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REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31ST DECEMBER 1986

PENGUIN BOOKS LIMITED

DIRECTORS' REPORT

The directors have pleasure in presenting their report together with the financial statements for the year ended 31st December 1986.

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

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

During the year a subsidiary company of the Penguin Group, Frederick Warne & Co Inc, was sold to a fellow subsidiary for £2,350,000.

RESULTS AND APPROPRIATION

	£
Profit before taxation	8,416,344
Taxation	840,637
Profit after taxation	<u>7,575,707</u>
Extraordinary charge	(12,040,904)
Loss after taxation and extraordinary charge	<u>£(4,465,197)</u>

The directors recommend the payment of a final dividend of £1,000,000 and that £5,465,197 be deducted from reserves.

DIRECTORS

The directors during the year were:-

P.M. Mayer	Chairman and Chief Executive
E.M. Attenborough	
J.A. Brown	
P.T.S. Carson	
A.F. Cotton	(Resigned 30.6.86)
A.S. Lacey	
J.H. Rolfe	
J.W. Webster	
C. Weller	
A. Wherry	(Resigned 30.9.86)
P.M.M. Wright	
J.R.R. Yglesias	
C. Vine	(Appointed 1.7.86)

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

PENGUIN BOOKS LIMITED

DIRECTORS' REPORT (continued)

DIRECTORS' INTERESTS

Messrs. Mayer, Carson, Webster, Wright, Lacey and Rolfe are directors of the company's holding company and are therefore not required to notify to this company their interests in group companies.

	<u>31st December 1986</u>	<u>1st January 1986</u>
C. Vine		
Pearson plc		
25p ordinary share options	5,000	* -

* Date of appointment.

None of the other directors or their families held any interests in group companies during the year.

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 in 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 objectives 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 representatives to keep them informed of the company's progress and future plans.

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

PENGUIN BOOKS LIMITED

DIRECTORS' REPORT (continued)

AUDITORS


In accordance with Section 384 of the Companies Act 1985 a resolution proposing the reappointment of Deloitte Haskins & Sells as auditors of the company at a remuneration to be agreed by the directors will be put to the annual general meeting.

BY ORDER OF THE BOARD

N.J. WILLIAMS

Secretary

Harmondsworth
Middlesex.

A handwritten signature in dark ink, appearing to read 'N.J. Williams', is written over the typed name and title.

18th March 1987

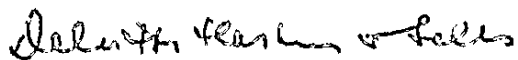
PENGUIN BOOKS LIMITED

AUDITORS' REPORT
TO THE MEMBERS OF PENGUIN BOOKS LIMITED

We have audited the financial statements on pages 5 to 14 in accordance with approved Auditing Standards.

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31st December 1986 and of its results for the year then ended and comply with the Companies Act 1985.

The financial statements do not include a statement of source and application of funds as required by Statement of Standard Accounting Practice No. 10.



DELOITTE HASKINS & SELLS

Chartered Accountants

London

18th March 1987

PENGUIN BOOKS LIMITED

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST DECEMBER 1986

	<u>Notes</u>	<u>1986</u> <u>£</u>	<u>1985</u> <u>£</u>
Turnover	1	51,022,732	48,345,681
Cost of sales		22,814,713	22,624,561
Gross profit		28,208,019	25,721,120
Other operating expenses (net)	2	24,905,083	23,213,625
Operating profit		3,302,936	2,507,495
Investment income	3	8,334,646	2,660,630
Profit before interest payable		11,637,582	5,168,125
Interest payable	4	3,221,238	2,518,272
Profit on ordinary activities before taxation	5	8,416,344	2,649,853
Taxation	7	840,637	598,228
Profit on ordinary activities after taxation		7,575,707	2,051,625
Extraordinary charge	8	12,040,904	57,519
Loss/Profit after taxation and extraordinary charge		(4,465,197)	1,994,106
Dividend - proposed		1,000,000	1,400,000
Deficit deducted from reserves (1985 - profit retained)	16	£(5,465,197)	£ 594,106

PENGUIN BOOKS LIMITED

BALANCE SHEET AT 31ST DECEMBER 1986

	<u>Notes</u>	<u>1986</u> <u>£</u>	<u>1985</u> <u>£</u>
FIXED ASSETS			
Tangible assets	9	2,980,560	1,620,476
Investments	10	11,879,141	23,920,045
		<u>14,859,701</u>	<u>25,540,521</u>
CURRENT ASSETS			
Stocks	11	11,065,379	10,889,800
Debtors	12	44,678,326	28,567,275
Cash at bank and in hand		687,279	1,235,336
		<u>56,430,984</u>	<u>40,692,411</u>
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	13	51,407,077	39,601,756
NET CURRENT ASSETS		<u>5,023,907</u>	<u>1,090,655</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		19,883,608	26,631,176
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	13	14,230,223	16,531,554
PROVISIONS FOR LIABILITIES AND CHARGES Deferred taxation	14	1,152,800	79,070
NET ASSETS		<u>£4,500,585</u>	<u>£10,020,552</u>
CAPITAL AND RESERVES			
Called-up share capital	15	300,000	300,000
Share premium account	16	1,139,407	1,139,407
Profit and loss account	16	3,061,178	8,581,145
		<u>£4,500,585</u>	<u>£10,020,552</u>

