

Principal subsidiaries

The principal operating subsidiaries at 31 December 2010 are listed below. They operate mainly in the countries of incorporation or registration. The investments are in equity share capital and they are all 100% owned.

	Country of incorporation or registration
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
Edexcel Ltd*	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England
Mergermarket Ltd	England
The Penguin Group	
Penguin Group (USA) Inc.	US
The Penguin Publishing Co Ltd	England
Dorling Kindersley Holdings Ltd*	England

* Direct investment of Pearson plc.

The company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A complete list of subsidiary and associated undertakings will be included in the next Pearson plc annual return filed with the Registrar of Companies.

Five year summary

All figures in £ millions	2006	2007	2008	2009	2010
Sales					
North American Education	1,679	1,667	2,002	2,470	2,640
International Education	640	735	866	1,035	1,234
Professional	211	226	244	275	333
Education	2,530	2,628	3,112	3,780	4,207
FT Group	280	344	390	358	403
Penguin	848	846	903	1,002	1,053
Continuing	3,658	3,818	4,405	5,140	5,663
Discontinued	765	511	414	484	296
Total sales	4,423	4,329	4,819	5,624	5,959
Adjusted operating profit					
North American Education	280	273	303	403	469
International Education	73	92	135	141	171
Professional	17	27	36	43	51
Education	370	392	474	587	691
FT Group	27	56	74	39	60
Penguin	66	74	93	84	106
Continuing	463	522	641	710	857
Discontinued	129	112	121	148	81
Total adjusted operating profit	592	634	762	858	938
Operating margin – continuing	12.7%	13.7%	14.6%	13.8%	15.1%
Adjusted earnings					
Total adjusted operating profit	592	634	762	858	938
Net finance costs	(90)	(85)	(88)	(97)	(85)
Income tax	(130)	(145)	(178)	(194)	(215)
Non-controlling interest	(28)	(32)	(36)	(44)	(17)
Adjusted earnings	344	372	460	523	621
Weighted average number of shares (millions)	798.4	796.8	797.0	799.3	801.2
Adjusted earnings per share	43.1p	46.7p	57.7p	65.4p	77.5p

Five year summary continued

All figures in £ millions	2006	2007	2008	2009	2010
Cash flow					
Operating cash flow	575	684	796	913	1,057
Operating cash conversion	97%	108%	104%	106%	113%
Operating free cash flow	434	533	631	723	904
Operating free cash flow per share	54.4p	66.9p	79.2p	90.5p	112.8p
Total free cash flow	433	407	631	723	904
Total free cash flow per share	54.2p	51.1p	79.2p	90.5p	112.8p
Net assets	3,644	3,874	5,024	4,636	5,605
Net debt	1,059	973	1,460	1,092	430
Return on invested capital (gross basis)					
Total adjusted operating profit	592	634	762	858	938
Cash tax paid	(59)	(61)	(89)	(103)	(85)
Return	533	573	673	755	853
Average invested capital	6,553	6,423	7,337	8,504	8,315
Return on invested capital	8.1%	8.9%	9.2%	8.9%	10.3%
Dividend per share	29.3p	31.6p	33.8p	35.5p	38.7p

Corporate and operating measures

Sales – underlying and constant exchange rate movement

Sales movement for continuing operations excluding the impact of acquisitions and disposals and movements in exchange rates.

All figures in £ millions	2010
Underlying increase	275
Portfolio changes	120
Exchange differences	128
Total sales increase	523
Underlying increase	5%
Constant exchange rate increase	8%

Adjusted income statement

Reconciliation of the consolidated income statement to the adjusted numbers presented as non-GAAP measures in the financial statements.

All figures in £ millions	2010								
	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
Operating profit	743	81	(2)	11	105	–	–	–	938
Net finance costs	(73)	–	–	–	–	(12)	–	–	(85)
Profit before tax	670	81	(2)	11	105	(12)	–	–	853
Income tax	(146)	(31)	(1)	(4)	(35)	3	36	(37)	(215)
Profit for the year from continuing operations	524	50	(3)	7	70	(9)	36	(37)	638
Profit for the year from discontinued operations	776	(50)	(731)	–	5	–	–	–	–
Profit for the year	1,300	–	(734)	7	75	(9)	36	(37)	638
Non-controlling interest	(3)	–	(12)	–	(2)	–	–	–	(17)
Earnings	1,297	–	(746)	7	73	(9)	36	(37)	621

Corporate and operating measures continued

Adjusted income statement continued

	2009								
All figures in £ millions	Statutory income statement	Discontinued operations	Other net gains and losses	Acquisition costs	Amortisation of acquired intangibles	Other net finance income/ costs	Tax amortisation benefit	Tax loss recognition	Adjusted income statement
Operating profit	619	148	–	–	91	–	–	–	858
Net finance costs	(96)	1	–	–	–	(2)	–	–	(97)
Profit before tax	523	149	–	–	91	(2)	–	–	761
Income tax	(146)	(52)	–	–	(33)	1	36	–	(194)
Profit for the year from continuing operations	377	97	–	–	58	(1)	36	–	567
Profit for the year from discontinued operations	85	(97)	–	–	8	–	4	–	–
Profit for the year	462	–	–	–	66	(1)	40	–	567
Non-controlling interest	(37)	–	–	–	(5)	–	(2)	–	(44)
Earnings	425	–	–	–	61	(1)	38	–	523

Adjusted operating profit – underlying and constant exchange rate movement

Operating profit movement excluding the impact of acquisitions, disposals and movements in exchange rates.

