Penguin Random House Venture Combined Financial Statements

Report of Independent Auditors

To Penguin Random House LLC, Wilmington (USA), and Penguin Random House Ltd, London (UK)

We have audited the accompanying combined financial statements of Penguin Random House Venture as described in note 1 to these combined financial statements which comprise the combined balance sheets as of December 31, 2018, 2017 and 2016, and the related combined income statements, combined statements of comprehensive income, combined statements of cash flows and combined statements of changes in equity and the notes to the combined financial statements for the years then ended.

Management's Responsibility for the Combined Financial Statements

Management of Penguin Random House LLC, New York City (US), and Penguin Random House Ltd, London (UK), is responsible for the preparation and fair presentation of the combined financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Penguin Random House Venture as of December 31, 2018, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

Emphasis of matter

We draw attention to the fact that, as described in note 1 to the combined financial statements, the Penguin Random House Venture included in the combined financial statements has not operated as a separate group of companies. These combined financial statements are, therefore, not necessarily indicative of results that would have occurred if the Penguin Random House Venture had operated as a separate group of companies during the years presented or of future results of the Penguin Random House Venture. Our opinion is not modified with respect to this matter.

Bielefeld (Germany), March 26, 2019

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

/s/ Christian Landau	/s/ ppa. Michael Kleffmann
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Penguin Random House Venture Combined Financial Statements

COMBINED FINANCIAL STATEMENTS

Combined Income Statement

in € millions	Notes	**2018**	2017	2016
Revenues	1	**3,134**	3,075	3,100
Other operating income	2	**31**	33	56
Cost of materials	3	**(616)**	(630)	(679)
Royalties	16	**(591)**	(631)	(626)
Personnel costs	4	**(705)**	(715)	(723)
Amortization/depreciation, impairment and reversals on intangible assets and property, plant and equipment	5	**(71)**	(75)	(76)
Other operating expenses	6	**(791)**	(655)	(648)
Results from investments accounted for using the equity method	12	**(2)**	—	—
Impairment and reversals on investments accounted for using the equity method	12	**—**	(10)	—
Results from financial assets		**n/a**	(1)	—
Results from disposals of investments		**6**	2	—
EBIT (earnings before interest and taxes)		**395**	393	404
Interest income	7	**1**	3	1
Interest expenses	7	**(45)**	(13)	(4)
Other financial income	8	**3**	1	2
Other financial expenses	8	**(6)**	(8)	(3)
Financial result		**(47)**	(17)	(4)
Earnings before taxes		**348**	376	400
Income tax expense	9	**(34)**	(10)	(27)
Group profit or loss		**314**	366	373
attributable to:				
Penguin Random House shareholders		**314**	366	373
Non-controlling interests		**—**	—	—

As of January 1, 2018, the new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers were applied for the first time. In accordance with the transitional provisions of IFRS 9 and IFRS 15, prior year comparatives have not been adjusted. Further details are presented in the section “Impact of New Financial Reporting Standards.”

Penguin Random House Venture Combined Financial Statements

Combined Statement of Comprehensive Income

in € millions	Notes	2018	2017	2016
Group profit or loss		**314**	366	373
Items that will not be reclassified subsequently to profit or loss				
Remeasurement component of defined benefit plans		**21**	20	(21)
Changes in fair value of equity instruments		**(2)**	n/a	n/a
Share of other comprehensive income of investments accounted for using the equity method		**—**	—	—
Items that will be reclassified subsequently to profit or loss when specific conditions are met				
Exchange differences				
– changes recognized in other comprehensive income		**14**	(161)	(19)
– reclassification adjustments to profit or loss		**—**	—	—
Cash flow hedges				
– changes in fair value recognized in other comprehensive income		**1**	(1)	(1)
– reclassification adjustments to profit or loss		**(1)**	—	—
Share of other comprehensive income of investments accounted for using the equity method		**(1)**	(2)	11
Other comprehensive income net of tax	18	**32**	(144)	(30)
Group total comprehensive income		**346**	222	343
attributable to:				
Penguin Random House shareholders		**346**	222	344
Non-controlling interests		**—**	—	(1)

As of January 1, 2018, the new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers were applied for the first time. In accordance with the transitional provisions of IFRS 9 and IFRS 15, prior year comparatives have not been adjusted. Further details are presented in the section "Impact of New Financial Reporting Standards."

Penguin Random House Venture Combined Financial Statements

Combined Balance Sheet

in € millions	Notes	12/31/2018	12/31/2017	12/31/2016
Assets				
Non-current assets				
Goodwill	10	**835**	815	859
Other intangible assets	10	**351**	380	446
Property, plant and equipment	11	**152**	150	169
Investments accounted for using the equity method	12	**9**	12	25
Other financial assets	13	**9**	9	7
Trade and other receivables	15	**—**	4	5
Other non-financial assets	16	**377**	282	295
Deferred tax assets	9	**37**	42	31
		1,770	1,694	1,837
Current assets				
Inventories	14	**279**	253	263
Trade and other receivables	15	**1,113**	777	734
Other financial assets	13	**4**	1	3
Other non-financial assets	16	**477**	430	452
Current income tax receivables		**11**	16	13
Cash and cash equivalents	17	**195**	376	312
		2,079	1,853	1,777
Assets held for sale		**—**	—	9
		3,849	3,547	3,623
Equity and liabilities				
Equity	18			
Combined shareholders' equity		**1,015**	979	2,183
Non-controlling interests		**3**	3	3
		1,018	982	2,186
Non-current liabilities				
Provisions for pensions and similar obligations	19	**21**	24	47
Other provisions	20	**41**	29	27
Deferred tax liabilities	9	**22**	19	17
Financial debt	21	**920**	666	1
Trade and other payables	22	**113**	91	114
Other non-financial liabilities	22	**15**	32	32
		1,132	861	238
Current liabilities				
Other provisions	20	**29**	20	17
Financial debt	21	**289**	438	103
Trade and other payables	22	**1,222**	1,107	916
Other non-financial liabilities	22	**140**	124	145
Current income tax payables		**19**	15	16
		1,699	1,704	1,197
Liabilities related to assets held for sale		**—**	—	2
		3,849	3,547	3,623

As of January 1, 2018, the new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers were applied for the first time. In accordance with the transitional provisions of IFRS 9 and IFRS 15, prior year comparatives have not been adjusted. Further details are presented in the section "Impact of New Financial Reporting Standards."

