Penguin Books Limited
(Registered Number 861590)

Directors' report and financial statements
For the year ended 31 December 2008

Penguin Books Limited

Contents

Penguin Books Limited

Directors' report

The directors present their report and the audited financial statements of the company for the year ended 31 December 2008.

Principal activities

The principal activity of the company and its subsidiaries continues to be book publishing, and the warehousing and distribution of books.

Business review

Penguin Books Limited turnover increased by £4m in 2008 compared to 2007. This was driven by performance of key authors (Jamie Oliver, Marian Keyes and Sebastian Faulks - all in hardback) in the home market and by a record sales year for Penguin Classics which all contributed to sales growth of 3%. The gross margin percentage remained constant at 43%.

Administrative expenses dropped by £32m year on year, with the key items being a reduction (exceptional payment in 2007) in Pearson Group Pension Fund additional contributions of £17m, transactional foreign currency exchange gain of £9m. Income from fixed asset investments rose by £17m due to the dividend received from Frederick Warne & Co Ltd.

As a result of the above the overall profit before taxation for the year was £34.7m compared to the previous year's loss of £14.3m.

Penguin monitors progress and performance during the year and historical trend data is set out in the following key performance indicators, calculated from the balance sheet and profit and loss account:-

	2008	2007
Sales growth	+3% YOY	-4% YOY
Gross profit %	43%	43%
New titles	608	526
Titles in Bookscan full year Top 50 sellers	4	8

Penguin Books Limited continued to attract and retain key talent, with no major authors leaving during the course of the year. As the business moves forward it faces the continuing challenge of attracting key authors to ensure sustained growth.

Going forward we expect our turnover to perform consistent with the market, which has shown significant downward volatility. Predicting market trends is difficult in the current economic climate. However continued focus on costs, inventory and print management should provide positive benefits. Apart from generally difficult market conditions no key operating risks have been identified by the directors.

In 2008 Penguin Books Limited further consolidated the work it has achieved since 2006 by cutting its carbon footprint for the second successive year. Penguin revised its travel policy to encourage a reduction in business flights and an increase in rail travel - over 40 people travelled to the Frankfurt Bookfair by train in October. Better office printers and a renewed working environment helped to contribute to an impressive 25% cut in office paper use. In 2008 Penguin held a charity walk with 375 staff participating and raising £25,000 for the Woodland Trust. All standard Royal and Demy hardbacks and trade paperbacks are printed on FSC approved paper. Penguin is working with its parent company Pearson towards ISO14001 certification.

ISO14001 is an Environmental Management Standard. As well as better management of environmental risks, now and in the future, adoption of the standard will lead to cost savings in terms of consumption, waste and recycling. For more information on Penguin Books Limited's environmental policies go to www.penguin.co.uk/greenpenguin.

Directors' report (continued)

Visitor numbers to Penguin UK websites grew by 8% over 2007, page views were slightly down due to the streamlined user experience introduced with the redesign of penguin.co.uk, puffin.co.uk and penguinclassics.co.uk. Late in the year eBooks launched on the Penguin website as well as a new site at penguindating.co.uk.

Penguin Books Limited remains committed to the highest employment standards. Our people initiatives and policies continue to evolve to ensure that we attract and retain the best talent to Penguin and that our people continue to enjoy a happy, fulfilling and challenging career with us. Our people make the difference and we seek to support, challenge and enable them through our innovative policies and programmes.

Results and dividend

An interim dividend of £24,000,000 was paid on 22 December 2008 (2007: £nil). The directors recommend that no final dividend be paid (2007: £nil), and the profit of £37,256,000 (2007: loss of £7,954,000) be transferred to (2007: deducted from) reserves.

Directors

The directors of the company and those who held office during the year and up to the date of signing of the financial statements are as follows:

S M D Floyer	Resigned 31/03/2008
H Fraser	
J Makinson	
B Landers	
M Symons	
P Field	

The present directors will continue in office pursuant to the Articles of Association.

Policy on disabled persons

It is the company's policy to give full and fair consideration to applications for employment by disabled persons, having regard to their particular experience, aptitudes and abilities and mindful that the willingness and conscientiousness of many disabled persons goes far to counter-balance their disability. It is also the company's policy, where appropriate, to train, to develop the careers of, and to promote disabled employees.

If employees become disabled while they are in the company's employment, it is the company's policy to continue to employ them where practical, or if necessary and feasible, to rehabilitate them to appropriate alternative employment.

