002. Three directors, David Bell, Terry Burns and Rana Talwar will retire by rotation at the AGM on 25 April 2003 and will stand for re-election. Terry Burns and Rana Talwar, as non-executive directors of the company, do not have service contracts. Rona Fairhead and Peter Jovanovich who were appointed to the board after the last AGM, retire from office in accordance with the company's articles of association and, being eligible, will offer themselves for reappointment.

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 2002. The tables on page 35 give information on directors' remuneration, pension positions and interests in Pearson shares.

FOR THE FULL DIRECTORS REPORT GO TO PEARSON ANNUAL REPORT 2002 AT ***www.pearson.com***

Annual general meeting (AGM) ‣ The notice convening the AGM to be held at 12 noon on Friday, 25 April 2003 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 2003.

JULIA CASSON ‣ **SECRETARY**
3 MARCH 2003

As well as sharing technology resources and expertise for product development across the company, we're also improving all of our information systems to bring us big benefits in terms of customer service and our ability to manage our working capital.

DAVID JESKA * PEARSON TECHNOLOGY

CAROL KENNEDY * PEARSON BROADBAND
BILL GAULD * CHIEF INFORMATION OFFICER, PEARSON

JASON KINCADE * PENGUIN
JESSICA GOLDSTEIN * PEARSON EDUCATION

Directors' remuneration

Remuneration policy ‣ This report sets out the company's policy on directors' remuneration. This policy will continue to apply to each director for 2003 and, so far as practicable, for subsequent years. The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the company's business environment and in remuneration practice. Any changes in policy for years after 2003 will be described in future reports, which will continue to be subject to shareholder approval. All statements in this report in relation to remuneration policy for years after 2003 should be considered in this context.

Pearson seeks to generate a performance culture by developing programmes that support its business goals and rewarding contributions towards their achievement. It is the company's policy that total remuneration (basic 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 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. Equity-based reward programmes align the interests of directors, and employees in general, with those of shareholders. They also enhance identification with Pearson by linking rewards with Pearson's financial success.

The committee selects performance measures and establishes targets for the company's various performance-related annual or long-term incentive plans based on an assessment of the interests of shareholders and the company and taking into account an appropriate balance of risk and reward for the directors and other participants.

Whether or not targets have been met under the company's various performance-related annual or long-term incentive plans is a matter for the committee to determine based on the relevant information and input from advisors and auditors as appropriate.

Performance ‣ We set out below Pearson's total shareholder return performance relative to the FTSE All-Share index (of which Pearson is a constituent) over the five-year period 1997 to 2002. We have chosen this index on the basis that it is a recognisable reference point and appropriate comparator for the majority of our investors.

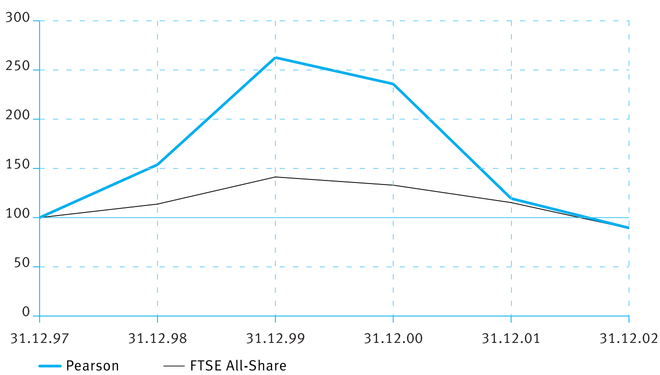
The five-year total shareholder return figures for Pearson, the FTSE All-Share index and the FTSE Media sector (of which Pearson is also a constituent) were as follows:

	PEARSON	FTSE ALL-SHARE	FTSE MEDIA
Dec 97	100.00	100.00	100.00
Dec 02	89.53	89.14	81.00

note ‣ Based on data from Bloomberg and FTSE International.

Remuneration ‣ The total remuneration of executive directors is made up of fixed and performance-linked elements. Fixed elements comprise base salary, other emoluments and retirement benefits. Consistent with its policy, the committee places considerable emphasis on the performance-linked elements that comprise annual bonus and bonus share matching and long-term incentives.