Penguin Random House Venture Combined Financial Statements

Combined Statement of Cash Flows

in € millions	2018	2017	2016
EBIT (earnings before interest and taxes)	**395**	393	404
Taxes paid	**(16)**	(20)	(20)
Depreciation and write-ups of non-current assets	**71**	86	76
Results from disposals of investments	**(6)**	(2)	—
Change in provisions for pensions and similar obligations	**10**	8	10
Change in other provisions	**10**	6	21
Contributions to defined benefit plans	**(13)**	(16)	(17)
Change in net working capital	**(85)**	(138)	(41)
Other effects	**(14)**	(11)	(15)
Cash flow from operating activities	**352**	306	418
Investments in:			
– intangible assets	**(10)**	(12)	(15)
– property, plant and equipment	**(26)**	(22)	(15)
– financial assets	**—**	(4)	(2)
– purchase prices for consolidated investments (net of acquired cash)	**(2)**	(40)	(1)
Disposals of subsidiaries and other business units	**9**	4	6
Disposals of other fixed assets	**3**	1	1
Cash flow from investing activities	**(26)**	(73)	(26)
Proceeds from other financial debt	**497**	1,277	188
Redemption of other financial debt	**(433)**	(207)	(231)
Interest paid	**(48)**	(8)	(7)
Interest received	**3**	3	1
Dividends to Penguin Random House shareholders	**(536)**	(1,206)	(317)
Change in equity	**—**	9	12
Cash flow from financing activities	**(517)**	(132)	(354)
Change in cash and cash equivalents	**(191)**	101	38
Exchange rate effects and other changes in cash and cash equivalents	**10**	(39)	(18)
Cash and cash equivalents 1/1	**376**	314	294
Cash and cash equivalents 12/31	**195**	376	314
Less cash and cash equivalents included within assets held for sale	**—**	—	(2)
Cash and cash equivalents 12/31 (according to the combined balance sheet)	**195**	376	312

As of January 1, 2018, the new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers were applied for the first time. In accordance with the transitional provisions of IFRS 9 and IFRS 15, prior year comparatives have not been adjusted. Further details are presented in the section "Impact of New Financial Reporting Standards."

Details on the cash flow statement are presented in note 25 "Statement of Cash Flows."

Penguin Random House Venture Combined Financial Statements

Combined Statement of Changes in Equity

in € millions	Combined equity, membership capital and combined retained earnings	Accumulated other comprehensive income[1)] Exchange differences	Cash flow hedges	Fair value reserve	Share of other comprehensive income of investments accounted for using the equity method	Combined shareholders' equity	Non-controlling interests	Total
Balance as of 1/1/2016	1,860	287	2	n/a	(6)	2,143	4	2,147
Group profit or loss	373	—	—	n/a	—	373	—	373
Other comprehensive income	(21)	(18)	(1)	n/a	11	(29)	(1)	(30)
Group total comprehensive income	352	(18)	(1)	n/a	11	344	(1)	343
Dividend distributions	(317)	—	—	n/a	—	(317)	—	(317)
Contributions by owners[2)]	12	—	—	n/a	—	12	—	12
Equity transactions with shareholders	(305)	—	—	n/a	—	(305)	—	(305)
Other changes	1	—	—	n/a	—	1	—	1
Balance as of 12/31/2016	1,908	269	1	n/a	5	2,183	3	2,186
Balance as of 1/1/2017	1,908	269	1	n/a	5	2,183	3	2,186
Group profit or loss	366	—	—	n/a	—	366	—	366
Other comprehensive income	20	(161)	(1)	n/a	(2)	(144)	—	(144)
Group total comprehensive income	386	(161)	(1)	n/a	(2)	222	—	222
Dividend distributions[3)]	(1,435)	—	—	n/a	—	(1,435)	—	(1,435)
Contributions by owners[2)]	9	—	—	n/a	—	9	—	9
Equity transactions with shareholders	(1,426)	—	—	n/a	—	(1,426)	—	(1,426)
Other changes	—	—	—	n/a	—	—	—	—
Balance as of 12/31/2017	868	108	—	n/a	3	979	3	982
Balance as of 1/1/2018	**868**	**108**	**—**	**—**	**3**	**979**	**3**	**982**
Group profit or loss	**314**	**—**	**—**	**—**	**—**	**314**	**—**	**314**
Other comprehensive income	**21**	**14**	**—**	**(2)**	**(1)**	**32**	**—**	**32**
Group total comprehensive income	**335**	**14**	**—**	**(2)**	**(1)**	**346**	**—**	**346**
Dividend distributions	**(310)**	**—**	**—**	**—**	**—**	**(310)**	**—**	**(310)**
Contributions by owners	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Equity transactions with shareholders	**(310)**	**—**	**—**	**—**	**—**	**(310)**	**—**	**(310)**
Other changes	**(2)**	**—**	**—**	**2**	**—**	**—**	**—**	**—**
Balance as of 12/31/2018	**891**	**122**	**—**	**—**	**2**	**1,015**	**3**	**1,018**

As of January 1, 2018, the new financial reporting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers were applied for the first time. In accordance with the transitional provisions of IFRS 9 and IFRS 15, prior year comparatives have not been adjusted. Further details are presented in the section "Impact of New Financial Reporting Standards."