Employee involvement

The company attaches importance to the creation amongst its employees of a sense of involvement in and identification with the objective and success of the business.

For several years the company has aimed to encourage this sense of involvement specifically through the provision to every employee of annual information on the progress and objectives of the company. Regular meetings are held with staff and staff representatives to keep them informed of the company's progress.

All employees, after a specified period of service, are eligible to participate in the Pearson plc Save-As-You-Earn option scheme.

Directors' report (continued)

Health and safety
Through the medium of a Health and Safety Committee, consisting of senior staff, staff representatives and an independent medical advisor, the company constantly monitors and reviews its operations to ensure the safety of its employees and visiting members of the public and to ensure compliance with statutory requirements.

Policy and practice on payment of creditors
Trade creditors at the year-end represented 51 days (2007: 47 days) of purchases. It is the company's policy in respect of all suppliers to agree payment terms in advance of the supply of goods and to adhere to those payment terms.

Statement of directors' responsibilities
The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors

The company has previously passed an elective resolution under the Companies Act 1985 dispensing with, amongst other things, the need for the annual appointment of auditors. Under the Companies Act 2006, the relevant sections of which came into force on 1 October 2007, this resolution remains in force in relation to the annual appointment of auditors. PricewaterhouseCoopers LLP, will, accordingly, continue in office as auditors of the Company

Disclosure of information to auditors

Each of the persons who is a director at the date of approval of this report confirms that:

(1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

Directors' report (continued)

(2) the director has taken all the steps that he ought to have taken as a director in order to make him aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s417 of the Companies Act 2006.

Approved by the board of directors and signed on behalf of the board

B Landers
Director
80 Strand
London
WC2R 0RL
30th June 2009

Independent Auditors' Report to the Members of Penguin Books Limited

We have audited the financial statements of Penguin Books Limited for the year ended 31 December 2008 which comprise the Profit and Loss account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985;and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
Date 30 JUNE 2009

Penguin Books Limited

Profit and loss account for the year ended 31 December 2008

	Notes	2008	2007
		£000	£000
			Restated
Turnover	2	**135,866**	131,701
Cost of sales		**(78,120)**	(75,722)
Gross profit		**57,746**	55,979
Distribution costs		**(7,296)**	(7,833)
Administrative expenses		**(40,064)**	(69,558)
Other operating income		**2,378**	2,770
Operating profit/(loss)	3	**12,764**	(18,642)
Interest receivable and similar income		**2,434**	2,812
Income from fixed asset investments		**19,500**	1,800
Interest payable and similar charges	4	**(35)**	(282)
Profit/(Loss) on ordinary activities before taxation		**34,663**	(14,312)
Tax credit on profit/(loss) on ordinary activities	6	**2,593**	6,358
Profit/(loss) for the financial year	15	**37,256**	(7,954)

The results shown above all arise from continuing operations.

There is no difference between the profit/(loss) on ordinary activities before taxation and the profit/(loss) for the financial year stated above, and their historical cost equivalents.

The notes on pages 8 to 20 form part of these financial statements.

Statement of total recognised gains and losses for the year ended 31 December 2008

	Notes	2008	2007
		£000	£000
Profit/(Loss) for the financial year		**37,256**	(7,954)
Deferred tax on share-based payments directly recognised in equity	13	**(36)**	(26)
Total recognised gains/(losses) since the last annual report		**37,220**	(7,980)

Penguin Books Limited

Balance sheet as at 31 December 2008

	Notes	2008	2007
		£000	£000
Fixed assets			
Tangible Assets	7	**13,675**	15,551
Investments	9	**32,029**	32,370
		45,704	47,921
Current assets			
Stocks	10	**8,344**	11,029
Debtors	11	**195,208**	102,011
Cash at bank and in hand		**26,369**	60,549
Creditors: amounts falling due within one year	12	**(151,285)**	(188,898)
Net current assets/(liabilities)		**78,636**	(15,309)
Total assets less current liabilities		**124,340**	32,612
Net assets		**124,340**	32,612
Capital and reserves			
Called up share capital	14	**88,300**	10,300
Share premium account	15	**1,139**	1,139
Other reserves	15	**967**	1,073
Profit and loss account	15	**33,934**	20,100
Total shareholders' funds	16	**124,340**	32,612

The notes on pages 8 to 20 form part of these financial statements.

