PEARSON PLC
Form 20-F
April 04, 2017
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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON April 3, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from to

or

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

Commission file number 1-16055

PEARSON PLC

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

80 Strand

London, England WC2R 0RL

(Address of principal executive offices)

Stephen Jones

Telephone: +44 20 7010 2000

Fax: +44 20 7010 6060

80 Strand

London, England WC2R 0RL

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Each Exchange on Which Registered
*Ordinary Shares, 25p par value	New York Stock Exchange
American Depositary Shares, each Representing One Ordinary Share, 25p per Ordinary Share	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the SEC.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock at the close of the period covered by the annual report:

Ordinary Shares, 25p par value	822,126,713

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated file and large accelerated filer , in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing

US GAAP	International financial Reporting Standards as Issued by the International Accounting Standards Board	Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

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INTRODUCTION

In this Annual Report on Form 20-F (the Annual Report) references to Pearson , the Company or the Group are references to Pearson plc, its predecessors and its consolidated subsidiaries, except as the context otherwise requires. Ordinary Shares refer to the ordinary share capital of Pearson of par value 25p each. ADSs refer to American Depositary Shares which are Ordinary Shares deposited pursuant to the Second Amended and Restated Deposit Agreement dated August 15, 2014, amended and restated as of August 8, 2000 among Pearson, The Bank of New York Mellon as depositary (the Depositary) and owners and holders of ADSs (the Deposit Agreement). ADSs are represented by American Depositary Receipts (ADRs) delivered by the Depositary under the terms of the Deposit Agreement.

We have prepared the financial information contained in this Annual Report in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) which in respect of the accounting standards applicable to the Group do not differ from IFRS as adopted by the European Union (EU). Unless we indicate otherwise, any reference in this Annual Report to our consolidated financial statements is to the consolidated financial statements and the related notes, included elsewhere in this Annual Report.

We publish our consolidated financial statements in sterling. We have included, however, references to other currencies. In this Annual Report:

references to sterling , pounds , pence or £ are to the lawful currency of the United Kingdom,

references to euro or are to the euro, the lawful currency of the participating Member States in the Third Stage of the European Economic and Monetary Union of the Treaty Establishing the European Commission, and

references to US dollars , dollars , cents or $ are to the lawful currency of the United States.

For convenience and except where we specify otherwise, we have translated some sterling figures into US dollars at the rate of £1.00 = $1.23, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2016. We do not make any representation that the amounts of sterling have been, could have been or could be converted into dollars at the rates indicated. On February 28, 2017 the noon buying rate for sterling was £1.00 = $1.24.

The Group currently consists of its education business, plus a 47% interest in the consumer publishing business Penguin Random House. See Item 4. Information on the Company Overview of operating divisions . The Pearson plc Consolidated Financial Statements are included in this report on pages F-2 to F-76. The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-77 to F-143.

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FORWARD-LOOKING STATEMENTS

You should not rely unduly on forward-looking statements in this Annual Report. This Annual Report, including the sections entitled Item 3. Key Information Risk Factors , Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects , contains forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terms such as may , will , should , expect , intend , plan , anticipate , believe , estimate , pred continue or the negative of these terms or other comparable terminology. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

- operations and prospects,
- growth strategy,
- funding needs and financing resources,
- expected financial position,
- market risk,
- currency risk,
- US federal and state spending patterns,
- debt levels, and
- general market and economic conditions.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. In evaluating them, you should consider various factors, including the risks outlined under Item 3. Key Information Risk Factors , which may cause actual events or our industry s results to differ materially from those expressed or implied by any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

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PART I

ITEM 1. ***IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS***
Not applicable.

ITEM 2. ***OFFER STATISTICS AND EXPECTED TIMETABLE***
Not applicable.

ITEM 3. ***KEY INFORMATION***
Selected consolidated financial data

The table below shows selected consolidated financial data under IFRS as issued by the IASB. The selected consolidated income statement data for the years ended December 31, 2016, 2015 and 2014 and the selected consolidated balance sheet data as at December 31, 2016 and 2015 have been derived from our audited consolidated financial statements included in Item 18. Financial Statements in this Annual Report.

On February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend.

On July 23, 2015, Pearson announced the sale of The Financial Times to Nikkei Inc. The transaction completed on November 30, 2015 and from that point Pearson no longer consolidated The Financial Times results or net assets. The results of The Financial Times have been included in discontinued operations for all years through to 2014 and for the 11 months to November 30, 2015.

On August 11, 2015, Pearson announced the sale of its 50% stake in The Economist Group. The transaction substantially completed on October 16, 2015 and from that point Pearson no longer had significant influence over The Economist Group. The share of profit after tax from the associate interest in the Economist Group has been included in discontinued operations for all years through to 2014 and for the period until October 16, 2015.

On November 29, 2013, Pearson announced the sale of the Mergermarket group which completed on February 4, 2014. The anticipated loss of control as at December 31, 2013 resulted in the Mergermarket business being classified as held for sale on the Pearson balance sheet at December 31, 2013. The results of the Mergermarket business have been included in discontinued operations for all the years through to 2014.

In October 2012, Pearson and Bertelsmann entered into an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction completed on July 1, 2013 and from that point, Pearson no longer controlled the Penguin Group of companies. Pearson accounts for its 47% associate interest in Penguin Random House on an equity basis.

The selected consolidated financial information should be read in conjunction with Item 5. Operating and Financial Review and Prospects and our consolidated financial statements and the related notes appearing elsewhere in this Annual Report. The information provided below is not necessarily indicative of the results that may be expected from future operations.

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For convenience, we have translated the 2016 amounts into US dollars at the rate of £1.00 = $1.23, the noon buying rate in The City of New York for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes on December 31, 2016.

	Year Ended December 31					
	2016 $	2016 £	2015 £	2014 £	2013 £	2012 £
	(In millions, except for per share amounts)					
Consolidated Income Statement data						
Sales operating	5,599	4,552	4,468	4,540	4,728	4,615
(Loss)/profit	(3,071)	(2,497)	(404)	348	431	469
(Loss)/profit after taxation from continuing operations	(2,872)	(2,335)	(352)	199	270	237
(Loss)/profit for the financial year	(2,872)	(2,335)	823	470	539	314
Consolidated Earnings data per share						
Basic (loss)/earnings per equity share(1)	(3.53)	(286.8)p	101.2p	58.1p	66.6p	38.7p
Diluted (loss)/earnings per equity share(2)	(3.53)	(286.8)p	101.2p	58.0p	66.5p	38.6p
Basic (loss)/earnings from continuing operations per equity share(1)	(3.53)	(286.8)p	(43.3)p	24.7p	33.3p	29.1p
Diluted (loss)/earnings from continuing operations per equity share(2)	(3.53)	(286.8)p	(43.3)p	24.6p	33.3p	29.0p
Dividends per ordinary share	0.64	52.0p	52.0p	51.0p	48.0p	45.0p
Consolidated Balance Sheet data at period end						
Total assets (non-current assets plus current assets)	12,381	10,066	11,635	11,397	10,931	11,348
Net assets	5,348	4,348	6,418	5,985	5,706	5,710
Long-term obligations(3)	(4,667)	(3,794)	(3,310)	(3,225)	(2,829)	(3,175)
Capital stock	252	205	205	205	205	204
Number of equity shares outstanding (millions of ordinary shares)	822	822	821	820	819	817

Notes:

(1) Basic earnings per equity share is based on profit for the financial period and the weighted average number of ordinary shares in issue during the period.

(2) Diluted earnings per equity share is based on diluted earnings for the financial period and the diluted weighted average number of ordinary shares in issue during the period. Diluted earnings comprise earnings adjusted for the tax benefit on the conversion of share options by employees and the weighted average number of ordinary shares adjusted for the dilutive effect of share options. There is no dilution in 2015 and 2016 due to there being a loss from continuing operations.

(3) Long-term obligations comprise any liabilities with a maturity of more than one year, including medium and long-term borrowings, derivative financial instruments, pension obligations and deferred income tax liabilities.

Dividend information

We pay dividends to holders of ordinary shares on dates that are fixed in accordance with the guidelines of the London Stock Exchange. Our board of directors normally declares an interim dividend in July or August of each year to be paid in September or October. Our board of directors normally recommends a final dividend following the end of the fiscal year to which it relates, to be paid in the following May or June, subject to shareholders approval at our annual general meeting. At our annual general meeting on May 5, 2017 our shareholders will be asked to approve a final dividend of 34.0p per ordinary share for the year ended December 31, 2016.

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The table below sets forth the amounts of interim, final and total dividends paid in respect of each fiscal year indicated, and is translated into cents per ordinary share at the noon buying rate in The City of New York on each of the respective payment dates for interim and final dividends. The final dividend for the 2016 fiscal year will be paid on May 12, 2017 (subject to shareholder approval).

Fiscal year	Interim	Final	Total	Interim	Final	Total
	(Pence per ordinary share)			(Cents per ordinary share)		
2016	18.0	34.0	52.0	23.6	41.8*	65.4*
2015	18.0	34.0	52.0	27.8	49.0	76.8
2014	17.0	34.0	51.0	27.6	51.5	79.1
2013	16.0	32.0	48.0	25.4	54.0	79.4
2012	15.0	30.0	45.0	24.3	46.7	71.0

* As the 2016 final dividend had not been paid by the filing date, the dividend has been translated into cents using the noon buying rate for sterling at December 31, 2016.

Future dividends will be dependent on our future earnings, financial condition and cash flow, as well as other factors affecting the Group. In January 2017, Pearson announced that the dividend will be rebased in 2017 to reflect portfolio changes, increased product investment, and our outlook for 2017.

Exchange rate information

The following table sets forth, for the periods indicated, information concerning the noon buying rate for sterling, expressed in dollars per pound sterling. The average rate is calculated by using the average of the noon buying rates in The City of New York on each day during a monthly period and on the last day of each month during an annual period. On December 31, 2016 the noon buying rate for cable transfers and foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes for sterling was £1.00 = $1.23. On February 28, 2017 the noon buying rate for sterling was £1.00 = $1.24.

Month	High	Low
February 2017	$ 1.26	$ 1.24
January 2017	$ 1.26	$ 1.21
December 2016	$ 1.27	$ 1.22
November 2016	$ 1.25	$ 1.22
October 2016	$ 1.28	$ 1.22
September 2016	$ 1.34	$ 1.30

Year Ended December 31	Average rate
2016	$ 1.34
2015	$ 1.53
2014	$ 1.65
2013	$ 1.57
2012	$ 1.59

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Risk Factors

You should carefully consider the risk factors described below, as well as the other information included in the rest of this document. Our business, financial condition or results from operations could be materially adversely affected by any or all of these risks, or by other risks that we presently cannot identify.

The pace and scope of our business transformation initiatives increase the execution risk that benefits may not be fully realized, costs of these changes may increase, or that our business as usual activities do not perform in line with expectations.

Business transformation and change initiatives in support of our strategic goals to accelerate our digital transition and to simplify our business will continue throughout 2017. The pace and scope of change increases the risk that not all these changes will deliver within anticipated timeframes, or that the costs of these changes may increase. In addition, as a result of the increased pressure of transformational change, our business as usual activities may not perform in line with our plans or our level of customer service may not meet expectations. In parallel with the business transformation as we respond to the digital revolution and shift from a product to a services business, we will continue to look at opportunities to develop business models and further refine organization structures. Resistance to change could restrict the organization from making the necessary changes to the business model.

Risk related to data quality and integrity may lead to non-compliance with legal and other requirements which could damage our business.

Unavailability of timely, complete and accurate data limits informed decision-making and increases risk of non-compliance with legal, regulatory and reporting requirements. Business change and transformation success is dependent on migration of a significant number of datasets.

Global economy and cyclical market factors may adversely impact our financial performance.

With the continued pressure and uncertainty in the worldwide economies, there remains a risk of a weakening in trading conditions, which could adversely impact our future financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across our different businesses and will depend on the depth, length and severity of any economic downturn. The education market can be affected by cyclical factors, which may lead to a reduction in demand for our products and services.

Failure to successfully invest in and deliver the right products and services and respond to competitive threats could result in lower than expected revenues and profits.

A common trend facing all our businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product and content distribution, consumers perception of value and the publisher s position between consumers, retailers and authors.

