



Pearson plc (PSO)

Updated November 20th, 2023 by Jonathan Weber

Key Metrics

Current Price:	\$12	5 Year CAGR Estimate:	2.4%	Market Cap:	\$8.5 B
Fair Value Price:	\$11	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	12/12/23 ¹
% Fair Value:	114%	5 Year Valuation Multiple Estimate:	-2.6%	Dividend Payment Date:	12/23/23 ²
Dividend Yield:	2.3%	5 Year Price Target	\$12	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	F	Rating:	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 pre-close trading update, the equivalent to its Q3 results, on October 30. The company announced that its revenues grew by 5% versus the previous year on an adjusted basis, which backs out currency rate changes and the impact of acquisitions and divestitures. English Language Learning was a growth driver for the company, and assessment and qualification was another well-performing business unit. English Language Learning had been one of the stronger units in Pearson's portfolio during previous quarters as well.

Pearson did not announce profits for the third quarter, as the company only releases profit numbers with its half-year results and its full-year results. But Pearson updated its profit guidance for the current year, raising it by 20 million Pound Sterling, to 570 million Pound Sterling. A solid earnings-per-share increase is expected for the current year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$0.92	\$0.87	\$0.92	\$0.78	\$0.71	\$0.91	\$0.75	\$0.40	\$0.46	\$0.64	\$0.70	\$0.81
DPS	\$0.61	\$0.65	\$0.69	\$0.69	\$0.51	\$0.88	\$0.24	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27
Shares³	819	820	821	814	802	781	788	755	757	742	730	700

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. Also, increased online learning revenue could be a growth driver in the future.

¹ Estimated date

² Estimated date

³ In Millions

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	22.0	21.7	17.6	14.2	14.6	13.2	11.1	23.3	18.0	17.7	17.1	15.0
Avg. Yld.	3.0%	3.4%	4.3%	6.2%	4.9%	2.0%	2.9%	3.0%	3.3%	2.4%	2.3%	2.2%

Based on current earnings-per-share estimates for this year, Pearson is trading at around 17 times net profits. Pearson traded at a price to earnings multiple of up to the low 20s at times 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 slightly overvalued, based on a 15x earnings multiple that we would deem fair for its shares. We thus see a small total return headwind from multiple compression over the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	66.3%	74.7%	75.0%	88.5%	71.8%	96.7%	32.0%	68.0%	58.7%	42.2%	38.6%	33.3%