The financial statements on pages 6 to 20 were approved by the board of directors on 30th June 2009 and were signed on its behalf by:

B Landers
Director

Notes to the financial statements for the year ended 31 December 2008 (continued)

1. Principal accounting policies

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom and the Companies Act 1985.

The company is a wholly owned subsidiary of Pearson plc and the cash flows of the company are included in the consolidated group cash flow statement of Pearson plc. Consequently the company is exempt under the terms of Financial Reporting Standard 1 (revised 1996) "Cash flow statements" from publishing a cash flow statement. The company is also exempt under the terms of Financial Reporting Standard 8 "Related party disclosures" from disclosing the related party transactions (but not balances) with entities that are part of the Pearson plc group or investees of the Pearson plc group (note 20).

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for depreciation, investment impairment, provisions for doubtful debts, provisions for liabilities and charges, provisions for returns, employee pension schemes, taxes and author advances.

A summary of the more important accounting policies, which have been applied consistently, is set out below.

a) Basis of accounting

The financial statements are prepared on the going concern basis under the historical cost convention. Group financial statements have not been prepared, as permitted by section 228 of the Companies Act 1985, as the company is a wholly owned subsidiary undertaking of another undertaking registered in England and Wales.

b) Turnover

Turnover comprises the fair value of the consideration received or receivable for the sale of goods and services net of value-added tax and other sales taxes, rebates, trade marketing costs and discounts.

Turnover from the sales of books is recognised when title passes. A provision for anticipated returns is made based primarily on historical return rates. If these estimates do not reflect actual returns in future periods then revenues could be understated or overstated for a particular period.

On certain contracts, where the company acts as agent, only commissions and fees receivable for services rendered are recognised as revenue. Any third party costs incurred on behalf of the principal that are rechargeable under the contractual arrangement are not included in revenue. Income from recharges of freight and other activities which are incidental to the normal revenue generating activities is included in other income.

In 2008, trade marketing costs incurred by the company in securing store space in retail customer outlets has been reclassed as a deduction to turnover, previously these costs incurred had been expensed as part of administration costs. The comparative for 2007 has been restated accordingly.

c) Fixed assets

Costs include the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. The cost of tangible fixed assets is depreciated over estimated economic lives in equal annual amounts. The rates generally in use are:

Freehold buildings	2%
Leasehold property	over the period of the lease
Plant and machinery	10 - 33.3%
Fixtures and fittings	10 – 25%
Motor vehicles	25%

d) **Fixed asset investments**

Fixed asset investments are stated at cost less any provision for impairment. Investments are tested for impairment when an event that might affect asset values has occurred. An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or by the discounted future cash flows from the investment.

e) **Stocks and work-in-progress**

Finished goods, work-in-progress and materials have been valued at the lower of cost and net realisable value. Cost comprises direct costs including related production overheads, which, in the case of first impressions of books, includes initial publishing expenditure. Provision is made for obsolete, slow moving and defective stocks.

f) **Deferred taxation**

Provision is made in full for deferred tax that arises from timing differences that have originated but not reversed by the balance sheet date on transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be taxable profits from which the underlying timing differences can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax assets and liabilities are not discounted. No deferred tax is provided in respect of any future remittance of earnings of foreign subsidiaries or associates where no commitment has been made to remit such earnings.

g) **Foreign currencies**

Transactions are translated at the rate of exchange applicable at the transaction date or, if hedged forward, at the contracted rate. Monetary assets and liabilities in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date. Foreign exchange differences are taken to the profit and loss account as they arise.

h) **Pension costs**

The company is a member of the Pearson Group Pension Plan which has both defined benefit and defined contribution sections. The Pearson Group Pension Plan is operated for the benefit of the majority of its employees, the assets of which are held separately from those of the company in independently administered funds.

