payable rose by 1.1% to 7.0%. In 2006 the net finance income relating to post-retirement plans was an income of £4m compared to a cost of £7m in the previous year. Other net finance income relating to foreign exchange and short-term fluctuations in the market value of financial instruments remained fairly constant year on year with a £16m gain in 2006 compared to a £14m gain in 2005. 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”.

Taxation

The total tax charge in 2006 of £11m represents just over 2% of pre-tax profits compared to a charge of £116m or 26% of pre-tax profits in 2005. The low tax rate in 2006 was mainly accounted for by two factors. First, in the light of the announcement of the disposal of Government Solutions, we were able to recognize a deferred tax asset in relation to capital losses in the US where previously we were not confident that the benefit of the losses would be realized prior to their expiry. Second, in light of our trading performance in 2006 and our strategic plans, together with the expected utilization of US net operating losses in the Government Solutions sale, we have re-evaluated the likely utilization of operating losses both in the US and the UK; this has enabled us to increase the amount of the deferred tax asset carried forward in respect of such losses. The combined effect of these two factors was to create a non-recurring credit of £127m.

Minority interests

Following the disposal of our 79% holding in Recoletos and the purchase of the remaining 25% minority stake in Edexcel in 2005, our minority interests now comprise mainly the minority share in IDC. In January 2006 we increased our stake in IDC reducing the minority interest from 39% to 38%.

Discontinued operations

In December 2006 the Group announced the sale of its Government contracting business, Pearson Government Solutions. The sale was completed in February 2007 and the results of this business have been shown in discontinued operations in the consolidated income statement in both 2006 and 2005. Operating profit for Government solutions in 2006 was £22m compared to £20m in 2005. Following the disposal of Recoletos in 2005 its results were consolidated for the period up to February 28, 2005 and included in discontinued operations in 2005. The results for 2005 include an operating loss for the two months to February 28, 2005 of £3m. The pre-tax profit on disposal of Recoletos reported in 2005 was £306m.

Profit for the year

The total profit for the year in 2006 was £469m compared to a profit in 2005 of £644m. The overall decrease of £175m was to the absence of the profits on disposal of Recoletos and MarketWatch reported in 2005. After taking account of these disposals there was an increase in profit in 2006 due to improvement in operating profits and the sharp reduction in tax due to the recognition of losses in 2006.

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 55.9p in 2006 compared to 78.2p in 2005 based on a weighted average number of shares in issue of 798.4m in 2006 and 797.9m in 2005. The decrease in earnings per share was due to the additional profit for 2005 described above and was not significantly affected by the movement in the weighted average number of shares.

The diluted earnings per ordinary share of 55.8p in 2006 and 78.1p in 2005 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 2006 compared to 2005. We estimate that if 2005 average rates had prevailed in 2006, sales would have been higher by £44m and operating profit would have been higher by £7m. 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 tables summarize our sales and operating profit for each of Pearson’s divisions. Adjusted operating profit is a non-GAAP measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments, as reported under FAS 131. See also note 2 of “Item 17. Financial Statements”.

In our adjusted operating profit we have excluded amortization and adjustment of acquired intangibles, other gains and losses and other net finance costs of associates. The amortization and adjustment of acquired intangibles is the amortization or subsequent impairment of intangible assets acquired through business combinations. The charge is not considered to be fully reflective of the underlying performance of the Group. Other gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and investments that are included within continuing operations but which distort the performance for the year.

Adjusted operating profit enables management to more easily track the underlying operational 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, 2006						
£m	School	Higher Education	Professional	FT Publishing	IDC	Penguin	Total
Sales	1,455	795	341	366	332	848	4,137
	36%	*19%*	*8%*	*9%*	*8%*	*20%*	*100%*
Total operating profit	167	161	37	35	82	58	540
	31%	*30%*	*7%*	*6%*	*15%*	*11%*	*100%*
Add back:							
Amortization and adjustment of acquired intangibles	17	—	1	2	7	8	35
Other net gains and losses including associates	—	—	—	(4)	—	—	(4)
Other net finance costs of associates	—	—	—	(1)	—	—	(1)
Adjusted operating profit: continuing operations	184	161	38	32	89	66	570
Adjusted operating profit: discontinued operations	—	—	22	—	—	—	22
Total adjusted operating profit	184	161	60	32	89	66	592
	31%	*27%*	*10%*	*6%*	*15%*	*11%*	*100%*

£m	Year Ended December 31, 2005 School	Higher Education	Professional	FT Publishing	IDC	Penguin	Total
Sales	1,295	779	301	332	297	804	3,808
	34%	*20%*	*8%*	*9%*	*8%*	*21%*	*100%*
Total operating profit	142	156	25	58	75	60	516
	28%	*30%*	*5%*	*11%*	*14%*	*12%*	*100%*
Add back:							
Amortization and adjustment of acquired intangibles	5	—	—	1	5	—	11
Other net gains and losses including associates	—	—	—	(40)	—	—	(40)
Other net finance costs of associates	—	—	—	2	—	—	2
Adjusted operating profit: continuing operations	147	156	25	21	80	60	489
Adjusted operating profit: discontinued operations	—	—	20	(3)	—	—	17
Total adjusted operating profit	147	156	45	18	80	60	506
	29%	*31%*	*9%*	*3%*	*16%*	*12%*	*100%*