1) As of December 31, 2018, and as of December 31, 2017, no assets were classified as held for sale in accordance with IFRS 5. As of December 31, 2016, no significant amounts related to assets classified as held for sale.
2) The amount related mainly to capital contributions. Further information is presented in note 26 "Related Party Disclosures."
3) In the financial year 2017, the dividend distributions to Penguin Random House shareholders resulted from special dividend distributions in connection with the acquisition of another 22 percent interest in Penguin Random House by Bertelsmann from Pearson. Further details are presented in the section "Background."

Penguin Random House Venture Combined Financial Statements

Notes

General Principles

Background

Penguin Random House is a trade book publishing company, which operates in the core business fields of print and digital trade book publishing with nearly 275 imprints across six continents. Each year Penguin Random House publishes about 15,000 new titles and sells around 600 million print books, e-books and audiobooks. Penguin Random House sells directly to bookshops and through wholesalers. Retail bookshops normally maintain relationships with both publishers and wholesalers and use the channel that best serves the specific requirements of an order. Penguin Random House also sells through online retailers such as Amazon.com, through its own websites and direct to the customer via digital sales agents.

The Penguin Random House Venture (hereafter referred to as "Penguin Random House" or "Group") was established when Bertelsmann SE & Co. KGaA (hereafter referred to as "Bertelsmann" or "Bertelsmann Group") and Pearson plc (hereafter referred to as "Pearson") combined their respective trade publishing groups, Random House (with exception of the German-speaking publishing business) and Penguin Books Group. The transaction agreed between Bertelsmann and Pearson in October 2012 for the combination of their trade publishing groups was concluded on July 1, 2013. Initially, controlling shareholder Bertelsmann held a 53 percent interest in this new publishing company Penguin Random House, with non-controlling interests Pearson holding 47 percent. On October 5, 2017, Bertelsmann acquired in addition to its existing interest another 22 percent of Penguin Random House from Pearson. The remaining 25 percent share remains with Pearson. As part of the agreement with Pearson, Bertelsmann executed different loans in US dollars to Penguin Random House, which were mainly intended to finance special dividend distributions of €1,021 million to the shareholders. Thereof, a special dividend distribution of €591 million related to Bertelsmann (of which €419 million was paid in the financial year 2017 and a further €172 million was paid in the financial year 2018) and of €430 million related to Pearson (of which €373 million was paid in the financial year 2017 and a further €57 million was paid in the financial year 2018). As of December 31, 2018, controlling shareholder Bertelsmann holds a 75 percent interest in Penguin Random House, with non-controlling interests Pearson holding 25 percent.

Description of Penguin Random House

Legally Penguin Random House consists of two legal groups: Penguin Random House LLC (hereafter referred to as "PRH LLC"), a Delaware limited liability company registered in Wilmington, Delaware, United States, and headquartered in New York City, New York, United States, and Penguin Random House Limited (hereafter referred to as "PRH Limited"), a company limited by shares, headquartered in London, United Kingdom. PRH LLC bundles all of the book publishing units in the United States, while PRH Limited comprises all other book publishing units (in Canada, Australia, New Zealand, India, South Africa, the United Kingdom, Spain, Latin America and in the Asian region, among others). Despite the separate legal structures of PRH LLC and PRH Limited, Bertelsmann and Pearson regard Penguin Random House as one business unit as it is managed together.

For periods up to and including the financial year ended December 31, 2018, both PRH LLC and PRH Limited prepared special purpose financial information comprising consolidated financial statements for each legal group due to IAS 28 accounting purposes of the minority shareholder. The latter consists of the income statement, statement of comprehensive income, balance sheet, statement of changes in equity and selected explanatory notes that did not represent a complete set of consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. However, it is technically possible to produce Combined Financial Statements for PRH LLC and PRH Limited in accordance with IFRS. The combined statement of changes in equity reflects the LLC and Limited legal structures, respectively.

Description of Penguin Random House continued

The ultimate parent company of Penguin Random House preparing consolidated financial statements, Bertelsmann SE & Co. KGaA, includes in its consolidated financial statements those of Penguin Random House. Bertelsmann SE & Co. KGaA is a company incorporated under German law whose registered office is established at Carl-Bertelsmann-Strasse 270, D-33311 Gütersloh, Germany. Consolidated financial statements for Bertelsmann SE & Co. KGaA can be obtained at its registered office.

Basis of Preparation of the Combined Financial Statements

These Combined Financial Statements have been prepared pursuant to Rule 3-09 of SEC Regulation S-X for purposes of a filing on Form 20-F of Pearson plc as Penguin Random House is an equity investee of Pearson plc. Due to the governance structure, the shareholder arrangements between Pearson and Bertelsmann, various operational matters, and the disclosures that Pearson and Bertelsmann provide to their respective shareholders, Penguin Random House has prepared Combined Financial Statements as these are generally appropriate for entities under common management.

The accompanying Penguin Random House Combined Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the related interpretations (IFRIC) of the IFRS Interpretations Committee (IFRS IC). Penguin Random House uses one set of global accounting policies, which are IFRS compliant. The principal accounting policies adopted in the preparation of the Combined Financial Statements are set out in the section "Accounting and Measurement Policies." These policies have been consistently applied to all the years presented, unless otherwise stated. The Combined Financial Statements were authorized for issue by Markus Dohle (CEO Penguin Random House) and James Johnston (CFO Penguin Random House) on March 22, 2019.