This is a highly competitive market that is subject to rapid change. We face competitive threats both from large media players and from smaller businesses, online and mobile portals and operators in the digital arena that provide alternative sources of content. New distribution channels, e.g. digital format, the internet, online retailers, growing delivery platforms (e.g., e-readers or tablets), pose both threats and opportunities to our traditional publishing business models, potentially impacting both sales volumes and pricing.

Students are seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, and rentals, along with open source. This change in behavior puts downward pressure on textbook prices in our major markets, and this could adversely impact our results.

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If we do not adapt rapidly to these changes we may lose business to faster and more agile competitors, who increasingly are non-traditional competitors, making their identification all the more difficult. We may be required to invest significant resources to further adapt to the changing competitive environment.

Changes in government policy and/or regulations have the potential to affect our business model and/or decisions across all markets.

Our educational services and assessment businesses may be adversely affected by changes in government funding resulting from either trends that are beyond our direct control, such as general economic conditions, changes in government educational funding, programs, policy decisions, legislation and/or changes in the procurement process, or our failure to successfully deliver previous contracts.

The results and growth of our US educational services and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. The inauguration of a new President of the US in January 2017 could result in changes in education policy and associated funding which may adversely impact Pearson businesses in the US. State, local and municipal education funding pressures remain, competition from low price and disruptive new business models continues and open source is promoted as a way to keep costs down for our customers. The current challenging environment could impact our ability to collect education-related debt.

State and local government leadership changes and resultant shifts in education policy can also affect the funding available for educational expenditure, which include the impact of educational reform. Similarly, changes in the government procurement process for textbooks, learning material and student tests, and vocational training programs can also affect our markets. Political pressure on testing, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year. For our UK examination and assessment businesses, changes in UK government policy have had, and could continue to have, a significant impact on our present business and 2017 particularly is a year of major qualification and accountability changes. Also, in June 2016 a UK referendum voted in favor of leaving the EU. The risk is one of uncertainty, as the full impacts of the UK s departure from the EU will not be known until the model that will replace the UK s membership becomes clearer.

There are multiple competing demands for educational funds and there is no guarantee that new courseware or testing or training programs will be funded, or that we will win or retain this business.

Failure to comply with anti-trust and competition legislation could result in costly legal proceedings and/or adversely impact our reputation.

We are subject to global and local anti-trust and competition law and although we are committed to conducting business in compliance with local and international laws, there is a risk that our management, employees or representatives may act in a way that violates applicable anti-trust or competition laws. As a result, there is a risk of litigation and regulatory proceedings in the countries in which we operate. These legal proceedings could result in greater scrutiny of our operations in other countries for anti-competitive behavior and, in the worst case, incur a substantial financial cost. This would also have an adverse impact on our reputation.

If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.

Our products and services largely comprise intellectual property delivered through a variety of print and digital media, online software applications and platforms. We rely on trademark, patent, copyright and other intellectual property laws to establish and protect our proprietary rights in these products and services.

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Our intellectual property rights (IPR) in countries such as the US and the UK, jurisdictions covering the largest proportion of our operations, are generally well established with the exception of patents, for which we only have a nascent portfolio based largely in the US. However, we also conduct business in other countries where our protection efforts have been limited or inconsistent and the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Where we have registered or otherwise established our IPR, we cannot guarantee that such rights will provide competitive advantages due to:

- the challenges and costs of monitoring and enforcement in jurisdictions where competition may be intense;
- the limited and/or ineffective IPR protection and enforcement mechanisms available to us in many countries;
- the potential that our IPR may lapse, be invalidated, circumvented, challenged, or abandoned, or that we may otherwise lose the ability to assert our intellectual property rights against others.

Moreover, despite trademark, brand and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

A control breakdown or service failure in our school assessment and qualification business could result in financial loss and reputational damage.

Our professional services and 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 or face increased competitive pressures.

There are inherent risks associated with our assessment and qualification businesses, both in the US and the UK. A service failure caused by a breakdown in our testing and assessment processes could lead to a mis-grading of student tests and/or late delivery of test results to students and their schools. In either event we may be subject to legal claims, penalty charges under our contracts, non-renewal of contracts and/or the suspension or withdrawal of our accreditation to conduct tests and a late delivery of qualification results could result in a potentially significant regulatory fine in addition to the contractual penalties. It is also possible that such events would result in adverse publicity, which may affect our ability to retain existing contracts and/or obtain new customers.

Our investment into inherently riskier emerging markets may deliver returns that are lower than anticipated.

To take advantage of international growth opportunities and to reduce our reliance on our US and UK markets we have invested in a number of emerging markets, some of which are inherently more risky than our traditional markets. Political, regulatory, economic and legal systems in emerging markets may be less predictable than in countries with more developed institutional structures. Political, regulatory, economic, currency, reputational and corporate governance and compliance risks (including fraud, bribery and corruption) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets.

Failure to effectively manage risks associated with compliance to global and local anti-bribery and corruption (ABC) legislation could result in costly legal investigations and/or adversely impact our reputation.

Although we are committed to conducting business in a legal and ethical manner in compliance with local and international statutory requirements and standards applicable to our business, there is a risk that our management, employees or representatives may take actions that violate applicable laws and regulations

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prohibiting the making of improper payments for the purposes of obtaining or keeping business, including laws such as the US Foreign Corrupt Practices Act or the UK Bribery Act. Responding to investigations is costly and requires a significant amount of management s time and attention. In addition, investigations may adversely impact our reputation, or lead to litigation and financial impacts.

Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations, could lead to goodwill and intangible asset impairments.

We continually acquire and dispose of businesses to achieve our strategic objectives and we will continue to consider both as means to pursue our strategic priorities, although we do not plan to make any significant acquisitions in the short term. In 2016, we completed our separation from the Financial Times.

We operate in markets that are dependent on Information Technology (IT) systems and technological change. Failure to maintain and support customer facing services, systems, and platforms, including addressing quality issues and execution on time of new products and enhancements, could negatively impact our revenues and reputation.

All our businesses, to a greater or lesser extent, are dependent on information technology. We either provide software and/or internet services to our customers or we use complex IT systems and products to support our businesses activities, including customer-facing systems, back-office processing and infrastructure. We face several technological risks associated with software product development and service delivery, information technology security (including virus and cyber-attacks), e-commerce, enterprise resource planning system implementation and upgrades. Although plans and procedures are in place to reduce such risks, from time to time we have experienced verifiable attacks on our system by unauthorized parties. To date, such attacks have not resulted in any material damage to us, but our businesses could be adversely affected if our systems and infrastructure experience a significant failure or interruption.

Failure to comply with data privacy regulations could result in an incident or other issue potentially causing reputational damage to our brands and financial loss.

Across our businesses we hold large volumes of personally identifiable information including that of employees, customers, students and citizens. Any perceived or actual unauthorized disclosure of personally identifiable information, whether through breach of our network by an unauthorized party, employee theft, misuse or error or otherwise, could harm our reputation, impair our ability to attract and retain our customers, or subject us to claims or litigation arising from damages suffered by individuals, and thereby harm our business and operation results. Failure to adequately protect personally identifiable information could potentially lead to penalties, significant remediation costs, reputational damage, cancellation of some existing contracts and difficulty in competing for future business. In addition, we could incur significant costs in complying with the relevant laws and regulations regarding the unauthorized disclosure of personal information. Changes to data privacy legislation must also be monitored and acted upon to ensure we remain in compliance across different markets.

Failure to prevent or detect a malicious attack on our systems could result in a breach of confidentiality, integrity and/or availability of sensitive information.

Cyber risk is continually evolving and comprises many complex external drivers: the ongoing digital revolution, increasing use of the cloud and increasingly sophisticated attack strategies. Across our businesses we hold large volumes of personally identifiable information including that of employees, customers, students and citizens. Despite our implementation of security measures, individuals may try to gain unauthorized access to our data in order to misappropriate such information for potentially fraudulent purposes. A significant breach can result in a devastating impact on Pearson s reputation, finance and student experience. Inability to prove due diligence can result in severe penalties and loss of business (existing and future).

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Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements.

We operate a number of pension plans throughout the world, the principal ones being in the UK and the US. The major plans are self-administered with the plans assets held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements. As these assets are invested in the capital markets, which are often volatile, the plans may require additional funding from us, which could have an adverse impact on results.

It is our policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. Our earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in our defined benefit plans. Our greatest exposure relates to our UK defined benefit pension plan, which is valued every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requests. As of the end of 2016, the UK defined benefit plan continues to show a surplus on an IAS19 basis. Following discussions with the plan trustee in 2016, we have committed to targeting a self-sufficient level of funding, resulting in the plan becoming largely independent of Pearson by the end of 2019. However the plan s ability to achieve and maintain this standard remains subject to market conditions, meaning that additional funding could still be required from Pearson in the future.

Operational disruption to our business caused by our third party providers, a major disaster and/or external threats could restrict our ability to supply products and services to our customers.

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. We have also outsourced some support functions, including information technology, warehousing and logistics to third party providers. The failure of third parties to whom we have outsourced business functions could adversely affect our reputation or financial condition. Failure to recover from a major disaster, (e.g. fire, flood, etc.) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict our ability to service our customers, and meet the terms of our contractual relationships with both government agencies and commercial customers. Penalty clauses and/or the failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth. Similarly external threats, such as flu pandemic, terrorist attacks, strikes, weather etc., could all affect our business and employees, disrupting our daily business activities.

A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability 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.

To the extent that worldwide economic conditions materially deteriorate, the Group s revenues, profitability and cash flows could be significantly reduced as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms.

While we anticipate that our existing cash and cash equivalents, together with availability under our existing credit facility, commercial paper program, cash balances and cash from operations, will be sufficient to fund our operations for at least the next 12 months, we may need to raise additional capital to fund maturities totaling $850m in 2018 and future operations.

The Group maintains investment grade credit ratings with Moody s and Standard and Poor s which facilitate good access to capital markets. These credit ratings in February 2017 were Baa2 (Negative outlook) with Moody s and BBB (Negative outlook) with Standard and Poor s. The negative outlooks reflect weak trading performance in 2016, particularly in Q4, which if continuing may result in credit rating downgrades.

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Disruption in capital markets or potential concerns about Pearson credit such as indicated by the credit rating agencies may mean that this capital may not be available on favorable terms or may not be available at all.

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.

As with any international business, our earnings can be materially affected by exchange rate movements. Our main exposure is to movements in the US dollar to sterling exchange rate as approximately 60% of our total revenue is generated in US dollars. We also have exposure to a range of other international currencies including emerging market currencies. The operating loss for 2016, translated at 2015 average rates, would have been £454m or 18% lower.

A lack of sufficient capital resources could adversely impact our ability to operate.

If the global economy weakens further and/or the global financial markets collapse, we may not have access to or could lose our bank deposits, or suffer a significant increase in customer bad debts. Lack of sufficient capital resources could significantly limit our ability to take advantage of business and strategic opportunities. If replacement funds are not available, we may be required to delay, reduce the scope of, or eliminate material parts of our business strategy, including potential additional acquisitions or development of new products, services and technologies.

Changes in tax law or perceptions on tax planning strategies may lead to higher effective tax rate or negative reputational impact.

Changes in corporate tax rates and/or other relevant tax laws in the UK, US or other jurisdictions could have a material impact on our future reported tax rate and/or our future tax payments. We have been subject to audit by tax authorities. Although we believe our tax provision is reasonable, the final determination of our tax liability could be materially different from our historical income tax provisions, which could have a material effect on our financial position, results of operations or cash flows.

Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We are committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy.

If we fail to attract, retain and develop appropriately skilled employees, we may limit our ability to achieve our strategic and operational goals and our business may be harmed.

Our success depends on the skill, experience and engagement of our employees. If we are unable to attract, retain and develop sufficiently experienced and capable staff, especially in technology, product development, sales and leadership, our business and financial results may suffer. When talented employees leave, we may have difficulty replacing those skills, and our business may suffer. There can be no assurance that we will be able to successfully retain and attract the skills that we need.

Failure to adequately protect learners could result in significant harm to one or more.

