



# Pearson plc (PSO)

Updated November 22<sup>nd</sup>, 2022 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$11.70	<b>5 Year CAGR Estimate:</b>	-1.6%	<b>Market Cap:</b>	\$8.4B
<b>Fair Value Price:</b>	\$8.30	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	12/12/22 <sup>1</sup>
<b>% Fair Value:</b>	142%	<b>5 Year Valuation Multiple Estimate:</b>	-6.7%	<b>Dividend Payment Date:</b>	12/23/22 <sup>2</sup>
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$9.60	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	F	<b>Rating:</b>	Sell

## 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 its third quarter and nine months trading update on October 24. The company announced that its revenues grew by 7% versus the previous year on an adjusted basis, which backs out currency rate changes and the impact of acquisitions and divestitures. Global Online Learning remained a bright spot for the company, and assessment and qualification was another well-performing business unit, showcasing 12% revenue growth versus the previous year. US student assessment revenue grew by an attractive 32% year over year.

Pearson did not announce an earnings-per-share result for the third quarter, which is typical for British companies, as they only announce net profits for Q2 and Q4. It is expected that profits will grow this year, although they will remain below pre-pandemic levels according to the analyst community, as earnings-per-share are forecasted at \$0.55.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$1.10	\$0.92	\$0.87	\$0.92	\$0.78	\$0.71	\$0.91	\$0.75	\$0.40	\$0.46	<b>\$0.55</b>	<b>\$0.64</b>
<b>DPS</b>	\$0.57	\$0.61	\$0.65	\$0.69	\$0.69	\$0.51	\$0.88	\$0.24	\$0.27	\$0.27	<b>\$0.25</b>	<b>\$0.25</b>
<b>Shares<sup>3</sup></b>	817	819	820	821	814	802	781	788	755	757	<b>755</b>	<b>720</b>

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. 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. Revenues declined during the pandemic, 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. Instead, they will recover eventually as schools stock up again in the future.

<sup>1</sup> Estimated date

<sup>2</sup> Estimated date

<sup>3</sup> In Millions

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## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	17.5	22.0	21.7	17.6	14.2	14.6	13.2	11.1	23.3	18.0	<b>21.3</b>	<b>15.0</b>
Avg. Yld.	3.0%	3.0%	3.4%	4.3%	6.2%	4.9%	2.0%	2.9%	3.0%	3.3%	<b>2.1%</b>	<b>2.6%</b>

Based on current earnings-per-share estimates for this year, Pearson is trading at around 21 times net profits. Pearson traded at a price to earnings multiple of up to the low 20s at times during the last decade as well, 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	51.8%	66.3%	74.7%	75.0%	88.5%	71.8%	96.7%	32.0%	68.0%	58.7%	<b>45.5%</b>	<b>39.2%</b>

