



Pearson 9 Month Trading Update

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Omar Abbosh

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Opening Remarks

Ladies and gentlemen, thank you for joining us today for our nine-month trading update. I am Omar Abbosh and I am here with our CFO, Sally Johnson. Many of you will already have seen our results announcement this morning, so I am just going to pick out a few key points and then we will open it up for Q&A. I set out three priorities at the start of the year, and I am very pleased to report that we are on track with all of them.

The first is to deliver on market expectations. Due to our continued focus on operational and financial performance, we have delivered another good quarter with underlying sales growth up 5%, taking us to 3% for the first nine months of the year. Each of our divisions are performing to plan and all contributed to growth for the quarter.

A&Q has accelerated in the third quarter as anticipated with all businesses contributing to growth, Virtual Schools delivered growth for the nine months with encouraging enrolment trends across our existing and new schools. Albeit we still expect a modest revenue decline for the full year given the school losses in prior years. Higher Education has indeed returned to growth in the third quarter and is on track to grow for the full year with the operational and business changes implemented over the past 18 months, starting to bear fruit.

English Language Learning continues to grow at high single digits for the first nine months and is performing well despite the well-known challenges in the wider English assessment market. And Workforce Skills has delivered a solid performance across both vocational qualifications and workforce solutions. So with this broad-based performance, we are on track to meet market expectations for the full year.

Second, I said we would sharpen our focus on the opportunities in the enterprise space and double down on Workforce Skills. As we told you at interims, Pearson already has many of the assets that enterprises need to address their problems in talent planning, talent sourcing, and talent development, and we can go after those opportunities by bundling our existing products, unlocking synergies across the company. As an example of that, we recently signed a meaningful multi-year deal with ServiceNow.

For those of you that don't know ServiceNow, they're a leading AI platform for business transformation and we have just concluded a deal with them covering many of the areas of scope that Pearson brings to market in the enterprise space. I see this as a great blueprint for the sorts of deals that you can expect Vishaal and the team to continue working on and a proof point that we are building momentum in our enterprise approach.

Third, I said we would increase the intensity by which we infuse our products and services with AI capabilities, and we continue to have examples of this from across Pearson. In our English Language Learning division, we are developing Teaching Pal, an AI powered tool that leverages our trusted IP to make educators' lives easier by creating customised lesson content and activities. In Higher Ed, we continue to make good progress with our AI initiatives, rolling out our AI study tools to more than 90 titles for Fall back to school.

We have seen over five million student interactions with these new features this year, and we are starting to see a positive commercial impact too with double digit year over year billings growth in products with those AI study tools. In Virtual Schools, we have also embedded AI study tools into our content, so that when high school students struggle with quizzes and practice tests, they can receive step-by-step help to walk them through tough material.

At our interim results in July, I outlined our medium-term strategy. It is early days, but I am pleased with the progress that the team and that we are making across the board. We are confident that we will deliver value for our stakeholders going forward. We are moving at pace to transition the strategy into execution with teams working to deliver high priority

projects for Pearson. As you would expect, these teams are focused on material opportunities which can generate strong returns and are being led with clear lines of accountability.

We continue to remain focused on driving performance in the core business, starting to realise synergy benefits and investing in adjacent market expansion. This includes a focus on our medium-term growth vectors of enterprise skilling and early careers where for example, we have decided to invest in a sales team dedicated to selling our leading advanced placement, dual enrolment and career and technical education materials directly into states and school districts.

This will expand and strengthen our customer relationships with school administrators in a space where the demand for college and career readiness programmes is growing strongly. I look forward to providing a further update on our strategic progress with our full year results next year. With that, let's go to Q&A.

Q&A

Operator: Thank you, Omar. Our first question comes from Nick Dempsey at Barclays Capital. Nick, please go ahead.

Nick Dempsey (Barclays Capital): Yeah, good morning, guys. I have got three questions please. So first all, can you give us an approximate indication for how the boost from the adoption cycle in your K-12 business inside Higher Ed benefited that good 4% organic growth in Q3 in Higher Ed?

Second question, national student clearing house enrolments pointed to 3% growth in undergraduates, two-year community colleges better than that, but freshmen cohort worse than that. Can you give a rough idea of what you think the enrolment growth in your footprint has been? And then on the tax rebate, that is good news, but can you give a rough indication of over how many years that 105 million pounds will flow into your cashflow?

Sally Johnson: So your line crackled slightly on the first question, but I think you are asking about the K-12 element of Higher Education in Q3. Correct me if I got that wrong. So I talked about K-12, particularly at the interim stage because it was material in the context of the interim result. It is not so material when you are getting into Q3 and the big fall back to school season, but K-12, which is about 10% of the Higher Education business, to put it into context, grew at around about 7%.

