Operating profit attributable to the Penguin Group decreased by £37 million, or 53%, to £33 million in 2004, from £70 million in 2003. The biggest single factor in the profit decline was exchange rates, which are estimated to have accounted for £14 million of the difference. There were also a number of other factors, including disruption in UK distribution following the move to a new warehouse and the weakness of the US consumer publishing market.

Operating profit attributable to our discontinued business, Recoletos, fell by £9m, or 41%, from £22 million in 2003 to £13 million in 2004 mainly due to one-off costs associated with the launch of a Spanish language newspaper in the US.

Non-operating Items

Profit before taxation on the sale of fixed assets, investments, businesses and associates was £9 million in 2004 compared to a profit of £6 million in 2003. In 2004, the principal items were profits on the sale of stakes in Capella and Business.com which were partially offset by losses elsewhere. In 2003 the principal item was a profit of £12 million on the sale of an associate investment in Unedisa by Recoletos.

Net Finance Costs

Net finance costs consist primarily of net interest expense related to our borrowings. Our total net interest payable decreased by £11 million, or 14%, to £69 million in 2004, from £80 million in 2003. The reduction is due to lower average net debt levels in 2004, which more than offset the effect of a general increase in floating interest rates, and a one-off credit of £9 million for interest on a repayment of tax in France reduced the net interest cost in 2004. Year end indebtedness (excluding finance leases) decreased to £1,206 million in 2004 compared to £1,361 million in 2003 due to funds generated from operations and foreign exchange movements. The weighted average three month London Interbank Offered (“LIBOR”) rate, reflecting our borrowings in US dollars, euros and sterling, rose by 40 basis points, or 0.4%. The company is partially protected from these increases by our treasury policy, which put £736 million of the year end debt on a fixed rate basis. As a result the net interest rate payable (excluding the £9 million credit referred to above) rose by only 25 basis points or 0.25% to 5% in 2004. For a more detailed discussion of our borrowings and interest expenses see “— Liquidity and Capital Resources — Capital Resources” and “— Borrowing” and “Item 11. Quantitative and Qualitative Disclosures About Market Risk”.

Taxation

The overall taxation charge for 2004 was £62 million, compared to a charge of £75 million in 2003. In 2004 the Group recorded a total pre-tax profit of £171 million giving a tax rate of 36% compared to a rate of 49% on total pre-tax profits of £152m in 2003. These high rates of tax were mainly a result of only partial tax relief being available for goodwill charged in the profit and loss account. The total tax charge in 2003 and 2004 also included credits of £56 million and £48 million respectively relating to prior year items; these reflect a combination of settlements with the Inland Revenue authorities and changes to deferred tax balances.

Minority Interests

Minority interests principally consist of the public’s 39% interest in Interactive Data and 21% interest in Recoletos.

Profit for the Financial Year

The profit for the financial year after taxation and equity minority interests in 2004 was £88 million compared to a profit in 2003 of £55 million. The overall increase of £33 million, or 60%, was mainly due to the reduced charges for goodwill amortization, interest and tax. Increases in operating profit before goodwill have been eroded by the adverse movement in exchange.

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 11.1 pence in 2004 compared to 6.9 pence in 2003 based on a weighted average number of shares in issue of 795.6 million in 2004 and 794.4 million in 2003. This increase was due to the additional profit for the financial year described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 11.0p in 2004 and 6.9p in 2003 was not significantly different from the basic earnings per share in those years as the effect of dilutive share options was again not significant.

Exchange Rate Fluctuations

The weakening of the US dollar against sterling on an average basis had a negative impact on reported sales and profits in 2004 compared to 2003. We estimate that if the 2003 average rates had prevailed in 2004, sales would have been higher by £306 million and operating profit would have been higher by £52 million. 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 Division

The following table summarizes our operating profit and results from operations for each of Pearson’s divisions. Results from operations are included as they are a key financial measure used by management to evaluate performance and allocate resources to business segments, as reported under SFAS 131. Since 1998 we have reshaped the Pearson portfolio by divesting of non-core interests and investing in educational publishing and testing, consumer publishing and business information companies. During this period of transformation management have used results from operations to track underlying core business performance. Results from operations are determined by adding back to total operating profit costs or charges arising from significant acquisition activity, typically goodwill amortization charges and integration costs. This enables management to more easily track the underlying operational performance of the group. A reconciliation of results from operations to operating profit is included in the table below:

	Year Ended December 31			
	2004		2003	
	£m	%	£m	%
Results from operations				
Pearson Education	**293**	**68**	313	68
FT Group	**86**	**20**	58	12
The Penguin Group	**54**	**12**	91	20
Pearson Group	**433**	**100**	462	100
Less:				
1) Goodwill Amortization				
Pearson Education	**174**		207	
FT Group	**20**		30	
The Penguin Group	**21**		21	
Pearson Group	**215**		258	
2) Goodwill Impairment				
Pearson Education	**—**		—	
FT Group	**—**		—	
The Penguin Group	**—**		—	
Pearson Group	**—**		—	
3) Integration Costs				
Pearson Education	**—**		—	
FT Group	**—**		—	
The Penguin Group	**—**		—	
Pearson Group	**—**		—	
Operating profit from continuing operations				
Pearson Education	**119**	**55**	106	52
FT Group	**66**	**30**	28	14
The Penguin Group	**33**	**15**	70	34
Pearson Group	**218**	**100**	204	100
Discontinued Operations (Recoletos)	**13**		22	
Total operating profit	**231**		226	
Non operating items	**9**		6	
Net Finance Costs	**(69)**		(80)	
Profit/(Loss) before taxation	**171**		152	

Pearson Education

Pearson Education's sales decreased by £95 million, or 4%, to £2,356 million in 2004 from £2,451 million in 2003, as good growth in our Higher Education and Professional businesses was reduced due to the effect of the weakening US dollar. Pearson Education's 2004 sales comprised 60% of Pearson's total sales. Results from operations decreased by £20 million, or 6%, from £313 million in 2003 to £293 million in 2004. The decrease is again attributable to exchange. After taking out the effect of exchange, profits were higher in all three businesses.

The School business sales decreased by £58 million, or 5%, to £1,118 million in 2004, from £1,176 million in 2003 and results from operations decreased by £10 million, or 8%, to £117 million in 2004 from £127 million in 2003. Both sales and results were adversely affected by the weakening US dollar and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £94 million higher than reported and results from operations £8 million higher. The School results include a full year contribution from Edexcel, 75% of which was acquired in 2003. The extra Edexcel contribution increased sales growth in 2004 but reduced profit growth as the business is loss making in the first half.

In the US school market, adoption spending in 2004 fell by some $200 million to approximately $500 million. Our school businesses took the largest share (27%) of the new adoption opportunities. We benefited from strength across a wide range of subjects and grade levels, with a decline in elementary sales (after particularly strong market share growth in 2003) mitigated by a strong performance in the secondary market. We returned to growth in the open territories and in supplementary publishing, helped by restructuring actions taken in 2003 and by the sharp recovery in US state budgets. Our US school testing business benefited from growth in new and existing state contracts, including Texas, Ohio, Virginia and Washington. We continued to win new multi-year contracts including Tennessee, New Jersey and California ahead of implementation of the No Child Left Behind Act testing requirements, which become mandatory in the school year starting in September 2005. Our digital learning business showed a further profit improvement on slightly lower sales as we continued to integrate our content, testing and technology in a more focused way.

Outside the US, the School business sales increased with continued growth in English Language Teaching helped by a very significant investment in ELT and in school testing we won $200 million of multi-year contracts.

The Higher Education business saw a decline in sales of £41 million, to £731 million in 2004, from £772 million in 2003. Results from operations decreased by £15 million, or 10%, to £133 million in 2004 from £148 million in 2003. Both sales and results were adversely affected by the weakening US dollar, and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £69 million higher than reported and results from operations £16 million higher than reported. In the US we grew faster than the market for the sixth consecutive year in US dollar terms, up 4% while the industry without Pearson was up 2% according to the Association of American Publishers.

In the US, our Higher Education business benefited from strength in two-year career colleges, a fast growing segment, with vocational programs in allied health, technology and graphic arts, and elsewhere in math and modern languages. Margins reduced a little as we achieved good growth outside the US and continued to invest to make our technology central to the teaching and learning process. Our custom publishing business, which creates specific programs built around the curricula of individual faculties or professors, grew strongly. Pearson Custom has now increased its sales in dollar terms eight-fold over the past six years and we have introduced our first customized online resources for individual college courses.

Sales and results from operations in our Professional business improved in spite of the weakening dollar. Sales increased by £4 million, or 1%, to £507 million in 2004 from £503 million in 2003. Results from operations increased by £5 million, or 13%, to £43 million in 2004, from £38 million in 2003. We estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £60 million higher than reported and results from operations £5 million higher than reported. After taking out the effect of exchange, Pearson Government Solutions grew sales by 25%, with strong growth from add-ons to existing programs. We also won some important new contracts, including multi-year contracts worth $500 million from customers such as the US Department of Health and Human Services and the London Borough of Southwark. Our professional testing business grew sales (before exchange impacts) by 31% as we benefited from the start-up of major new contracts, although we continued to operate at a small loss as we invested in building up the infrastructure for our 150-strong UK test center network. Markets remained tough for our technology publishing titles, where although sales were lower, profits were broadly level as a result of further cost actions.

