Pearson's Nine Month Trading Update

Monday, 30th October 2023

Introduction

Joanne Russell

SVP, Investor Relations, Pearson

Welcome

Good morning, everyone, and welcome to Pearson's 2023 nine months trading update. Today, we will host a presentation followed by a Q&A session. There will be two ways to submit your questions. If you would like to ask your question personally, please use the numbers that are displayed on screen. These lines will be open following the presentation. Alternatively, please type your questions into the questions tab at the top right of the screen and we will address them in turn.

And with that, I will hand over to Andy.

Opening Remarks

Andy Bird

CEO, Pearson

Highlights

Thanks, Jo, and welcome and good morning, everyone. Thank you for taking the time to join us today. As ever, I would like to allow for as much time as possible for you to ask questions, so I will quickly run through the highlights from today's announcement before handing over to Sally.

We have continued the positive momentum from the first half of the year and delivered another period of strong performance with a 5% increase in underlying sales. This was driven by particularly strong growth in English Language Learning and our Assessments & Qualifications division.

We saw solid growth in workforce skills driven by the performance of both vocational qualifications and workforce solutions. In virtual schools, we are seeing positive retention rates and applications for our Connections Academy Career Pathways programme have been encouraging since its launch in June.

Our Higher Education business continues to trade in line with expectations. Now Sally will go into greater detail on the moving parts of the financials, but some key highlights are that inclusive access sales were up 26% year-over-year, and we continue to place focus on growing that part of the business. There has been encouraging growth in our platform products and Pearson+ continues to perform well with around 30% growth in paid subscriptions versus the prior fall semester. As usual, we will be providing complete metrics for Pearson+ at our full year results.

As a result of this continued sales growth and focus on efficiency and operating margins, we are upgrading our full-year guidance for adjusted operating profits by £20 million to between £570 million and £575 million. In September, we launched a beta of generative AI tools in Pearson+ and Mastering.

These features summarise complex topics and offer students learning prompts and practice questions. While we are still in the early stages of the beta, we have been encouraged by what we are seeing. Students who are using the tools are showing strong levels of engagement with the features and we are gaining valuable insights about how students want help with their material and their work.

Meanwhile, in English Language Learning, we have started a beta of several tools that use generative AI for speaking practice. We believe student expectations around AI will only increase and we remain confident that Pearson is in a strong position to benefit from generative AI.

I am also pleased that we've started delivering our trusted Pearson Test of English for student direct stream visas in Canada, and we are ready to deliver PTE for economic immigration visas as soon as we receive a start date from the Canadian authorities. We are excited by the size of the opportunity in Canada, and we will be investing in building our brand awareness in this competitive market.

In India, we recently opened one of our largest Pearson VUE testing centres with the capacity to deliver 14,000 tests per month. That is to accommodate the demand for the high stakes testing, including Pearson Test of English.

In Assessments & Qualifications, the integration of PDRI continues to progress well with a number of new contract wins for assessment services across the US federal government, including the Department of Homeland Security and the United States Air Force amongst others.

Across the business, we remained focused on the execution on all aspects of our strategy, the delivery of our cost-efficiency programme, and on our transformation efforts to build a digital-first and consumer-orientated company.

To conclude, we have made excellent progress across Pearson and remain confident about our future growth prospects. We are well-positioned for the company's next chapter, bolstered by the amazing talent we have here within the Group.

Now I will hand you over to Sally, who will talk you through the financials.

Financial Review

Sally Johnson

CFO, Pearson

Strong financial performance

Thanks, Andy, and hi, everyone. We continue to see a strong performance in 2023 with revenue growth, excluding OPM, at 5% year-to-date. We are firmly on track to deliver the full-year revenue growth we guided to at the beginning of the year and anticipate being in the upper end of that guidance range.

We are also raising our profit guidance, the details of which I will talk through in a minute. The divisional revenue highlights follow the themes we have guided to. Assessments & Qualifications revenue grew 8%, driven by an excellent performance in Pearson VUE, particularly in IT and Healthcare. There was also good growth across US student

assessments, clinical and UK and international qualifications due to new contract wins, good government funding and price increases.