School

School business sales increased by £160m, or 12%, to £1,455m in 2006, from £1,295m in 2005 and adjusted operating profit increased by £37m, or 25%, to £184m in 2006 from £147m in 2005. In addition to strong underlying growth in sales and profits, the School results in 2006 benefit from the inclusion of National Evaluation Systems (NES), Paravia Bruno Mondadori (PBM), Chancery and PowerSchool together with a number of smaller acquisitions all made in the first half of 2006 and from a full year contribution from AGS Publishing, acquired in July 2005. Offsetting these factors was the effect of the weakening of the US dollar, which we estimate reduced sales by £17m when compared to the equivalent figures at constant 2005 exchange rates.

In the US school market, Pearson’s school publishing business grew 3% against the Association of American Publishers’ estimate of a decline in the industry of 6%. New adoption market share was 33% in the adoptions where Pearson competed (and 30% of the total new adoption market). The School business now has the number one or number two market share in reading, math, science and social studies. US School testing sales were up in the high single digits even after growth in excess of 20% in 2005. School testing benefited from further contract wins, market share gains and leadership in onscreen marking, online testing and embedded (formative) assessment. The acquisition of NES providing customized assessments for teacher certification in the US has allowed us to expand in an attractive adjacent market. The School technology business grew both through the acquisitions of Chancery and PowerSchool and through organic growth in the digital curriculum business which continued to grow while investing in a new generation of digital products to meet the demands of school districts for personalized classroom learning.

The international School business, outside the US, continued to grow. The international testing business was again able to benefit from technology leadership. In the UK, we have marked over 9 million GCSE, AS and A-Level scripts on screen. In School publishing, the launch in the UK of ActiveTeach technology providing multimedia teaching resources has brought increased market share in math and science. The acquisition of PBM, one of Italy’s leading education publishers, has allowed us to expand our existing Italian business and integrate publishing, sales and marketing, distribution and back office operations. Our market leading school companies in Hong Kong and South Africa both outperformed their respective markets in 2006 and our worldwide English Language Training program for elementary schools, *English Adventure* (with Disney), was successfully launched in Asia and Latin America.

School margins improved again in 2006 and were up by 1.2% points to 12.6% with continued efficiency gains in central costs, production, distribution and software development.

Higher Education

Sales in Higher Education increased by £16m, or 2%, to £795m in 2006, from £779m in 2005. Adjusted operating profit increased by £5m, or 3%, to £161m in 2006 from £156m in 2005. Both sales and adjusted operating profit were affected by the weakening of the US dollar which we estimate reduced sales by £8m when compared to the equivalent figures at constant 2005 exchange rates.

In the US, the Higher Education sales were up by 4% (in US dollars) ahead of the Association of American Publishers' estimate of industry growth once again. Over the past eight years, Pearson's US Higher Education business has grown at an average annual rate of 7% compared to the industry's average growth rate of 4%. In the US there was rapid growth in the online learning businesses with approximately 4.5 million US college students using one of our online programs. Of these approximately 2.3 million register for an online course on one of our 'MyLab' online homework and assessment programs, an increase of almost 30% on 2005. In psychology and economics, two of the three largest markets in US higher education, Pearson published successful first edition bestsellers: Cicarrelli's *Psychology* together with MyPsychLab and Hubbard's *Economics* together with MyEconLab. Cicarrelli's *Psychology* increased Pearson's market share in the subject by 3% to 25% and is the bestselling launch of a first edition in the discipline in the past decade. Also in the US the custom publishing business, which builds customized textbooks and online services around the courses of individual faculties or professors, continued its strong progress with another year of double-digit growth.

International Higher Education publishing sales grew by 3%, benefiting from good growth in local language publishing programs and an increasing focus on custom publishing and technology based assessment services with the MyLab suite of products.

Higher Education margins remained constant year on year with only a small increase of 0.3% points to 20.3% in 2006.

Professional

After excluding sales and adjusted operating profit from Government Solutions which were reported as discontinued in 2006, Professional sales increased by £40m, or 13%, to £341m in 2006 from £301m in 2005. Adjusted operating profit increased by £13m, or 52%, to £38m in 2006, from £25m in 2005. Sales were only slightly affected by the weakening US dollar, which we estimate reduced sales by £2m when compared to the equivalent figures at constant 2005 exchange rates.

Professional testing sales were up more than 30% in 2006 benefiting in particular from the acquisition of Promissor and the successful start-up of the Graduate Management Admissions Test with 220,000 examinations delivered in 400 test centers in 96 countries during the first year of the new contract. Professional Testing has moved into profitability in 2006 compared to a break-even position in 2005. Technology publishing profits were up in 2006 as cost actions offset sales weakness in a market that continues to decline. There was a strong performance in other professional publishing with particular successes in the Wharton School Publishing and FT Press imprints.

Overall margins in the Professional business were significantly higher at 11.1% in 2006 compared to 8.3% in 2005 as the testing business moved into profitability and the technology publishing business took specific cost actions.