The financial statements on pages 5 to 14 were approved by the board of directors on 18th March 1987 and were signed on its behalf by:

P.M. MAYER)
) Directors
J.W. WEBSTER)

Peter M. Mayer
J.W. Webster

PENGUIN BOOKS LIMITED

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES
FOR THE YEAR ENDED 31ST DECEMBER 1986

a) BASIS OF ACCOUNTING

The annual financial statements are prepared on the historical cost basis of accounting.

b) TURNOVER

Turnover represents the value of publications supplied net of discounts and returns.

c) TANGIBLE FIXED ASSETS

Tangible fixed assets are stated at cost and are depreciated over their estimated economic lives by equal annual instalments.

The rates of depreciation used are:-

Leasehold property	over the period of the lease
Plant and equipment	10-33.3%
Motor vehicles	25%

d) FIXED ASSET INVESTMENTS

Fixed asset investments are stated at cost less any provision for permanent diminution in value.

e) STOCKS

Finished books, work in progress and materials have been valued at the lower of cost and net realisable value which, in the case of paperback books, has been calculated according to a formula. Cost comprises direct costs including related production overheads which, in the case of first impressions of books, includes initial publishing expenditure.

f) DEFERRED TAXATION

Deferred taxation is provided to take account of timing differences between the treatment of certain items for accounts purposes and their treatment for taxation purposes except to the extent it is, in the opinion of the directors, reasonable to assume that the timing differences will not reverse so as to crystallise a tax liability in the foreseeable future.

g) OVERSEAS CURRENCIES

Assets and liabilities in overseas currencies are translated into sterling at the rates ruling at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986

	<u>1986</u> £	<u>1985</u> £
1. TURNOVER		
Geographical markets supplied:		
United Kingdom	33,321,061	30,698,637
Europe	5,040,000	4,106,856
Africa	1,712,000	1,222,161
America	5,063,671	6,178,943
Asia	2,111,000	2,126,028
Australasia	3,775,000	4,013,056
	<u>£51,022,732</u>	<u>£48,345,681</u>
2. OTHER OPERATING EXPENSES (net)		
Distribution costs	7,045,000	6,630,000
Administrative expenses	18,210,955	16,832,025
	<u>25,255,955</u>	<u>23,462,025</u>
Other operating income	(350,872)	(248,400)
	<u>£24,905,083</u>	<u>£ 23,213,625</u>
3. INVESTMENT INCOME		
Interest receivable		
Group	2,305,247	1,306,777
Other	29,399	53,853
Dividend receivable from subsidiary	6,000,000	1,300,000
	<u>£ 8,334,646</u>	<u>£ 2,660,630</u>
4. INTEREST PAYABLE		
On bank loans, overdrafts and other loans		
repayable within 5 years not by instalments	828,947	778,083
Group loans	2,392,291	1,740,189
	<u>£3,221,238</u>	<u>£ 2,518,272</u>
5. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		
After crediting:		
Rent receivable (net of outgoings)	25,048	26,245
after charging:		
Depreciation of tangible fixed assets	373,818	575,142
Auditors' remuneration		
Current year	50,075	35,500
Prior year	5,570	6,500
Hire of plant and machinery		16,191
Exceptional costs:		
Closure of Stanwell and Dorking warehouses	-	83,217
Transfer of editorial office to Kensington	197,000	419,126
Sales Agency changes	-	489,393
Provision for bad debt	450,000	-

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

6. EMPLOYEES INCLUDING DIRECTORS	<u>1986</u> £	<u>1985</u> £
Staff costs of employees (including directors) were:		
Wages and salaries	5,305,027	4,216,958
Social security costs	336,176	270,555
Other pension costs	346,713	349,394
	<u>£5,987,916</u>	<u>£4,836,907</u>

The average weekly number of persons (including directors) employed by the company during the year was 414 (1985 - 370) all of whom were employed in administration.