Incidents may occur that could cause harm to learners. For example, where we have direct learner contact via online learning, or in our direct delivery businesses where we are operating, either ourselves or in partnership with schools, colleges, universities, testing and assessment centers. These incidents can cause harm to learners, which is something we take extremely seriously, and could also have a negative financial, legal and reputational impact to the business.

Failure to adequately protect the safety and security of people and assets could increase our costs and adversely impact our reputation.

We have implemented policies to safeguard the health, safety, well-being and protection of our employees, learners and stakeholders. However, there may be accidents or incidents that occur due to unforeseen risks, for example due to changing local and global threats, causing injury or harm to individuals and impacting our business operations.

Social, environmental and ethical risks may also adversely impact our business.

We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. These include ethical business behavior, compliance with UN Global Compact standards, environmental impact, people and data privacy.

Our business depends on a strong brand, and any failure to maintain, protect and enhance our brand would hurt our ability to retain or expand our business.

Protecting the Pearson brand is critical to expanding our business and will depend largely on our ability to maintain our customers trust in our solutions and in the quality and integrity of our products and services. If we do not successfully maintain a strong brand, our business could be harmed. Beyond protection, strengthening the Pearson brand will enable us to more effectively engage governments, administrators, teachers, learners and influencers.

ITEM 4. *INFORMATION ON THE COMPANY*

Pearson plc

Pearson plc, (Pearson) is an international education company with its principal operations in the education and consumer publishing markets. We deliver content plus assessments, powered by services and technology, in order to drive personalized learning at scale. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names. We deliver our content in a variety of forms and through a variety of channels, including books and online services. We offer services as well as content, from test creation, administration and processing to teacher development and school software. Though we operate in more than 70 countries around the world, today our largest markets are the US (62% of sales) and Europe (14% of sales) on a continuing basis.

Pearson was incorporated and registered in 1897 under the laws of England and Wales as a limited company and re-registered under the UK Companies Act as a public limited company in 1981. We conduct our operations primarily through our subsidiaries and other affiliates. Our principal executive offices are located at 80 Strand, London WC2R 0RL, United Kingdom (telephone: +44 20 7010 2000).

Overview

Pearson consists of its worldwide education business plus a 47% interest in Penguin Random House.

Pearson is a leading provider of educational materials and learning technologies. It provides test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. It publishes across the curriculum and provides a range of education services including teacher development, educational software and system-wide solutions, and also owns and operates schools.

From 1 January 2014 the Group has been run as one global education company, organized around three geographical operating segments (North America, Core and Growth).

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Pearson owns a 47% interest in Penguin Random House, which was formed on July 1, 2013, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House. Pearson accounts for its interest in Penguin Random House on an equity basis.

Recent developments

On February 24, 2017, Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend.

On February 24, 2017, Pearson announced the intention to trigger the early repayment option on its $550m 6.25% Global Dollar bonds 2018. The bonds were fully redeemed on March 28, 2017.

On February 24, 2017, Pearson announced the intention to explore potential partnership for our English language learning business Wall Street English (WSE) and possible sale of our English test preparation business Global Education (GEDU) as we reduce our exposure to large scale direct delivery services and focus on more scalable online, virtual, and blended services.

Our strategy

Pearson s mission is to help people make progress in their lives through learning. Over the past decade, through a major program of organic investment and acquisitions, Pearson has become one of the leading education companies in the world, with unique geographic reach, product breadth and professional depth.

Pearson s goal is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, powered by services and technology.

Pearson s strategy is to combine world class-capabilities in content and assessment with technology and services, to enable more effective teaching and personalized learning at scale.

In 2017 the strategic growth drivers set out below will guide our work:

- Develop digital & services: Our strategy is to improve access and outcomes in education through our world-class capabilities in educational content and assessment, and services powered by technology. This will be focused on where we see the greatest potential for growth and scalability, and increasingly driven by our expertise in adaptive and personalized learning, enabling educators to be even more effective in reaching their students. Product and market strategy set our priorities for greatest growth and impact. Products are developed with insight from markets, to best meet local needs and opportunities.

- Build market presence: One of our key strategic drivers is to build our market-leading presence in North America, the UK and other key markets. We also aim to build our leading presence in select developing markets to meet the growing global demand for education, while reducing the geographical complexity of Pearson in order to focus on fewer, bigger opportunities in education. Sales, branding and marketing functions build on our presence and reputation. Customer service and support creates valuable long-term relationships.

- Deliver measurable outcomes: Our strategy is to improve access and outcomes in education. In other words, we want to help more learners learn more. Efficacy is becoming more deeply embedded into our strategy and is helping drive faster improvement in our content, assessment, services and technology. We are the only education company committed to efficacy with such rigor and at such scale and depth. Measuring and improving impact informs all strategic decisions, targeting areas with greatest potential need. Understanding customer and learner needs focuses investment on growth and impact opportunities.

Our short term priorities are to simplify our portfolio, control costs and invest in the biggest opportunities in education. Our constant goals are: to deliver growth by building a sustainable business, being a trusted partner and reaching more learners, to create long-term value.

In 2017, we will be focused on holding or gaining share in all our major markets from seeking improvements in US higher education to building on the rapid growth we have achieved with virtual schools, online degrees, professional testing and the Pearson Test of English.

We have made Pearson a more focused business and lowered operating costs significantly over the past three years. We intend to continue to make Pearson simpler, more efficient and effective. We intend to further rationalize our platforms and tools, supply chain process and property portfolio; improve our efficacy and the speed with which we launch new product features; and ensure our digital and marketing capabilities are optimized and effective. These investments in stronger simpler platforms and in better learning outcomes should all contribute to better user experiences for the millions of teachers and students we serve.

Our recent announcement of our intention to exit our 47% stake of Penguin Random House reflects an intention that we will now focus entirely on our education strategy.

We are creating a more digital, services-led company that can maximize opportunities and mitigate threats by making education more accessible, affordable and effective for far more people. We are making Pearson a more efficient company, with digital services that support a new generation of personalized learning and which create subscription-style business models for us to renew and repeat sales.

Operating divisions

Pearson is one of the leading providers of educational courseware, assessment and digital teaching and learning technologies. We provide test development, processing and scoring services to governments, educational institutions, corporations and professional bodies around the world. We publish across the curriculum and provide a range of education services including teacher development, educational software and system-wide solutions.

We report Pearson s performance in three segments: North America, Growth, and Core.

North America Segment

Our North American business serves educators and students in the US and Canada from early education through elementary, middle and high schools and into higher education with a wide range of products and services: courseware including curriculum textbooks and other learning materials; assessments including test development and scoring; and services including the provision of online learning services. Pearson has a leading position in each of these areas and a distinctive strategy of connecting those parts to support institutions and personalize learning. Our largest market is North America, and across the US we are working with states, schools and colleges to help make education more effective, accessible and affordable for a diverse community of learners.

Our North America school business offers early learning solutions that help educators and families teach fundamental math and literacy skills; elementary and secondary imprints publish leading school programs in reading, literature, math, science, and social studies; and digital instructional solutions for pre K-12, such as enVisionMATH and Miller-Levine Biology. Through our Connections Education business we provide school management services and operate virtual and blended schools.

Testing plays an integral role in determining educator and student success and we are the largest provider of educational assessment services in the US. We mark large-scale school examinations for the US federal government and more than 25 American states, scoring billions of machine-scorable test questions and evaluating more than 111 million essays, portfolios and open-ended test questions every year. Working with

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educators and education advocates, our experts are helping to lead the development of Next-Generation Assessments that feature technology-enhanced items, performance-based assessments, and adaptive learning to foster problem-solvers and critical thinkers ready to compete in the global economy.

Our solutions include learning assessments to help gauge how students learn, talent assessments to help growing companies develop their workforce, and clinical assessments to help psychologists and speech/language/ hearing/occupational and physical therapists diagnose and monitor patients.

Our professional testing business, Pearson VUE (VUE), is a global leader in electronic testing for regulatory and certification boards, providing a full suite of services from test development to test delivery and data management. Pearson VUE offers exams through an extensive network of over 8,000 test centers across the globe, delivering the NCLEX exam for the National Council of State Boards of Nursing, the GMAT for the Graduate Management Admissions Council and numerous IT exams such as Cisco and CompTIA.

Pearson VUE also includes Certiport, the world-leader in IT performance-based exams delivered through a global network of academic test centers, and GED Testing Service, a joint venture with the American Council on Education to deliver a leading high school equivalency exam.

Our North America Higher Education business offers learning services for students, colleges and universities in the US. We provide learning tools and technologies. Our custom content and curriculum solutions offer educators the opportunity to tailor their programs based on the needs of students. We also offer workforce education products and flexible workforce development solutions to fill the growing skills gap and increased demand for quality certification prep training. College and career readiness is a K-20 issue, and it requires effective strategies employed in both K-12 and higher education. Our solutions are designed to help institutions retain students and prepare them for success in college and beyond.

Global digital user registrations of Mylab and related products are more than 13 million. The growing trend provides a wealth of data and analytics to improve the performance of individual students. Our advanced capabilities in data, analytics and adaptive learning, and our leading efficacy research, enable us to design a smart learning path for every student.

The demand for online learning is steadily rising and we see this area as one of the fastest growing parts of the market where we can see demand increasing significantly over the next few years, where we ve already got a good presence and where we think we could deploy our courseware, assessment, and technology capabilities at scale. Pearson Online Services runs fully online undergraduate and graduate learning programs, such as the programs at Arizona State University Online. Likewise, at school level, Connections Education, our virtual school business serves tens of thousands of students through both virtual and blended school programs.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division North America for a discussion of developments during 2016 with respect to this segment.

Core Segment

Our biggest Core markets are the UK, Australia, Italy, Germany, France and the Benelux countries. These are countries where we work closely with educators and policy makers to improve learning through creating curriculum, designing assessments and developing digital learning systems. Additionally we have many other markets, where we do not have scale ourselves, so we collaborate with others who share our values and commitment to efficacy to maximize reach and impact.

In the UK school market, we are the largest awarding organization offering academic and vocational qualifications that are globally recognized and benchmarked, with educational excellence rooted in names like Edexcel, BTEC and LCCI. Learners take our qualifications in many countries worldwide. We use our online marking technology to mark over 94% of examination papers and our ResultsPlus service provides detailed analysis of every learner s examination results. We are also driving innovation through digital products such as Bug Club and ActiveLearn, and supporting skills for employability for progression in study, work and life.

Through Pearson College we are the only FTSE 100 company delivering degrees in the UK. Our students get the chance to learn from leading employers as well as experienced academics and subject experts, in the heart of a 21st Century business.

In the UK Pearson VUE works with professional and government bodies including the Driving and Vehicle Standards Agency (DVSA), Chartered Institute of Management Accountants (CIMA) and the Construction Industry Training Board (CITB).

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Core for a discussion of developments during 2016 with respect to this segment.

Growth Segment

Our aim is to take educational products and services and apply them at scale in countries such as Brazil, South Africa, China, India and other fast-growing economies. Around one third of our employees now work in these countries. We served over 600,000 students through our English language schools in China, Brazil and elsewhere, our partner schools in Brazil and India, and our higher education institutions in South Africa.

In Brazil we are leading primary and secondary education with our sistemas or learning systems which include COC, Dom Bosco and NAME. In South Africa we run 12 of our CTI and MGI campuses throughout the country. We have over 8,500 students enrolled in courses ranging from undergraduate degrees in IT and sociology, to business diplomas and Masters courses in psychology. Our campuses prioritize digital learning with the majority of our students accessing their courses through tablet devises, and focus on learning outcomes that prepare students for employment opportunities in their chosen careers.

Pearson s English assets make the Company the world s largest English language learning business. MyEnglish Lab and other English courseware registrations were over 860,000. The businesses in Pearson s English division include: Wall Street English (center-based learning for consumers); PTE Academic (computer-based test of English for study abroad and immigration); Pearson ELT (institutional English language courses including FOCUS, Poptropica English and Longman); and Grupo Multi (the leading adult English language training company in Brazil).

In 2014 Pearson English released the Global Scale of English, the world s first common, global benchmark of English language learning. It measures English language progress on a numeric scale in a way that is consistent, granular and actionable for governments, corporates, academics, institutions and learners. The Scale has been created as the Open Standard for English that meets a global need.

In February 2017, Pearson announced the intention to explore potential partnership for our English language learning business Wall Street English (WSE) and possible sale of our English test preparation business Global Education (GEDU).