FT Publishing

Sales at FT Publishing increased by £34m or 10%, from £332m in 2005 to £366m in 2006. Adjusted operating profit increased by £11m, from £21m in 2005 to £32m in 2006. Much of the sales and profit increase was again at the FT newspaper and FT.com where sales were up 8% and profit increased by £9m to £11m.

The FT newspaper advertising revenues were up 9% for the year with rapid growth in online, luxury goods and corporate finance categories, all up more than 30% on 2005. FT worldwide circulation was up 1% to 430,469 copies per day (Source: ABC, average for six months to December 2006). FT.com's paying subscribers were up 7% to 90,000 while the December audience was up 29% to 4.2 million. The FT continued to benefit from international expansion with approximately three-quarters of the FT's advertising booked in two or more international editions and almost half booked for all four editions worldwide. The FT's 'new newsroom' has created an integrated multi-media newsroom that improves commissioning, reporting, editing and production efficiency and provided further cost savings in 2006.

In September 2006, the FT Publishing business acquired Mergermarket, an online financial data and intelligence provider that contributed additional sales and profit in the last three months of 2006. FT Business showed good growth and improved margins driven by strong performances in events, UK retail financial titles (*Investment Adviser* and *Financial Adviser*) and internationally with *The Banker. Les Echos* achieved modest circulation and advertising growth in a weak market ahead of the French presidential elections in 2007. *FT Deutschland* outperformed the German newspaper market once again increasing circulation by 2% and reducing losses. *The Economist,* in which Pearson owns a 50% stake, increased its contribution to FT Publishing's adjusted operating profit with another good year that saw circulation increase by 9% to 1.2 million (for the July-December ABC period).

Overall margins at FT Publishing continued to increase as the newspaper becomes more profitable and are now 8.7% compared to 6.3% in 2005.

Interactive Data

Interactive Data, grew its sales by 12% from £297m in 2005 to £332m in 2006. Adjusted operating profit grew by 11% from £80m in 2005 to £89m in 2006. Both sales and adjusted operating profit were affected by the weakening US dollar, which we estimate reduced sales by £4m and adjusted operating profit by £1m when compared to the equivalent figures at constant 2005 exchange rates.

Interactive Data Pricing and Reference Data (formerly FT Interactive Data), IDC's largest business (approximately two-thirds of IDC revenues) generated strong growth in North America and Europe. Growth was driven by sustained demand for fixed income evaluated pricing services and related reference data. Interactive Data Pricing and Reference Data continued to expand its market coverage, adding independent valuations of credit default swaps and other derivative securities. There was improved momentum at Interactive Data Real-Time Services (formerly Comstock) with new sales to institutional clients and lower cancellation rates and also at eSignal with continued growth in its base of direct subscription terminals. The acquisition of Quote.com in March 2006 has expanded eSignal's suite of real-time market data platforms and analytics and added two financial websites which enabled eSignal to generate strong growth through online advertising in 2006. IS.Teledata, acquired at the end of 2005 and rebranded Interactive Data Managed Solutions, contributed a full year of sales and profit for the first time in 2006.

IDC margins remained roughly constant year on year at 26.8% in 2006 compared to 26.9% in 2005.

The Penguin Group

Penguin Group sales were up 5% to £848m in 2006 from £804m in 2005 and adjusted operating profit up 10% to £66m in 2006 from £60m in 2005. Both sales and adjusted operating profit were affected by the weakening US dollar which we estimate reduced sales by £13m and adjusted operating profit by £7m when compared to the equivalent figures at constant 2005 exchange rates.

2006 was a record year for Penguin in terms of literary success and bestseller performance. In the US, Penguin placed 139 books on the *New York Times* bestseller list, 10 more than in 2005, and kept them there for 809 weeks overall, up 119 weeks from 2005. Penguin UK placed 59 titles in the BookScan Top Ten bestseller list, up by 5 from 2005, and kept them there for 361 weeks, up 42 weeks from 2005.

Penguin authors won a large number of prestigious awards during 2006: a Pulitzer Prize for Fiction (*March* by Geraldine Brooks); a National Book Critics Circle Award (*THEM: A Memoir of Parents* by Francine du Plessix Gray); the Michael L. Printz award (*Looking for Alaska* by John Green); the Orange Prize for Fiction (*On Beauty* by Zadie Smith); and the Man Booker Prize (*The Inheritance of Loss* by Kiran Desai).

Penguin UK's focus on fiction in 2006 was rewarded with a substantial increase in market share, led by Marina Lewycka's *A Short History of Tractors in Ukrainian.* In the US, the premium paperback format accelerated revenue growth and increased profitability in the important mass-market category. In India, Penguin continued its rapid growth and extended its market leadership and there was also strong growth and increased market share for Penguin in South Africa. 2006 also saw strong growth in online revenues and unique visitors to the Penguin and DK websites.

Penguin continued to focus on efficiency and improvement in operating margins and has benefited from the Pearson-wide renegotiation of major global paper, print and binding contracts, the integration of warehouse and back office operations in Australia and New Zealand and is investing in India as a pre-production and design center for reference titles.