So in terms of that 4%, it is not a meaningful part of it, but a decent growth in that part of the business. I think this point that we are making about bringing the K-12 sales team in-house is strategically important, particularly as we are talking about early careers.

And then the NSC announcement on enrolments. The thing I would say about that data is it is early days, so it is a kind of September 1st look, so it only has a proportion of schools. What I would say is that last year, actually the breakdown underneath in particular did change relatively materially between now and then, so we should take it as a data point but not the final data point.

You are quite right that freshmen actually within that context went down by about 5%. The kind of non-freshmen piece went up by about 4%, which is how you get to 3%. When you take into account the fact that the materials and things tend to be weighted to freshmen, that 3% becomes about 2% in a Pearson context.

And then the tax, I am not sure I necessarily call it a rebate, but the repayments that we will get, obviously we are delighted that the appeal was successful. You all have seen in our notes to our annual report, we had paid 105 million pounds relating to this case, which will now be repayable. We are in conversation with HMRC about how we make that happen. I would expect it to all come in one go. I am guessing it is going to be next year rather than this year.

Operator: Our next question comes from Luke Holbrook at Morgan Stanley. Luke, please unmute yourself and go ahead.

Luke Holbrook (Morgan Stanley): Hi. Morning everyone. My question is just on Workforce Skills. I have seen the ServiceNow contract looks quite interesting here in the way that you are discussing bundling services across the organisation. I am just wondering, is this a change in approach from the more modular approach that you have indicated before and is there a pipeline of other types of these contracts that could come through or is this more one-off in nature?

Then, just changing tack a little bit on ELL, I would just love to hear your thoughts on that UK Home Office contract potential, it is large, \$1.1 billion contract I understand coming up in the next few years. Just interested to hear how we should think about that and what's going on behind the scenes. Thank you very much.

Omar Abbosh: With pleasure, Luke. So good to hear from you. On Workforce, yeah, the reason I am so happy about what Vishaal and the team have done is indeed it is one contract, but it is a proof point of the needs of any big enterprise that has a big workforce around help with how they do talent planning and how they do talent development in an era where more and more companies will deploy more automation and AI into their workforce.

So as you can imagine, the scope of the contract includes things like Faethm, but it also includes assessment and learning capabilities from other parts of Pearson as well, and it all comes together as a bundle. So yes, you should absolutely expect us to be bringing more of these deals forward in the coming months and years, and you will hear about that from us. But it is a very nice blueprint and what for me it does is it demonstrates the nice fit between the set of product service that Pearson has to the need that customers have as they develop their talent and their workforces going forward.

On the home office topic, again, I think it is probably worth saying the current contract has got a couple of years to run still. So that is in train until 2026. Yeah, until 2026. So Sally, I don't know if you want to elaborate more on what the current process is, but we don't see a short-term change impacting us, but of course it is clearly an interesting opportunity and we are plugged into the conversation.

Sally Johnson: Yeah, so I think the stage it is at at the moment is there has been one kind of, I guess you would call it consultation process with experts in the field like Pearson with the government about what they might propose to do. There is going to be another round of that, and I think then it is going to be opened up to further discussions in March next year.

The current contract runs until 2026 and I think we will see whether the government goes with the construct it has suggested, which you are right, could be a really big opportunity or whether it decides to tweak it at all, but we will know more next year. And then specific on your Workforce question in the modular versus bundled approach, I think they're the same approach. It is not a change that we are signalling there.

Luke Holbrook (Morgan Stanley): Understood. Thank you very much.

Sally Johnson: Thanks, Luke.

Operator: The next question this morning comes from James Tate at Goldman Sachs International.

James Tate (Goldman Sachs): Hi, good morning, James from Goldman Sachs. I have got two questions please. I think firstly, could you give some colour on PTE revenues and volumes in Q3? I guess you sort of talked about Institutional being down in the quarter and that implies PTE is return growth. Do you expect that to continue into Q4? I guess secondly, Higher Ed growing 4% in Q3 is probably a bit better than the market expected and just interested how you think about that dropping through to profit in H2, given that you took some restructuring costs in H1 as well. Thank you.

Sally Johnson: Thanks, James. On PTE, you will remember that volumes were down when we disclosed those at the half year. Revenue was down very slightly. In Q3, it did return to

growth and so that indication I had given that it was likely to be down for the full year, it could be flatter, maybe even slightly up. I think it is fair to say that the market for PTE is a challenging one at the moment, and we anticipate that continuing, but we are very confident in the English business and the opportunity there in the more medium term.

You mentioned Institutional in Q3, that is some very specific phasing that has moved from Q3 to Q4. I understand what customer it is and therefore we have got good line of sight to the fact that that is going to come through in Q4.