All figures in £ millions	2010
Underlying increase	103
Portfolio changes	5
Exchange differences	39
Total adjusted operating profit increase	147
Underlying increase	14%
Constant exchange rate increase	15%

Free cash flow per share

Operating cash flow for continuing and discontinued operations before tax and finance charges, divided by the weighted average number of shares in issue.

All figures in £ millions	2010	2009
Adjusted operating profit	938	858
Cash conversion	113%	106%
Operating cash flow	1,057	913
Operating tax paid	(85)	(103)
Net operating finance costs paid	(68)	(87)
Total operating free cash flow	904	723
Non operating tax paid	–	–
Total free cash flow	904	723
Weighted average number of shares in issue (millions)	801.2	799.3
Operating free cash flow per share	112.8p	90.5p
Total free cash flow per share	112.8p	90.5p

Return on invested capital

All figures in £ millions	Net invested capital		Gross invested capital	
	2010	2009	2010	2009
Total adjusted operating profit	938	858	938	858
Amortisation of acquired intangibles	(113)	(103)	–	–
Operating tax paid	(85)	(103)	(85)	(103)
Return	740	652	853	755
Average goodwill and other intangibles	5,362	5,152	7,341	7,194
Average net operating assets	974	1,310	974	1,310
Average invested capital	6,336	6,462	8,315	8,504
Return on invested capital	11.7%	10.1%	10.3%	8.9%

Return on invested capital is calculated using two methods:

Gross basis – total adjusted operating profit less operating cash tax paid expressed as a percentage of average gross invested capital. Gross invested capital includes the original unamortised goodwill and intangibles.

Net basis – total adjusted operating profit less intangible amortisation and operating cash tax paid expressed as a percentage of average net invested capital. Net invested capital includes the carrying value (after amortisation) of goodwill and intangibles.

Other risks

Principal risks and uncertainties are outlined on page 35 of section 3 'Our performance'. Additional risks are set out below.

Other risks	Mitigating factors
Changes in students' buying and distribution behaviour put downward pressure on price.	We are continuing to improve our pricing strategies, product bundling and contract terms. We are monitoring the development of rental programs.
Our professional services and school assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed.	In addition to the internal business procedures and controls implemented to ensure we successfully deliver on our contractual commitments, we also seek to develop and maintain good relationships with our customers to minimise associated risks. We also look to diversify our portfolio to minimise reliance on any single contract.
We operate in markets which are dependent on Information Technology (IT) systems and technological change.	We mitigate these IT risks by establishing strong IT policies and operational controls, employing project management techniques to manage new software developments and/or system implementations and have implemented an array of security measures to protect our IT assets from attacks or failures that could impact the confidentiality, availability or integrity of our systems.
Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions could lead to goodwill and intangible asset impairments.	We perform pre-acquisition due diligence and closely monitor the post-integration performance to ensure we are meeting operational and financial targets. Any divergence from these plans will result in management action to improve performance and minimise the risk of any impairments. Executive management and the board receive regular reports on the status of acquisition performance.
Expected benefits from our finance transformation programme initiatives may not be realised.	We monitor the programme performance closely and seek to mitigate this risk through strong project management techniques and developed project plans. The project is managed by an executive committee and governance programmes have been established with our outsource providers.
Changes in our tax position can significantly affect our reported earnings and cash flows.	We employ internal tax professionals in the UK and the US who review all significant arrangements around the world and respond to changes in tax legislation. They work closely with local management and external tax advisors.
We generate a substantial proportion of our revenue in foreign currencies particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet.	The Group's policy on managing foreign currency risk is described in note 19 to the financial statements.

Other risks	Mitigating factors
<p>The inherent volatility of advertising could adversely affect the profitability of our newspaper business.</p>	<p>The diversification of the FT Group into other business models and revenue streams, e.g. subscription based businesses, digital revenues, business to business products, conferences, in addition to its global reach, offsets reliance on newspaper print advertising and circulation revenue streams.</p>
<p>A significant deterioration in Group profitability and/or cash flow caused by a severe economic depression could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants.</p>	<p>The Group's approach to funding is described on page 31 and the Group's approach to the management of financial risks is set out in note 19 to the financial statements.</p>
<p>Social, environmental and ethical risk.</p>	<p>We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. Our 2009 risk assessment did not identify any significant under-managed SEE risks, nor have any of our most important SEE risks, many concerned with reputational risks, changed year-on-year. These are: journalistic/author integrity, ethical business behaviour, intellectual copyright protection, compliance with UN Global Compact standards, environmental impact, people and data privacy.</p> <p>For more information, see the Pearson corporate responsibility report 'Live and Learn: Our Impact on Society'. The web link is available at www.pearson.com</p>

Shareholder information

Pearson ordinary shares are listed on the London Stock Exchange and on the New York Stock Exchange in the form of American Depositary Receipts.