Staff costs include the following remuneration to directors of the company	<u>1986</u>	<u>1985</u>
Directors' emoluments	£ 736,789	£ 745,827
Compensation for loss of office	£ 86,000	£ NIL
	<u> </u>	<u> </u>

The directors' remuneration disclosed above (excluding pension contributions) included amounts paid to:

The Chairman, who was also the highest paid director	<u>£ 255,677</u>	<u>£ 338,278</u>
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The number of other directors who received emoluments (excluding pension contributions) in the following ranges was:

	<u>1986</u> Number	<u>1985</u> Number
£10,001 - £15,000	-	1
£15,001 - £20,000	1	-
£20,001 - £25,000	1	1
£25,001 - £30,000	2	3
£30,001 - £35,000	4	2
£35,001 - £40,000	-	1
£40,001 - £45,000	2	2
£45,001 - £50,000	1	1
£50,001 - £55,000	1	-

7. TAXATION

UK Corporation tax at 36.25% (1985 - 41.25%) on the profit for the year:

	<u>1986</u> £	<u>1985</u> £
Current	48,000	741,000
Deferred	935,794	(202,930)
	<u>983,794</u>	<u>538,070</u>

PENGUIN BOOKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

7. TAXATION (continued)

	<u>1986</u> £	<u>1985</u> £
Adjustments made in respect of prior years:		
Current	(281,093)	56,158
Deferred	137,936	4,000
	<u>£840,637</u>	<u>£598,228</u>
	=	=

The taxation charge for the year has been increased by £110,000 as a result of non-allowable expenditure.

8. EXTRAORDINARY CHARGE

	<u>1986</u> £	<u>1985</u> £
Provisions made for diminution in value of interests in subsidiaries	12,040,904	57,519
	<u>£12,040,904</u>	<u>£57,519</u>

9. TANGIBLE FIXED ASSETS

	<u>Short Leasehold Property</u> £	<u>Plant & Machinery</u> £	<u>Fixtures & Fittings</u> £	<u>Motor Vehicles</u> £	<u>Total</u> £
Cost					
At 1st January 1986	205,255	566,469	1,411,903	765,254	2,948,881
Additions	794,055	121,980	500,583	393,845	1,810,463
Disposals	(734)	(431,237)	(195,643)	(248,771)	(876,385)
Group transfers	-	-	-	62,004	62,004
At 31st December 1986	<u>998,576</u>	<u>257,212</u>	<u>1,716,843</u>	<u>972,332</u>	<u>3,944,963</u>
Depreciation					
At 1st January 1986	10,363	519,516	574,982	223,544	1,328,405
Charge for the year	28,350	17,522	125,228	202,718	373,818
Eliminated in respect of disposals	-	(431,237)	(153,892)	(152,691)	(737,820)
Group transfers	-	(51,409)	51,409	-	-
At 31st December 1986	<u>38,713</u>	<u>54,392</u>	<u>597,727</u>	<u>273,571</u>	<u>964,403</u>
Net book value					
At 31st December 1986	<u>£959,863</u>	<u>£202,820</u>	<u>£1,119,116</u>	<u>£698,761</u>	<u>£2,980,560</u>
At 31st December 1985	<u>£194,892</u>	<u>£46,953</u>	<u>£836,921</u>	<u>£541,710</u>	<u>£1,620,476</u>

PENGUIN BOOKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

10. FIXED ASSET INVESTMENTS

Interests in subsidiaries	<u>Share capital</u> £	<u>Loan stock</u> £	<u>Total</u> £
Cost at 1st January 1986	8,238,899	15,681,146	23,920,045
Provisions for diminution in value	<u>3,750,056</u>	<u>8,290,848</u>	<u>12,040,904</u>
Cost less provisions at 31st December 1986	<u>£4,488,843</u>	<u>£7,390,298</u>	<u>£11,879,141</u>

The company owns all the equity interests in the following subsidiaries which are incorporated in Great Britain unless otherwise shown.

Penguin Warehousing and Distribution Limited
 Allen Lane T^o Penguin Press Limited
 Penguin Overseas Limited
 Penguin Nominees Limited
 Frederick Warne & Co. Limited
 Frederick Warne (Publishers) Limited
 The Newdigate Press Limited
 T.B.L. Book Service Limited
 Michael Joseph Limited
 Pelham Books Limited
 Hamish Hamilton Limited
 Hamish Hamilton Childrens Books Limited
 Elm Tree Books Limited
 Sphere Books Limited
 The Rainbird Publishing Group Limited
 George Rainbird Limited
 The Illustrated Book Club Limited

In the opinion of the directors, the value of interests in subsidiaries is not less than the book value included in the balance sheet.

The company and its subsidiaries make up their financial statements to 31st December.

11. STOCKS	<u>1986</u> £	<u>1985</u> £
Stocks comprise:		
Raw materials and consumables	1,385,402	1,201,966
Work in progress	2,501,113	2,003,054
Finished books	<u>7,178,864</u>	<u>7,684,780</u>
	<u>£11,065,379</u>	<u>£ 10,889,800</u>

The replacement cost of stocks is greater than their balance sheet value by £NIL (1985 - £457,000).