And then Higher Education returning to growth, obviously what we had indicated and very much in line with expectations. That will drop through at the normal operating leverage. The one thing I will point out is that K-12 piece where we have invested in that sales force ahead of taking that sales force in-house for that part of the business next year. As I said, strategically very important to us from an early careers perspective and building those direct relationships with customers who are getting increasingly interested in early years and CTE, so careers and technical product.

Operator: Thank you. The next question comes from Simon Baker at Bernstein. Simon, please go ahead.

Simon Baker (Bernstein): Two questions please. In terms of synergies, Omar, thanks for sharing a few more of the examples coming through. I was just wondering how that roadmap is playing out because I guess when you launched that as a new part of the strategy, it opened the gates for lots of ideas coming forward. I am wondering how's that materiality in your view? Is it exceeding expectation in terms of the queue of potential projects there? Is it proving a little bit more cumbersome in terms of infrastructure you have, et cetera? So that is the first question.

And secondly, I remember some time ago, and apologies if this is not a data point that you recognise, but we were told that 40% of the higher education classroom would typically have the product as such and the others would get it through other means. I wonder whether you can update us on that theme and for us to gauge how much of this improvement coming through in the third quarter is that removal of the headwinds of the past? Thank you.

Omar Abbosh: Yeah, so thank you, Simon, very much. So on the synergies, as you know, we talked about this at the end of July. We are now one quarter in, so I don't want to make too much of a meal of it, but I will pick out two areas that I am pleased with progress. So, firstly, what I said before, I said synergies is focus on the core business and drive performance in the core business in the five business units. So that is 100% our number one focus. So we are staying extremely focused on execution and basic performance disciplines in each of the business units.

Now, having said that, I will give you two. One is Sally and her team did some beautiful work on a sales incentive for our sellers across the company to allow them to get sales credit and retire quota if they sell products that a customer wants that happen to be from another business unit in Pearson.

In other words, we are making it easier for buyers to buy our stuff and easier for our sellers to sell it, and that has been received very well by our salesforce, and by the way, their management hierarchy as well because we make sure we recognise the whole hierarchy if people are collaborating in pursuit of value for a customer. There are some early signals there that I quite like, and the ServiceNow deal that we talked about is a classic example. That is actually a larger material deal, but it will happen in the tail of deals as well. So there is a synergy there around sales.

The second one is around product and common services, and so our technical leaders in the company, so MaryKay, Dave and Tony have gone down and worked through what are all the common services that we have and that we can have for all of our products across the company. So if for example, we build APIs into AI study tools in Higher Ed, how do we call those APIs and leverage them in the Connexus platform in Virtual Schools so that we don't rebuild something twice that we built once, but we can use it twice. So that kind of synergy

we are also beginning to see happen in the company. It is early days, but I am pleased with the direction of travel and where we are going there.

Now on your second question on Higher Ed, I think you are talking a bit about things like secondary market recapture and piracy and various things that we have seen before. And while some of those themes are still out there, it is diminishing over time. As you know, 86% of Pearson is now digital. That is very much true in the higher ed space, and so when you have more and more of the product being delivered in digital format, textbook piracy and all this kind of stuff becomes a bit less of an issue from the past.

Also, the new learning experience is much more meaningful than simply serving up a text. People are engaging with the technology in a way which is much more interactive. The AI is a part of it, but it is not the only part. You embed assessments in there and learning all in a package, and I think that clearly is the direction of travel for the future of how learning experiences improve over time.

Operator: We now have a written question from Sami Kassab at BNP Paribas. Can you disclose how much revenues you generate from AP and related products? What financial impact will the change in distribution have on revenues and margins?

Sally Johnson: So I think, Sami, maybe you wrote that question in before I answered Nick's first question because I think you are talking about the same thing. So AP advanced placement is part of our K-12 business. I said an answer to that question. It is about 10% of Higher Ed's revenues. And then the financial impact of the distribution, so we have been bringing on a sales team towards the end of this year so that they are ready to go as the next sale season for next year starts at the beginning of next year. I think it is fair to say that next year will be a transition year, but then we do see the opportunity for growth as part of that early career strategy and in particular talking to customers who are ever increasingly interested in that career and technical part of our product base.

Operator: The next question comes from Tom Singlehurst at Citigroup. Tom, please go ahead. Your line is now open.

Thomas Singlehurst (Citigroup): Perfect, thank you. Thanks for the presentation. I have got three questions if that is okay. The first one is you explicitly talk about, I think it is double digit billings growth in AI enabled products. I just wonder whether there is a pathway to additional specific additional revenue for AI functionality or whether this going forward will just be a question of driving value via AI to drive yield. That was the first question.