Results of operations

Year ended December 31, 2005 compared to year ended December 31, 2004

Consolidated results of operations

Sales

Our total sales increased by £329m, or 9%, to £3,808m in 2005, from £3,479m in 2004. Sales growth was due to strong performance in our markets, helped in part by a favorable exchange rate impact. We estimate that had the 2004 average rates prevailed in 2005, sales would have been approximately £3,765m.

Pearson Education had a strong year with an increase in sales of 13%. The School businesses were the biggest contributors to this growth with an increase of 19%. Higher Education growth was 7% in total and 6% in the US. Pearson's US Higher Education business has grown faster than the industry for seven straight years. The School publishing business benefited from a large share of the new adoption market in the US and testing sales were up more than 20% as the business made significant market share gains and benefited from mandatory state testing in the US under No Child Left Behind. In the Professional business sales increased 4%, with testing sales ahead of last year following the successful start-up of major new contracts. Worldwide sales of technology-related books were again lower than the previous year although weakness in the professional markets was partly offset by growth in consumer technology publishing.

The FT Group sales were 7% in 2005 ahead of 2004. FT Publishing sales were up by 4% driven by higher advertising revenues at the *Financial Times* and IDC sales were up by 10% with organic growth at all its businesses aided by a full year contribution from FutureSource, acquired in September 2004, and the strength of the US dollar. Penguin's sales grew by 2% with successful format innovation helping to offset the weakness in the mass-market category in the US, down a further 4% for the industry in 2005.

Pearson Education, our largest business sector, accounted for 62% of our sales in 2005, compared to 61% in 2004. North America continued to be the most significant source of our sales although sales there decreased, as a proportion of total sales, to 64% in 2005, compared to 66% in 2004.

Cost of goods sold and net operating expenses

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

	Year ended December 31	
	2005	**2004**
	£m	**£m**
Cost of goods sold	1,787	1,631
Distribution costs	292	226
Administration and other expenses	1,351	1,340
Other operating income	(84)	(83)
Total	1,559	1,483

Cost of goods sold. Cost of sales consists of costs for raw materials, primarily paper, printing costs, amortization of pre-publication costs and royalty charges. Our cost of sales increased by £156m, or 10%, to £1,787m in 2005, from £1,631m in 2004. The increase mainly reflected the increase in sales over the period so the overall gross margin stayed constant at 53%.

Distribution Costs. Distribution costs consist primarily of shipping costs, postage and packing and are typically a fairly constant percentage of sales.

Administration and other expenses. Our administration and other expenses increased by £11m, or 1%, to £1,351m in 2005, from £1,340m in 2004, although as a percentage of sales they decreased to 35% in 2005, from 39% in 2004. The increase in administration and other costs comes principally from additional employee benefit expense, but cost savings and more modest increases in other administration expenses have enabled overall operating margins to improve.

Other operating income. Other operating income mainly consists of freight recharges, sub-rights and licensing income and distribution commissions.

Other net gains and losses

Profits or losses on the sale of businesses, associates and investments that are included in our continuing operations are reported as “other net gains and losses”. In 2005 the only item in this category was the £40m profit on the sale of our associate interest in MarketWatch. In 2004, other gains and losses amounted to £9m, with the principal items being profits on the sale of stakes in Capella and Business.com.

Share of results of joint ventures and associates

The contribution from our joint ventures and associates increased from £8m in 2004 to £14m in 2005. The increase was due to profit improvement at The Economist Group and a reduction in losses at FT Deutschland.

Operating profit

The total operating profit increased by £134m, or 35%, to £516m in 2005 from £382m in 2004. This £134m or 35% increase was due to increases across all the businesses, the one-off gain from the sale of MarketWatch of £40m and a beneficial impact of exchange. We estimate that had the 2004 average rates prevailed in 2005, operating profit would have been £12m lower.

Operating profit attributable to Pearson Education increased by £58m, or 22%, to £323m in 2005, from £265m in 2004. The increase was due to strong sales and improved margins in both the School and Higher Education businesses. Operating profit attributable to the FT Group increased by £63m, or 90%, to £133m in 2005, from £70m in 2004. £40m of the increase was due to the profit from the sale of MarketWatch but there were also increases at IDC of £13m and FT Publishing of £10m. Operating profit attributable to the Penguin Group increased by £13m, or 28%, to £60m in 2005, from £47m in 2004. The increase at Penguin was due in part to increased efficiencies and improved margins and also due to exchange gains and one-off items in 2004. Penguin’s operating profit in 2004 was reduced by costs associated with disruption in UK distribution following the move to a new warehouse and closure costs associated with Penguin TV.

Net finance costs

Net finance costs reduced from £79m in 2004 to £70m in 2005. Net interest payable in 2005 was £77m, up from £74m in 2004. The Group’s net interest rate payable rose by 0.9% to 5.9%. Although we were partly protected by our fixed rate policy, the strong rise in US dollar floating interest rates had an adverse effect. Year on year, average three month LIBOR (weighted for the Group’s borrowings in US dollars, euro and sterling) rose by 1.9% to 3.4%. This was largely offset by the £260m fall in average net debt, reflecting in particular the proceeds from the disposal of Recoletos and good cash generation. In addition, in 2005 we did not benefit from a one-off credit of £9m for interest on a repayment of tax that occurred in 2004. As at January 1, 2005 we adopted IAS 39 *‘Financial Instruments: Recognition and Measurement’* in our financial statements. This has had the effect of introducing increased volatility into the net finance cost and in 2005 the adoption of IAS 39 reduced net finance costs by £14m. For a more detailed discussion of our borrowings and interest expenses see "— Liquidity and Capital Resources — Capital Resources" and "— Borrowing" below and "Item 11. Quantitative and Qualitative Disclosures About Market Risk".