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Growth for a discussion of developments during 2016 with respect to this segment.

Penguin Random House

On July 1, 2013 Penguin Random House was formed, upon the completion of an agreement between Pearson and Bertelsmann to merge their respective publishing companies, Penguin and Random House, with the parent companies owning 47% and 53% respectively.

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Penguin Random House comprises the adult and children s fiction and nonfiction print and digital book publishing businesses of Penguin and Random House in the US, UK, Canada, Australia, New Zealand and India, Penguin s publishing activity in Asia and South Africa, as well as Dorling Kindersley worldwide, and Random House s companies in Spain, Mexico, Argentina, Uruguay, Columbia and Chile.

Penguin Random House employs more than 10,000 people globally across almost 250 editorially and creatively independent imprints and publishing houses that collectively publish more than 15,000 new titles annually. Its publishing list includes more than 70 Nobel Prize laureates and hundreds of the world s most widely read authors.

Penguin Random House sells directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. It also sells through online retailers such as Amazon.com, as well as its own websites and direct to the customer via digital sales agents.

In 2016, our share of Penguin Random House profit after tax was £98m.

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend. We will use proceeds from this action to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating.

See Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by division Penguin Random House for a discussion of developments during 2016 with respect to Penguin Random House.

Operating cycles

Pearson determines a normal operating cycle separately for each entity/cash generating unit within the Group with distinct economic characteristics. The normal operating cycle for each of the Group s education businesses is primarily based on the expected period over which the educational programs and titles will generate cash flows, and also takes account of the time it takes to produce the educational programs. The operating cycles for the courseware markets are typically longer than one year as described below.

Particularly for the North American businesses, there are well established cycles operating in the courseware market:

- The School courseware market is primarily driven by an adoption cycle in which major state education boards adopt programs and provide funding to schools for the purchase of these programs. There is an established and published adoption cycle with new adoptions taking place on average every 5 years for a particular subject. Once adopted, a program will typically sell over the course of the subsequent 5 years. The Company renews its pre-publication assets to meet the market adoption cycles. Therefore the operating cycle naturally follows the market cycle.

- The Higher Education courseware market has a similar pattern, with colleges and professors typically refreshing their courses and selecting revised programs on a regular basis, often in line with the release of new editions or new technology offerings. The Company renews its pre-publication assets to meet the typical demand for new editions of, or revisions to, educational programs. Analysis of historical data shows that the typical life cycle of Higher Education content is up to 5 years. Again the operating cycle mirrors the market cycle.

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A development phase of typically 12 to 18 months for Higher Education and up to 24 months for School precedes the period during which the Company receives and delivers against orders for the products it has developed for the program.

The Core and Growth courseware markets operate in a similar way although often with less formal adoption processes.

The operating cycles in respect of our professional content are more specialized in nature as they relate to educational or heavy reference products released into smaller markets (e.g. the financial training and IT sectors). Nevertheless, in these markets, there is still a regular cycle of product renewal, in line with demand which management monitor. Typically the life cycle is 5 years for Professional content. Elsewhere in the Group operating cycles are typically less than one year.

Competition

Pearson s businesses operate in highly competitive environments.

Pearson competes with other publishers and creators of educational materials and services. These companies include publishers such as Cengage Learning, McGraw-Hill and Houghton Mifflin Harcourt, and services companies, such as K-12 Inc, alongside smaller niche players that specialize in a particular academic discipline or focus on a learning technology. Competition is based on the ability to deliver quality products and services that address the specified curriculum needs and appeal to the school boards, educators and government officials making purchasing decisions.

Intellectual property

Our principal intellectual property assets consist of:

- trademarks and other rights in our brands (including corporate and business unit brands, imprints, as well as product and service brands);
- copyrights for our textbook and related educational content and software code; and
- patents and trade secrets related to the innovative methods deployed in our key technologies.

We believe we have taken all reasonable legal steps to protect our key brands in our top markets and copyright in our content and have taken appropriate steps to develop a comprehensive patent program to ensure appropriate protection of emerging inventions that are critical to our new business strategies.

Raw materials

Paper is the principal raw material used by Pearson. We purchase most of our paper through our Global Sourcing department located in the United States. We have not experienced and do not anticipate difficulty in obtaining adequate supplies of paper for our operations, with sourcing available from numerous suppliers. While local prices fluctuate depending upon local market conditions, we have not experienced extensive volatility in fulfilling paper requirements. In the event of a sharp increase in paper prices, we have a number of alternatives to minimize the impact on our operating margins, including modifying the grades of paper used in production.

Government regulation

The manufacture of certain of our products in various markets is subject to governmental regulation relating to the discharge of materials into the environment. Our operations are also subject to the risks and uncertainties attendant to doing business in numerous countries. Some of the countries in which we conduct these operations maintain controls on the repatriation of earnings and capital and restrict the means available to us for hedging potential currency fluctuation risks. The operations that are affected by these controls, however, are not material to us. Accordingly, these controls have not significantly affected our international operations. Regulatory

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authorities may have enforcement powers that could have an impact on us. We believe, however, that in light of the nature of our business the risk of these sanctions does not represent a material threat to us.

Licenses, patents and contracts

We are not dependent upon any particular licenses, patents or new manufacturing processes that are material to our business or profitability. Likewise, we are not materially dependent upon any contracts with suppliers or customers, including contracts of an industrial, commercial or financial nature. Notwithstanding the foregoing, our Education business is dependent upon licensed rights since most textbooks and digital learning tools include content and/or software that is licensed to us by third parties (or assigned subject to royalty arrangements). In addition, some of our software products in various business lines, particularly those of our Clinical business, rely upon patents licensed from third parties.

Legal proceedings

We and our subsidiaries are from time to time the subject of legal proceedings incidental to the nature of our and their operations. These may include private litigation or arbitrations, governmental proceedings and investigations by regulatory bodies. We do not currently expect that the outcome of pending proceedings or investigations, either individually or in aggregate, will have a significant effect on our financial position or profitability nor have any such proceedings had such effect in the recent past. To our knowledge, there are no material proceedings in which any member of senior management or any of our affiliates is a party adverse to us or any of our subsidiaries or in respect of which any of those persons has a material interest adverse to us or any of our subsidiaries.

Organizational structure

Pearson plc is a holding company which conducts its business primarily through subsidiaries and other affiliates throughout the world. Below is a list of our significant subsidiaries and associates as at December 31, 2016, including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.

Name	Country of incorporation/residence	Percentage interest/voting power
Pearson Education Inc.	United States (Delaware)	100%
Pearson Education Ltd.	England and Wales	100%
NCS Pearson Inc.	United States (Minnesota)	100%
Penguin Random House LLC.	United States (Delaware)	47%
Penguin Random House Ltd.	England and Wales	47%

In February 2014 the Group acquired Grupo Multi, Brazil s leading adult English language training company. There were no significant acquisitions in 2015 or 2016.

During 2015 the Group disposed of its interest in the FT Group including its 50% share of The Economist. The Financial Times sale was completed on 30 November 2015 and the sale of our 50% share of The Economist Group was substantially completed on 16 October 2015 with the remaining stake sold in 2016. Also, in July 2015, the Group disposed of its interest in PowerSchool.

During 2014 the Group disposed of its interest in the Mergermarket group of companies and our North America business disposed of its joint venture interests in Safari Books Online and CourseSmart.

During 2013 the Group disposed of its interest in the Penguin group of companies in exchange for a 47% interest in Penguin Random House.

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Property, plant and equipment

Our headquarters are located at leasehold premises in London, England. We own or lease approximately 900 properties, including approximately 650 testing/teaching centers in over 55 countries worldwide, the majority of which are located in the United Kingdom, the United States and China.

The properties owned and leased by us consist mainly of offices, distribution centers and computer testing/ teaching centers.

In some cases properties leased by us are then sublet to third parties. These properties are not included in the list below as they are not considered to be principal properties.

The vast majority of our printing is carried out by third party suppliers. We operate a small digital print operation as part of our Pearson Assessment & Testing businesses which provides short-run and print-on-demand products, typically custom client applications.

We own the following principal properties at December 31, 2016:

General use of property	Location	Area in square feet
Office	Iowa City, Iowa, USA	312,760
Office	Southwark, London, UK	310,200
Warehouse/Office	Old Tappan, New Jersey, USA	212,041
Warehouse/Office	Cedar Rapids, Iowa, USA	205,000
Office	Hadley, Massachusetts, USA	137,070
Printing	Owatonna, Minnesota, USA	128,000
Office	Manchester, UK	139,680

We leased the following principal properties at December 31, 2016:

General use of property	Location	Area in square feet
Office	Hoboken, New Jersey, USA	216,273
Office	New York City, New York, USA	313,285
Office	Westminster, London, UK	282,923
Office	San Antonio, Texas, USA	117,063
Warehouse/Office	Austin, Texas, USA	226,076
Office	Boston, Massachusetts, USA	225,299
Office	Glenview, Illinois, USA	187,500
Office	Bloomington, Minnesota, USA	172,797
Warehouse/Office	Cape Town, South Africa	160,387
Warehouse/Office	Uttar Pradesh, India	145,041
Office	Harlow, UK	137,857
Office	Chandler, Arizona, USA	270,920
Warehouse	Sao Paulo, Brazil	132,331
Warehouse/Office	Cedar Rapids, Iowa, USA	119,682
Office	Centennial, Colorado, USA	117,554
Teaching Centre	Pretoria, South Africa	134,553
Warehouse	Naucalpan de Juarez, Mexico	113,638
Call Center/Office	Lawrence, Kansas, USA	105,000

Capital Expenditures

See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources for description of the Company s capital expenditure.

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ITEM 4A. ***UNRESOLVED STAFF COMMENTS***

The Company has not received, 180 days or more before the end of the 2016 fiscal year, any written comments from the Securities and Exchange Commission staff regarding its periodic reports under the Exchange Act which remain unresolved.

ITEM 5. ***OPERATING AND FINANCIAL REVIEW AND PROSPECTS***

The following discussion and analysis is based on and should be read in conjunction with the consolidated financial statements, including the related notes, appearing elsewhere in this Annual Report. The financial statements have been prepared in accordance with IFRS as issued by the IASB.

Where this discussion refers to constant currency comparisons, these are estimated by re-calculating the current year results using the exchange rates prevailing for the prior period. The increase or reduction in the value calculated is the estimate of impact of exchange rates. We believe this presentation provides a more useful period to period comparison as changes due solely to changes in exchange rates are eliminated.

General overview

Introduction

Pearson s primary segments for management and reporting are geographical as follows: North America, comprising the courseware, assessment and services businesses in US and Canada; Core, comprising the courseware, assessment and services businesses in more mature markets, including the UK, Australia and Italy; and Growth, comprising the courseware, assessment and services businesses in emerging markets, including Brazil, China, India and South Africa. In addition Pearson separately reports on an equity basis the results from its 47% interest in Penguin Random House (PRH).

On 16 October 2015, Pearson substantially completed the sale of its 50% interest in the Economist to EXOR and The Economist Group and on 30 November 2015 Pearson completed the sale of the Financial Times to Nikkei. The results of the Economist and the Financial Times are included in discontinued operations in 2014 and to the date of sale in 2015. Also, in July 2015, the Group disposed of its interest in PowerSchool to Vista Equity Partners for consideration of £222m realizing a pre-tax gain of £30m net of a £70m write down of related software assets. The PowerSchool business was not significant enough to meet the definition of a discontinued business and its results to the date of disposal are included in continuing operations.

On February 4, 2014, Pearson completed the sale of the Mergermarket Group to BC Partners. Mergermarket s results for 2014 to the date of sale have been included in discontinued operations.

Sales from continuing operations increased from £4,468m in 2015 to £4,552m in 2016, an increase of £84m or 2%. This year on year increase was the result of currency movements, primarily the strength of the US dollar relative to sterling during the year but also due to the strength of many of the other currencies that the Group is exposed to. In 2016 currency movements increased sales by £486m when compared to the equivalent figures at constant 2015 rates. When measured at 2015 constant exchange rates, our sales declined by 9%. Part of the decrease is due to the absence of sales from businesses sold during the year and we estimate that after excluding the impact of disposals, sales declined by 8% at constant exchange rates. This decrease is primarily explained by weakness in US higher education courseware, US K12 assessment and courseware and UK student assessment.

