Pearson plc (PSO)

Updated November 2nd, 2021 by Jonathan Weber

Key Metrics

Current Price:	$8	**5 Year CAGR Estimate:**	2.8%	**Market Cap:**	$6B
Fair Value Price:	$7	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	09/25/21
% Fair Value:	119%	**5 Year Valuation Multiple Estimate:**	-3.3%	**Dividend Payment Date:**	11/07/21
Dividend Yield:	3.4%	**5 Year Price Target**	$8	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	-

Overview & Current Events

Pearson plc is a book publishing and education company whose services include business information, consumer publishing and educational content delivered through books and online services. Pearson was founded in 1944 and is headquartered in London, United Kingdom. Pearson is the biggest publishing company by market capitalization. Pearson reports its results in Pound Sterling, but the numbers in this report are in US$, unless noted otherwise.

Pearson reported the results for the first nine months of the current fiscal year on October 15. The company announced that its revenues grew by 10% versus the previous year's period on an underlying basis, which was an improvement versus the rather weak results the company had to report during fiscal 2020. Many school systems in international markets that the company targets have started to open up again, resulting in improving business conditions for that segment. Global Online Learning remained a bright spot for the company during this period as well thanks to tailwinds from increased tele-schooling in some of the countries Pearson does business in. Virtual Learning revenues rose by 14% year over year. It is expected that Pearson's revenue will climb during the remainder of the year as well.

Pearson did not announce earnings-per-share for the third quarter, as Pearson does showcase its profits only twice a year, during the Q2 and Q4 presentation. The company has, however, reiterated its guidance for operating profits of around 380 million Pound Sterling. Earnings-per-share should recover slightly this year, although not to pre-crisis levels.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.11	$1.10	$0.92	$0.87	$0.92	$0.78	$0.71	$0.91	$0.75	$0.40	***$0.45***	***$0.52***
DPS	$0.53	$0.57	$0.61	$0.65	$0.69	$0.69	$0.51	$0.88	$0.24	$0.27	***$0.27***	***$0.27***
Shares[1]	816	817	819	820	821	814	802	781	788	755	***745***	***720***

Pearson reports its results in Pound Sterling, so exchange rate changes can impact Pearson's results once those are converted to US$. Pearson generated strong growth between 2008 and 2010, but its profits peaked in 2011 and have been trending downward since, despite the fact that the economy has been doing well since then.

The publishing industry has changed significantly over the last decade, but other publishing companies have had fewer problems when it comes to maintaining their profitability during that time frame. Since Pearson is the largest among its peers, one would have guessed that the company would be able to keep its profitability high, due to advantages in terms of scale and the company's global reach, but that has not been the case. Pearson has established a cost-cutting strategy that aims at increasing the company's margins, which seems like a good idea, as declining profits during the last couple of years were primarily based on margin pressures. Pearson plans to cut more than $400 million in expenses on an annual basis by the end of 2020. If Pearson could hit that target, its profitability would grow significantly in a vacuum, but it looks like most of those cost-cutting benefits will be offset by headwinds such as gross margin pressures, which is why net profits during 2020 did not come in at a strong level – the pandemic further impacted profits negatively. For now, revenues are down due to the pandemic impact, but it seems reasonable to assume that sales will be higher in the future again, as schools will still need new books and material, thus these sales should not be lost forever.

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[1] In Millions

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	16.0	17.5	22.0	21.7	17.6	14.2	14.6	13.2	11.1	23.3	***17.8***	***15.0***
Avg. Yld.	3.0%	3.0%	3.0%	3.4%	4.3%	6.2%	4.9%	2.0%	2.9%	3.0%	***3.4%***	***3.5%***

Based on current earnings-per-share estimates for this year, Pearson is trading at around 18 times net profits. Pearson traded at a price to earnings multiple of up to the low 20s during the last decade, which is somewhat surprising when we account for the quite weak growth performance that Pearson delivered during the last ten years. Right now, shares seem overvalued, we believe, based on a 15x earnings multiple that we would deem fair for its shares. We thus see considerable downside potential for shares from the current level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	47.7%	51.8%	66.3%	74.7%	75.0%	88.5%	71.8%	96.7%	32.0%	68.0%	***60.0%***	***51.8%***