Taxation

The total tax charge for the year was £116m, representing a 26% rate on pre-tax profits of £446m. This compares with a 2004 rate of 18% (or £55m on a pre-tax profit of £303m). In 2004, the tax charge reflected credits of £48m relating to previous years, a substantial element of which was non-recurring; adjustments relating to previous years in 2005 resulted in a credit of £18m. The 2005 rate benefited from the fact that the profit of £40m on the sale of Marketwatch.com was free of tax.

Minority interests

Following the disposal of our 79% holding in Recoletos in April 2005 and the purchase of the 25% minority stake in Edexcel in February 2005, our minority interests now mainly comprise the 39% minority share in IDC.

Discontinued operations

Following the announcement of the disposal of Government Solutions in December 2006, the results of the Pearson Government Solution business have been reclassified as discontinued in 2005 and 2004. The results for the year ended December 31, 2005 included an operating profit of £20m with a corresponding operating profit of £22m in 2004. The results of Recoletos have been consolidated for the period up to February 28, 2005 and included in discontinued operations in 2005 and 2004. The results for 2005 include an operating loss for the two months to February 28, 2005 of £3m compared to an operating profit in the full year to December 31, 2004 of £26m. The pre-tax profit on disposal of Recoletos reported in 2005 was £306m.

Profit for the year

The total profit for the year in 2005 was £644m compared to a profit in 2004 of £284m. The overall increase of £360m was mainly due to the profit on disposal of Recoletos and MarketWatch together with significant improvement in operating profits reported across all the Pearson businesses. These increases were only partially offset by the increase in the tax charge in 2005.

Earnings per ordinary share

The basic earnings per ordinary share, which is defined as the profit for the year divided by the weighted average number of shares in issue, was 78.2p in 2005 compared to 32.9p in 2004 based on a weighted average number of shares in issue of 797.9 million in 2005 and 795.6 million in 2004. This increase in earnings per share was due to the additional profit for the 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 78.1p in 2005 and 32.9p in 2004 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 strengthening of the US dollar against sterling on an average basis had a positive impact on reported sales and profits in 2005 compared to 2004. We estimate that if the 2004 average rates had prevailed in 2005, sales would have been lower by £43m and operating profit would have been lower by £12m. 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 tables summarize our sales and operating profit for each of Pearson's divisions. Adjusted operating profit is a non-GAAP measure and is included as it is a key financial measure used by management to evaluate performance and allocate resources to business segments, as reported under FAS 131. See also note 2 of "Item 17. Financial Statements".

In our adjusted operating profit we have excluded amortization and adjustment of acquired intangibles, other gains and losses and other net finance costs of associates. The amortization and adjustment of acquired intangibles is the amortization or subsequent impairment of intangible assets acquired through business combinations. The charge is not considered to be fully reflective of the underlying performance of the Group. Other gains and losses represent profits and losses on the sale of subsidiaries, joint ventures, associates and investments that are included within continuing operations but which distort the performance for the year.

Adjusted operating profit enables management to more easily track the underlying operational performance of the Group. A reconciliation of operating profit to adjusted operating profit is included in the tables below:

	Year ended December 31, 2005						
£m	School	Higher Education	Professional	FT Publishing	IDC	Penguin	Total
Sales	1,295	779	301	332	297	804	3,808
	34%	*20%*	*8%*	*9%*	*8%*	*21%*	*100%*
Total operating profit	142	156	25	58	75	60	516
	28%	*30%*	*5%*	*11%*	*14%*	*12%*	*100%*
Add back:							
Amortization and adjustment of acquired intangibles	5	—	—	1	5	—	11
Other net gains and losses including associates	—	—	—	(40)	—	—	(40)
Other net finance costs of associates	—	—	—	2	—	—	2
Adjusted operating profit: continuing operations	147	156	25	21	80	60	489
Adjusted operating profit: discontinued operations	—	—	20	(3)	—	—	17
Total adjusted operating profit	147	156	45	18	80	60	506
	29%	*31%*	*9%*	*3%*	*16%*	*12%*	*100%*

£m	Year ended December 31, 2004 School	Higher Education	Professional	FT Publishing	IDC	Penguin	Total
Sales	1,087	729	290	318	269	786	3,479
	31%	*21%*	*8%*	*9%*	*8%*	*23%*	*100%*
Total operating profit	112	133	20	8	62	47	382
	29%	*35%*	*5%*	*2%*	*16%*	*13%*	*100%*
Add back:							
Amortization and adjustment of acquired intangibles	—	—	—	—	5	—	5
Other net gains and losses including associates	(4)	(4)	(2)	(4)	—	5	(9)
Other net finance costs of associates	—	—	—	—	—	—	—
Adjusted operating profit: continuing operations	108	129	18	4	67	52	378
Adjusted operating profit: discontinued operations	—	—	22	26	—	—	48
Total adjusted operating profit	108	129	40	30	67	52	426
	25%	*30%*	*9%*	*7%*	*16%*	*13%*	*100%*