The IFRS provide no guidelines for the preparation of combined financial statements, which are therefore subject to the rules given in IAS 8.12. This article requires consideration of the most recent pronouncements of other standard-setting bodies, other financial reporting requirements and recognized industry practices. For the purposes of the Combined Financial Statements, all income, expenses, assets, liabilities and other comprehensive income were directly included in the Combined Financial Statements. As the legal perspective was applied, the taxes related to the transparent entities of the legal group PRH LLC, which are incurred on the level of the shareholders, were not accounted for in the Combined Financial Statements. In addition, it was agreed as a general principle by the shareholders that each shareholder shall assume or retain all liabilities relating to covered employee benefits provided under the covered plans that arise on or prior to closing and that Penguin Random House should assume or retain all liabilities relating to covered employee benefits that arise after the closing and relate to any continuing employee. For processing reasons, parts of the employee matter liabilities that arise prior to closing remain legally within Penguin Random House and payments for these liabilities by Penguin Random House are part of a reimbursement mechanism by the shareholders. Bertelsmann Group supports Penguin Random House with administrative services. Those services have been charged by Bertelsmann Group to Penguin Random House and are therefore included in the Combined Financial Statements and in the related party disclosures (note 26).

Although the functional currencies of PRH LLC and PRH Limited are the US dollar and British pound, respectively, the special purpose financial information of PRH LLC and PRH Limited is always prepared in euros for the minority shareholder. Due to consistency of presentation, Penguin Random House also considers it appropriate to prepare the Combined Financial Statements in euros. Therefore, unless otherwise stated, all amounts in the Combined Financial Statements are presented in millions of euros (€ million).

Basis of Preparation of the Combined Financial Statements continued

The Combined Financial Statements have been prepared under the historical cost convention except for the following material items in the combined balance sheet:

- Equity instruments at fair value through other comprehensive income are measured at fair value.
- Derivative financial instruments are measured at fair value.
- Non-derivative financial instruments at fair value through profit or loss are measured at fair value.
- The defined benefit assets and liabilities are measured in accordance with IAS 19.

For the sake of clarity, certain items are aggregated in the combined income statement, combined statement of comprehensive income, combined balance sheet, combined statement of cash flows and combined statement of changes in equity. These items are disclosed and explained in greater detail in the notes.

Impact of New Financial Reporting Standards Effective from January 1, 2018

With the exception of the new financial reporting standards IFRS 9 ”Financial Instruments“ and IFRS 15 “Revenue from Contracts with Customers,” the first-time application of new financial reporting standards and interpretations had no material impact on Penguin Random House.

IFRS 9 “Financial Instruments” replaces the provisions of IAS 39 concerning recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets, and hedge accounting. The new financial reporting standard introduces new rules for classifying and measuring financial assets and includes new rules for impairment of financial instruments. Details on the accounting and measurement policies applied to financial instruments in accordance with IFRS 9 since January 1, 2018, are presented in the section “Accounting and Measurement Policies.” Application of the standard is mandatory for financial years beginning on or after January 1, 2018. Penguin Random House makes use of the exception not to adjust prior year comparatives. As a result, only the Consolidated Opening Balance as of January 1, 2018, has been adjusted.

For Penguin Random House, the new requirements of IFRS 9 primarily concern the impairment of financial assets, in particular the impairment of trade receivables. From January 1, 2018, onwards, Penguin Random House uses a risk scoring model based on qualitative and quantitative risk factors for its major customers. For insignificant customers impairment matrices are used to determine the loss allowances on trade receivables on the basis of historic bad debt losses, maturity bands and expected credit losses reflecting the ability of the customers to settle the receivables. The impairment matrices have been created for business-unit-specific groups of receivables, each with similar default patterns. In addition, separate risk assessments are performed. Due to the changed calculation of loss allowances, there was only an immaterial effect, which was recognized in combined retained earnings as of January 1, 2018. Beyond that, there was no material effect on the classification and thus on the measurement of financial instruments. In accordance with the IFRS 9 classification and measurement approach for financial assets, there are three classification categories for financial assets in the Group:

- at amortized cost,
- at fair value with changes in fair value through profit or loss (FVTPL) and
- at fair value with changes in fair value through other comprehensive income (FVOCI).

The analysis of debt instruments, consisting of mainly trade receivables and other receivables, indicated that, in the vast majority of cases, these were held in order to collect the contractual cash flows representing exclusively

Impact of New Financial Reporting Standards Effective from January 1, 2018 continued

principal and interest payments. Thus, the majority of the debt instruments continues to be measured at amortized cost except for certain debt instruments where the contractual cash flows do not represent exclusively principal and interest payments, in which case IFRS 9 requires a measurement at fair value. As of December 31, 2017, financial assets totaling €2 million were classified as available for sale and measured at cost. They were individually and in aggregate immaterial for the Group. With application of IFRS 9 as of January 1, 2018, these financial assets are accounted for at fair value through other comprehensive income. As changes in fair value are recognized in other comprehensive income for these instruments, they are no longer recycled to the income statement when these instruments are sold. The first-time application of IFRS 9 had no impact on the classification and measurement of financial liabilities. No material impacts resulted from the new regulations for hedge accounting.

IFRS 15 "Revenue from Contracts with Customers" includes new comprehensive regulations for the recognition of revenue that are independent of a specific industry or transaction. The new standard replaces the risk and reward approach with a contract-based five-step model. In addition to substantially more extensive application guidance for the accounting treatment of revenue from contracts with customers, there are more detailed disclosure requirements in the notes. Application of the standard is mandatory for financial years beginning on or after January 1, 2018. The modified retrospective method was used for the transition to IFRS 15. For its first-time application, Penguin Random House has applied the expedients provided in the standard for the modified retrospective method. The immaterial cumulative effect of the first-time application as of January 1, 2018, was recognized in combined retained earnings. Prior year comparatives were not adjusted. The Group has not restated contracts which have been modified prior to January 1, 2018. Instead, PRH has reflected the aggregate effect of all of the historic modifications for contracts still in force after January 1, 2018 when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligations. Further Penguin Random Hous applied this standard only to contracts that were not completed contracts at the date of initial application. Under IFRS 15 expected returns are no longer offset with trade receivables, but a refund liability for the expected refunds to customers is recognized as adjustment to revenue in the balance sheet position "Trade and other payables."