Second question was on Virtual Schools. Obviously very encouraging performance in the third quarter, and you are very clear that there is a comp effect and funding. I suppose I am just trying to work out what the underlying expected growth is across the academic year. I presume it is going to be in that low single digit decline level, but just to be explicit about that and therefore for next year, the expectation of growth I presume is linked to the 2025/2026 academic year.

And then the final question is on ELL, you have mentioned the tough broader market, but I would love some extra detail on whether you think you are taking share within the PTE, specifically talking about PTE, but whether you are taking share within the English language proficiency testing market.

Omar Abbosh: Okay, so Tom, I will pick up on the first and third question, then Sally, maybe ask you to dive into Virtual Schools. So I think I said this at the interims, Tom, with the application of AI, we first want to make sure we build beautiful, really useful experiences that help learners learn and help educators educate. So that is the number one job.

So the way in which I see the monetisation working in the near term is just by building better products that make you more competitive and actually make our sellers job easier when they go into a customer and say, let me show you what this thing does. And the customer goes, wow, that is amazing. And I have heard more and more of those examples and I really want us to stay very focused on that.

Now, as you start to build that into the raft of products across the board, then we can do a little bit more of some of the AB testing things to say like, well, what experiences work better and which ones could monetise? For example, if you think about what we do in the world of channels, it is a very small base, but it is had fantastic growth and great feedback, and as Sally jokes about it, even Sally can now notice it in the numbers, which is not a trivial thing to say.

So you can expect us to do more of those experiments going forward, but we are of course sensitive to the wider market, how people purchase, how they monetise, and actually when professors make adoption decisions, they're also looking to say, is this company being fair in terms of its overall pricing and these sorts of topics? So we want to do this in exactly the right way for the markets we are in, but we are building the capability first to build high products that have high win rates and second to build experimentation, AB testing capability into the product set over time so that we can get in the direction of what you are talking about.

Sally, do you want to pick up the Virtual Schools comps topic?

Sally Johnson: Yeah, there is quite a lot in that question, wasn't there? So you are right, Tom. For the full year, we expect to be down the same amount as we were last year. So last year we were down 2%. That is driven by the loss of that school for the 24/25 academic year. And you are right, that will be something that is a feature for the first half of next year. So around about that amount down for the first half would be in line with expectations. But then we are through that and we are expecting good growth for the 25/26 academic year and growth for Virtual Schools for next year from an annual perspective.

Two data points for that. If you do things on a like for school basis, we saw 4% growth in enrolments. So that is what is happening in terms of interest in Pearson's Virtual Schools on an underlying basis. And if you then include the new schools that we have got, that rises to 6%. So we are anticipating good growth for Virtual Schools for next year.

Omar Abbosh: Thanks, Sally. And then on the PTE topic that you asked about, Tom, again, without naming names, if you go and look at some of the competitive players in the space they will talk to you about meaningful late teens, 20% percentage reductions in testing volumes. That is what they're seeing in the market overall. So the fact that actually Gio and the team delivered growth in PTE in the quarter in that kind of a market context, of course implies that we are taking share, and of course implies that we are executing in a very intense and focused way, which you can expect us to continue to do in the context of a market that is indeed subject to some of these policies in different countries. And we understand that market very well.

Operator: We have another written question from Sami Kassab at BNP Paribas. Can you please remind us of the Q4 2023 movements around virtual schools funding? Was the funding increase related to ESSER funding receipts? And if so, what impact do you expect from ESSER expiration in Q4 2024?

Omar Abbosh: Yeah, the short answer is not much, but go ahead, Sally.

Sally Johnson: I will give a bit more flavour than that. So Q4 2023, so last year we talked about a funding improvement of, I think it was between 10 and 15 million pounds, half of which had related to previous periods, and that is why you won't see that repeating this year. And Q4 will see a decline, which leads to the guidance for the full year that I have given you, and half of which was funding that was on a continual basis, and therefore would be wrapped into this year as well.

From an ESSER perspective, the amount of funding that we have received from that is really very small. It is not material in a Pearson context, but of course there are things that we will replace ESSER that we will look to from a future facing point of view so that we are getting funding for some of the additional kind of products that we can give to learners in that market. I think career and technical is a really good example of that and something that strategically is very interesting for us in that space as well.

Omar Abbosh: Thanks, Sally.

Operator: That was the last question this morning, which concludes the Q&A session, and I would now like to hand back to Omar for any closing remarks.

Omar Abbosh: Thanks, Vanessa. Well, all of you out there, thank you so much for joining us. Thank you for your interest in Pearson as we will continue to stay focused on executing what we have said all along and look forward to seeing you at our prelims early in the new year. So thank you very much.

Sally Johnson: Perfect. Thank you, everybody. Bye-Bye.