As the company is unable to identify its share of the assets and liabilities of the group scheme, it accounts for contributions as if they were to a defined contribution pension scheme. Contributions are charged to the profit and loss account in the year to which they relate.

i) **Operating leases**

Costs in respect of operating leases are charged to the profit and loss account on a straight line basis over the lease term.

j) **Share-based payments**

Options and shares are awarded to the company's employees under Pearson share and option plans. The fair value of options granted is recognised as an employee expense after taking into account the company's best estimate of the number of awards expected to vest. Fair value is measured at the date of the grant and is spread over the vesting period of the option or share. The fair value of the options granted is measured using an option model that is most appropriate to the award. The fair value of shares awarded is measured using the share price at the date of the grant unless another method is more appropriate.

k) **Trade debtors**

Trade debtors are initially recognised at fair value, which is usually the original invoiced amount and subsequently carried at amortised cost using the effective interest method less provisions made for doubtful receivables. Provisions are made specifically where there is objective evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age, previous losses experienced and general economic conditions.

l) **Author advances**

Advances of royalties to authors are included within trade and other receivables when the advance is paid less any provision required to adjust the advance to its net realisable value. The realisable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the estimated realisable value of author contracts is overstated then this will have an adverse effect on operating profits as these excess amounts will be written off.

The recoverability of royalty advances is based upon an annual detailed management review of the age of the advance, the future sales projections for mew authors and prior sales history of repeat authors. The royalty advance is expensed at the contracted or effective royalty rate as the related revenues are earned. Royalty advances which will be consumed within one year are held in current assets. Royalty advances which will be consumed after one year are held in non current assets.

2 Turnover

The turnover is attributable to the one principal activity of the company and represents amounts invoiced to customers excluding value added tax, in respect of goods and services supplied. The analysis of turnover by destination is as follows:

	2008	2007
	£000	£000
United Kingdom	**95,400**	94,960
Europe	**10,658**	12,059
Africa	**1,930**	1,859
North and South America	**8,257**	7,466
Asia	**5,132**	4,648
Australasia	**14,489**	13,252
	135,866	134,244

3 Operating profit/(loss)

	2008	2007
	£000	£000
Operating profit/(loss) is stated after charging/crediting:		
Depreciation of tangible fixed assets	**2,483**	1,790
Profit on disposal of investments	**(431)**	-
Auditors' Remuneration:		
Audit services	**195**	196
Hire of plant and machinery – operating leases	**257**	125
Hire of other assets - operating leases	**47**	(9)
Foreign exchange gain	**(10,635)**	(556)
Staff costs (note 5)	**46,194**	66,214

As the primary operating company in the Penguin Group (UK), the company incurs administrative, distribution and other operating expenses on behalf of the following Pearson Group companies: Dorling Kindersley Limited; Frederick Warne & Co Limited; Ladybird Limited; Funfax Limited; and

Notes to the financial statements for the year ended 31 December 2008 (continued)

Rough Guides Limited (The). Costs incurred in 2008 of £69,658,495 were recharged back to the associate group companies as a management charge (2007: £66,450,501).

Auditors' remuneration is in respect of Penguin Books Limited, the immediate parent undertaking, the fellow Pearson plc subsidiary undertakings of the Dorling Kindersley group of companies and certain Penguin group subsidiary undertakings.

4 Interest payable and similar charges

	2008 £000	2007 £000
Interest payable on other loans	**35**	282

5 Employee costs and directors' remuneration

Costs of employees (including directors) were:

	2008 £000	2007 £000
Wages and salaries	**34,686**	36,816
Social security costs	**3,163**	3,377
Other pension costs (note 18)	**7,837**	25,493
Share-based payments (note 19)	**508**	528
	46,194	66,214

The average number of persons (including directors) employed by the company during the year was:

By activity:	2008 Number	2007 Number
Editorial	**426**	409
Production	**105**	98
Selling	**82**	91
Administrative	**277**	284
	890	882

Staff costs include remuneration to directors of Michael Joseph Limited, Acacia Interactive Limited, Dorling Kindersley Limited and DK Vision Limited who are not remunerated as directors of Penguin Books Limited. Their remuneration is disclosed in the accounts of this company.

Staff costs also include the following remuneration to directors of the company in respect of their services to the company:

	2008 £000	2007 £000
Directors' emoluments (including benefits in kind)	**1,149**	1,218
Company contributions to defined contribution pension schemes	**121**	109
	1,270	1,327

Retirement benefits are accruing to 7 (2007: 6) directors under a defined benefit scheme and 2 (2007: none) directors under a money purchase scheme.

The number of directors who exercised options or were granted shares during the year was 5 (2007: 6). All directors participate in a long term incentive scheme, whereby shares are receivable

in the ultimate parent undertaking if certain performance conditions are met.
The directors' remuneration disclosed above (excluding pension contributions) included amounts paid to the highest paid director as follows:

	2008 £000	2007 £000
Directors' emoluments (including benefits in kind)	**451**	500
Defined benefit pension scheme:		
Accrued pension at end of year	**22**	19

The highest paid director participated in a long term incentive scheme, whereby shares are receivable in the ultimate parent undertaking if certain performance conditions are met.