Following the disposal of polls within OPM, our Virtual Learning underlying growth is reported excluding this part of the business. The Virtual Learning revenue decrease of 20% is therefore driven by the loss of the ASU contract, which will, as expected, continue to impact growth in Q4.

Virtual school's revenue declined 4% impacted by the loss of the major school. Excluding that, enrolments were up 2%, demonstrating an underlying return to growth following normalisation post-COVID. Whilst this trend for enrolment is positive, as we move into 2024, we should remember the business will be impacted by the loss of a further large school in the 2024 to 2025 academic year.

Higher education revenue was down 5% in line with expectations, driven by pricing mix and the anticipated deferral of revenue into Q4, given the growth of Pearson+ and platform products. Excluding the revenue recognition phasing impact, revenues declined low-single digits in line with our expectations for the full year.

Recently published NSC data suggests fall 2023 enrolments in Pearson's addressable market are up 1%, meaning the impact on enrolments in the year-to-date financials is flat. You may have seen that the NSC headline was growth in enrolments of 2%. The difference between these two data points takes into account undergraduate certificates, a market Pearson is not in, and the weighting of two-year and four-year colleges and freshmen students.

Clearly, both data sets are hopeful, if not yet a trend. English Language Learning revenue was up 34% with Pearson Test of English continuing to perform strongly across most markets.

Our institutional business and Mondly also delivered strong growth. Workforce Skills revenue grew 8% with solid performance in both Vocational Qualifications and Workforce Solutions.

2023 Group adjusted operating profit upgraded

Turning to the Group outlook for the remainder of the year. Full-year Group revenue growth, which we have guided to, excluding OPM, will be at the higher end of the low- to mid-single-digit range we have guided to. Virtual Schools and Higher Education growth is expected to be in line with the guidance we gave at prelims and interims. Assessments & Qualifications growth will be mid-single digits.

English Language Learning growth will be at least 25%. And Workforce Skills growth will be high-single digits. We are investing a portion of the English Language operating leverage into growth opportunities and that will continue into 2024 and beyond.

We are upgrading our full year adjusted operating profit guidance to £570 million to £575 million. This is at the current trending average pound to US dollar FX rate for the full year being 1.24. Previous guidance as published on [inaudible] was £568 million at a dollar-pound rate of 1.2, which equates to £552 million at the 1.24. The upgrade to £570 million to 575 million of circa £20 million is driven by the expectation that revenue will grow at the higher end of that guided range.

We remain on track to deliver £120 million of cost efficiencies in 2023 with Group margin to improve to mid-teens. Our tax rate is expected to be in the range of 23% to 24%, and the interest charge is expected to be circa £35 million.

As usual, we will provide guidance for 2024 with our full-year results. Our £300 million share buyback is progressing well, and our financial position remains strong.

And finally, we look forward to seeing many of you at our investor seminar focused on our Assessments & Qualifications business on Monday, 6th November. The event will be held in person at the New York Stock Exchange and also virtually for those unable to attend in person.

And with that, I will hand back to Andy.

Conclusion

Andy Bird

CEO, Pearson

Wrap-up

Thanks a lot, Sally. So as you have heard, we have delivered yet another quarter of growth and strategic progress. And to reflect that strong performance, we upgraded our full-year guidance.

Now this is my last earnings presentation as CEO of Pearson, and I want to thank all of you for your interest and support across the last three years. In particular, I respect and appreciate the recognition that the Pearson of today is a very different company from the one I joined three years ago.

The really exciting part of this story is that we are only just beginning. When I became CEO, I had one primary objective, to set this company up for sustained growth. What comes next is extremely exciting and will play into the unique assets that Pearson possesses. I am truly delighted that we have been able to appoint Omar as Pearson's new CEO. He is, in my mind, the right person to build on the company's success to date and its journey of transformation and growth as a digital consumer-focused business.