In 2016, Pearson reported an operating loss (from continuing operations) of £2,497m compared to a loss of £404m in 2015. The increase in the loss of £2,093m mainly reflects an increase in intangible charges. At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, we revised our strategic plans and our estimates for future cash flows and as a consequence made an impairment to North American goodwill of £2,548m. In 2015,

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following economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations we impaired intangible assets in North America by £282m, in Core markets by £37m and in Growth markets by £530m. Operating profit before these impairments decreased by £394m in 2016 compared to 2015 mainly due to restructuring costs and the impact of lower revenues partly offset by favorable currency movements.

In January 2016, Pearson announced that it was embarking on a major restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. Total restructuring in 2016 amounted to £338m and includes costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships. After excluding impairment and restructuring, currency movements increased operating profit by £78m when compared to the equivalent figures translated at constant 2015 exchange rates.

The loss before taxation in 2016 of £2,557m compares to a loss before taxation of £433m in 2015. The increase in the loss of £2,124m mainly reflects the £2,093m increase in the reported operating loss identified above and an increase in net finance costs of £31m, from £29m in 2015 to £60m in 2016. The Group s net interest payable increased from £46m in 2015 to £59m in 2016. The majority of the movement in net interest payable was due to a one-off release of accrued interest in 2015 following agreement of historical tax positions. The most significant element of the net interest payable figure is interest on bond debt with the impact of interest on tax provisions and interest receivable off setting each other. Interest on bond debt was in line with the prior year, with the savings from bond repayments offset by the impact of rising US dollar interest rates. Also included in net finance costs are net finance costs relating to employee benefit plans, foreign exchange and other gains and losses. In 2016 the total of these items was a loss of £1m compared to a gain of £17m in 2015. Income relating to employee benefit plans was £7m higher in 2016 than in 2015 mainly reflecting the better funding position in the UK pension plan at the beginning of 2016. Other gains and losses in 2016 and 2015 mainly relate to foreign exchange differences on un-hedged cash and cash equivalents, and other financial instruments.

Net cash generated from operations increased to £522m in 2016 from £518m in 2015. The increased cash flow reflects lower cash incentive payments and tight working capital partially offset by restructuring spend and higher pension deficit payments. Net interest paid at £51m in 2016 was the same as for 2015 and reflects the similar interest charge for the year after taking out the one-off release of accrued interest in 2015 following agreement of historical tax positions. Tax paid in 2016 was £45m compared to £232m in 2015. Tax paid in 2015 included the tax on disposals made during the year of approximately £103m whilst tax paid in 2016 included tax relief on pension payments made in connection with the disposal of the Financial Times in 2015. In addition the lower tax paid in 2016 also reflects lower profits following restructuring charges taken in the year.

Net capital expenditure on property, plant and equipment after proceeds from sales remained constant at £84m in both 2015 and 2016 and net capital expenditure on software intangibles reduced slightly from £160m in 2015 to £157m in 2016. The expenditure on both tangible and intangible capital is largely attributed to the continuing investment in enabling function technology designed to lower administrative costs. There were no significant acquisitions in either 2015 or 2016 and the net cash outflow in respect of businesses and investments acquired was £27m in 2015 and £21m in 2016. The net cash inflow in respect of businesses and investments disposed was £1,422m in 2015 compared to £42m in 2016. In 2015 the cash received largely related to the Financial Times, The Economist and PowerSchool disposals and in 2016 includes proceeds from the sale of the remaining stake in the Economist partially offset by costs paid in 2016 relating to the Financial Times sale in 2015. Dividends from joint ventures and associates decreased from £162m in 2015 to £131m in 2016 mainly due to the absence of dividends from the Economist and a smaller dividend from PRH. Dividends paid of £424m in 2016 compares to £423m in 2015 reflecting the same dividend per share in both years. Overall the Group s net borrowings increased from £654m at the end of 2015 to £1,092m at the end of 2016. The reduction in net debt was due to the factors noted above exacerbated by an increase in reported net debt due to the strengthening of the US dollar relative to sterling.

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Outlook

In North America, our largest market, our guidance for 2017 is based on assumptions of further declines in enrolment and other pressures in the US higher education courseware market. If the 2016 inventory correction (see Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2016 compared to year ended December 31, 2015 Sales and operating profit by segment North America Courseware for further explanation of this item) at key channel partners partially unwinds, lower returns will result in net revenue growth in our US higher education courseware business of approximately 1%. If inventory levels continue to fall we expect the result to be a 7% net revenue decline. In both cases, we assume an underlying decline in demand of between 6% and 7% for US higher education courseware. Elsewhere in North America, we anticipate modest declines in school courseware revenues reflecting a slightly larger adoption market offset by our lower participation rate due to our earlier decision not to compete in the current California English Language Arts (ELA) adoption; and flat revenues in Open Territories (i.e. those US states in which schools purchase educational materials independently) reflecting a smaller impact from new products after a very successful 2016. We expect some continued pressure on testing revenues in North America due to the annualization of contract losses announced in 2015 and the roll-off of temporary contracts won in 2016, together with a further shift to digital tests which reduces revenue but benefits margins. We expect Connections Education to see double-digit growth in enrolment partially offset by some virtual school partners choosing to take some non-core services in-house. We expect online program management and professional certification to continue to grow well.

In our Core markets (which include the UK, Australia, Germany, France, the Benelux countries and Italy), we anticipate: flat revenues with continued growth in Pearson Test of English Academic and in Online Program Management due to program additions and new customer wins; growth in UK school and higher education courseware due to a strong slate of new products aligned with Pearson qualifications; offset by modest declines in UK student assessment, where revenue is expected to lag behind the greater stability that we are now seeing in vocational course registrations; together with business exits and weakness in smaller markets.

In our Growth markets (which include Brazil, China, India and South Africa and other fast growing economies), we expect a modest increase in revenues; with growth in China driven by new product offerings and center openings at Wall Street English; in South Africa due to improving enrolments in CTI, our private university; and in Brazil on evidence of greater economic stability. We expect courseware businesses across Growth to grow well on new product launches, offsetting some business exits as we focus on fewer, larger opportunities.

In Penguin Random House, we anticipate a broadly level publishing performance. We announced the intention to exit our 47% stake of the combined business reflecting an intention to focus entirely on our education strategy. Should Bertelsmann choose to buy Pearson s stake, or we elect to recapitalize the business and extract a dividend, we will use the proceeds to maintain a strong balance sheet, invest in our business and return excess capital to shareholders, while retaining a solid investment grade credit rating.

We completed the sale of a number of small subscale businesses which, combined, will have the effect of reducing 2017 adjusted operating profit by £10m. Group incentive compensation increased by £55m in 2016, lower than the budgeted £110m reflecting the weakness of performance versus budget. The incentive pool will be budgeted for in full in 2017 to ensure our workforce is properly incentivized.

To ensure efficient use of the cash balances we held at 31 December 2016, we announced that we will trigger the early repayment option on our $550m 6.25% Global dollar bonds 2018. These bonds were fully redeemed on March 28, 2017. We expect our interest charge to be £74m (2016: £59m) due to currency movements and increases in US dollar LIBOR.

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Sales information by segment

The following table shows sales information for each of the past three years by segment:

	Year Ended December 31		
	2016 £m	2015 £m	2014 £m
North America	2,981	2,940	2,906
Core	803	815	892
Growth	768	713	742
Total continuing operations	4,552	4,468	4,540
Discontinued operations		312	343
Total	4,552	4,780	4,883

Sales information by geographic market supplied

The following table shows sales information for each of the past three years by geographic region:

	Year Ended December 31		
	2016 £m	2015 £m	2014 £m
Continuing operations			
European countries	648	667	725
North America	2,947	2,907	2,871
Asia Pacific	632	590	565
Other countries	325	304	379
Total continuing operations	4,552	4,468	4,540
Discontinued operations			
European countries		198	236
North America		74	69
Asia Pacific		35	34
Other countries		5	4
Total discontinued operations		312	343
Total	4,552	4,780	4,883

In the table above sales are allocated based on the country in which the customer is located.

Exchange rate fluctuations

We earn a significant proportion of our sales and profits in overseas currencies, principally the US dollar. Sales and profits are translated into sterling in the consolidated financial statements using average rates. The average rate used for the US dollar was £1:$1.33 in 2016, £1:$1.53 in 2015 and £1:$1.65 in 2014. Fluctuations in exchange rates can have a significant impact on our reported sales and profits. In 2016, Pearson generated 65% of its continuing sales in the US (2015: 63%; 2014: 61%). In 2016 we estimate that a five cent change in the average exchange rate between the US dollar and sterling would have had an impact on our reported loss per share of approximately 10.0p and a five cent change in the closing exchange rate between the US dollar and sterling would have had an impact on shareholders funds of approximately £130m. See

Item 11. Quantitative and Qualitative Disclosures about Market Risk for more information. The year-end US dollar rate for 2016 was £1:$1.23 compared to £1:$1.47 for 2015 and £1:$1.56 for 2014. The total impact on shareholders funds of

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foreign exchange translation was a gain of £913m in 2016 compared to a loss of £69m in 2015. These net movements are principally driven by movements in the US dollar as a significant portion of the Group s operations are in the US, however, in 2016 other currencies contributed to the foreign exchange gain as many of these other currencies also strengthened in comparison to sterling. In 2015 these other currencies were generally weaker relative to sterling and this weakness was more than enough to offset the gain from the stronger dollar.

Critical accounting policies

Our consolidated financial statements, included in Item 18. Financial Statements , are prepared based on the accounting policies described in note 1 to the consolidated financial statements.

Certain of our accounting policies require the application of management judgment in selecting assumptions when making significant estimates about matters that are inherently uncertain. Management bases its estimates on historical experience and other assumptions that it believes are reasonable. These policies are described in note 1a(3) in Item 18. Financial Statements .

Results of operations

Year ended December 31, 2016 compared to year ended December 31, 2015

Consolidated results of operations

Sales

Our total sales from continuing operations increased from £4,468m in 2015 to £4,552m in 2016, an increase of £84m or 2%. This year on year increase was the result of currency movements, primarily the strength of the US dollar relative to sterling during the year but also due to the strength of many of the other currencies that the Group is exposed to. In 2016 currency movements increased sales by £486m when compared to the equivalent figures at constant 2015 rates. When measured at 2015 constant exchange rates, our sales declined by 9%. Part of the decrease is due to the absence of sales from businesses sold during the year and we estimate that after excluding the impact of disposals, sales declined by 8% at constant exchange rates.

North America sales increased by £41m or 1% from £2,940m to £2,981m, mainly due to the strengthening of the US dollar against sterling. We estimate that after excluding the impact of exchange and the contribution from businesses disposed in 2015 and 2016, North America sales declined by 10% in 2016 compared to 2015 due to a significant decline in US higher education courseware, together with anticipated declines in school assessment, due to previously announced contract losses and in school courseware, due to a smaller adoption market and our lower participation rate. The declines were partially offset by growth in professional certification, virtual and blended schools and Online Program Management. North America continued to be the most significant source of our sales and as a proportion of sales contributed 65% in 2016 and 66% in 2015.

Core sales declined by £12m or 1% from £815m in 2015 to £803m in 2016. We estimate that after excluding the impact of exchange and the closure of Wall Street English Germany, the disposal of other sub-scale businesses and the transfer of some smaller businesses to our Growth segment, Core sales declined by 4%. The decline was primarily due to expected declines in vocational course registrations in UK schools and courseware. This was partially offset by strong growth in English assessments in Australia and OPM services in the UK and Australia.

Growth sales increased by £55m or 8% from £713m in 2015 to £768 in 2016, almost all of the increase can be attributed to exchange and the strength of key emerging market currencies compared to sterling. We estimate that after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test

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preparation. In Brazil, revenues declined due to enrolment declines in our English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to our previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015.