TOTAL SHAREHOLDER RETURN



Directors' remuneration

MICK MCGALE * PENGUIN

TABLE 1 *all figures in £000s*	2002 SALARIES/FEES	BONUS	OTHER*	TOTAL	2001 TOTAL
Chairman					
Dennis Stevenson	**275**	**–**	**–**	**275**	275
Executive directors					
Marjorie Scardino	**525**	**273**	**54**	**852**	583
David Bell	**310**	**161**	**16**	**487**	325
Rona Fairhead (appointed 1 June 2002)	**193**	**100**	**8**	**301**	–
Peter Jovanovich (appointed 1 June 2002)	**325**	**240**	**5**	**570**	–
John Makinson	**419**	**279**	**157**	**855**	396
Non-executive directors					
Terry Burns	**35**	**–**	**–**	**35**	35
Patrick Cescau (appointed 1 April 2002)	**26**	**–**	**–**	**26**	–
Reuben Mark	**47**	**–**	**–**	**47**	45
Vernon Sankey	**40**	**–**	**–**	**40**	40
Rana Talwar	**35**	**–**	**–**	**35**	35
Total	**2,230**	**1,053**	**240**	**3,523**	1,734
Total 2001†	**1,653**	**–**	**94**	**–**	1,747

* 'other' excludes pension contributions † Includes amounts to former directors

note 1 ‣ John Makinson was the highest paid director in 2002. His total remuneration, including pension contributions, amounted to £859,607. Other emoluments include £36,090 in respect of housing costs for Marjorie Scardino and a location and market premium of £130,640 for John Makinson.

note 2 ‣ For the full-year, Rona Fairhead's and Peter Jovanovich's remuneration was as follows:

all figures in £000s	SALARIES/FEES	BONUS	OTHER	TOTAL
Rona Fairhead	318	165	13	496
Peter Jovanovich	557	412	9	978

Directors' interests

	1 JAN 02 ORDINARY SHARES†	31 DEC 02 ORDINARY SHARES†	1 JAN 02 RESTRICTED SHARES‡	31 DEC 02 RESTRICTED SHARES‡	1 JAN 02 SHARE OPTIONS	31 DEC 02 SHARE OPTIONS
Interests of directors were						
Dennis Stevenson	110,017	161,894	74,396	–	2,512	2,512
Marjorie Scardino	82,225	86,121	202,405	532,571	574,953	574,953
David Bell	49,438	50,939	88,292	233,313	199,808	199,430
Terry Burns	812	1,712	–	–	–	–
Patrick Cescau	–	–	–	–	–	–
Rona Fairhead	–	560	–	165,611	60,000	60,000
Peter Jovanovich	54,986	54,986	195,878	365,818	493,252	493,252
John Makinson	28,620	29,333	111,680	299,634	430,293	426,951
Reuben Mark	10,713	11,837	–	–	–	–
Vernon Sankey	801	1,666	–	–	–	–
Rana Talwar	3,283	6,848	–	–	–	–

† Amounts include shares acquired by individuals under the annual bonus share matching plan.

‡ Restricted shares comprise awards made under the incentive share, reward, annual bonus share matching and long-term incentive plans. The number of shares shown represents the maximum number of shares, including accumulated share dividends on incentive share plan shares, but not on reward or long-term incentive plan shares, which may vest, subject to the performance conditions being fulfilled.

note 1 ‣ On 2 January 2003, Terry Burns acquired 260 shares, Reuben Mark 339, Vernon Sankey 261 and Rana Talwar 1,074. The shares were acquired as part of their directors' fees.

note 2 ‣ 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 175,402 and 850,779 Pearson ordinary shares of 25p each respectively at 31 December 2002 and also at 3 March 2003.

INTERESTS OF DIRECTORS IN LISTED SUBSIDIARIES

At 31 December 2002, 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.

Board of directors

CHAIRMAN

Dennis Stevenson ▸ chairman, aged 57, has been a non-executive director of Pearson since 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 ▸ chief executive, aged 56, joined the Pearson board in January 1997. She trained and practised as a lawyer, and published a weekly newspaper in the US. In 1985 she joined The Economist Group as president of its North American operations and was its chief executive from 1993 until joining Pearson. She is also a non-executive director of Nokia Corporation.