In the meantime, we remain focused on moving the company forward and building on the solid foundation that we have in place. There is a lot of momentum across the business. The whole of the company is working together with an unwavering focus on execution. So we are well-placed to keep building trusted relationships with consumers and delivering value for shareholders, underpinned by a robust strategy and a leadership position in sustainability.

And with that, Sally, and I would be happy to take your questions. Jo, over to you.

Joanne Russell: Thanks, Andy. I can see quite a few people on the line. So operator, can we take the first call please?

Q&A

Luke Holbrook (Morgan Stanley): Just a few from my side on Higher Ed. I guess the first one is, can you just give us a bit more detail on what is the pricing mix versus the revenue recognition part and how that looks Q3 to Q4, given the 8% decline in Q3?

The second is can you just comment a little bit colloquially on what you are seeing on print and platform maybe versus the textbook in the segment?

And then just finally, are you noticing any cannibalisation at all from Pearson+ and how that fares versus the textbook business?

Andy Bird: So over to you, I think.

Sally Johnson: Shall I take the first two, you take the last one.

Andy Bird: Yes, that is fine.

Sally Johnson: So the pricing pick mix point is one that we have talked about before. As the business moves from a print business to a digital business, it moves out of the higher price point print and package products into the lower price point eText and platform-only product. As we have talked about before, that is something that has a flaw to it. So we saw a decline in print and packages we were expecting in Q3, and I would anticipate that by the end of the year we have got a million, maybe less from a unit perspective in print and package.

And then the revenue recognition piece is the piece that I highlighted at interim. So completely as expected. As we move into digital, we recognise the revenue over a period of time, which crosses over Q3 and Q4. And therefore whilst it is built in the third quarter, the revenue recognition from a top-line perspective is over those two periods.

So we have got a proportion that is moving from Q3 to Q4 as our digital products grow. And from a Q3 specifically point of view, rather than year-to-date, that revenue recognition is around about the same number between Q3 and year-to-date. And then you have got a denominator which is smaller for the quarter than it is for the full year and hence the percentage.

And then on the print and platform versus eText piece, I mean that is exactly the portion that I was talking about in terms of that pricing mix. You have got, as expected, a shift out of print and packages into our digital products. So Pearson+ platform and eText.

Andy Bird: And, Luke, as regards to Pearson+, as I mentioned, 30% year-over-year Q3 growth in subscriptions, 80% growth year-to-date. So that gives you a sense of the growing importance of Pearson+ within Higher Education.

What is also very, very encouraging and I referenced is the study tools within Pearson+. You are seeing Pearson+ evolve beyond just an eText reader. We started last year with channels, not only academic channels but of course life skill channels. And with the addition of generative AI within the study and channels piece, linking video to questions that students are having, we are seeing a real take-up and a constant evolution in that space. And you are going to see also an increasing role for Pearson+ in terms of inclusive access. And you will start to see that as we roll through into 2024.

We have started to see that this year and you will see more of that as we roll into 2024. It is all about being student first, consumer first, totally digital. And what I love about Pearson Plus is it is a constantly evolving product. It is not a fixed product; it is constantly evolving. Every other day I am getting screenshots from Tony about what about this, how do we do this?

So I am very, very excited about the roadmap for Pearson+ and some of the other things beyond higher education that the team are working on busily in the background.

Adam Berlin (UBS): Just two questions from me please, if I can. Just on Higher Ed again, did you win adoption share in this full sales process, given the investments you have made in products? Because that was something that was not in the release. So just helpful, and maybe you do not have all the data right now, but what do you think will happen in terms of adoption share into this fall season?

And the second question, just on workforce skills and workforce solutions. Can you give us an update on where the feedback is for your workforce solutions software product? I noticed the Q3 growth was a little bit slowed down for the workforce skills group as a whole. Is the guidance for double-digit growth in workforce skills still relevant? Thanks.

Sally Johnson: Hi, Adam. Good to hear from you. So in terms of adoption share, we do have a dataset, but as you have just said, it is quite early on in the process. So we have only got about 60% of that dataset. And because of the way it is pulled together by an external party and to do with a very boring IT thing, one of the big retailers is not in there yet.