6 Tax on profit/(loss) on ordinary activities

	2008	2007
The tax credit comprises:	**£000**	£000
Current tax		
UK corporation tax on profit/(losses) for the year	**(1,563)**	(3,755)
Overseas taxation	**71**	151
Adjustment in respects of prior years	**(774)**	(170)
Total current tax credit	**(2,266)**	(3,774)
Deferred tax credit (note 13)	**(327)**	(2,584)
Tax (credit) on ordinary activities	**(2,593)**	(6,358)

The tax assessed for the year is lower (2007: higher) than the standard rate of corporation tax in the UK. The differences are explained below:

	2008	2007
	£000	£000
Profit/(Loss) on ordinary activities before taxation	**34,663**	(14,312)
Profit/(Loss) on ordinary activities multiplied by standard rate of 28.5% (2007: 30%)	**9,879**	(4,294)
Accelerated capital allowances and other timing differences	**916**	(1,096)
Expenses not deducted for tax purposes	**212**	286
Overseas withholding tax expensed	**(20)**	(45)
Overseas withholding tax suffered	**71**	151
Pension contribution spreading	**(1,327)**	4,192
Other timing differences	**-**	(63)
Loss on disposal of subsidiaries	**-**	442
Tax free income	**(5,558)**	(540)
Notional interest for UK transfer pricing purposes	**(2,394)**	(2,480)
Share scheme deduction	**(359)**	(369)
Share based payments	**145**	212
Adjustment in respect of prior years	**(258)**	(170)
Brought forward trading losses utilised	**(3,057)**	-
Current tax credit for the year	**(2,266)**	(3,774)

7 Tangible fixed assets

	Plant and machinery	Fixtures and fittings	Total
	£000	£000	£000
Cost			
At 1 January 2008	29,010	6,132	35,142
Additions	4,030	701	4,731
Transfers	(4,124)	-	(4,124)
At 31 December 2008	**28,916**	**6,833**	**35,749**
Accumulated depreciation			
At 1 January 2008	19,226	365	19,591
Charge for the year	2,608	606	3,214
Transfers	(731)	-	(731)
At 31 December 2008	**21,103**	**971**	**22,074**
Net book value			
At 31 December 2008	**7,813**	**5,862**	**13,675**
At 31 December 2007	9,784	5,767	15,551

8 Dividends

	2008	2007
	£000	£000
Equity – Ordinary		
Interim paid: 27.18p (2007: nil) per £1.00 share	**24,000**	-

9 Investments

	Total
Shares in group undertakings:	£000
Cost	
At 1 January 2008	32,370
Additions	501
Disposals	(842)
At 31 December 2008	**32,029**
Impairment	
At 1 January 2008 and 31 December 2008	**0**
Net Book Value	
At 31 December 2008	**32,029**
At 31 December 2007	32,370

In 2008, Penguin acquired an additional share in Penguin Books Deutschland GmbH, increasing the shareholding to 100%. The consideration for this addition was £501,000 which was credited to DK Verlag intercompany account. DK Verlag ultimate parent company is Pearson Plc

In 2008, Penguin Books (South Africa) pty repaid the company £842,000 as settlement of an outstanding equity loan.

Interests in group undertakings are as follows:

Name	Country of incorporation	Principal activities	Class of share	Proportion held
Penguin Warehousing and Distribution Limited	UK	Dormant	Ordinary	100%
Allen Lane The Penguin Press Limited	UK	Dormant	Ordinary	100%
Frederick Warne & Co Limited; owning	UK	Publishing and Distribution	Ordinary	100%
Frederick Warne (Publishers) Limited	UK	Dormant	Ordinary	100%
Michael Joseph Limited; owning	UK	Dormant	Ordinary	100%
Pelham Books Limited	UK	Dormant	Ordinary	100%
Hamish Hamilton Limited; owning	UK	Dormant	Ordinary	100%
Hamish Hamilton Children's Books Limited	UK	Dormant	Ordinary	100%
Elm Tree Books Limited	UK	Dormant	Ordinary	100%
The Rainbird Publishing Group Limited; owning	UK	Dormant	Ordinary	100%
George Rainbird Limited	UK	Dormant	Ordinary	100%
Godfrey Cave Holdings Limited; owning	UK	Dormant	Ordinary	100%
Omega Books Limited	UK	Dormant	Ordinary	100%
Godfrey Cave Associates Limited	UK	Dormant	Ordinary	100%
Penguin France SA	France	Publishing & Distribution	Ordinary	100%
Penguin Italia Srl	Italy	Publishing & Distribution	Ordinary	95%
Penguin Books Deutschland GmbH	Germany	Publishing & Distribution	Ordinary	100%
Penguin Books SA (Spain)	Spain	Publishing & Distribution	Ordinary	96%
Penguin Books Hellas Limited	Greece	Publishing & Distribution	Ordinary	94%
Penguin Books (South Africa) Pty	UK	Publishing & Distribution	Ordinary	100%
The Rough Guides Limited (The); owning	UK	Publishing & Distribution	Ordinary	100%
The Rough Guides (US) Limited	UK	Dormant	Ordinary	100%
Ventura Publishing Ltd; owning	UK	Merchandising	Ordinary	100%
Salspot Limited	UK	Publishing & Distribution	Ordinary	100%
Penguin Books Japan Limited	Japan	Publishing & Distribution	Ordinary	99.5%
Ladybird Books Limited	UK	Publishing & Distribution	Ordinary	100%
Penguin Books Deutschland GmbH	Germany	Marketing	Ordinary	100%
Penguin Books Netherlands BV	Netherlands	Publishing & Distribution	Ordinary	5%
Children's Character Books Limited	UK	Publishing & Distribution	Ordinary	75%

In the opinion of the directors, the value of interests in subsidiary undertakings is not less than the book value included in the balance sheet. All of the subsidiary undertakings make up their financial statements to 31 December.

Notes to the financial statements for the year ended 31 December 2008 (continued)

10 Stocks

	2008 £000	2007 £000
Stocks comprise:		
Raw materials and consumables	**192**	383
Work in progress	**2,066**	1,520
Finished goods and goods for resale	**6,086**	9,126
	8,344	11,029

11 Debtors

	2008 £000	2007 £000
Trade debtors	**28,985**	25,729
Amounts owed by group undertakings	**122,948**	32,646
Other debtors	**29,399**	30,190
Prepayments and accrued income	**2,669**	2,349
Corporation Tax	**5,705**	5,886
Deferred tax (note 13)	**5,502**	5,211
	195,208	102,011

Balances owed by group undertakings are unsecured, interest free and payable on demand.

12 Creditors

	2008 £000	2007 £000
Amounts falling due within one year:		
Trade creditors	**31,177**	27,031
Amounts owed to group undertakings	**96,902**	140,376
Other creditors	**5,512**	4,677
Accruals and deferred income	**17,694**	16,814
	151,285	188,898

Balances owed to group undertakings are unsecured, interest free and payable on demand.

13 Deferred taxation

The deferred taxation provided is as follows:

	Amount provided		**Total potential asset**	
	2008 £000	2007 £000	**2008 £000**	2007 £000
Accelerated capital allowances	**2,727**	1,111	**2,727**	1,111
Pensions spreading	**2,608**	3,912	**2,608**	3,912
Share based payments	**167**	188	**167**	188
Net deferred tax asset	**5,502**	5,211	**5,502**	5,211

The movement in the asset during the year was as follows:

	2008 £000	2007 £000
At 1 January	**5,211**	2,653
Credited to the profit and loss account – origination and reversal of timing differences	**(410)**	3,010
Adjustment in respect of the rate change	**(6)**	(372)
Deferred tax credit in profit and loss account	**743**	(54)
Deferred tax credit in statement of total recognised gains and losses	**(36)**	(26)
At 31 December	**5,502**	5,211

There are trading tax losses of £6,954,717 (2007: £22,008,660) for which no deferred tax asset is recognised in the financial statements. These trading losses will be utilised against any profits chargeable to corporation tax of Penguin Books Limited in 2009 and future years, but due to the uncertainties presented by the current economic outlook, the level of trading loss utilisation for 2009 cannot be accurately calculated at this point, so a deferred tax asset has not been recognised.

14 Called up share capital

	2008 £000	2007 £000
Authorised, allotted and fully paid		
88,300,000 (2007: 10,300,000) ordinary shares of £1 each	**88,300**	10,300

During the year 78,000,000 ordinary shares were allotted and issued for cash. The nominal value of these shares was £78,000,000 and the consideration received was £78,000,000.

