

Risk Factors

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

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

Business transformation and change initiatives in support of the Group's strategic goals to accelerate its digital transition and to simplify its business will continue throughout 2018. 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, business as usual activities may not perform in line with plans or the level of customer service may not meet expectations. In parallel with the business transformation, as the Group responds to the digital revolution and shift from a product to a services business, it 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 noncompliance with legal and other requirements which could damage the Group's 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 the Group's 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 future financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across 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 the Group's 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 the Group's 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. The Group faces 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 traditional publishing business models, potentially impacting both sales volumes and pricing.

Students are seeking cheaper sources of content, e.g. second hand and rental copies, online discounters, file sharing and use of pirated copies. This change in behavior puts downward pressure on textbook prices in major markets, and this could adversely impact the Group's results.

If the Group does not adapt rapidly to these changes, it may lose business to ‘faster’ and more ‘agile’ competitors, who increasingly are non-traditional competitors, making their identification all the more difficult. The Group 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 the Group’s business model and/or decisions across all markets.

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

The results and growth of the Group’s 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. While the US tax reform bill that was signed into law by the President in December avoids the significant immediate impacts learners would have felt from earlier versions, concern remains about the potential impact that the cap on state and local tax (‘SALT’) deductions, the tax on certain college endowments, and the disincentives for charitable contributions could have on education funding. 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 customers. The current challenging environment could impact the Group’s ability to collect on 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 the Group’s 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 the market in any given year. The full impact of the UK’s pending departure from the EU is still unclear, however known potential risk areas include tax, data privacy and non-tariff exposure arising from cross-border transactions.

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 the Group 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 the Group’s reputation.

The Group is subject to global and local anti-trust and competition law and although it is committed to conducting business in compliance with local and international laws, there is a risk that 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 the Group operates. These legal proceedings could result in greater scrutiny of the Group’s 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 the Group’s reputation.

If the Group does not adequately protect its intellectual property and proprietary rights, its competitive position and results may be adversely affected and its ability to grow limited.

The Group’s products and services largely comprise intellectual property delivered through a variety of print and digital media, online software applications and platforms. The Group relies on trademark, patent, copyright and other intellectual property laws to establish and protect its proprietary rights in these products and services.

The Group's intellectual property rights (IPR) in brands and content – historically its core assets – are generally well established in key markets. As technology has become an increasingly critical component of the Group's business strategy, it has also been steadily increasing investment in its patent program to expand its protection of high value inventions in the US. The Group's forward-looking IP strategy also includes plans to increase its global patent footprint in key markets outside the US. However, the Group also conducts business in other countries where its 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 future growth. Where the Group has registered or otherwise established its IPR, it 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 it in many countries; the potential that its IPR may lapse, be invalidated, circumvented, challenged, or abandoned, or that it may otherwise lose the ability to assert its intellectual property rights against others. Moreover, despite trademark, brand and copyright protection, third parties may copy, infringe or otherwise profit from the Group's proprietary rights without its authorization. The loss or diminution in value of these proprietary rights or the Group's intellectual property could have a material adverse effect on the Group's business and financial performance.

A control breakdown or service failure in the Group's school assessment and qualification business could result in financial loss and reputational damage.

The Group's professional services and assessment businesses involves complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. The Group's 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 the Group's assessment and qualification businesses, both in the US and the UK. A service failure caused by a breakdown in 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 the Group may be subject to legal claims, penalty charges under contracts, non-renewal of contracts and/or the suspension or withdrawal of its accreditation to conduct tests. 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 the Group's ability to retain existing contracts and/or obtain new customers.

The Group's investment in inherently riskier emerging markets may deliver returns that are lower than anticipated.

To take advantage of international growth opportunities and to reduce its reliance on the US and UK markets, the Group has invested in a number of emerging markets, some of which are inherently more risky than its 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 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 the Group's reputation.

Although the Group is committed to conducting business in a legal and ethical manner in compliance with local and international statutory requirements and standards applicable to its business, there is a risk that the Group's management, employees or representatives may take actions that violate applicable laws and regulations 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 the Group's 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.

The Group periodically acquires and disposes of businesses to achieve its strategic objectives and will continue to consider both as means to pursue its strategic priorities, although it does not plan to make any significant acquisitions in the short term.

The Group operates 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 the Group's revenues and reputation.

All the Group's businesses, to a greater or lesser extent, are dependent on information technology. It either provides software and/or internet services to its customers or uses complex IT systems and products to support its businesses activities, including customer-facing systems, back-office processing and infrastructure. The Group faces 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 the Group has experienced verifiable attacks on its systems by unauthorized parties. To date, such attacks have not resulted in any material damage, but the Group's businesses could be adversely affected if its systems and infrastructure experience a significant failure or interruption.