But the indications from that early dataset is that we have maintained market share. But I will update you more once we have got the full dataset at the full year.

Andy Bird: And as it relates to workforce skills, Adam, and particularly workforce solutions, of course, there are two parts to the workforce skills numbers. The first is essentially our vocational qualifications detail and then the workforce solutions. We are seeing good growth in the workforce solutions. I think that's the area that you are particularly focused on.

In fact, Sally and I meet with the team weekly, and I am very encouraged by seeing the progress that has been made in terms both the number and the quality of clients we are getting in the sales lead pipeline, increasing size of contracts. And the decision to move, as we mentioned at interims, to a more modular solution sale is really starting to pay off because every company, and it is not just companies by the way, it is also governments, are interested in tailor-made bespoke solutions to their particular challenges.

When they get to see us create bespoke solutions, we really see a good product market fit. So I feel encouraged by the progress that the team is making. There is no doubt there is increasing demand. There is more and more as companies, governments and other institutions become aware of the need. We are moving to, as I have often said, a skill-based economy. And more and more enterprises, institutions are looking for answers to help them solve their skill-based problems. We are a perfect fit for them.

Tom Singlehurst (Citi): Andy, thank you very much for all the hard work and over the last three years. You have been unfailingly enthusiastic and energetic, so it is very much appreciated. The first question is on, in particular English Language Learning, both A&Q and ELL have been very strong in the quarter. You have raised the full-year guidance, but I suppose both require a significant slowdown in the fourth quarter or imply significant slowdown. For A&Q, you have already flagged some timing issues there, but for ELL. What are the moving parts there? I mean, are we just moving into a fast and natural level of growth because of the opportunity in Canada and does that alter the mid-term guidance? That is the first question.

And then a second one on virtual schools. I mean the underlying performance in the third quarter looks like it is fairly okay, but you obviously have lost the contract, which we already knew about. And I think Sally, you mentioned you have lost another one for 2024, 2025. So could you just talk about the competitive dynamics there and what is driving the contract losses and how they might be mitigated going forward? Thank you.

Sally Johnson: Shall I take both of those?

Andy Bird: Yes.

Sally Johnson: So in English Language Learning, so growth of at least 25% for the full year, which is obviously a fantastic performance. You will remember that in the first part of the year and actually starting about this time last year, we have had the tailwind from the Australian government, the fact that unemployment has been very low there and therefore their migration policies have meant that they have gone for increased migration into the country.

We always expected and guided the fact that that would slow down in the second half of that year and that is exactly what we have seen happen, and we expect that level to continue on a go-forward basis. Then, of course, growth coming from the win of that Canadian contract that we have got, which comes online at the end of this year. So to be completely clear, the student part of that is online already. Volume is relatively small at the start of that as expected.

The immigration piece, we are just waiting for a few boxes to be ticked before that goes live. So lots to be really optimistic about in terms of English Language Learning as we look into future.

And then for Virtual Schools, have you pointed out, Tom, post that COVID normalisation underlying enrolments up. We said at prelims that we had two larger schools that we have lost, one affecting this year that we are currently in, so the 2023 to 2024 year, one impacting the 2024 to 2025 year.

This is a normal part of these types of business and then it just takes a little bit of time for us to get a new school up and running to take over from that. So we are really enthusiastic about this part of the business in the medium and long term. We just need to get over this transitioning period right now.

And the other point to make is that we have gone live with our first career academies, and those are showing a really good sign for them as well.

Andy Bird: Yes, I will just add. Firstly, thanks for the kind words, Tom, and I am enthusiastic and full of optimism because I believe that there are amazing things that are going to happen with this company. All I have done is basically provide the foundations for future growth. So my optimism I believe is well-founded.