As a result of the accounting treatment total assets increased by €305 million as of January 1, 2018. Return assets, if any, are presented as non-financial assets rather than in inventory.

With regard to certain digital products presentation of revenue and expenses change as a result of the new standard. Previously, Penguin Random House recognized its revenue at amount to which Penguin Random House expected to be entitled from the intermediary (that is, amount from the end customer less commission retained), as according to the principle set out in IAS 18 the revenue was measured at the fair value of the consideration received or receivable from an intermediary. Based on a more specific concept of the term "customer" or more specific definition of the term "customer," the control concept underlying IFRS 15 and the application of the enhanced principal-agent approach – revenue is recognized in the amount of the retail price to the end consumer. Further IFRS 15 provides detail requirements for determining the transaction price and estimating variable consideration. Thus in accordance with IFRS 15 Penguin Random House recognizes its revenue at amount charged to end customers by an intermediary by applying judgement und using all information available to it. Any commissions for online retailers are recognized as an expense. Consequently, the increase in the item "Revenues" corresponds directly with an increase in the item "Other operating expenses" with no impact on the item "Group profit and loss." The introduction of IFRS 15 lead to an increase of both line items "Revenues" and "Other operating expenses" by €147 million. This change in revenue recognition did not have an impact on the opening balances for January 1, 2018.

Impact of New Financial Reporting Standards Effective from January 1, 2018 continued

Details on the accounting and measurement policies applied to revenues in accordance with IFRS 15 since January 1, 2018, are presented in the section “Accounting and Measurement Policies.”

Impact of Issued Financial Reporting Standards that Are Not Yet Effective

Penguin Random House has not opted for early adoption of any additional standards, interpretations or amendments that have been issued by the IASB or the IFRS IC but are not yet mandatory. IFRS 16 Leases is a financial reporting standard that is not yet effective and will have a material impact on Penguin Random House.

IFRS 16 Leases, issued in January 2016, sets out principles for recognition, measurement, presentation and disclosure requirements for leases. The changes mainly affect lessee accounting and generally require lessees to recognize contractual rights and obligations on the lessee’s balance sheet. Penguin Random House will apply IFRS 16 to all contracts previously identified as leases under IAS 17 and IFRIC 4. Short-term leases with a lease term of up to one year, and leases covering low-value assets for which Penguin Random House will not recognize a right-of-use asset to use the leased object or a lease liability, constitute an exception. The new standard replaces the straight-line recognition of operating lease expense in accordance with IAS 17 with the recognition of depreciation expenses for the right-of-use asset and interest expenses on the lease liability (included within the financial result). In addition, IFRS 16 includes more extensive disclosures in the notes for lessees.

Application of the standard is mandatory for financial years beginning on or after January 1, 2019. IFRS 16 was introduced in Penguin Random House as part of a Bertelsmann Group-wide transition project. Under this project, initially, Penguin Random House’s material lease agreements were analyzed to determine the approach for the initial application of IFRS 16, among other things. In addition, the analysis focused on separating the lease and non-lease components of a contract, defining guidelines for determining the lease term taking into account renewal or termination options, and setting discount rates for calculating the lease liability. The complete analysis of IFRS 16 took place decentrally in the Group companies by conducting an inventory of leases. The vast majority of leases in Penguin Random House concern rental properties. In addition, leases also exist for technical equipment and machinery, vehicles and other fixtures, furniture, and office equipment. As part of the project, adjustments have been made to the reporting systems, chart of accounts and disclosure templates.

Penguin Random House will apply IFRS 16 retrospectively with the cumulative effect of initially applying this standard as an adjustment to the opening balance of combined retained earnings at the date of initial application. Prior year comparatives will be not adjusted. For individual real estate leases, on the date the standard is applied for the first time, Penguin Random House will recognize the right-of-use asset at an amount as if IFRS 16 had been applied since commencement date of the leases. In all other cases, the right-of-use asset will correspond to the amount of the lease liability on the date of first-time application, adjusted by the amounts for any prepaid or accrued lease payments. According to current calculations, the first-time application of IFRS 16 will result in the recognition of right-of-use assets and lease liabilities in an amount between €350 million and €430 million in the consolidated balance sheet as of January 1, 2019, in addition to the finance leases already existing under IAS 17. First-time application of IFRS 16 will create temporary differences and the corresponding deferred taxes on the right-of-use assets and the lease liability. For first-time application, the right-of-use assets are not tested for impairment. Instead, existing provisions for onerous leases are offset against the corresponding right-of-use assets. Going forward, depreciation on the right-of-use assets and the interest expense for the lease liabilities will be recognized on the combined income statement in place of other operating expenses for operating leases. In the combined statement of cash flows, the application of IFRS 16 will result in an improvement of cash flows from operating activities, while the lease payments will reduce the cash flows from financing activities.

Penguin Random House has not opted for early application of the standard IFRS 16.

Penguin Random House Venture Combined Financial Statements

Consolidation

Principles of Consolidation

The Penguin Random House Combined Financial Statements combine the financial statements of the two legal groups, PRH LLC and PRH Limited, and their subsidiaries, joint ventures and associates. PRH LLC and PRH Limited are parent companies in the respective legal groups.

