

March 2003	\$	1.61	\$	1.56
February 2003	\$	1.65	\$	1.57
January 2003	\$	1.65	\$	1.60
December 2002	\$	1.61	\$	1.56
Year Ended December 31			Average Rate	
2002	\$		1.51	
2001	\$		1.45	
2000	\$		1.52	
1999	\$		1.62	
1998	\$		1.66	

## Risk Factors

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

***Our reliance on intellectual property and proprietary rights that may not be adequately protected under current laws in some jurisdictions may adversely affect our results and our ability to grow***

Our products are largely comprised of intellectual property delivered through a variety of media, including newspapers, books and the internet. We rely on trademark, copyright and other intellectual property laws to establish and protect our proprietary rights in these products. However, we cannot

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assure you that our proprietary rights will not be challenged, invalidated or circumvented. Our intellectual property rights in jurisdictions such as the United States and the United Kingdom, which are the jurisdictions with the largest proportions of our operations, are well established. However, we also conduct business in other countries where the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Moreover, despite trademark and copyright protection, third parties may be able to copy, infringe or otherwise profit from our proprietary rights without our authorization. These unauthorized activities may be more easily facilitated by the internet.

The lack of internet-specific legislation relating to trademark and copyright protection creates an additional challenge for us in protecting our proprietary rights relating to our online business processes and other digital technology rights.

***We operate in a highly competitive environment that is subject to rapid change and we must continue to invest and adapt to remain competitive***

Our education, business information and book publishing businesses operate in highly competitive markets. These markets continue to change in response to technological innovations and other factors. In recent years, some of the markets in which we operate have experienced significant consolidation. Although we currently have strong positions in each of our market segments, further consolidation could place us at a competitive disadvantage with respect to scale, resources and our ability to develop and exploit new media technologies.

***We may not be able to achieve continued growth in our operations or strengthen our financial position due to economic and political forces beyond our control***

Political and economic factors beyond our control can inhibit the growth of our operations or weaken our financial position. These factors include a significant weakening of the global advertising environment, particularly in financial advertising, US state and federal government spending patterns for educational materials, the slowing of the US economy, heightened political tensions and war affecting the United Kingdom and the United States, foreign currency exchange rate risks, trade protection measures, tax and regulatory or other economic conditions. In particular, during 2002, the ongoing weak advertising environment caused by a general decline in corporate earnings and an uncertain economic environment resulted in a continuing decline in advertising revenue. For additional information about this decline, please see "Operating and Financial Review and Prospects—Results of Operations—Year ended December 31, 2002 compared to year ended December 31, 2001", pages 26-34.

The deterioration in the fiscal position of many US states, due to the present weak economic environment, is resulting in expenditure reductions as the US states attempt to eliminate projected fiscal deficits for 2003 and beyond. There is a risk that any expenditure cuts in education will lead to either delayed adoptions or lower expenditure on our textbooks or testing services. While we believe our education businesses will benefit from various US federal education programmes including the "no child left behind" initiative, reduced expenditures by US states for educational materials could adversely affect the financial performance of Pearson Education.

***We operate in markets which are increasingly dependent on Information Technology systems and technological change***

All our businesses, to a greater or lesser extent, are dependent on technology either as a provider of software or internet services or as a user of complex information technology systems and products to support our business activities, particularly in back-office processing and infrastructure.

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We face several technological risks associated with software product development in our educational businesses, IT security (including virus and hacker attacks), e-commerce, ERP system implementations and upgrades and business continuity in the event of a major disaster in a key data center.

***We operate in several markets with risks which are inherently greater than our publishing and newspaper business and which, if unmanaged, could adversely affect our financial results and potentially damage our reputation***

With the acquisition and growth of NCS we have moved into new markets and products, some of which are inherently riskier than our traditional publishing and newspaper businesses.

Within NCS, Pearson Government Solutions provides outsourcing services to the US government and other third parties.