FT Group

Sales at the FT Group (excluding discontinued businesses) decreased by £1 million, from £588 million in 2003 to £587 million in 2004 but results from operations increased by £28 million, or 48%, from £58 million in 2003 to £86 million in 2004. We estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £22 million higher than reported and results from operations £8 million higher than reported. Sales increased in all divisions with another good year for Interactive Data and a return to sales growth at the Financial Times newspaper ("FT") for the first year since 2000. The FT returned to profit in the seasonally strong fourth quarter of 2004 with both advertising and circulation revenues ahead for the full year.

Advertising performance across all categories and regions at the FT were mixed throughout the year. While the recruitment and luxury goods categories increased by more than 20%, the business-to-business and technology sectors showed few signs of recovery. In terms of geography, good growth in Europe and Asia offset a very weak US corporate advertising market. Average circulation for 2004 was 3% lower than in 2003, whilst FT.com now has 76,000 paying subscribers and 3.7 million unique users.

Results from operations at the FT improved by £23 million over 2003 as we continued to reduce the FT's cost base, which is now £110 million lower than it was in 2000.

Les Echos achieved euro sales growth of 4% and profits grew strongly despite a volatile advertising market. Average circulation grew 3% to 119,800, while competitors saw falling sales. FT Business posted significant sales growth of 8%, with progress in all its main markets. Profits improved 25% following a continued emphasis on cost management.

Results from operations at the FT's associates and joint ventures showed a profit of £6 million compared to £3 million in 2003. Losses narrowed at FT Deutschland as circulation and advertising revenue grew strongly. FT Deutschland reached the 100,000 copy sales mark in December and circulation averaged 96,600, up 6% on the previous year. The Economist Group again increased its results from operations with The Economist's circulation passing the 1 million mark with an average weekly circulation of 1,009,759.

Interactive Data, our 61%-owned financial information business, grew its sales by 3% and results from operations by 9% after taking out the effect of exchange rates. FT Interactive Data and e-Signal (its online financial information and pricing business) performed well particularly in the US where there were some signs of improvement in market conditions. Worldwide renewal rates among institutional clients remained at or above 95%. Demand for Interactive Data's value-added services remained strong, with the signing of our 100th customer for our Fair Value Information Service product in December 2004. IDC had a first full year contribution from acquisitions made in 2003, ComStock and Hyperfeed Technologies, and acquired FutureSource in September 2004 to expand and compliment e-Signal. The consolidation of seven US data centers is on track for completion by the end of 2005.

In December 2004 we announced our intention to sell our shareholding in Recoletos, our 79%-owned Spanish media group to Retos Cartera as part of a tender offer for all of Recoletos. Retos Cartera's tender offer was launched on February 16, 2005 and we accepted it on February 25, 2005. The sale closed in early April and net cash proceeds of £372 million were received on April 8, 2005. In January 2005 we sold our 22% stake in MarketWatch to Dow Jones & Co for $101 million. The results of Recoletos have been included as a discontinued business in the financial statements.

The Penguin Group

The Penguin Group had a difficult year with sales down 6% to £786 million in 2004 from £840 million in 2003 and results from operations down 41% to £54 million in 2004 from £91 million in 2003. Both sales and results were adversely affected by the weakening US dollar, and we estimate that had 2003 average rates prevailed in 2004 then sales would have been approximately £57 million higher than reported and results from operations £14 million higher than reported. In addition to exchange, the decline in results from operations was caused by a number of factors including disruption at the new UK warehouse and a weakening in the US consumer publishing market.

In the UK, our move to a new warehouse, to be shared with Pearson Education, disrupted supply of our books and had a particular impact on backlist titles. Although we traded well in the second half of 2004, and shipped more books to our UK customers than in the previous year, we incurred some £9 million of additional costs as we took special measures to deliver books, including the costs of running two warehouses, shipping books direct and additional marketing support. By the end of the year we had eliminated the order backlog in the warehouse and the new management team has continued to make good progress in the early part of 2005.

After a good start to the year, the US consumer publishing market deteriorated sharply in the second half and full year industry sales were 1% lower than in 2003, according to the Association of American Publishers. The adult mass market segment, which accounts for approximately one-third of Penguin’s US sales, was down 9% for the industry for the full year, and 13% in the second half.

Despite the problems outlined above, Penguin had another great publishing year. We benefited from our new imprint strategy, with a further four imprints published for the first time. Non-fiction performed particularly well, with a 40% increase in our titles on the New York Times bestseller list, including Lynne Truss’s *Eats Shoots & Leaves* (now with over one million copies in print), Ron Chernow’s *Alexander Hamilton* and Maureen Dowd’s *Bushworld.* Best selling UK titles included Jamie Oliver’s *Jamie’s Dinners,* Sue Townsend’s *Adrian Mole and the Weapons of Mass Destruction* and Gillian McKeith’s *You Are What You Eat*.