Failure to comply with data privacy regulations, or any unauthorized disclosure of personal information, could result in an incident or other issue potentially causing reputational damage to the Group's brands and financial loss.

Across the Group's businesses, it holds 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 the Group's network by an unauthorized party, employee theft, misuse or error or otherwise, could harm the Group's reputation, impair its ability to attract and retain its customers, or subject the Group to claims or litigation arising from damages suffered by individuals, and thereby harm its business and operational 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, the Group 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 the Group remains in compliance across different markets.

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

Information security and cyber risk is continually evolving and comprises many complex external drivers: increasing customer demand to demonstrate a strong security posture, external compliance requirements, ongoing digital revolution, increasing use of the cloud and increasingly sophisticated attack strategies. Across its businesses, the Group holds large volumes of personally identifiable information including that of employees, customers, students and citizens, and other highly sensitive business critical data such as financial data, internal sensitive information, and intellectual property. Despite its implementation of security measures, individuals may try to gain unauthorized access to the Group's data in order to misappropriate such information for potentially

fraudulent purposes. A significant breach can result in a devastating impact on the Group's reputation, customer loyalty, and student experience. Inability to prove due diligence can result in severe penalties and loss of business (existing and future).

The Group's reported earnings and cash flows may be adversely affected by changes in its pension costs and funding requirements.

The Group operates 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 the Group, which could have an adverse impact on its results.

It is the Group's policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. The Group's earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in its defined benefit plans. The Group's greatest exposure relates to the 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 2017, the UK defined benefit plan continues to show a surplus on an IAS19 basis. The Group has 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 the Group in the future.

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

Across all its businesses, the Group manages complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. It has also outsourced some support functions, including information technology, warehousing and logistics to third party providers. The failure of third parties to whom it has outsourced business functions could adversely affect its 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 the Group's ability to service its customers and meet the terms of its 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 future revenue growth.

A significant deterioration in the Group's profitability and/or cash flow caused by prolonged economic instability could reduce its liquidity and/or impair its financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate its 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.

Disruption in capital markets or potential concerns about the Group's credit, such as downgrades or negative outlooks by the credit rating agencies, may mean that this capital may not be available on favorable terms or may not be available at all, although the reduced size of debt maturities mean that this risk is reduced.

The Group generates a substantial proportion of its revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuations could adversely affect the Group's earnings and the strength of its balance sheet.

As with any international business, the Group's earnings can be materially affected by exchange rate movements. The main exposure is to movements in the US dollar to sterling exchange rate as approximately 60% of the Group's total revenue is generated in US dollars. The Group also has exposure to a range of other international currencies including emerging market currencies. Operating profit for 2017, translated at 2016 average rates, would have been £13m or 1% lower.

A lack of sufficient capital resources could adversely impact the Group's ability to operate.

If the global economy weakens further and/or the global financial markets collapse, the Group may not have access to or could lose its bank deposits or suffer a significant increase in customer bad debts. Lack of sufficient capital resources could significantly limit the Group's ability to take advantage of business and strategic opportunities. If replacement funds are not available, the Group may be required to delay, reduce the scope of, or eliminate material parts of its business strategy, including potential additional acquisitions or development of new products, services and technologies. The Group aims to mitigate this risk by enforcing limits and financing through strong counterparties.

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 the Group's future reported tax rate and/or its future tax payments. The Group has been subject to audit by tax authorities. Although the Group believes its tax provision is reasonable, the final determination of its tax liability could be materially different from its historical income tax provisions, which could have a material effect on the Group's financial position, results of operations or cash flows.

The Group's tax strategy reflects its business strategy and the locations and financing needs of its operations. In common with many companies, the Group seeks to manage its tax affairs to protect value for its shareholders, in line with its broader fiduciary duties. The Group is 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 the Group fails to attract, retain and develop appropriately skilled employees, it may limit its ability to achieve its strategic and operational goals and its business may be harmed.

The Group's success depends on the skill, experience and engagement of its employees. If it is unable to attract, retain and develop sufficiently experienced and capable staff, especially in technology, product development, sales and leadership, its business and financial results may suffer. When talented employees leave, the Group may have difficulty replacing those skills, and its business may suffer. There can be no assurance that the Group will be able to successfully retain and attract the skills that it needs.

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 the Group has direct learner contact via online learning, or in its direct delivery businesses where it is operating, either itself or in partnership with schools, colleges, universities, testing and assessment centers. These incidents can cause harm to learners, which is something the Group takes extremely seriously, and could also have a negative financial, legal and reputational impact to the business.