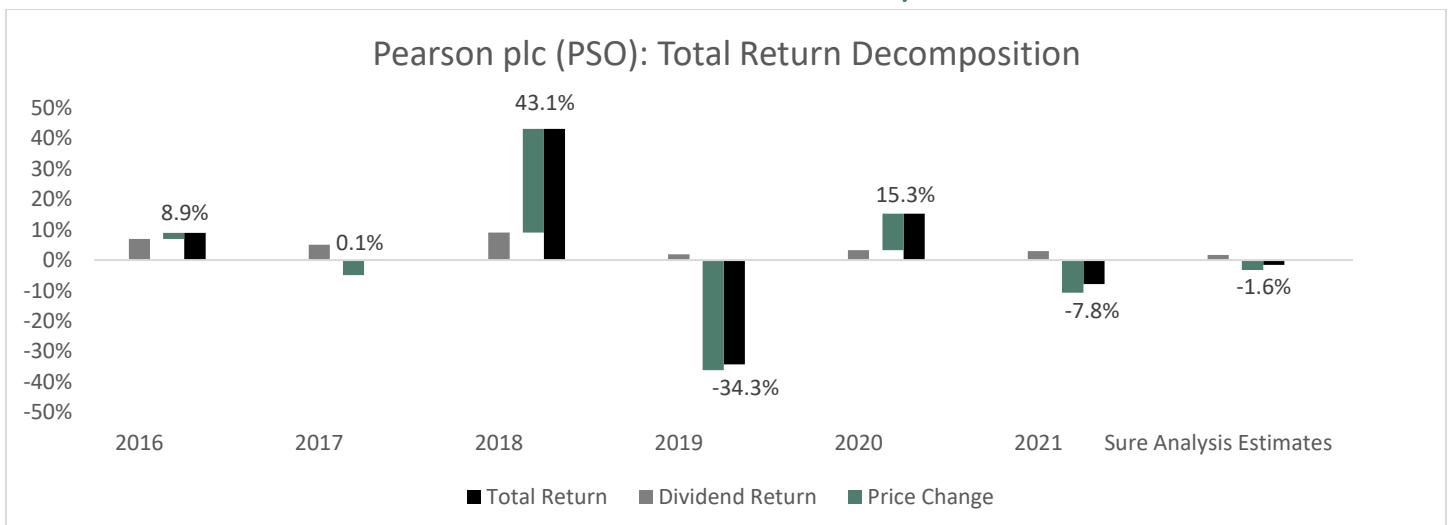
Pearson's dividend payout ratio was in the 40s a decade ago but has risen to as much as 97% in 2018. Following a steep dividend cut, Pearson's dividend payout ratio has declined to a more reasonable, although still not really low level of around 50%. At the current level, the dividend looks sustainable, 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, yet Pearson cannot be described as a growth investment. Pearson's total return outlook is not compelling at all, mainly due to a too-high valuation, relative to what we deem fair value. We thus rate Pearson a strong sell at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	7,858	7,931	7,484	6,828	6,168	5,827	5,509	4,940	4,360	4,716
<b>Gross Profit</b>	4,393	4,314	4,152	3,801	3,332	3,159	2,917	2,568	2,092	2,313
<b>Gross Margin</b>	55.9%	54.4%	55.5%	55.7%	54.0%	54.2%	52.9%	52.0%	48.0%	49.0%
<b>SG&amp;A Exp.</b>	3,564	3,566	3,598	3,316	2,998	2,806	2,516	2,174	1,857	1,905
<b>D&amp;A Exp.</b>	502	483	661	1,834	3,945	404	338	497	407	561
<b>Operating Profit</b>	937	907	755	654	383	418	498	462	293	458
<b>Operating Margin</b>	11.9%	11.4%	10.1%	9.6%	6.2%	7.2%	9.0%	9.4%	6.7%	9.7%
<b>Net Profit</b>	493	842	776	1,258	-3,166	524	785	337	398	219
<b>Net Margin</b>	6.3%	10.6%	10.4%	18.4%	-51.3%	9.0%	14.2%	6.8%	9.1%	4.6%
<b>Free Cash Flow</b>	990	272	450	(55)	224	85	350	225	327	206
<b>Income Tax</b>	219	136	92	(124)	(301)	17	(123)	(43)	56	(4)

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	18,338	18,025	17,739	17,237	12,366	10,660	10,031	10,030	10,154	9,910
<b>Cash &amp; Equivalents</b>	1,716	1,202	825	2,523	1,792	700	721	573	1,495	1,265
<b>Acc. Receivable</b>	1,403	1,423	1,499	1,390	1,181	999	1,109	1,184	1,083	1,151
<b>Inventories</b>	422	369	349	313	289	200	208	222	176	132
<b>Goodwill &amp; Int.</b>	10,048	9,566	9,821	7,650	4,229	4,006	3,818	3,802	3,737	3,737
<b>Total Liabilities</b>	9,111	8,616	8,424	7,729	7,025	5,226	4,289	4,362	4,521	4,134
<b>Accounts Payable</b>	545	521	512	473	409	358	395	469	463	474
<b>Long-Term Debt</b>	3,644	3,653	3,448	3,440	3,021	1,455	907	1,083	1,319	1,035
<b>Total Equity</b>	9,189	9,399	9,306	9,502	5,337	5,423	5,730	5,655	5,622	5,763
<b>LTD/E Ratio</b>	0.40	0.39	0.37	0.36	0.57	0.27	0.16	0.19	0.23	0.18

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	2.8%	4.6%	4.3%	7.2%	-21.4%	4.6%	7.6%	3.4%	3.9%	2.2%
<b>Return on Equity</b>	5.4%	9.1%	8.3%	13.4%	-42.7%	9.7%	14.1%	5.9%	7.1%	3.8%
<b>ROIC</b>	3.9%	6.5%	6.0%	9.8%	-29.7%	6.9%	11.6%	5.0%	5.8%	3.2%
<b>Shares Out.</b>	817	819	820	821	814	802	781	788	755	757
<b>Revenue/Share</b>	9.75	9.80	9.22	8.40	7.57	7.16	7.07	6.35	5.77	6.21
<b>FCF/Share</b>	1.23	0.34	0.55	(0.07)	0.27	0.10	0.45	0.29	0.43	0.27

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

### Disclaimer

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