PENGUIN BOOKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

12. DEBTORS

	<u>1986</u> £	<u>1985</u> £
Amounts falling due within one year:		
Trade debtors	9,982,783	10,029,292
Amounts owed by subsidiary companies	11,615,810	5,280,615
Amounts owed by holding company and fellow subsidiaries	4,665,411	5,181,523
Other debtors	5,827,353	2,200,492
Prepayments and accrued income	1,243,044	815,544
	<u>33,334,401</u>	<u>23,507,466</u>
Amounts falling due after more than one year:		
Amounts owed by subsidiaries	9,466,000	4,750,000
Amounts owed by fellow subsidiaries	1,877,925	309,809
	<u>£44,678,326</u>	<u>£28,567,275</u>

13. CREDITORS

Amounts falling due within one year:		
Bank overdraft	5,893,005	3,382,065
Trade creditors	12,083,216	8,887,053
Amounts owed to subsidiary companies	8,304,296	5,994,705
Amounts owed to holding company and fellow subsidiaries	20,972,766	14,730,076
Proposed dividend	1,000,000	1,400,000
Corporation tax	459,009	2,489,932
Other taxation and social security payable	278,957	176,480
Other creditors	2,415,828	2,541,445
	<u>£51,407,077</u>	<u>£39,601,756</u>
Amounts falling due after more than one year:		
Corporation tax	-	495,111
Amount owed to holding company	14,230,223	16,036,443
	<u>£14,230,223</u>	<u>£16,531,554</u>

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

14. DEFERRED TAXATION

The deferred taxation provided and the total potential liability were as follows:

	<u>Amount provided</u>		<u>Total potential liability</u>	
	1986	1985	1986	1985
	£	£	£	£
Excess of tax allowances over depreciation	276,400	211,000	276,400	211,000
Capital gains rolled over	-	-	20,816	20,816
Provisions which will qualify for relief in future years	(136,500)	(126,000)	(136,500)	(184,589)
Interest receivable/payable	1,012,900	(5,930)	1,012,900	(5,930)
	<u>£1,152,800</u>	<u>£ 79,070</u>	<u>£1,173,616</u>	<u>£41,297</u>

The movement in the provision during the year was as follows: £

At 1st January 1986	79,070
Transferred from profit and loss account	1,073,730
At 31st December 1986	<u>£1,152,800</u>

1986 1985

15. CALLED-UP SHARE CAPITAL

<u>Authorised</u>		
300,000 Ordinary Shares of £1 each	£ 300,000	£ 300,000
<u>Allotted, called up and fully paid</u>		
300,000 Ordinary Shares of £1 each	£ 300,000	£ 300,000

16. SHARE PREMIUM ACCOUNT AND PROFIT AND LOSS ACCOUNT

	<u>Share Premium Account</u>	<u>Profit and loss account</u>
	£	£
At 1st January 1986	1,139,407	8,581,145
Loss for the year	-	(5,465,197)
Exchange adjustments	-	(54,770)
At 31st December 1986	<u>£1,139,407</u>	<u>£ 3,061,178</u>

17. CONTINGENT LIABILITIES

The company together with certain other subsidiaries of Pearson plc has guaranteed interest on and repayment of £30,937,000 guaranteed unsecured loan stock of Pearson plc.

The company has given letters of support to certain subsidiaries, in which it guarantees to meet their obligations for the ensuing year.

PENGUIN BOOKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 1986 (continued)

17. CONTINGENT LIABILITIES (continued)

A claim had been made against the company for approximately £550,000 concerning a possible breach of contract on certain publications. The claim is being contested and the Directors consider that no provision is appropriate in the Financial Statements.

18. FUTURE COMMITMENTS

	<u>1986</u> £	<u>1985</u> £
Capital		
At 31st December there were future commitments for which contracts had been placed amounting to	£87,000	£ 3,000

and amounts authorised by the directors but not contracted for of	<u>£547,000</u>	<u>£308,000</u>
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	Land and Buildings		Plant	
	<u>1986</u> £	<u>1985</u> £	<u>1986</u> £	<u>1985</u> £
Revenue				
At 31st December 1986 the company had annual commitments under non cancellable operating leases as set out below				

Operating leases which expire:

Within one year	-	-	-	7,214
1-5 years	-	-	-	13,642
Over 5 years	1,417,950	-	-	-
	<u>£1,417,950</u>	<u>-</u>	<u>-</u>	<u>£20,856</u>

19. ULTIMATE HOLDING COMPANY

The company's immediate holding company is The Penguin Publishing Company Limited and its ultimate holding company is Pearson plc. Both companies are incorporated in Great Britain.