Cost of goods sold and operating expenses

The following table summarizes our cost of sales, net operating expenses and impairment of intangible assets:

	Year Ended December 31	
	2016	2015
	£m	£m
Cost of goods sold	2,093	1,981
Operating expenses		
Distribution costs	88	80
Selling, marketing and product development costs	908	895
Administrative and other expenses	1,240	1,195
Restructuring costs	329	35
Other net gains and losses	25	(13)
Other income	(85)	(98)
Total net operating expenses	2,505	2,094
Impairment of intangible assets	2,548	849
Total expenses	7,146	4,924

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. Our cost of sales increased by £112m, or 6%, from £1,981m in 2015, to £2,093m in 2016. The increase reflects the increase in sales but also the mix of sales, as sales declines in higher margin products were offset by sales increases in lower margin products and services. Cost of sales was 46.0% of sales in 2016 compared to 44.3% in 2015.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs increased due to the effect of exchange. After taking out the impact of exchange, distribution costs decreased due to the continuing shift to digital and services products.

Selling, marketing and product development costs. Our selling, marketing and product development costs increased by £13m or 1% from £895m in 2015 to £908m in 2016. As a percentage of sales these costs were relatively consistent at 19.9% in 2016 and 20.0% in 2015, the slight decline reflecting benefits from restructuring.

Administrative and other expenses. Our administrative and other expenses increased by £45m or 4% from £1,195m in 2015 to £1,240m in 2016. The increase is largely due to exchange and increased investment in technology which offset significant savings from restructuring in 2016.

Restructuring costs. In January 2016, Pearson announced that it was embarking on a major restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. The scope and costs of the 2016 program are significantly more than normal levels of restructuring. Total restructuring in 2016 for our subsidiary companies amounted to £329m compared to £35m in 2015 and includes costs associated with headcount reductions, property rationalization and closure or exit from certain systems, platforms, products and supplier and customer relationships.

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Other net gains and losses. Included in other gains and losses in 2016 of £25m are the losses associated with the closure of our English language schools in Germany and the sale of the Pearson English Business Solutions business. Included in other net gains and losses in 2015 is the profit on sale of PowerSchool of £30m net of £70m of write downs on related software assets and small losses on investments and costs relating to prior year disposals totaling £17m.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions, together with the service fee income from Penguin Random House. Other operating income decreased to £85m in 2016 compared to £98m in 2015 mainly due to a reduction in Penguin Random House service fee income. This income decreased as Penguin Random House reduced its reliance on Pearson systems and processes and the fee of £16m in 2015 compares to a fee of £4m in 2016.

Impairment of intangible assets. At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, we revised our strategic plans and our estimates for future cash flows and as a consequence made an impairment to North American goodwill of £2,548m. In 2015, following economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations we impaired intangible assets in North America by £282m, in Core markets by £37m and in Growth markets by £530m.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased by £45m to £97m in 2016 from £52m in 2015. The increase is mainly due to Penguin Random House where there was an improved operating performance coupled with a reduced amortization charge. The intangibles amortization charge arises on intangibles recognized on the creation of Penguin Random House in 2013. The amortization profile recognizes more of the amortization in the early years with progressively less amortization in later years.

Operating loss / profit

In 2016 there was an operating loss on a continuing basis of £2,497m compared to an operating loss on a continuing basis of £404m in 2015. The increase in loss is due to the impairment of intangible assets and the additional restructuring charges taken in 2016 as outlined above.

Net finance costs

Net interest payable in 2016 was £59m, compared to £46m in 2015. The majority of the movement in net interest payable was due to a one-off release of accrued interest in 2015 following agreement of historical tax positions. The most significant element of the net interest payable figure is interest on bond debt with the impact of interest on tax provisions and interest receivable off setting each other. Interest on bond debt was in line with the prior year, with the savings from bond repayments off set by the impact of rising US dollar interest rates.

Other net finance costs are finance income and costs on retirement benefits, foreign exchange and other gains and losses. The increase in finance income in respect of employee benefit plans from £4m in 2015 to £11m in 2016 is a reflection of the more favorable funding position at the end of 2015. Both the exchange loss in 2016 of £12m and the exchange gain in 2015 of £13m mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments.

For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

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Taxation

The total tax benefit in 2016 of £222m represents 8.7% of pre-tax losses and compares to a benefit of £81m or 18.7% of pre-tax losses in 2015. The increased benefit in 2016 is mainly due to the release of deferred tax liabilities relating to tax deductible goodwill that has been impaired. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 20% in 2016 and 20.25% in 2015).Although tax relief on the impairment of goodwill was significant in both 2015 and 2016, this tax relief only related to a portion of goodwill impaired and this has driven the overall tax rate below the effective statutory rates.

Discontinued operations

Profit from discontinued operations in 2015 of £1,175m includes the results to date of sale and the gain on sale of the Financial Times and the Economist. There were no discontinued operations in 2016.

Profit/(loss) for the year

The loss for the financial year in 2016 was £2,335m compared to a profit in 2015 of £823m. The loss in 2016 includes the impairment charge of £2,548m as noted above. The 2015 profit includes the gains on the sale of the Financial Times and Economist partly offset by significant impairment charges in the year.

Earnings/(loss) per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was a loss of 286.8p in 2016 compared to earnings of 101.2p in 2015 based on a weighted average number of shares in issue of 814.8m in 2016 and 813.3m in 2015. The decrease in earnings per share was due to the decrease in profit for 2016 described above and was not significantly affected by the movement in the weighted average number of shares.

A diluted earnings per ordinary share was not calculated in either 2015 or 2016 as a result of the losses from continuing operations.

Exchange rate fluctuations

Currency movement increased sales by £486m and increased the operating loss by £454m. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding our management of exchange rate risks.

Sales and operating profit by segment

The following tables summarize our sales and adjusted operating profit for each of Pearson s business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables our investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income or expenditure relating to acquisition and disposal transactions.

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs, amortization and impairment of acquired intangibles and the cost of major restructuring. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical

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expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group. In 2016, the definition of adjusted operating profit has been amended to exclude the cost of major restructuring activity. In January 2016, Pearson announced that it was embarking on a restructuring program to simplify the business, reduce costs and position the company for growth in its major markets. The costs of the program in 2016 are significant enough to exclude from our adjusted operating profit measure so as to better highlight the underlying performance.

A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

	Year Ended December 31, 2016						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,981	803	768		4,552		4,552
	65%	*18%*	*17%*		*100%*		
Total operating profit	(2,448)	(33)	(100)	84	(2,497)		(2,497)
Add back:							
Other net gains and losses	12	12	1		25		25
Acquisition costs							
Costs of major restructuring	172	62	95	9	338		338
Intangible charges	2,684	16	33	36	2,769		2,769
Adjusted operating profit: continuing operations	420	57	29	129	635		635
Adjusted operating profit: discontinued operations							
Total adjusted operating profit	420	57	29	129	635		635
	66%	*9%*	*5%*	*20%*	*100%*	*%*	*100%*

	Year Ended December 31, 2015						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,940	815	713		4,468	312	4,780
	66%	*18%*	*16%*		*100%*		
Total operating profit	113	21	(586)	48	(404)	1,232	828
Add back:							
Other net gains and losses	(19)	5		1	(13)	(1,184)	(1,197)
Costs of major restructuring							
Acquisition costs							
Intangible charges	386	79	583	41	1,089	3	1,092
Adjusted operating profit: continuing operations	480	105	(3)	90	672		672
Adjusted operating profit: discontinued operations						51	51
Total adjusted operating profit	480	105	(3)	90	672	51	723
	66%	*15%*	*(0)%*	*12%*	*93%*	*7%*	*100%*

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North America

North America sales increased by £41m or 1% from £2,940m to £2,981m and adjusted operating profit decreased by £60m, or 13%, from £480m in 2015 to £420m in 2016. We estimate that after excluding the impact of exchange and the contribution from businesses disposed in 2015 and 2016, North America sales declined by 10% in 2016 compared to 2015 due to a significant decline in US higher education courseware, together with anticipated declines in school assessment, due to previously announced contract losses and in school courseware, due to a smaller adoption market and our lower participation rate. The declines were partially offset by growth in professional certification, virtual and blended schools and Online Program Management.

In 2016 we recognized an impairment to our US goodwill. At the end of 2016, following trading in the final quarter of the year, it became clear that the underlying issues in the North American higher education courseware market were more severe than anticipated. These issues related to declining student enrolments, changes in buying patterns of students and correction of inventory levels by distributors and bookshops. As a result, in January 2017, we revised our strategic plans and our estimates for future cash flows and as a consequence made an impairment to North American goodwill of £2,548m. In 2015 we recognized an impairment of £282m following ongoing cyclical and policy related pressures in our main US markets. Also in our results was the cost of the major restructuring program of £172m and other losses on disposal mainly relating to the sale of the Pearson English Business Solutions business. In 2015 we realized a gain on sale of PowerSchool of £30m net of the write down of related software assets. In addition to the gain on PowerSchool there were also small losses on the sale and write down of smaller investments of £11m.

Overall adjusted operating margins in the North America business declined in 2016 to 14.1% compared to 16.3% in 2015 as cost savings from restructuring were more than offset by the margin impact of lower sales particularly in higher education courseware.

North America courseware

In school courseware, revenue declined 10% with a smaller new Adoption Market and our lower participation rate partially offset by good growth and market share gains in Open Territories resulting from new product launches. Our new adoption participation rate fell from over 90% in 2015 to 64% in 2016 due to our decision not to compete for the California Grades K-8 English Language Arts (ELA) adoption with a core basal program. We won an estimated 30% share of adoptions competed for (31% in 2015) and 19% of total new adoption expenditure of $470m (29% of $730m in 2015) driven by strong performance in Indiana Math and Social Studies and South Carolina Science and Social Studies. In Open Territories, we grew strongly benefiting from our new MyPerspectives program in Grades 6 12 ELA, ReadyGen, Investigations 3.0, the extension of enVisionMATH to cover Grades 6 8 and growth in our digital reading intervention program, iLit.

In higher education courseware, total US college enrolments fell 1.4%, with combined two-year public and four-year for-profit enrolments declining 5.0%, affected by rising employment rates and regulatory change impacting the for-profit and developmental learning sectors, partially offset by modest growth in combined enrolments at four-year public and private not-for-profit institutions. Net revenues in our US higher education courseware business declined an unprecedented 18% during the year. We estimate 2% of this decline was driven by lower enrolment, particularly in Community College and among older students; 3 4% by an accelerated impact from rental in the secondary market; and approximately 12% due to an inventory correction in the channel reflecting the cumulative impact of these factors in prior years. Underlying market share trends remained stable and our market share in the 12 months to January 2017 was 40.4%.

During 2016, we performed strongly in Science and Business & Economics with key titles including: *Applying, Biochemistry: Concepts & Connections 1e*; Amerman, *Human Anatomy & Physiology 1e*; Marieb, *Human Anatomy & Physiology 10e*; Young, Freedman, *University Physics 14e* and Parkin, *Economics 12e*. Global digital registrations of MyLab and related products grew 2%. In North America, digital registrations grew

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2% with good growth in Science, Business & Economics and Revel partly offset by continued softness in Developmental Mathematics. Skill Builder Adaptive Practice, our in-house adaptive homework solution launched in over 60 titles in 2016. Faculty-generated studies indicate that the use of MyLab, Mastering and Revel programs, as part of a broader course redesign, can support improvements in student test scores and lower institutional cost. Findings from an efficacy study suggest that students in Developmental Mathematics courses who increased their number of homework and quiz attempts in MyMathLab-Developmental increased their odds of passing; and that users of MyLab Writing who complete seven topics or more increase their final exam scores by 14%. In another study at a mid-sized university in the Midwest, during the 2015 2016 academic year, students using My IT Lab were able to raise their exam scores by half a letter grade for every seven additional activities attempted. In institutional courseware solutions, Pearson signed 148 large-scale, enterprise adoptions of direct digital access (DDA), where content is purchased via an upfront course fee and integrated with university IT systems. New signings in the year included University of Tennessee Knoxville and Kentucky State University.