School

School business sales increased by £208m, or 19%, to £1,295m in 2005, from £1,087m in 2004 and adjusted operating profit increased by £39m, or 36%, to £147m in 2005 from £108m in 2004. The School results in 2005 benefit from the inclusion of AGS Publishing, acquired in July 2005 and the strengthening of the US dollar, which we estimate added £12m to sales and £2m to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

In the US school market, Pearson’s school publishing business grew 12% ahead of the Association of American Publishers’ estimate of industry growth of 10.5%. New adoption market share was 33% in the adoptions where Pearson competed (and 24% of the total new adoption market). The School business now has leading positions in math, science, literature and foreign languages. School testing sales were up more than 20%, benefiting from significant market share gains and mandatory state testing under No Child Left Behind. School software also had a strong year with good sales and profit growth on curriculum and school administration services.

Outside the US, the School publishing sales increased in high single digits. The worldwide English Language Teaching business benefited from strong demand for English language learning and investments in new products, including *English Adventure* (with Disney) for the primary school market, *Sky* for secondary schools, *Total English* for adult learners and *Intelligent Business* (with *The Economist*) for the business markets. There was also strong growth in the international school testing markets. Four million UK GCSE, AS and A-Level scripts were marked onscreen and 2005 saw the first year of running the UK National Curriculum tests and a new contract for a national school testing pilot in Australia.

School margins were up by 1.5% points to 11.4% with efficiency gains in central costs, production, distribution and software development.

Higher Education

Sales in Higher Education increased by £50m, or 7%, to £779m in 2005, from £729m in 2004. Adjusted operating profit increased by £27m, or 21%, to £156m in 2005 from £129m in 2004. Both sales and adjusted operating profit benefited from the strengthening US dollar which we estimate added £14m to sales and £3m to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

In the US, the Higher Education sales were up by 6% ahead of the Association of American Publishers’ estimate of industry growth of 5%. 2005 is the seventh consecutive year that Pearson’s US Higher Education business has grown faster than the industry. The US business benefited from continued growth from market-leading authors in key academic disciplines including biology (Campbell & Reece), chemistry (Brown & LeMay), sociology (Macionis), marketing (Kotler & Keller), math (Tobey & Slater), developmental math (Martin-Gay) and English composition (Faigley’s *Penguin Handbook*). There was also expansion in the career and workforce education sector, with major publishing initiatives gaining market share in allied health, criminal justice, paralegal, homeland security and hospitality. The online learning and custom publishing businesses saw rapid growth. Approximately 3.6 million US college students are studying through one of our online programs, an increase of 20% on 2004; and custom publishing, which builds customized textbooks and online services around the courses of individual faculties or professors, had double digit sales growth.

International Higher Education publishing sales grew by 4%, benefiting from the local adaptation of global authors, including Campbell and Kotler, and the introduction of custom publishing and online learning capabilities into new markets in Asia and the Middle East.

Higher Education margins were up by 2.3% points to 20%. Good margin improvement in the US and in international publishing was helped by shared services and savings in central costs, technology, production and manufacturing.

Professional

Professional sales (excluding discontinued businesses) increased by £11m, or 4%, to £301m in 2005 from £290m in 2004. Adjusted operating profit increased by £7m, or 39%, to £25m in 2005, from £18m in 2004. Sales benefited from the strengthening US dollar, which we estimate added £5m to sales when compared to the equivalent figures at constant 2004 exchange rates.

Professional testing sales were up more than 40% in 2005 benefiting from the successful start-up of major new contracts including the Driving Standards Agency, National Association of Securities Dealers and the Graduate Management Admissions Council.

Overall margins in the Professional business were a little lower in 2005 compared to 2004 mainly due to new contract start-up costs. Margins in the Professional publishing businesses were maintained despite falling sales.

FT Publishing

Sales at FT Publishing (excluding discontinued businesses) increased by £14m or 4%, from £318m in 2004 to £332m in 2005. Adjusted operating profit increased by £17m, from £4m in 2004 to £21m in 2005. Much of the sales and profit increase was at the FT newspaper; sales at the other business newspapers were broadly level with 2004 with a small increase in adjusted operating profit compared to 2004.

FT newspaper sales were up 6% while adjusted operating profit increased £14m to register a profit of £2m in 2005 compared to a loss of £12m in 2004. FT advertising revenues were up 9% for the year with sustained growth in luxury goods and worldwide display advertising. FT.com advertising sales were up 27% as some of the FT’s biggest advertisers shifted to integrated print and online advertising. The FT’s worldwide circulation was 2% lower for the year at 426,453 average copies per day although the second half of the year showed improvement to 430,635 average copies per day. FT.com’s paying subscribers increased by 12% to 84,000 and the average unique monthly users was up 7% to 3.2m.