Year ended December 31, 2003 compared to year ended December 31, 2002

Consolidated Results of Operations

Sales

Our total sales decreased by £272 million to £4,048 million, or 6%, in 2003, from £4,320 million in 2002. The decrease was mainly attributable to Pearson Education’s Professional business where the shortfall was due to the absence of reported sales from the £250 million TSA contract and the effect of foreign currency exchange. The strength of sterling compared to the US dollar had a significant negative effect on sales, and we estimate that had the 2002 average rates prevailed in 2003, sales would have been higher by £181 million. In constant exchange rate terms the School and Higher Education businesses increased sales in 2003 by 8% and 6% respectively. The School business was helped by the acquisition of 75% of Edexcel, the UK testing business, in the first half of 2003 that contributed additional sales of £89 million. Penguin saw a small increase in sales even after the adverse effect of foreign currency movements as the schedule of new titles enabled Penguin to grow ahead of the industry despite tough conditions for backlist publishing in the US. The FT Group sales were slightly ahead of last year mainly due to Interactive Data where sales increased for the fourth consecutive year in a difficult marketplace (even after excluding additional sales generated from the acquisition of ComStock at the beginning of 2003). Our business newspapers continued to suffer from the corporate advertising recession which has seen advertising volumes at the *Financial Times* newspaper fall almost two-thirds since their peak in 2000.

Pearson Education, our largest business sector, accounted for 61% of our sales in 2003, compared to 64% in 2002. North America continued to be the most significant source of our sales although sales in the region decreased, as a proportion of total sales, to 67% in 2003, compared to 72% in 2002. Some of this decrease, however, reflects the comparative strength of sterling and the euro compared to the US dollar.

Cost of Sales and Net Operating Expenses

The following table summarizes our cost of sales and net operating expenses:

	Year Ended December 31	
	2003	**2002**
	£m	**£m**
Cost of sales	**(1,910)**	(2,064)
Distribution costs	**(239)**	(233)
Administration and other expenses	**(1,724)**	(1,888)
Other operating income	**51**	59
Net operating expenses	**(1,912)**	(2,062)

Cost of Sales. Cost of sales consists of costs for raw materials, primarily paper, production costs, amortization of pre-publication costs and royalty charges. Our cost of sales decreased by £154 million, or 7%, to £1,910 million in 2003, from £2,064 million in 2002. The decrease mainly reflected the decrease in sales over the period with overall gross margins remaining consistent. Cost of sales as a percentage of sales improved slightly to 47% in 2003 from 48% in 2002.

Distribution Costs. Distribution costs consist primarily of shipping costs, postage and packing.

Administration and Other Expenses. Our administration and other expenses decreased by £164 million, or 9%, to £1,724 million in 2003, from £1,888 million in 2002. Administration and other expenses as a percentage of sales decreased to 43% in 2003, from 44% in 2002. Included within administration and other expenses is the charge for goodwill amortization and impairment relating to subsidiaries. Total goodwill amortization, including that relating to associates (£7 million in 2003; £48 million in 2002) decreased by £66 million to £264 million in 2003, from £330 million in 2002. The main reason for this decrease over last year is Family Education Network and our interest in Marketwatch, where the final amortization charges were incurred in the first half of 2003. In 2002, we also took a goodwill impairment charge of £10 million relating to a subsidiary of Recoletos in Argentina while in 2003 no impairment charges were deemed necessary. Also included in administration and other costs are the one-off costs of integrating significant recent acquisitions into our existing businesses. The last of these significant acquisitions occurred in 2000 and the final costs of integration of £10 million relating to Pearson NCS and Dorling Kindersley were incurred in 2002 with no further charges in 2003.

After excluding goodwill charges and integration costs, administration and other expenses were £1,467 million in 2003 compared to £1,586 million in 2002. This 8% improvement of £129 million includes the beneficial effect of exchange rate movements, the results of cost saving measures taken in 2002 and 2003 and a reduced spend on internet enterprises.

Other Operating Income. Other operating income mainly consists of sub-rights and licensing income and distribution commissions. Other operating income decreased to £51 million in 2003 from £59 million in 2002 with the decrease coming at both Pearson Education and Penguin where distribution commissions we receive for distributing third parties’ books has continued to decline.

Operating Profit/ Loss

The total operating profit in 2003 of £226 million compares to a profit of £143 million in 2002. This 58% increase was principally due to a £76 million reduction in the total goodwill charge and the absence of integration costs. Operating profit was adversely affected by the impact of reduced profits at Pearson Education’s Professional business, due to the absence of the prior year TSA contract, but this was offset by growth in School and Higher Education, Interactive Data and Penguin. In addition there were reduced losses following disposals and rationalization of the FT Knowledge business. In 2003, operating profit was adversely