North America assessment

In school assessment (State and National Assessments), revenues declined 22% due to previously announced contract losses. The states of Arkansas, Mississippi and Ohio discontinued the Partnership for Assessment of Readiness for College and Careers (PARCC) assessments and we ceased to administer the majority of the current State of Texas Assessments of Academic Readiness (STAAR) contract, as announced in 2015. We replaced the loss from Massachusetts leaving PARCC by winning a five-year sub-contract to deliver Massachusetts new custom assessment. We were awarded a one-year emergency contract in Tennessee to score and report 2016 state assessments. Kentucky renewed a contract with Pearson for two years to provide its state assessments in Math, English Language Arts, and Science. Arizona extended Pearson s contract to provide the English language learner assessments for the 2016 2017 school year, while Colorado extended a contract with Pearson to provide PARCC, science and social studies assessments. We won new contracts in Delaware for social studies assessment and a sub-contract to develop high school math and English language arts assessments in Louisiana. We delivered 23.6 million standardized online tests to K-12 students, a reduction of 11% from 2015 due to overall reduction in test counts across contracts. Paper-based standardized test volumes fell 33% to 21.9 million. Digital tests on Pearson s TestNav platform now account for over 52% of our testing volumes. We launched *aimswebPlusTM*, an update to our leading formative assessment platform, first launched in 2000.

In professional certification, revenues grew 7% with VUE global test volume up 3% to almost 15 million, boosted by continued growth in IT, professional, US teacher certification programs and strong growth in GED (General Educational Development, the high school equivalency test that is part of a joint venture with the American Council on Education). We renewed our contracts with the Computing Technology Industry Association (CompTIA) for three years, the Florida Department of Business & Professional Regulation for five years, the American Register of Radiologic Technologists (ARRT) for seven years and a contract to administer insurance back office licensing services in North Carolina for five years.

Clinical assessment sales declined 1% following the strong performance over the previous two years driven by the introduction of the fifth edition of the Wechsler Intelligence Scale for Children (WISC-V). Behavior Assessment for Children 3e (BASC) continues to see strong growth; and Q-Interactive, Pearson s digital solution for clinical assessment administration, saw continued strong growth in licence sales with sub-test administrations up more than 80% over the same period last year.

North America services

Connections Education, our virtual school business, served nearly 73,000 full-time equivalent students through full-time virtual and blended school programs, up 6% on last year. Connections revenues grew 8%. Five new full-time online, statewide, partner schools opened for the 2016 17 school year in Arkansas, Washington, Colorado, Pennsylvania and New Mexico. The 2016 Connections Education Parent Satisfaction Survey showed strong results with 92% of families with students enrolled in full-time online partner schools stating that they would recommend the schools to others.

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In Pearson Online Services, our higher education OPM business, course enrolments grew strongly, up over 19% to more than 314,000, boosted by strong growth in Arizona State University Online, new partners and program extensions. We signed 11 new programs in 2016 including two new partners: Eastern Gateway Community College in collaboration with American Federation of State, County and Municipal Employees, and we took over an existing suite of online Nursing programs with Duquesne University. Strong growth in OPM was partially offset by a decline in Learning Studio, which is currently being retired. Overall revenues grew 5%.

Core

Sales in our Core markets decreased by £12m, or 1%, from £815m in 2015 to £803m in 2016 while adjusted operating profit decreased by £48m, or 46%, from £105m in 2015 to £57m in 2016. At constant exchange there and after excluding the closure of Wall Street English Germany, the disposal of other sub-scale businesses and the transfer of some smaller businesses to our Growth segment, Core sales declined by 4% and profits by 51%. The decline was primarily due to expected declines in vocational course registrations in UK schools and courseware. This was partially offset by strong growth in English assessments in Australia and OPM services in the UK and Australia.

In our statutory results in 2016 we recognized restructuring costs of £62m and a loss on closure of Wall Street English Germany of £12m. In 2015 we recognized an impairment to our goodwill of £37m mainly related to our English language teaching businesses in Europe.

Core courseware

Courseware revenues declined 7%. School revenues declined in smaller markets in Europe and Africa, in Australia as we exited a number of sub-scale market segments and in the UK primary due to a smaller adoption cycle, partially offset by growth in secondary in the UK due to new product launches aligned with our qualifications and the successful delivery of The Crunch food project in partnership with the Wellcome Trust. In higher education courseware, revenues declined in smaller markets, in Australia due to phasing and in the UK as we exited sub-scale market segments. In the UK, 2.1 million pupils are now using a Pearson digital service on ActiveLearn Primary, including Bug Club, up from 1.8 million a year ago. In a randomized control trial, where its impact was periodically assessed, Bug Club was shown to have made a highly statistically significant impact on pupils reading, vocabulary and spelling performance, with a greater positive impact in schools with a higher proportion of children receiving free school meals.

Core assessments

In higher education and School assessment, revenues fell 10%. UK qualifications have been impacted by government policy, where changes to accountability measures have led to lower vocational registrations. As expected, BTEC Firsts registrations in UK schools have begun to stabilize, though overall BTEC and apprenticeship registrations continued to fall in 2016 albeit at a slower rate. GCSE and GCE entries for summer 2016 declined modestly compared with 2015, primarily due to lower AS level entries as a result of a policy-driven shift to more linear courses. We successfully delivered the National Curriculum Test for 2016, marking 3.4 million scripts and successfully implemented the transition from levels to scaled scores.

Clinical assessment grew 9% with Australian revenues benefiting from strong growth in the new edition of the WISC-V. At VUE, revenues declined 1% due to the initial impact of contract renewals. We were awarded contracts: to continue to administer the UK driving theory test for the UK DVSA for four years from September 2016; to continue to provide testing services to the Construction Industry Training Board for four years from April 2017; and to administer the UK Clinical Aptitude Test for five years from January 2017. In France, VUE was awarded a new licence by the Délégation à la Sécurité et à la Circulation Routières (DSCR) du Ministere de l Intérieur to be one of the providers administering the country s computer-based driving theory exam throughout France.

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The Pearson Test of English (PTE) Academic saw continued strong growth in global test volumes with the Australian Department of Immigration and Border Protection and New Zealand immigration accepting the test for proof of English ability for a range of student visas. The number of professional associations using PTE Academic to credential English language standards of their members continued to grow and now includes the Australian Nursing & Midwifery Accreditation Council. All Australian and NZ universities now accept PTE Academic for admissions purposes, as do most of the UK and Canadian universities, and a growing number of US institutions including Harvard Business School, Yale and Wharton Business School.

Core services

In higher education services, revenues grew 12%. Our OPM revenues grew 74%. In Australia, we saw strong growth due to our successful partnership with Monash University, led by the Graduate Diploma in Psychology, now one of Monash s largest postgraduate courses. Our partnership with Griffith University remains strong, with performance driven mainly by the MBA course. In the UK, our ongoing OPM partnership with King s College London saw us commence teaching in early 2016 of several post graduate Psychology and Law programs. We have signed an additional partnership with Manchester Metropolitan University to launch three online postgraduate degrees in Business Studies in 2017, and have also partnered with another Russell Group University to launch a wide range of online postgraduate programs over the next four years.

Wall Street English revenues grew strongly in Italy as we opened new centers and rolled out the New Student Experience (NSE) in all centers in the country. The NSE delivers a next generation Wall Street English service with adaptive, personalized learning incorporating Pearson s Global Scale of English. We announced the closure of our unprofitable Wall Street English schools in Germany.

Growth

Growth sales increased by £55m, or 8%, to £768m in 2016 from £713m in 2015. Adjusted operating profit increased by £32m to a profit of £29m in 2016 from a loss of £3m in 2015. We estimate that after excluding the impact of exchange rates and the incremental contribution from businesses disposed in 2015 and 2016 and the transfer of smaller businesses from the Core segment, sales declined by 1%. In China, growth in adult English language learning and English courseware was partly offset by declines in English test preparation. In Brazil, revenues declined due to enrolment declines in our English language learning business, related to macroeconomic pressures. In South Africa, revenues grew strongly with growth in school textbooks, offset by enrolment declines at CTI. In the Middle East, revenues fell significantly due to our previously announced withdrawal from an agreement to run three Saudi Colleges of Excellence, with the colleges transitioning to new providers from 30 June 2015.

Adjusted operating profit increased reflecting the benefits of restructuring and the absence of a contract termination charge in the Middle East which impacted the first half of 2015.

In our statutory results, we included restructuring costs of £95m in 2016. In 2015, reflecting the significant economic and market deterioration in the Group s operations in emerging markets, we wrote down the balance sheet value of our goodwill and intangibles for businesses in Growth markets by £530m. This represented impairments of £269m for Brazil, £181m for China, £58m for South Africa and £22m for other Growth markets.

In February 2017, Pearson announced the intention to explore potential partnership for our English language learning business Wall Street English (WSE) and possible sale of our English test preparation business Global Education (GEDU).

Growth courseware

Courseware revenues grew 8%, due to strong growth in school textbook sales in South Africa and English language courseware in China, Argentina and Mexico partially offset by weakness in Brazil. We saw strong growth in registrations for MyEnglishLab boosted by new editions of key titles such as Speakout and Top Notch. Middle East school courseware declined as a result of macroeconomic pressure and lower purchases from key international school clients.

Growth services

In China, growth in Wall Street English (WSE) was offset by declines at Global Education. Enrolments grew 8% at WSE, to 72,500. We launched the New Student Experience across all 68 WSE China centers, opened two new retail centers in Beijing and Shenzhen and a new corporate training center in Shenzhen. In global education, we transferred two cities to franchisees. Underlying revenue declined with lower enrolments partially offset by an ongoing shift to more premium courses with smaller class sizes.

In Brazil, student enrolment in our sistemas business fell 9% due to attrition in NAME and Dom Bosco partially offset by new students at COC. Revenues grew slightly due to improved mix. Revenues in English language learning fell due to challenging economic conditions, partially offset by an increased footprint for our leading brand in language learning, Wizard, where new school openings expanded the number of franchise schools by 7% to 2,392.At our public sistema NAME, an efficacy study suggested that, after controlling for all of the identified student and school level factors, grade 5 NAME students significantly outperformed comparison students by 28 points in mathematics equating to one level higher attainment in the state Prova Brasil assessment. In another study at our largest private sistema COC, students scored significantly higher than students in similar non-COC schools in Writing, natural sciences, humanities, language, and mathematics.

In South Africa, student enrolment at CTI Education Group and Pearson Institute of Higher Education fell by 25% to 8,500 driven primarily by tightening consumer credit affecting enrolment rates.

In India, Pearson MyPedia, an inside service sistema solution for schools comprising print and digital content, assessments and academic support services, expanded to over 200 schools with approximately 56,000 learners in its first full year since launch. PTE Academic saw nearly 50% growth in the volume of tests taken.

Penguin Random House

Pearson owns 47% of Penguin Random House the first truly global consumer book publishing company. Our share of Penguin Random House adjusted operating profits were £129m compared to £90m for 2015.

Penguin Random House delivered a strong profit performance in 2016 with continued net benefits from the merger integration. Revenues declined after a very strong performance in 2015, which was boosted by the success of multi-million sellers *Grey* and *The Girl on the Train*, due to the anticipated industry-wide decrease in ebook purchases following 2015 s industry-wide digital-terms changes.

Revenues in 2016 benefited from strong sales of *The Girl on the Train* by Paula Hawkins, in its second year of publication, and Jojo Moyes s *Me Before You* and *After You*, together with broad resilience of print books, including growing print sales online and increased demand for audio books. The US business published 585 New York Times print and ebook bestsellers in 2016 (2015: 584). The division benefited from multi-million copy successes of *The Girl on the Train* and two novels from Jojo Moyes. Additional number one adult titles were *The Whistler* by John Grisham; *Night School* by Lee Child; *Fool Me Once* by Harlan Coben; *When Breath Becomes Air* by Paul Kalanithi; and Ina Garten s *Cooking For Jeffrey*. Children s authors who extended their outstanding sales in 2016 included Dr. Seuss and Roald Dahl, whose *The BFG* benefited from a movie tie-in; Rick Yancey; James Dashner; Drew Daywalt; Oliver Jeffers; and R. J. Palacio.

The UK business published 202 titles on the Sunday Times bestseller lists (2015: 201). The division s top-selling hardback was *Night School* by Lee Child. *The Girl On The Train* sold over three million copies in multi-formats, and *Me Before You* and *After You* cumulatively sold more than 2.5 million. Top-performing children s franchises were Roald Dahl and the tenth volume in Jeff Kinney s *Diary Of A Wimpy Kid* series.