Les Echos advertising and circulation revenues for 2005 were level with 2004 despite tough trading conditions. FT Business improved margins with growth in its international finance titles. Our share of the results of the FT’s joint ventures and associates improved as *FT Deutschland* reduced its losses and increased its average circulation despite a weak advertising market in Germany and *The Economist* increased profits helped by an increase in circulation (10% to an average weekly circulation of 1,038,519 for the January-June ABC period).

Interactive Data

Interactive Data, grew its sales by 10% from £269m in 2004 to £297m in 2005. Adjusted operating profit grew by 19% from £67m in 2004 to £80m in 2005. Both sales and adjusted operating profit benefited from the strengthening US dollar, which we estimate added £2m to sales and £1m to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates.

FT Interactive Data, IDC's largest business (approximately two-thirds of IDC revenues) generated strong growth in North America and returned to growth in Europe. There was more modest growth at Comstock, IDC's business providing real-time data for global financial institutions, and at CMS BondEdge, its fixed income analytics business. Renewal rates for IDC's institutional businesses remain at around 95%. eSignal, IDC's active trader services business, increased sales by 27% with continued growth in the subscriber base and a full year contribution from FutureSource, acquired in September 2004.

The Penguin Group

The Penguin Group sales were up 2% to £804m in 2005 from £786m in 2004 and adjusted operating profit up 15% to £60m in 2005 from £52m in 2004. Both sales and adjusted operating profit benefited from the strengthening US dollar which we estimate added £9m to sales and £6m to adjusted operating profit when compared to the equivalent figures at constant 2004 exchange rates. 2005 adjusted operating profit also benefited from reduced operating costs at our UK distribution center.

In the US, successful format innovation helped to address weakness in the mass-market category that saw a further decline of 4% for the industry in 2005. The first seven Penguin Premium paperbacks were published in 2005, priced at $9.99, and all became bestsellers, with authors including Nora Roberts, Clive Cussler and Catherine Coulter.

Penguin authors received a number of awards during the year: A Pulitzer Prize (for Steve Coll's *Ghost Wars*), a National Book Award (William T. Vollman's *Europe Central*), the Whitbread Book of the Year (Hilary Spurling's *Matisse the Master*), the Whitbread Novel of the Year (Ali Smith's *The Accidental*) and the FT & Goldman Sachs Business Book of the Year Award (Thomas Friedman's *The World is Flat*). In 2005, there were 129 New York Times bestsellers and 54 top 10 bestsellers in the UK. Major bestselling authors include Patricia Cornwell, John Berendt, Sue Grafton, Jared Diamond, Jamie Oliver, Gillian McKeith, Jeremy Clarkson and Gloria Hunniford.

In 2005, there was also a strong contribution from new imprints and first-time authors. The new imprint strategy continued to gather pace and Penguin published more than 150 new authors in the US and approximately 250 worldwide — its largest ever investment in new talent. Sue Monk Kidd's first novel, *The Secret Life of Bees*, has been a New York Times bestseller for almost two years; her second, *The Mermaid Chair*, reached number one in 2005. *The Kite Runner*, Khaled Hosseini's first book, stayed on the New York Times bestseller list for all of 2005, selling an additional two million copies (three million in total). In the UK, there was also strong performance from new fiction authors including Jilliane Hoffman, PJ Tracy, Karen Joy Fowler and Marina Lewycka.

Liquidity and capital resources

Cash flows and financing

Net cash inflow from operating activities decreased by £32m, or 5%, to £621m in 2006, from £653m in 2005. This reduction was entirely due to the weakening of the US dollar compared to sterling. The majority of the Group's cash flows arise in US dollars, so any weakening of the US dollar reduces the Group's cash flows in sterling terms. The closing rate for translation of dollar cash flows was $1.96 in 2006 ($1.72 in 2005). Underlying working capital efficiency continued to improve. On an average basis, the working capital to sales ratio for our book publishing businesses improved from 27.4% in 2005 to 26.3% in 2006. The net cash inflow from operating activities in 2005 increased by £129m, or 25%, to £653m from £524m in 2004, even though 2004 included receipt of a $151m receivable in respect of the TSA contract. Part of this increase was due to the strengthening of the US dollar during that period. The closing rate for translation of dollar cash flows was

$1.72 in 2005, compared to $1.92 in 2004. The improvement in cash flow from operating activities also reflected more efficient use of working capital. On an average basis, the working capital to sales ratio for our book publishing businesses improved from 29.4% in 2004 to 27.4% in 2005.

Net interest paid was £82m in 2006 compared to £72m in 2005 and £85m in 2004. The 14% increase in 2006 over 2005 reflected the higher average debt resulting from the acquisitions made in the year and higher interest rates (particularly in the US). The 15% reduction in 2005 over 2004 was primarily due to the reduced debt following receipt of the proceeds from the sale of Recoletos and MarketWatch.

Capital expenditure on property, plant and equipment was £68m in 2005 compared to £76m in 2005 and £101m in 2004. The reduction in 2006 compared to 2005 is due to the movement in US dollar exchange rates. The higher expenditure in 2004 reflected up-front expenditure on Professional testing contracts.