This is a contracting business providing a variety of services from call centre operations to the complete outsourcing of administrative functions. Contract values vary significantly, from a few million to several hundred million pounds sterling over the term of the contract, which typically run for three to five years in length. As in any contract business, there are inherent risks associated with the bidding process, operational performance, contract compliance (including penalty clauses), indemnification (if available) and contract re-bidding.

An inherent risk in our schools testing and assessment business is a student grading failure due to control breakdown in our testing and assessment products and processes.

**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**

We generate approximately 70% of our revenue in US dollars. We estimate that a five cent change in the average exchange rate between the US dollar and sterling during any year could affect our adjusted earnings per share by approximately 1 pence. Our earnings could be materially and adversely affected by foreign exchange rate fluctuations, particularly if the value of the US dollar continues to decline compared to sterling.

#### **Item 4. Information on the Company**

##### **Pearson**

Pearson is a global publishing company with its principal operations in the education, business information and consumer publishing markets. We have significant operations in the United States, where we generate over 70% of our revenues, and in the United Kingdom and continental Europe. We create and manage intellectual property, which we promote and sell to our customers under well-known brand names, to inform, educate and entertain. We deliver our content in a variety of forms and through a variety of channels, including books, newspapers and internet services. We increasingly offer services as well as content, from test processing to training.

Pearson was incorporated and registered in 1897 under the laws of England and Wales as a limited company and re-registered 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 (0) 20 7010 2000). Our principal executive offices in the United States are located at 1330 Avenue of the Americas, 7th Floor, New York, New York, 10019.

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#### **Overview of Operating Divisions**

Although our businesses increasingly share markets, brands, processes and facilities, they break down into three core segments:

**Pearson Education** is a global leader in educational publishing and services. We are a leading international publisher of textbooks, supplementary materials and electronic education programs for elementary and secondary school, higher education and business and professional markets worldwide. We also play a major role in the testing and certification of school students and professionals, mainly in the US.

**The FT Group** consists of our international newspaper, print and online financial information, business magazine and professional publishing interests. Our flagship product is the *Financial Times*, known internationally for its premium editorial content and international scope both in newspaper and internet formats.

**The Penguin Group** is one of the premier English language publishers in the world, with brand imprints such as Penguin, Putnam, Berkeley, Viking and Dorling Kindersley ("DK"). We publish an extensive portfolio of fiction, non-fiction, reference and illustrated works. We publish the works of many authors, including Maeve Binchy, Tom Clancy, Patricia Cornwell, Nick Hornby, Jamie Oliver, Nora Roberts and Amy Tan.

#### **Our Strategy**

Over the past five years we have reshaped the group by divesting a range of non-core interests and investing over \$7 billion in education, consumer publishing and business information companies. Our strategy is now to focus on publishing, in the broadest sense of the word, including online and on paper, in general and for specific uses for the business, education and consumer markets. In doing so, we seek to make the most of the customers, brands and processes that our three divisions share.

#### **Operating Divisions**

##### **Pearson Education**

Pearson Education is one of the world's largest publishers of textbooks and paper and online teaching materials based on published sales figures and independent estimates of sales. Pearson Education serves the growing demands of teachers, students, parents and professionals throughout the world for stimulating effective education programs. With federal and state governments under pressure to measure academic progress against clear objective standards, the market for educational testing services in the United States has grown significantly. NCS Pearson enables us to combine testing and assessment with our traditional educational curriculum services and products to form one of the world's leading integrated education companies. NCS Pearson provides the entire spectrum of educational services—from educational curriculum to testing and assessment to data management.

We report Pearson Education's performance along the lines of the three markets it serves: School, Higher Education and Professional. In 2002, Pearson Education had sales of £2,756 million or 64% of Pearson's total sales (62% in 2001). The business makes approximately two thirds of its sales, and all of its profits, in the second half of the year.

##### **School**

In the US, our School business includes publishing, testing and software operations. Outside of the United States we have a growing English Language Teaching business and we also publish school materials in local languages in a number of countries. In the US we publish for kindergarten through 12th grade, with a comprehensive range of textbooks, supplementary materials and electronic education