Subsidiaries are companies controlled by either PRH LLC or PRH Limited in accordance with IFRS 10. Control exists if Penguin Random House has the power over the investee as well as the exposure, or rights, to variable returns from its involvement with the investee and is able to exercise its power over the investee such that it can affect the amount of these returns. Consolidation begins on the date on which the possibility to exercise control exists and ends when Penguin Random House loses the possibility to exercise control. Profit or loss and each component of total comprehensive income are attributed to the shareholders of the parent company and the non-controlling interests, even if this results in the non-controlling interests having a deficit balance.

In accordance with IFRS 3, business combinations are accounted for using the acquisition method. Accordingly, the acquisition date fair value of the consideration transferred is offset against the fair value of equity on the acquisition date. Acquisition-related costs are generally recognized in profit or loss. If applicable, contingent consideration is measured at the fair value that applies on the acquisition date. If the aggregate of the consideration transferred, the amount of any non-controlling interests in the acquiree and the acquisition date fair value of a previously held equity interest in the acquiree exceeds the fair value of the identifiable net assets, the excess is carried as goodwill. Negative differences are reflected in profit or loss in the period in which the acquisition is made. Deferred taxes from assets acquired and liabilities assumed in a business combination are carried and measured in accordance with IAS 12. Subsequent measurement of the acquired assets and the liabilities assumed or entered into is performed in line with the applicable IFRSs. Non-controlling interests are also measured at the proportionate fair value of the assets and liabilities. If the consideration transferred for the business combination or the fair values attributable to the identifiable assets and liabilities of the company acquired can only be provisionally identified on the date of initial accounting, the business combination is accounted for using these provisional values. Initial accounting is completed in accordance with IFRS 3.45, taking into account the one-year measurement period. Comparative information for reporting periods prior to the completion of initial accounting is presented as if it had already been completed on the acquisition date.

Changes in the parent's ownership interest in a subsidiary that do not lead to a loss of control are accounted for as equity transactions. After the loss of control of a subsidiary, it is deconsolidated in accordance with the requirements of IFRS 10. Any investment retained in the former subsidiary and any amounts owed by or to the former subsidiary are accounted for in accordance with the applicable IFRSs from the date when control is lost.

In accordance with IFRS 11, joint ventures are joint arrangements in which the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint ventures are accounted for using the equity method in accordance with IAS 28. In addition, associates are included in the Combined Financial Statements using the equity method. Associates are companies over which Penguin Random House exercises a significant influence. This is generally the case for voting rights between 20 percent and 50 percent. Smaller shareholdings are accounted for using the equity method if there is a significant influence in accordance with IAS 28.6.

According to the equity method, interests in a joint venture or an associate are initially recognized at cost. These acquisition costs are then adjusted for changes to the Penguin Random House's interest in the net assets of the joint venture or the associate after the acquisition date. The same method used for fully consolidated subsidiaries is applied when accounting for the difference between the acquisition cost at the acquisition date and the share of net assets acquired. Losses from interests in a joint venture or an associate that exceed their carrying amounts are not recognized unless there is an obligation to make additional contributions. When changing the accounting treatment of investments

Consolidation continued

Principles of Consolidation continued

to the equity method, IFRS 3 is applied in analogy so that the fair value of the previously held interest is used in determining the cost of the investment accounted for using the equity method on the transition date. The difference between the fair value and carrying amount of the previously held interest is recognized in profit or loss.

Penguin Random House recognizes immaterial investments in accordance with IFRS 9.

Accounting and measurement policies are applied consistently for all companies consolidated within the Combined Financial Statements. Intercompany assets, liabilities, equity, income and expenses, and cash flows relating to transactions between Group companies are eliminated. Deferred taxes on consolidation transactions recognized in profit or loss are accounted for in accordance with IAS 12. The Penguin Random House share of unrealized gains or losses on intragroup transactions between fully consolidated Group companies and investments accounted for using the equity method is eliminated.

Scope of Consolidation

The scope of consolidation consists of 96 (2017: 88; 2016: 86) companies. This includes 95 (2017: 87; 2016: 85) fully consolidated companies. In addition, one immaterial associate is accounted for using the equity method in the Combined Financial Statements (2017: 1; 2016: 1). Penguin Random House had no joint ventures in the financial years 2018, 2017 and 2016. A total of 17 (2017: 26; 2016: 17) companies without significant business operations were excluded from the scope of consolidation due to their negligible importance for the financial position and financial performance of Penguin Random House.

For the financial year 2018, the detailed list of fully consolidated subsidiaries (FC) and associates accounted for using the equity method (EM) is as follows:

Name	Country	Share	Consolidation Method
Arrow Books Limited	Great Britain	100.00	FC
Barrie & Jenkins Limited	Great Britain	98.00	FC
Bartlett Bliss Productions Limited	Great Britain	100.00	FC
Bellew & Higton Publishers Limited	Great Britain	100.00	FC
Business Books Limited	Great Britain	100.00	FC
Century Benham Limited	Great Britain	100.00	FC
Century Hutchinson Limited	Great Britain	100.00	FC
Century Hutchinson Publishing Limited	Great Britain	100.00	FC
Century Publishing Co. Limited	Great Britain	100.00	FC
Chatto and Windus Limited	Great Britain	100.00	FC
Children's Character Books Limited	Great Britain	75.00	FC
Direct Group Grandes Obras, S.L.	Spain	100.00	FC
Distribuidora Penguin Random House S.A.S.	Colombia	99.97	FC
Dorling Kindersley Limited	Great Britain	100.00	FC
Dorling Kindersley Publishing Private Limited	India	100.00	FC
Dorling Kindersley Verlag GmbH	Germany	100.00	FC
Ediciones B Uruguay S.A.	Uruguay	100.00	FC
Editora Schwarcz S.A.	Brazil	45.00	EM
Flaname 0 Limited	Great Britain	100.00	FC
Flaname 1 Limited	Great Britain	100.00	FC
Flaname 2 Limited	Great Britain	100.00	FC