The acquisition of subsidiaries, joint ventures and associates accounted for a cash outflow of £367m in 2006 against £253m in 2005 and £51m in 2004. In 2006, the principal acquisition was of Mergermarket for £109m. The balance relates to various smaller bolt-on acquisitions (primarily in the school segment) including those of National Evaluation Systems and Paravia Bruno Mondadori. The principal acquisitions in 2005 were of AGS for £161m within the School business and IS. Teledata for £29m by Interactive Data. The principal acquisitions in 2004 were of KAT and Dominie Press for £10m within our education businesses and FutureSource by Interactive Data for £9m. The sale of subsidiaries and associates produced a cash inflow of £10m in 2006 against £430m in 2005 and £31m in 2004. The disposal in 2006 relates entirely to the proceeds from the take-up of share options issued to minority shareholders. The principal disposals in 2005 were of Recoletos for net cash proceeds of £371m and MarketWatch for net cash proceeds of £54m. The proceeds in 2004 relate primarily to the sale of Argentaria Cartera by Recoletos.

The cash outflow from financing of £348m in 2006 primarily reflects the payment of the Group dividend (at a higher dividend per share than 2005) and the repayment of a $250m bond at its maturity date. The cash outflow from financing of £321m in 2005 reflects the improved Group dividend (compared to 2004) and the repayment of bank borrowings following the sale of Recoletos. The cash outflow from financing of £261m in 2004 reflects the payment of the Group dividend and the repayment of one €550m bond offset by the proceeds from the issue of new $350m and $400m bonds. Bonds are issued as part of our overall financing program to support general corporate expenditure.

Capital resources

Our borrowings fluctuate by season due to the effect of the school year on the working capital requirements in the educational materials business. Assuming no acquisitions or disposals, our maximum level of net debt normally occurs in July, and our minimum level of net debt normally occurs in December. Based on a review of historical trends in working capital requirements and of forecast monthly balance sheets for the next 12 months, we believe that we have sufficient funds available for the Group’s present requirements, with an appropriate level of headroom given our portfolio of businesses and current plans. Our ability to expand and grow our business in accordance with current plans and to meet long-term capital requirements beyond this 12-month period will depend on many factors, including the rate, if any, at which our cash flow increases and the availability of public and private debt and equity financing, including our ability to secure bank lines of credit. We cannot be certain that additional financing, if required, will be available on terms favorable to us, if at all.

At December 31, 2006, our net debt was £1,059m compared to net debt of £996m at December 31, 2005. Net debt is defined as all short-term, medium-term and long-term borrowing (including finance leases), less all cash and liquid resources. Liquid resources comprise short-term deposits of 90 days and investments that are readily realizable and held on a short-term basis. Short-term, medium-term and long-term borrowing amounted to £1,743m at December 31, 2006, compared to £1,959m at December 31, 2005. At December 31, 2006, cash and liquid resources were £592m, compared to £902m at December 31, 2005. Some of the cash at December 31, 2006 was being held to fund a €591m bond repayment due on February 1, 2007.

Contractual obligations

The following table summarizes the maturity of our borrowings and our obligations under non-cancelable operating leases.

	At December 31, 2006				
	Total	Less than one year	One to two years	Two to five years	After five years
	£m	£m	£m	£m	£m
Gross borrowings:					
Bank loans, overdrafts and commercial paper	173	173	—	—	—
Variable rate loan notes	—	—	—	—	—
Bonds	1,566	421	105	444	596
Lease obligations	1,369	123	113	276	857
Total	**3,108**	**717**	**218**	**720**	**1,453**

At December 31, 2006 the Group had capital commitments for fixed assets, including finance leases already under contract, of £nil (2005: £1m). There are contingent liabilities in respect of indemnities, warranties and guarantees in relation to former subsidiaries and in respect of guarantees in relation to subsidiaries and associates. In addition there are contingent liabilities in respect of legal claims. None of these claims or guarantees is expected to result in a material gain or loss.

The Group is committed to a fee of 0.0675% per annum, payable quarterly in arrears on the unused amount of the Group’s bank facility.

Off-Balance sheet arrangements

The Group does not have any off-balance sheet arrangements, as defined by the SEC Final Rule 67 (FR-67), “Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations”, that have or are reasonably likely to have a material current or future effect on the Group’s financial position or results of operations.

Borrowings

We have in place a $1.75bn revolving credit facility, which matures in May 2011. At December 31, 2006, approximately $1.75bn was available under this facility. This included allocations to refinance short-term borrowings not directly drawn under the facility. The credit facility contains two key covenants measured for each 12 month period ending June 30 and December 31:

We must maintain the ratio of our profit before interest and tax to our net interest payable at no less than 3:1; and

We must maintain the ratio of our net debt to our EBITDA, which we explain below, at no more than 4:1.

“EBITDA” refers to earnings before interest, taxes, depreciation and amortization. We are currently in compliance with these covenants.

Treasury policy

We hold financial instruments for two principal purposes: to finance our operations and to manage the interest rate and currency risks arising from our operations and from our sources of financing.

We finance our operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer term loans from banks and capital markets. We borrow principally in US dollars, sterling and euro at both floating and fixed rates of interest, using derivatives, where