Corporate website

The investors' section of our corporate website www.pearson.com provides a wealth of information for shareholders. It is also possible to sign up to receive email alerts for reports and press releases relating to Pearson.

Shareholder information online

Equiniti provides 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. For more information, please contact our registrar, Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2233* or, for those shareholders with hearing difficulties, textphone number 0871 384 2255*.

Information about the Pearson share price

The company's share price can be found on our website at www.pearson.com. It also appears in the financial columns of the national press.

Payment of dividends to mandated accounts

Should you elect to have your dividends paid through BACS, this can be done directly into a bank or building society account, with the tax voucher sent to the shareholder's registered address. Equiniti can be contacted for information on 0871 384 2043*.

Dividend reinvestment plan (DRIP)

The DRIP gives shareholders the right to buy the company's shares on the London stock market with their cash dividend. For further information, please contact Equiniti on 0871 384 2268*.

Individual Savings Accounts (ISAs)

Equiniti offers ISAs in Pearson shares. For more information, please go to www.shareview.co.uk/dealing or call customer services on 0845 300 0430*.

Share dealing facilities

Equiniti offers telephone and internet services for dealing in Pearson shares. For further information, please contact them on 08456 037 037 (telephone dealing – weekdays only) or log on to www.shareview.co.uk/dealing (online dealing). You will need your shareholder reference number as shown on your share certificate.

A weekly postal dealing service is also available through Equiniti. Please telephone 0871 384 2248* for details or log on to www.shareview.co.uk to download a form.

ShareGift

Shareholders with small holdings of shares, whose value makes them uneconomic to sell, may wish to donate them to ShareGift, the share donation charity (registered charity number 1052686). Further information about ShareGift and the charities it has supported may be obtained from their website, www.ShareGift.org or by contacting them at 17 Carlton House Terrace, London SW1Y 5AH.

American Depositary Receipts (ADRs)

Pearson's ADRs are listed on the New York Stock Exchange and traded under the symbol PSO. Each ADR represents one ordinary share. For enquiries regarding registered ADR holder accounts and dividends, please contact BNY Mellon Shareowner Services, PO Box 358516, Pittsburgh, PA 15252-8516, telephone 1 866 259 2289 (toll free within the US) or 001 201 680 6825 (outside the US). Alternatively, you may e-mail shrrelations@bnymellon.com, or log on to www.bnymellon.com/shareowner. Voting rights for registered ADR holders can be exercised through The Bank of New York Mellon, and for beneficial ADR holders (and/or nominee accounts) through your US brokerage institution. Pearson will file with the Securities and Exchange Commission a Form 20-F.

*Calls to these numbers are charged at 8p per minute from a BT landline. Other provider costs may vary. Lines open 8.30am to 5.30pm Monday to Friday.

Share register fraud: protecting your investment

Pearson does not contact its shareholders directly to provide recommendation advice and neither does it appoint third parties to do so. As required by law, our shareholder register is available for public inspection but we cannot control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from Pearson with caution.

Tips on protecting your shares

- › Keep any documentation that contains your shareholder reference number in a safe place and shred any unwanted documentation.
- › Inform the registrar promptly when you change address.
- › Be aware of dividend payment dates and contact the registrar if you do not receive your dividend cheque or better still, make arrangements to have the dividend paid directly into your bank account.
- › Consider holding your shares electronically in a CREST account via a nominee.

For more information, please log on to our website at www.pearson.com/shareholderfaqs

Advisers

Auditors PricewaterhouseCoopers LLP

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Brokers JPMorgan Cazenove Limited and Citigroup

Financial advisers Goldman Sachs,

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

2011 Financial calendar

Ex-dividend date	6 April
Record date	8 April
Last date for dividend reinvestment election	12 April
Annual General Meeting	28 April
Payment date for dividend and share purchase date for dividend reinvestment	6 May
Interim results	1 August
Payment date for interim dividend	16 September

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Pearson has supported the planting of half an acre of new native woodland with the Woodland Trust, helping to offset 70 tonnes of carbon dioxide emissions generated by the production of this report.

This report has been printed on Cocoon Offset 100 and Cocoon Pre-print 100 which is FSC® certified and contains 100% recycled de-inked waste paper. It was printed using vegetable oil based inks by a CarbonNeutral® printer certified to ISO 14001 environmental management system and registered to EMAS the Eco Management Audit Scheme.

Learn more at www.pearson.com