Consolidation continued

Scope of Consolidation continued

Name	Country	Share	Consolidation Method
Flaname 3 Limited	Great Britain	100.00	FC
Flaname 4 Limited	Great Britain	100.00	FC
Flaname 5 Limited	Great Britain	100.00	FC
Flaname 6 Limited	Great Britain	100.00	FC
Flaname 7 Limited	Great Britain	100.00	FC
Flaname 8 Limited	Great Britain	100.00	FC
Frederick Warne & Co Limited	Great Britain	100.00	FC
Frederick Warne & Co. LLC	United States	100.00	FC
Golden Treasures LLC	United States	100.00	FC
Grantham Book Services Limited	Great Britain	100.00	FC
Hammond, Hammond and Company, Limited	Great Britain	100.00	FC
Herbert Jenkins Limited	Great Britain	100.00	FC
Hind Pocket Books Private Limited	India	100.00	FC
Hurst & Blackett Limited	Great Britain	100.00	FC
Hutchinson & Co. (Publishers) Limited	Great Britain	100.00	FC
Hutchinson Books Limited	Great Britain	100.00	FC
Hutchinson Childrens Books Limited	Great Britain	100.00	FC
Jackdaw Publications Limited	Great Britain	100.00	FC
Jonathan Cape Limited	Great Britain	100.00	FC
Ladybird Books Limited	Great Britain	100.00	FC
Mainstream Publishing Company (Edinburgh) Limited	Great Britain	100.00	FC
Market Self Chile SpA	Chile	83.54	FC
Market Self S.A.	Argentina	83.54	FC
Martin Secker and Warburg Limited	Great Britain	100.00	FC
Penguin Australia Pty Ltd	Australia	100.00	FC
Penguin Books Benelux B.V.	Netherlands	100.00	FC
Penguin Books Deutschland GmbH	Germany	100.00	FC
Penguin Books Limited	Great Britain	100.00	FC
Penguin Books, S.A.	Spain	100.00	FC
Penguin Random House (Beijing) Culture Development Co. Ltd.	China	100.00	FC
Penguin Random House (Hong Kong) Limited	China	100.00	FC
Penguin Random House Australia Pty Ltd	Australia	100.00	FC
Penguin Random House Canada Limited	Canada	100.00	FC
Penguin Random House Grupo Editorial (USA) LLC	United States	100.00	FC
Penguin Random House Grupo Editorial S.A.	Argentina	98.28	FC
Penguin Random House Grupo Editorial S.A.	Peru	100.00	FC
Penguin Random House Grupo Editorial S.A.	Uruguay	99.85	FC
Penguin Random House Grupo Editorial S.A.S.	Colombia	99.92	FC
Penguin Random House Grupo Editorial, S.A.	Chile	100.00	FC
Penguin Random House Grupo Editorial, S.A. de C.V.	Mexico	100.00	FC
Penguin Random House Grupo Editorial, S.A.U.	Spain	100.00	FC
Penguin Random House Grupo Editorial, Unipessoal, Lda.	Portugal	100.00	FC
Penguin Random House India Private Limited	India	100.00	FC
Penguin Random House Ireland Limited	Ireland	100.00	FC
Penguin Random House Korea LLC	South Korea	100.00	FC
Penguin Random House Limited	Great Britain	100.00	FC

Consolidation continued

Scope of Consolidation continued

Name	Country	Share	Consolidation Method
Penguin Random House LLC	United States	100.00	FC
Penguin Random House New Zealand Limited	New Zealand	100.00	FC
Penguin Random House SEA Pte. Ltd.	Singapore	100.00	FC
Penguin Random House South Africa (Pty) Ltd.	South Africa	100.00	FC
Plane Tree Publishers Limited	Great Britain	100.00	FC
Random House Children's Entertainment LLC	United States	100.00	FC
Random House Properties Limited	Great Britain	100.00	FC
Random House Publishing Group Limited	Great Britain	100.00	FC
Random House Struik Proprietary Limited	South Africa	100.00	FC
Random House UK Ventures Limited	Great Britain	100.00	FC
RHA Holdings Pty Ltd	Australia	100.00	FC
Salspot Limited	Great Britain	100.00	FC
Sasquatch Books LLC	United States	100.00	FC
Sinclair – Stevenson Limited	Great Britain	100.00	FC
Snowdog Enterprises Limited	Great Britain	100.00	FC
Snowman Enterprises Limited	Great Britain	100.00	FC
Sputnik 84 LLC	United States	100.00	FC
Stanley Paul & Co Limited	Great Britain	100.00	FC
T. Werner Laurie, Limited	Great Britain	100.00	FC
The Bodley Head Limited	Great Britain	100.00	FC
The Book Service Limited	Great Britain	100.00	FC
The Cresset Press Limited	Great Britain	100.00	FC
The Harvill Press Limited	Great Britain	100.00	FC
The Hogarth Press Limited	Great Britain	100.00	FC
The Random House Group Limited	Great Britain	100.00	FC
Transworld Publishers Limited	Great Britain	100.00	FC
Ventura Publishing Limited	Great Britain	100.00	FC
Virgin Books Limited	Great Britain	100.00	FC
Woodlands Books Limited	Great Britain	85.00	FC

Acquisitions and Disposals

Penguin Random House made only one acquisition of a diminutive size in the financial year 2018. The overall impact of the acquisition on the financial position and financial performance of the Group was minor. The cash flow from acquisition activities totaled €-2 million, of which €-1 million relates to the new acquisitions during the reporting period less cash and cash equivalents acquired, and €-1 million relates to acquisitions in previous years.