15 Reserves

	Called up share capital £000	Share premium account £000	Profit and loss account £000	Other reserves £000	Total £000
At 1 January 2008	10,300	1,139	20,100	1,073	32,612
Profit for the financial year	-	-	37,256	-	37,256
Deferred tax on share-based payments directly recognised in equity	-	-	(36)	-	(36)
Dividends paid (note 8)			(24,000)		(24,000)
Share capital issued	78,000	-	-	-	78,000
Share based payments	-	-	-	508	508
Shares vested in year	-	-	614	(614)	-
At 31 December 2008	**88,300**	**1,139**	**33,934**	**967**	**124,340**

16 Reconciliation of movements in shareholders' funds

	2008 £000	2007 £000
Profit/(loss) for the financial year	**37,256**	**(7,954)**
Share based payments	508	528
Other recognised gains and losses	(36)	(26)
Dividends paid	(24,000)	
Net proceeds of issue of ordinary share capital (note 13)	78,000	
	91,728	**(7,452)**
Opening shareholders' funds	**32,612**	**40,064**
Closing shareholders' funds	**124,340**	**32,612**

17 Lease commitments

At 31 December 2008 the company had annual commitments under non-cancellable operating leases as set out below:

	2008 £000	Other 2007 £000
Operating leases which expire:		
Within one year	**130**	117
Between 2 and 5 years inclusive	**145**	100
	275	217

18 Pension costs

The company participates in the Pearson Group Pension Scheme, which is a hybrid with both defined benefit contribution sections but, predominantly, consisting of defined benefit liabilities. The company is unable to identify its share of the underlying assets and liabilities of the Pearson Group Pension Scheme owing to information regarding non-active members, and changes to the group structure including acquisitions and disposals. Accordingly, the Company accounts for its participation in the scheme as defined contribution under the multi-employer rules of FRS 17. The sponsoring entity to this scheme is Pearson Services Limited.

The profit and loss charge for the company in respect of its participation in the scheme, representing regular contributions paid was £4,294,000 (2007: £4,493,000).

The total market value of assets in the Pearson Group Pension Scheme was £1,478 million as at 31 December 2008 (2007: £1,747 million) and the value of liabilities calculated in accordance with FRS 17 was £1,420 million as at 31 December 2008 (2007: £1,671 million). Hence the total FRS 17 surplus for Pearson Group Pension Scheme was £58 million (2007: £75 million surplus). This was determined by an actuarial valuation using the projected unit method.

The company will be required to make incremental contributions to the scheme as part of the Group's obligations to fund the scheme and any deficit arising and contributions will increase by £151,824 for 2009 (2008: £527,000)

19 Share based payments

The company's employees are entitled to shares and options under the following equity-settled employee option and share plans:

Save-for-Shares-Plans Under these plans, employees can save a portion of their monthly salary over periods of three, five or seven years. At the end of this period, the employee has the option to purchase ordinary shares with the accumulated funds at a purchase price equivalent to 80% of the market price prevailing at the time of the commencement of the employee's participation in the plan. Options that are not exercised within six months of the third, fifth or seventh anniversary after grant lapse unconditionally.

Long-Term Incentive Plan This plan was introduced in 2001 and renewed in 2006 and consists of two parts: share options and/or restricted shares.

Options were granted under this plan in 2001 based on a pre-grant earnings per share growth test and are not subject to further performance conditions on exercise. The options became exercisable in tranches and lapse if they remain unexercised at the tenth anniversary of the date of grant.

The vesting of restricted shares is normally dependent on continuing service and/or upon the satisfaction of corporate performance targets over a three-year or five-year period. These targets may be based on market and/or non-market performance criteria. Restricted shares awarded to senior management in 2007 and 2008 vest dependent on relative shareholder return, return on invested capital and a combination of earnings per share growth. The award was split equally across all three measures. Other restricted shares awarded in 2007 and 2008 vest depending on continuing service over a three-year period.

Annual bonus share matching This plan permits executive directors and senior executives to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the Pearson Group meets an earnings per share growth target, the company will match them on a gross basis of up to one share for every one held.

In addition to the above, share options remain outstanding under Executive Share Option, Reward and Special Share Option Plans. These are legacy plans which were replaced with the introduction of the Long-Term Incentive Plan in 2001.