Penguin Random House completed the sale of its travel-content division, Fodors, to Internet Brands, an online media and technology company, on 30 June 2016, and transferred the ownership of Random House Studio, its film and television development and production division, to a division of Bertelsmann.

The integration of Penguin and Random House continued to provide benefits in 2016 including net benefits from the first full year of systems and warehouse combinations in North America and in Spain and Latin America.

With the integration of Penguin Random House complete, and with greater industry-wide stability on digital terms, on February 24, 2017 Pearson announced that it had issued an exit notice regarding our 47% stake in Penguin Random House to our JV partner Bertelsmann SE & Co. KGaA, in the contractual window, with a view to selling our stake or recapitalizing the business and extracting a dividend. We will use proceeds from this action to maintain a strong balance sheet; invest in our business; and return excess capital to shareholders whilst retaining a solid investment grade credit rating.

The Penguin Random House Venture Combined Financial Statements are included in this report on pages F-77 to F-143.

Results of operations

Year ended December 31, 2015 compared to year ended December 31, 2014

Consolidated results of operations

Sales

Our total sales from continuing operations decreased by £72m, or 2%, from £4,540m in 2014, to £4,468m in 2015. The 2015 sales benefitted from the impact of currency movements. The 2015 sales, translated at 2014 average exchange rates, would have been £137m less at £4,331m a 5% decrease at constant exchange rates. Part of the decrease is due to the absence of sales from businesses sold during the year and also in light of the evolution of our Connections Education business in North America a greater proportion of that revenue is now recognized on a net basis. We estimate that after excluding the impact of acquisitions and disposals and after taking account of the evolution of sales at Connections Education, sales declined by 2% at constant exchange rates.

North America sales increased by £34m or 1% from £2,906m to £2,940m, due to the strengthening of the US dollar against sterling. We estimate that after excluding the impact of exchange, the contribution from acquisitions and disposals and adjustments made in respect of Connections Education, North America sales declined by 1% in 2015 compared to 2014. Revenue growth in our professional and clinical assessments businesses was offset by contract losses in our State and National assessments businesses. In addition Higher Education and School courseware sales fell as a result of lower college enrolments and a smaller market opportunity in School despite market share gains in both Higher Education and School. North America continued to be the most significant source of our sales and as a proportion of sales contributed 66% in 2015 and 64% in 2014.

Core sales declined by £77m or 9% from £892m in 2014 to £815m in 2015. We estimate that after excluding acquisitions and disposals and the impact of exchange, Core sales declined by 5%. Growth in Pearson Online Services in Australia, Wall Street English in Italy, Clinical Assessment in Germany and the Pearson Test of English in Australia was more than offset by revenue declines in UK qualifications as the business nears the end of a period of policy change. In addition revenue declines at VUE, phasing and market weakness in Australian Higher Education courseware and the focusing of our UK school courseware on products that directly support Pearson Qualifications also contributed to the overall decline.

Growth sales declined by £29m or 4% from £742m in 2014 to £713m in 2015, much of the decline can be attributed to exchange and the strength of sterling against key emerging market currencies. We estimate that after

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excluding the impact of exchange rates and the incremental contribution from acquisitions made in 2014 sales declined by 1%. In China, revenues grew modestly reflecting strong sales of premium services in our direct delivery English Language Learning businesses offset by list disposals. In Brazil, revenues were stable with good growth in private sistemas and language schools offset by declines in government funded sistemas and language schools. In South Africa, revenues declined significantly due to a smaller textbook adoption cycle and lower enrolments at CTI. In the Middle East, our business was impacted by the withdrawal from contracts in Saudi Arabia.

Cost of goods sold and operating expenses

The following table summarizes our cost of sales, net operating expenses and impairment of intangible assets:

	Year Ended December 31	
	2015	2014
	£m	£m
Cost of goods sold	1,981	2,021
Operating expenses		
Distribution costs	80	84
Selling, marketing and product development costs	895	931
Administrative and other expenses	1,195	1,168
Restructuring costs	35	64
Other net gains and losses	(13)	(2)
Other income	(98)	(120)
Total net operating expenses	2,094	2,125
Impairment of intangible assets	849	77
Total expenses	4,924	4,223

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing and binding costs, amortization of pre-publication costs, royalty charges, the cost of service provision in the assessment and testing business and the cost of teaching and facilities in direct delivery businesses. Our cost of sales decreased by £40m, or 2%, from £2,021m in 2014, to £1,981m in 2015. The decrease corresponds primarily to the decrease in sales, with cost of sales at 44.3% of sales in 2015 compared to 44.5% in 2014.

Distribution costs. Distribution costs consist primarily of shipping costs, postage and packing. Distribution costs decreased due to the continuing shift to digital and services products.

Selling, marketing and product development costs. Our selling, marketing and product development costs decreased by £36m or 4% from £931m in 2014 to £895m in 2015. As a percentage of sales these costs were relatively consistent at 20.0% in 2015 and 20.5% in 2014, reflecting some continuing benefits of restructuring.

Administrative and other expenses. Our administrative and other expenses increased by £27m or 2% from £1,168m in 2014 to £1,195m in 2015. Increases in intangible amortization and investment in technology offset decreases in employee compensation.

Restructuring costs. Restructuring costs, which include costs for redundancy and property exits, returned to a more normal level in 2015 after a period of transformation in 2013 and 2014. Restructuring costs were £29m lower in 2015 at £35m compared with £64m in 2014.

Other net gains and losses. Included in other net gains and losses in 2015 is the profit on sale of PowerSchool of £30m net of £70m of write downs on related software assets and small losses on investments and costs relating to prior year disposals totaling £17m. Other gains and losses in 2014 are gains on the sale of joint venture interests in Safari Books Online and CourseSmart totaling £40m and a loss on the disposal of an investment in Nook Media of £38m.

Other income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions, together with the service fee income from Penguin Random House. Other operating income decreased to £98m in 2015 compared to £120m in 2014 mainly due to a reduction in Penguin Random House service fee income. This income decreased as Penguin Random House reduced its reliance on Pearson systems and processes and the fee of £41m in 2014 compares to a fee of £16m in 2015.

Impairment of intangible assets. Following significant economic and market deterioration in the Group s operations in emerging markets and ongoing cyclical and policy related pressures in the Group s mature market operations, management s expectations of future returns were revised down in the course of 2015, consistent with our outlook for 2018, resulting in the impairment of intangible assets in North America of £282m, in Core markets of £37m and in Growth markets of £530m. In 2014 impairments of £77m related to India.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased by £21m to £52m in 2015 from £31m in 2014. The increase is mainly due to Penguin Random House where there was an improved operating performance coupled with a reduced amortization charge.

Operating loss / profit

In 2015 there was an operating loss on a continuing basis of £404m compared to an operating profit on a continuing basis of £348m in 2014. The reduction in profit is entirely due to the impairment of intangible assets outlined above.

Net finance costs

Net finance costs reduced by £64m, from £93m in 2014 to £29m in 2015. Net interest payable in 2015 was £46m, compared to £64m in 2014. The majority of the movement in net interest payable is due to the release of accrued interest following agreement of historical tax positions. For our debt portfolio, our fixed rate policy reduces the impact of changes in market interest rates, however we were still able to benefit from low average US dollar interest rates during the year as the majority of the Group s debt is US dollar denominated. Year-on-year, average three month US dollar LIBOR rose by 0.1% to 0.3%. This slight increase in floating market interest rates, along with the impact of changes in our debt portfolio, foreign exchange translation and the effect of slightly lower levels of average net debt in the period led to little change in the year-on-year interest charge on debt. Interest receivable on cash balances held overseas was reduced from the prior year due mainly to the weakening of emerging market currencies against sterling. The Group s average net debt fell by £61m, largely as a result of disposals in the fourth quarter of 2015 offsetting the translation of our predominantly US dollar debt. These combined factors contributed to the overall decrease in the Group s average net interest payable from 3.6% to 2.7%.

Other net finance costs are finance income and costs on retirement benefits, finance costs on related to deferred consideration associated with acquisitions, foreign exchange and other gains and losses. In 2015, the total of these items was a gain of £17m compared to a loss of £29m in 2014. Both the gain in 2015 and the loss in 2014 mainly relate to foreign exchange differences on unhedged cash and cash equivalents and other financial instruments. For a more detailed discussion of our borrowings and interest expenses see Liquidity and Capital Resources Capital Resources and Borrowings below and Item 11. Quantitative and Qualitative Disclosures about Market Risk .

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Taxation

The total tax benefit in 2015 of £81m represents 18.7% of pre-tax losses and compares to a charge of £56m or 22.0% of pre-tax profits in 2014. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 20.25% in 2015 and 21.5% in 2014). The reduced rate in 2015 reflects the lack of tax relief on some of our goodwill impairments offset in part by adjustments arising from agreement of historical tax positions. Both these items were more significant in 2015 than they had been in 2014.

Discontinued operations

Profit from discontinued operations in 2015 was £1,175m compared to £271m in 2014 with the difference being due primarily to gains on disposals in the respective years.

On 16 October 2015, Pearson substantially completed the sale of its 50% interest in the Economist to EXOR and on 30 November 2015 Pearson completed the sale of the Financial Times to Nikkei. The pre-tax gains on these sales were £473m and £711m respectively. We expect both of these transactions to qualify for substantial shareholder exemption in the UK and therefore there was no tax on the Economist gain and tax on the Financial Times sale amounted to £49m. The gains on these transactions and the results for both 2014 and 2015 to the respective sale dates have been included in discontinued operations.

The sale of Mergermarket to BC partners was completed on 4 February 2014 and resulted in a gain of £244m before tax. The gain on sale and the results for 2014 to the date of sale have been included in discontinued operations. Also included in discontinued operations in 2014 is a gain of £29m relating to adjustments to liabilities arising on the formation of the Penguin Random House group. Although this transaction completed in 2013 there were subsequent adjustments relating to the potential transfer of pension liabilities and tax.

Profit for the year

The profit for the financial year in 2015 was £823m compared to a profit in 2014 of £470m. The 2015 profit includes the gains on the sale of the Financial Times and Economist partly offset by significant impairment charges in the year. The net of these items were more significant than disposal gains and impairment charges had been in 2014.

Earnings per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the financial year divided by the weighted average number of shares in issue, was 101.2p in 2015 compared to 58.1p in 2014 based on a weighted average number of shares in issue of 813.3m in 2015 and 810.9m in 2014. The increase in earnings per share was due to the increase in profit for 2015 described above and was not significantly affected by the movement in the weighted average number of shares.

A diluted earnings per ordinary share was not calculated in 2015 as a result of the loss from continuing operations in 2015. The diluted earnings per share of 58.0p in 2014 was not significantly different from the basic earnings per share in that year as the effect of dilutive share options was again not significant.

Exchange rate fluctuations

Currency movement increased sales by £137m and had only a small impact on operating profit. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for a discussion regarding our management of exchange rate risks.

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Sales and operating profit by segment

The following tables summarize our sales and adjusted operating profit for each of Pearson s business segments. Adjusted operating profit is a non-GAAP financial measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments. The measure also enables our investors to more easily, and consistently, track the underlying operational performance of the Group and its business segments by separating out those items of income or expenditure relating to acquisition and disposal transactions.

In our adjusted operating profit we have excluded other net gains and losses, acquisition costs and amortization and impairment of acquired intangibles. The intangible charges relate only to intangible assets acquired through business combinations and acquisition costs are the direct costs of acquiring those businesses. We do not believe these charges are relevant to an understanding of the underlying performance of the Group. Charges relating to acquired intangible assets are non-cash charges that reflect the historical expenditure of the acquired business. These acquired intangible assets continue to be supported by ongoing expenditure that is reported within our adjusted operating profit measure. Other net gains and losses that represent profits and losses on the sale of subsidiaries, joint ventures, associates and other financial assets are also excluded from adjusted operating profit as it is important to highlight their impact on operating profit, as reported, in the period in which the disposal transaction takes place in order to understand the underlying trend in the performance of the Group.

A reconciliation of operating profit to adjusted operating profit for continuing operations is included in the tables below:

	Year Ended December 31, 2015						
£m	**North America**	**Core**	**Growth**	**PRH**	**Continuing**	**Discontinued**	**Total**
Sales	2,940	815	713		4,468	312	4,780
	66%	*18%*	*16%*		*100%*		