David Bell ▸ director for people, aged 56, 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 ▸ chairman and chief executive officer of the Penguin Group, aged 48, 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 a non-executive director of George Weston Limited in Canada.

Rona Fairhead ▸ chief financial officer, aged 41, joined the Pearson board and became chief financial officer in June 2002. Prior to this she 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.

Peter Jovanovich ▸ chief executive of Pearson Education, aged 54, joined the Pearson board in June 2002. He became chief executive of Pearson Education in 1998. Prior to this he was chairman and chief executive of Addison Wesley Longman. He also serves on the boards of the Association of American Publishers and the Alfred Harcourt Foundation.

NON-EXECUTIVE DIRECTORS

Terry Burns*† ▸ aged 58, was the 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.

Reuben Mark*† ▸ aged 64, is chairman and chief executive of the Colgate-Palmolive Company and a director of AOL Time Warner Inc. He became a non-executive director of Pearson in 1988.

Vernon Sankey* ▸ aged 53, 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 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† ▸ aged 54, was previously group chief executive of Standard Chartered plc. He became a non-executive director of Pearson in March 2000.

Patrick Cescau ▸ aged 54, is a director of Unilever plc and Unilever NV. He became a non-executive director of Pearson in April 2002.

* a member of the audit committee.
† a member of the personnel committee.

SHANE BREAUX • PEARSON EDUCATION

JULIE SAUSEN • PEARSON EDUCATION

Reading is fundamental to Pearson. We help more people learn to read – and enjoy doing it – than any other company. Our programmes cover every stage of learning from Dorling Kindersley's pre-school picture books to basic school literacy programmes, to customised electronic reading software to Longman's world-famous English language teaching resources.

Shareholder information

TODD FRIES * KIM HIGHLAND * JAY HENRY * THERESE BURKE * LORI BURKE * DK, PENGUIN

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 FACILITY

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.

SHAREHOLDER INFORMATION ON-LINE

Lloyds TSB Registrars provide a range of shareholder information online. You can check your holding and find practical help on transferring shares or updating your details at 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 Financial Times CityLine. Telephone 0906 843 3620.

AMERICAN DEPOSITARY RECEIPTS (ADRS)

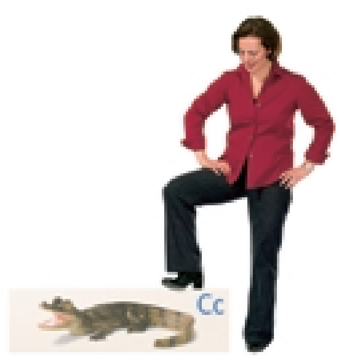
Pearson's ordinary shares are listed on the New York Stock Exchange in the form of ADRs and traded under the symbol PSO. Each ADR represents one ordinary share. Voting rights as a shareholder may be exercised through The Bank of New York, ADR Department, 101 Barclay Street, New York, New York 10286, telephone 800 BNY ADRS (toll free within the US) or (1) 610 312 5315 (outside the US). All enquiries regarding ADR holder accounts and payment of dividends should be directed to The Bank of New York, the authorised depositary bank for Pearson's ADR programme, at the address given above. 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 **broker** ▸ Cazenove & Co. Limited
financial advisers ▸ Lazard Brothers & Co. Limited, J. Henry Schroder & Co. Limited
solicitors ▸ Freshfields Bruckhaus Deringer, Herbert Smith and Morgan, Lewis & Bockius.