I will just add on the ELL piece. Of course, as we mentioned in the prepared remarks, Sally mentioned, part of what we will be doing, Gio and the team are doing, is putting marketing behind the opening of Canada to increase awareness that Canada is now coming on. So you are going to see some marketing spend as we go into the first part to the end of this year into 2024 to increase awareness as that opportunity opens itself up.

Lisa Yang (Goldman Sachs): The first one is on Higher Education. I am just wondering, given the better-than-expected enrolment data, I was by the way curious how that compares your expectations. But given it is a 1%, does that increase your confidence that revenue could be return to positive growth in 2024, or is this more something for 2025? Was just keen to hear your thoughts on the growth inflection there. So that is the first question.

The second one is on Canada. You said we are very excited by the Canada opportunity. Do you think you can maybe help us quantify what opportunity we could be thinking of over time? How do typical new contracts like this ramp in terms of revenue and profits, and over how many years and what time does it become modular credit? That is the second question.

And I think thirdly, just in general on capital allocation, I am just wondering if you can maybe give us a bit of an update feel for the share buyback. You have done already a third in less than two months, so it should be done basically by the time of your full year results. So is the plan just to continue stimulus of share buyback on an ongoing basis, or whether you think there is a potential greater allocation towards M&A, especially in workforce skills, for instance, to strengthen your position there?

Sally Johnson: Three for me.

Andy Bird: I believe they are.

Sally Johnson: Thank you, Lisa. So in Higher Ed and enrolments, as I said, you can see the headline there from the NSC with 2%. That includes all years of college, all types of college, different sorts of certificates. So we have looked at the underlying detailed data and adjusted it for the things that I mentioned in my prepared remarks. And the Pearson impact of the 2% is actually 1%.

Again, as I said in my prepared remarks, I think that is a hopeful sign. It is not a theme as yet. Another one of the data points in the detail is that we continue to see that increase in younger people enrolment. So that is 17 and under what's called dual enrolment, which is showing I guess an indication that people are interested in going to college, but it is as simple as that.

In terms of 2024 and the growth that we have indicated for higher education that is driven by the opportunity in the secondary market and all the things that we have done in order to improve market share, both in the sales team and from a product point of view. We are not relying on enrolment growth in 2024 to get to that, but obviously it would be helpful and add to the confidence.

Canada and the opportunity, as I have said, we have gone online with SDS. As Andy mentioned, we are putting marketing behind that and integration will come online as we enter into next year as well.

As you saw when we got Australia recognition that we will then build market share over the next few years. That is something that we have demonstrated that we can do. And as I think people know, PTE is a really lovely profitable part of the business, and it creates a real synergy between the Assessments & Qualifications business that we have got and the English business that we have got.

And then on the share buyback, the way things are trending at the moment, it does look like we might be complete by the end of the year, but obviously that has to do with what happens in the market.

The Board will then apply our capital allocation policy, investment in the business, strong balance sheet, our dividend policy, and we will make a decision on any further returns in due course, but we will apply that capital allocation policy as we go. Thanks so much, Lisa.

Andy Bird: One thing just to add, Lisa, on the Higher Ed enrolments. It just struck me very interesting, when you dig beneath those headline numbers, you see that we are seeing that actually the return to college of a lot of students who left during the pandemic and so they are now coming back to complete their degrees.

And I find that very encouraging along with the interest of dual enrolments from younger cohorts, as Sally mentioned, the fact that people left because of the pandemic presumably went and worked and are now returning. So if you look between the breakdown between first, second, third, fourth year enrolments, you will see that actually it is weighted beyond the fresher year. And that signals that there are students actually who had left, we presume because of the pandemic, who are coming back.

So it seems that there is increased interest in going to college. How that plays out next year, we will wait and see.

Nick Dempsey (Barclays): I have got three. So first of all, bit of a double question on Virtual Schools. I mean, had you previously told us that one of the schools that you were losing was going to impact the academic year starting in September 2024? because I do not think I had understood that.

And then we can see that your listed competitor Stride is having a really strong year, shares up, organic growth outperforming everyone's expectations. So are they winning these schools away from you, and is that a trend? Is that something that they are doing differently to you or is this not to do with Stride? That was one question.