The movement and weighted average exercise prices of share options granted under the Group's schemes are as follows:

	2008	2008	2007	2007
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
	000s	£	000s	£
Outstanding at beginning of year	418	14.08	796	11.71
Granted during the year	189	5.87	5	6.90
Exercised during the year	(57)	4.59	(54)	6.55
Forfeited during the year	(134)	11.14	(197)	7.96
Expired during the year	(5)	6.63	(50)	5.48
Transfers	161	5.31	(83)	15.39
Outstanding at end of year	**573**	**10.60**	**418**	**14.08**
Options exercisable at the end of year	**332**	**14.04**	**397**	**14.49**

Options were exercised regularly during the year. The weighted average share price during the year was £6.44 (2007: £7.32). Early exercises are treated as an acceleration of vesting and the Company therefore recognises immediately the amount that otherwise would have been recognised for services received over the remainder of the original vesting period in the profit and loss account.

The options outstanding at the end of the year have a weighted average remaining contractual lives and exercise prices as follows:

	2008	2008	2007	2007
Range of exercise prices	Number of share options	Weighted average contractual life	Number of share options	Weighted average contractual life
£	000s	Years	000s	Years
0-5	38	0.80	9	0.82
5-10	307	2.81	91	3.54
10-15	151	1.83	229	2.29
15-20	9	0.44	9	1.41
20-25	-	-	-	-
>25	68	1.19	80	2.19
	573	**2.19**	**418**	**2.50**

In 2008 and 2007 options were granted under the Worldwide Save for Shares Plan. The weighted average estimated fair value for the options granted was calculated using a Black-Scholes option pricing model.

The weighted average estimated fair values and the inputs to the Black-Scholes model are as follows:

	2008	2007
	Weighted average	Weighted average
Fair value (£)	1.96	2.40
Weighted average share price (£)	7.62	8.91
Weighted average exercise price (£)	5.87	6.90
Expected volatility	20.84%	17.33%
Expected life (years)	4.0	3.5
Risk free rate	4.63%	5.37%
Forfeiture rate	3.5%	3.0%
Expected dividend yield	4.12%	3.29%

The expected volatility is based on the historic volatility of the Pearson Group's share price over the previous 3 to 7 years depending on the vesting term of the options.

During the year, the following shares were granted under restricted share arrangements:

	2008	2008	2007	2007
	Number of shares	Weighted average fair value	Number of shares	Weighted average fair value
	000s	£	000s	£
Annual bonus share matching plan	3	6.73	7	7.67
Long-term incentive plan	94	6.23	62	7.77

Notes to the financial statements for the year ended 31 December 2008 (continued)

Restricted shares granted under the Annual Bonus Share Matching Plan are valued using the share price at the date of grant. Until 2007 this was discounted by the dividend yield (2008: n/a; 2007: 3.26%) to take into account any dividends forgone. From 2008 shares granted include the entitlement to dividends during the vesting period and therefore the share price is not discounted.

20 Related party transactions

The company is a wholly owned subsidiary within Pearson plc and utilises the exemption contained in Financial Reporting Statement 8 "Related party disclosures" not to disclose any transactions with entities that are part of the Pearson plc group. The address at which the Pearson plc consolidated financial statements are publicly available is The Company Secretary, Pearson plc, 80 Strand, London, WC2R 0RL.

21 Contingent liabilities

Bank guarantees

The company participates in an arrangement with HSBC Bank plc whereby the accounts of Pearson plc and 33 of its subsidiaries, "the guarantors", are combined, with cleared debit and credit balances being offset for interest calculation purposes. In order to comply with banking regulations, each guarantor to this arrangement has provided a multilateral guarantee in respect of the overdraft obligations (but no other debts due to the bank) of each of the other participants. The net balance under this arrangement at 31 December 2008 was a credit balance of £306,079 (2007: £1,794,375).

The maximum amount of this guarantee is limited to a net overdraft of £50,000,000.

As at 31 December 2008 and 31 December 2007 the potential liability arising from these guarantee arrangements amounted to £50,000,000 for the parent undertaking and fellow subsidiary undertakings and £nil for the subsidiary undertakings of the company.

22 Ultimate parent undertaking

The immediate and ultimate parent undertaking is Pearson plc, a company that is registered in England and Wales. Copies of the consolidated financial statements of Pearson plc may be obtained from The Company Secretary, Pearson plc, 80 Strand, London WC2R 0RL.