FINANCIAL CALENDAR FOR 2003	
EX-DIVIDEND DATE	WEDNESDAY 12 MARCH
RECORD DATE	FRIDAY 14 MARCH
LAST DATE FOR DIVIDEND REINVESTMENT ELECTION	THURSDAY 24 APRIL
ANNUAL GENERAL MEETING	FRIDAY 25 APRIL
PAYMENT DATE FOR DIVIDEND AND SHARE PURCHASE DATE FOR DIVIDEND REINVESTMENT	FRIDAY 9 MAY
INTERIM RESULTS	MONDAY 28 JULY
INTERIM DIVIDEND	FRIDAY 26 SEPTEMBER

PETER JOVANOVICH * CHIEF EXECUTIVE, PEARSON EDUCATION



JOAN MAZZEO * PEARSON EDUCATION

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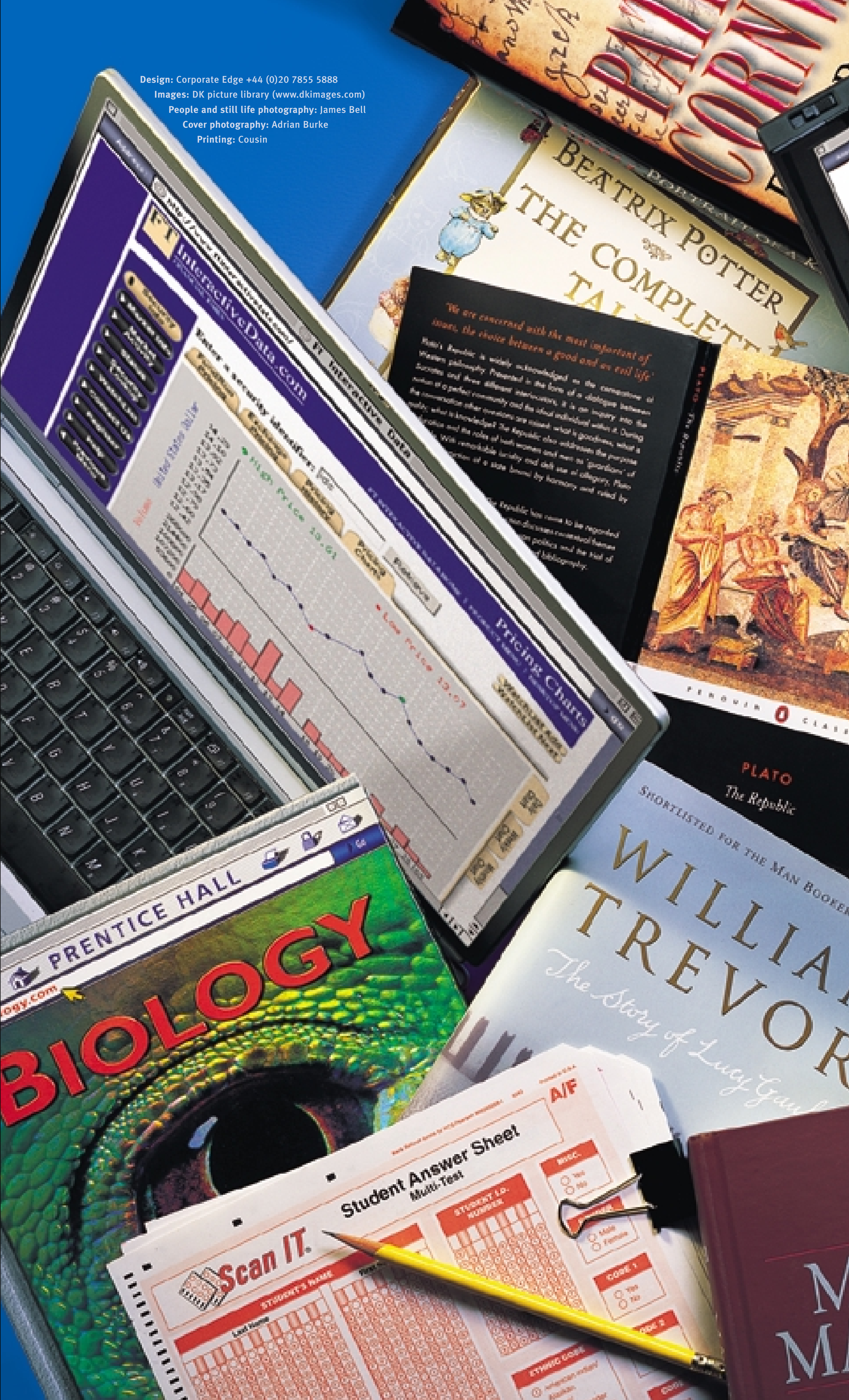

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