Second question, given that we continue to see declines in Higher Ed in 2023 and just a small increase in enrolments, and given that your visibility has typically been quite low, what gives you the confidence that you will indeed return to positive growth in 2024?

And the last question, I suppose just going into English Language Learning again. I mean if we look at the start of next year, we have got a very tough comp in Australia and we have got the start of the Canadian opportunity. Could English Language Learning growth be a little weak because of those comps first before Canada starts to really follow through?

Sally Johnson: Thanks, Nick. Shall I start? And you can complement.

Andy Bird: Yeah, I will interject.

Sally Johnson: So on virtual schools, yes, absolutely. We did talk about both of those at prelims. It is absolutely as expected, and the team have been working since the beginning of the year on setting up the processes to get the new skills on board in order to offset that.

In terms of Stride, it was great to see that they have come out with strong results demonstrating the strengths in this business. They have had enrolments that have been

slightly lower over the last couple of years, so I do not think this is a shared thing. I think it is just a recovery from their point of view.

And the schools do not quite work like that in terms of schools being taken over from a competitor. What tends to happen is that schools decide to bring things back in house. You will remember they quite often then decide to come back to us after a period of time. We had one of those at the beginning of the year. So I do not think it is a kind of Stride versus us thing.

I think we are both in the market, see real opportunity in the market, and there is more than enough enrolment growth for us to both go after.

From a Higher Ed point of view, I think there is two things which we have talked about in the past that continue to be what gives me confidence in the future. That is the secondary market we recapture, and as we have discussed before, that has been from a demand side point of view over recent years. The supply side of that is coming into account now. So as I said earlier, if you look back only a few years, print and package was like six million odd units. We are down to one million units, and therefore the supply into that secondary market is less.

And then the second opportunity is in order to gain market share. And that is driven by all the things that we have done in our sales team, where we are seeing the KPIs. They are looking really good, and then the things that we have done from a product point of view that we have talked about as well. So that is what gives me confidence putting enrolments to one side.

And then in ELL, as expected, I think the Australia piece is flattening out now. We always expected that to happen, and Canada is in this year already from that SDF point of view. So that is ready and waiting for the beginning part of the year and we expect the immigration piece to come online as well. So I am still guiding to that high-single digits that we have looked at over that period of time and that would be a good way of thinking about it against next year.

Andy Bird: Yes, not much further to add to that, Nick. As I mentioned in my remarks, there is no shortage of demand for Pearson Test of English, reference the test centre we opened in India. And remember, we have over 20,000 Pearson VUE test centres around the world to service demand.

And as Sally said, I think you are going to see a slight flattening off in Australia, but that would be more than compensated over time with the opportunity in Canada, both in terms of immigration and also student visas.

Sally Johnson: Thanks very much, Andy. I think all questions are answered through the line, so I will hand back to you to conclude.

Andy Bird: Well, thank you very much. As I said, this is the last opportunity that we are going to have to speak at earnings. I would like to thank all of you for your interest in the company. As I said before, it means a lot. I actually do read every single analyst report, even the bad ones. And I really, really value all of the feedback you have given us. It has been an amazing three years to think of where the company was three years ago and the fact

that I spent the first, we did not meet for 10 months in person, which is the first 10 months of restructuring the company totally virtually in a pandemic.

It is kind of interesting, but I have thoroughly enjoyed it. And I think on screen you see the leadership team. And whilst I may be struck off, and I think Omar, you are watching this as well. We are leading a great leadership team, and continuity is really, really important because it is going to maintain the momentum and the strategic progress we have within the company.

The other thing that is really interesting about that team is there is only you and Cynthia still have the same job three years ago. And talking of you, it would be remiss of me to not say thank you so much. I could not have done any of this without Sally's help. Always had my back. We, as a company, are incredibly lucky to have you. I was incredibly lucky to have you. So thank you very, very much.

Sally Johnson: Thank you.

Andy Bird: Please take care of her. Bye all.

Sally Johnson: We will miss you.

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