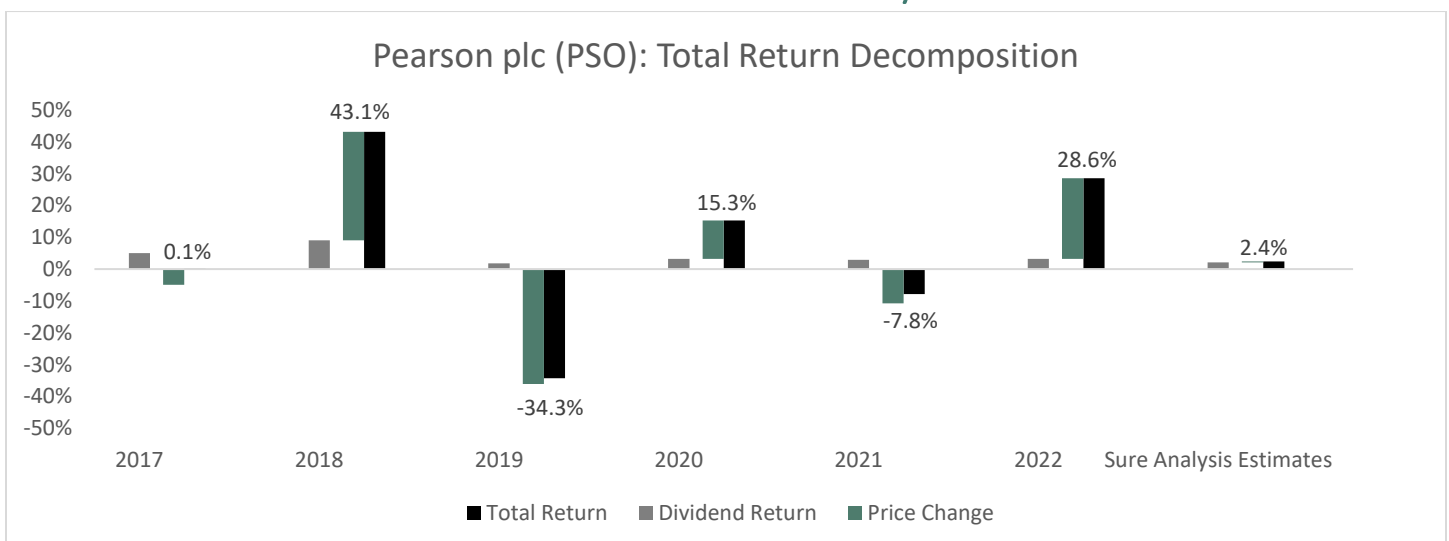
Pearson's dividend payout ratio was in the 40s a decade ago but has risen to as much as 97% in 2018. Following a steep dividend cut, Pearson's dividend payout ratio has declined to a more reasonable, although still not really low level of around 50%. At the current level, the dividend looks sustainable, 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 a leading player in its industry by size, 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 far from great, and due to the fact that shares are trading above fair value, we rate the stock a sell at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	7,931	7,484	6,828	6,168	5,827	5,509	4,940	4,360	4,716	4,756
Gross Profit	4,314	4,152	3,801	3,332	3,159	2,917	2,568	2,092	2,313	2,223
Gross Margin	54.4%	55.5%	55.7%	54.0%	54.2%	52.9%	52.0%	48.0%	49.0%	46.7%
SG&A Exp.	3,566	3,598	3,316	2,998	2,806	2,516	2,174	1,857	1,905	1,793
D&A Exp.	483	661	1,834	3,945	404	338	497	407	561	765
Operating Profit	907	755	654	383	418	498	462	293	458	490
Operating Margin	11.4%	10.1%	9.6%	6.2%	7.2%	9.0%	9.4%	6.7%	9.7%	10.3%
Net Profit	842	776	1,258	-3,166	524	785	337	398	219	300
Net Margin	10.6%	10.4%	18.4%	-51.3%	9.0%	14.2%	6.8%	9.1%	4.6%	6.3%
Free Cash Flow	272	450	(55)	224	85	350	225	327	206	265
Income Tax	136	92	(124)	(301)	17	(123)	(43)	56	(4)	98

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	18,025	17,739	17,237	12,366	10,660	10,031	10,030	10,154	9,910	8,864
Cash & Equivalents	1,202	825	2,523	1,792	700	721	573	1,495	1,265	675
Acc. Receivable	1,423	1,499	1,390	1,181	999	1,109	1,184	1,083	1,151	997
Inventories	369	349	313	289	200	208	222	176	132	127
Goodwill & Int.	9,566	9,821	7,650	4,229	4,006	3,818	3,802	3,737	3,737	3,845
Total Liabilities	8,616	8,424	7,729	7,025	5,226	4,289	4,362	4,521	4,134	3,520
Accounts Payable	521	512	473	409	358	395	469	463	474	421
Long-Term Debt	3,653	3,448	3,440	3,021	1,455	907	1,083	1,319	1,035	756
Total Equity	9,399	9,306	9,502	5,337	5,423	5,730	5,655	5,622	5,763	5,327
LTD/E Ratio	0.39	0.37	0.36	0.57	0.27	0.16	0.19	0.23	0.18	0.14

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.6%	4.3%	7.2%	-21.4%	4.6%	7.6%	3.4%	3.9%	2.2%	3.2%
Return on Equity	9.1%	8.3%	13.4%	-42.7%	9.7%	14.1%	5.9%	7.1%	3.8%	5.4%
ROIC	6.5%	6.0%	9.8%	-29.7%	6.9%	11.6%	5.0%	5.8%	3.2%	4.6%
Shares Out.	819	820	821	814	802	781	788	755	757	742
Revenue/Share	9.80	9.22	8.40	7.57	7.16	7.07	6.35	5.77	6.21	6.41
FCF/Share	0.34	0.55	(0.07)	0.27	0.10	0.45	0.29	0.43	0.27	0.36

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

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