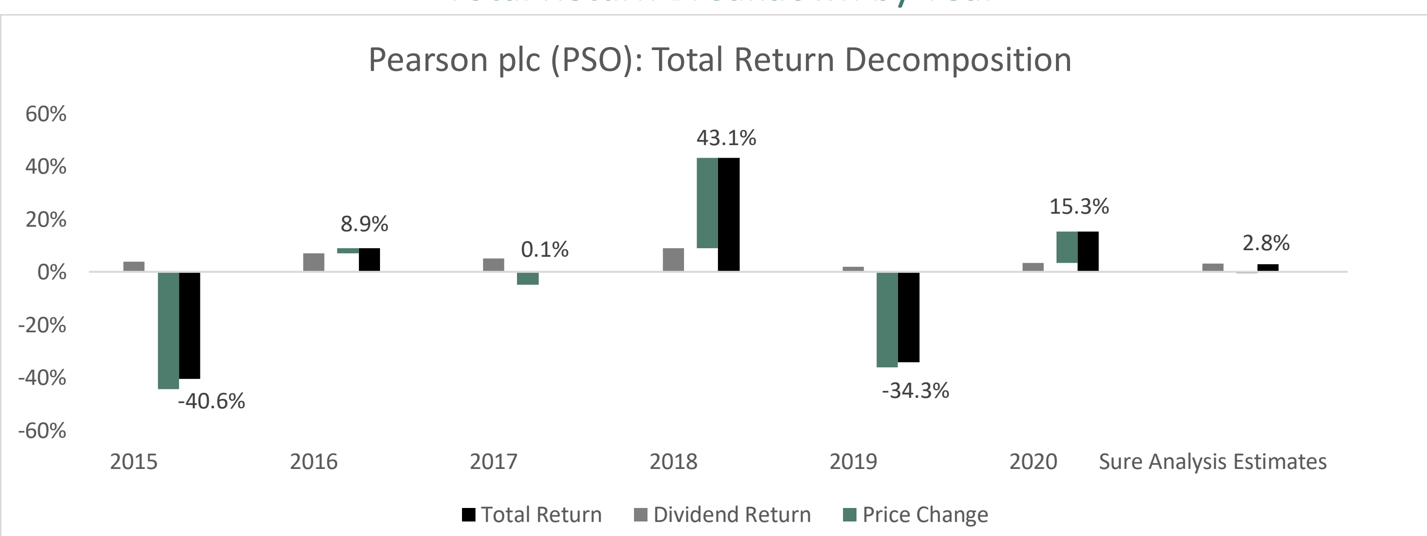
Pearson's dividend payout ratio was in the 40s a decade ago but has risen to as much as 97% in 2018. Following a steep dividend cut, Pearson's dividend payout ratio has declined to a more reasonable, although still not really low level of around 60%. At the current level, the dividend looks sustainable, but due to the company's history of cutting its dividend repeatedly, Pearson still is not a sleep-well-at-night stock for income-oriented investors.

Pearson is the largest publishing company in the world, which should theoretically result in major advantages when it comes to sales networks and margins due to the company's size and scale, but Pearson has not profited from its leadership position in the recent past. During the financial crisis Pearson was able to grow its profits.

Final Thoughts & Recommendation

Pearson is the largest player in its industry, but that has not helped the company in achieving sustained growth throughout the last couple of years. Pearson's cost-cutting efforts, coupled with deleveraging that lowers its interest expenses, could result in some earnings growth in the long run, thus the growth outlook has improved to some degree, yet Pearson cannot be described as a growth investment. Pearson's total return outlook is not really compelling, mainly due to a relatively high valuation. We rate Pearson a sell at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	7,724	7,858	7,931	7,484	6,828	6,168	5,827	5,509	4,940	4,360
Gross Profit	4,402	4,393	4,314	4,152	3,801	3,332	3,159	2,917	2,568	2,092
Gross Margin	57.0%	55.9%	54.4%	55.5%	55.7%	54.0%	54.2%	52.9%	52.0%	48.0%
SG&A Exp.	3,510	3,564	3,566	3,598	3,316	2,998	2,806	2,498		
D&A Exp.	412	502	483	661	1,834	3,945	404	338	497	407
Operating Profit	1,079	937	907	755	654	383	418	498	262	293
Operating Margin	14.0%	11.9%	11.4%	10.1%	9.6%	6.2%	7.2%	9.0%	5.3%	6.7%
Net Profit	1,535	493	842	776	1,258	-3166	524	785	337	398
Net Margin	19.9%	6.3%	10.6%	10.4%	18.4%	-51.3%	9.0%	14.2%	6.8%	9.1%
Free Cash Flow	1,167	990	272	450	(55)	224	85	350	225	327
Income Tax	260	219	136	92	(124)	(301)	17	(123)	(43)	56

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	17,325	18,338	18,025	17,739	17,237	12,366	10,660	10,031	10,030	10,154
Cash & Equivalents	2,109	1,716	1,202	825	2,523	1,792	700	721	573	1,495
Acc. Receivable	1,615	1,403	1,423	1,499	1,390	1,181	999	1,109	1,184	1,083
Inventories	627	422	369	349	313	289	200	208	222	176
Goodwill & Int.	9,772	10,048	9,566	9,821	7,650	4,229	4,006	3,818	3,802	3,737
Total Liabilities	8,139	9,111	8,616	8,424	7,729	7,025	5,226	4,289	4,362	4,521
Accounts Payable	744	545	521	512	473	409	358	395	469	1,630
Long-Term Debt	3,132	3,644	3,653	3,448	3,440	3,021	1,455	907	1,083	2,250
Total Equity	9,157	9,189	9,399	9,306	9,502	5,337	5,423	5,730	5,655	5,622
D/E Ratio	0.34	0.40	0.39	0.37	0.36	0.57	0.27	0.16	0.19	0.40

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	9.1%	2.8%	4.6%	4.3%	7.2%	-21.4%	4.6%	7.6%	3.4%	3.9%
Return on Equity	17.3%	5.4%	9.1%	8.3%	13.4%	-42.7%	9.7%	14.1%	5.9%	7.1%
ROIC	12.5%	3.9%	6.5%	6.0%	9.8%	-29.7%	6.9%	11.6%	5.0%	5.4%
Shares Out.	816	817	819	820	821	814	802	781	788	755
Revenue/Share	9.63	9.75	9.80	9.22	8.40	7.57	7.16	7.07	6.35	5.77
FCF/Share	1.46	1.23	0.34	0.55	(0.07)	0.27	0.10	0.45	0.29	0.43

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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