In the financial year 2017, the cash flow from acquisition activities totaled €-40 million, which fully related to new acquisitions during the reporting period 2017 less cash and cash equivalents acquired. The consideration transferred in accordance with IFRS 3 amounted to €44 million taking into account contingent consideration of €4 million.

In July 2017, Penguin Random House acquired an interest of 100 percent in the publishing group Ediciones B from Spain's Grupo Zeta media group. Penguin Random House considers the acquisition as a reinforcement of Penguin Random House Grupo Editorial's market position and cultural importance in Spain, Latin America and the entire Spanish-speaking world. The consideration transferred amounted to €37 million and was fully paid in

Consolidation continued

Acquisitions and Disposals continued

cash. The purchase price allocation resulted in non-tax-deductible goodwill of €28 million, mainly representing synergy potential to be realized from efficiency optimization in direct and structural expenses. In the financial year 2017, transaction-related costs amounted to €2 million and were recognized in profit or loss.

In addition, Penguin Random House made several acquisitions in the financial year 2017, none of which was material on a stand-alone basis. Payments net of acquired cash and cash equivalents amounted to €-4 million; the consideration transferred in accordance with IFRS 3 for these acquisitions amounted to €7 million taking into account contingent consideration of €3 million. The other acquisitions resulted in goodwill totaling €3 million, which reflects synergy potential and is tax deductible. Due to exercising an optional right in the United States, from a tax perspective the other acquisitions were treated as asset deals. On an individual level, the total consideration transferred in the amount of €7 million is tax deductible over 15 years. In the financial year 2017, transaction-related costs amounted to less than €1 million and have been recognized in profit or loss.

The following table shows the fair values of the assets and liabilities of the acquisitions made in the financial year 2017 on their dates of initial consolidation based on the purchase price allocations:

Effects of Acquisitions in the Financial Year 2017

in € millions	Ediciones B	Other	Total
Non-current assets			
Goodwill	28	3	31
Other intangible assets	8	3	11
Other non-current assets	2	—	2
Current assets			
Inventories	7	2	9
Trade and other receivables	5	1	6
Other current assets	2	1	3
Cash and cash equivalents	1	—	1
Liabilities			
Financial debt	—	1	1
Other financial and non-financial liabilities	16	2	18

In the financial year 2016, Penguin Random House made no acquisitions. The cash flow from acquisition activities in 2016 of €-1 million related to acquisitions in previous years.

The fair values of the identifiable assets, liabilities and contingent liabilities acquired are measured in accordance with IFRS 3, and primarily using the market price-oriented approach. According to this approach, assets and liabilities are measured at the prices observed in active markets. If measurement using the market price-oriented approach is not feasible, the income approach is to be applied. Within the income approach, the following methods are usually applied: multi-period excess earnings method ("MEEM") and relief from royalty method. According to the multi-period excess earning method the fair value is at first determined as the present value of directly attributable cash flows, generated solely by the asset being valued. According to the relief from royalty method the fair value is determined as the present value of the royalty savings as a result of the acquisition. The income approach is used particularly in the valuation of imprints or backlists.

Penguin Random House Venture Combined Financial Statements

Consolidation continued

Effects of Acquisitions in the Financial Year 2017 continued

In June 2018, Penguin Random House sold its Seattle-based company Smashing Ideas to Luxoft Holding, a global IT service provider based in Switzerland. The sale resulted in a gain of €6 million recognized in the item "Results from disposals of investments."

In November 2017, Penguin Random House sold its travel guidebook and reference publisher The Rough Guides Limited to Media Tune Holding AG, Switzerland. The sale resulted in an immaterial loss recognized in the item "Results from disposals of investments."

In October 2017, Penguin Random House completed the sale of Penguin Random House Pte. Ltd., Singapore and Penguin Books Malaysia Sdn Bhd, Malaysia to Times Publishing Limited. The sale resulted in a gain of €1 million recognized in the item "Results from disposals of investments." As of December 31, 2016, Penguin Random House management had seen the sale as highly probable due to the advance-stage negotiations and had therefore classified the assets and related liabilities of PRH Singapore and Malaysia as held for sale at the end of the reporting period 2016.

In June 2016, Penguin Random House sold its American travel content publisher Fodor's to Internet Brands, a California-based online media and technology company. The sale resulted in a gain of €3 million recognized in the item "Results from disposals of investments."

After considering the cash and cash equivalents disposed of, Penguin Random House generated cash flows in the amount of €9 million from disposals (2017: €4 million; 2016: €6 million). The disposals resulted in a gain from deconsolidation of €6 million (2017: €1 million; 2016: €3 million), which is recognized in the item "Results from disposals of investments." The following table shows their impact on the assets and liabilities at the time of deconsolidation:

Effects of Disposals

in € millions	**2018**	2017	2016
Non-current assets			
Goodwill	**2**	1	1
Other intangible assets	**—**	2	1
Property, plant and equipment	**—**	—	—
Other non-current assets	**—**	1	—
Current assets			
Inventories	**—**	3	1
Other current assets	**2**	3	—
Cash and cash equivalents	**—**	—	—
Liabilities			
Financial debt	**—**	—	—
Other financial and non-financial liabilities	**—**	2	—

Assets Held for Sale and Liabilities Related to Assets Held for Sale

As of December 31, 2018, and as of December 31, 2017, no amounts related to assets classified as held for sale and related liabilities in accordance with IFRS 5.

Consolidation continued

Assets Held for Sale and Liabilities Related to Assets Held for Sale continued

The carrying amounts of the assets classified as held for sale and related liabilities as of December 31, 2016, are presented in the following table:

Assets Held for Sale and Related Liabilities

in € millions	12/31/2016
Assets	
Non-current assets	
Goodwill	1
Other intangible assets	3
Property, plant and equipment	—
Current assets	
Inventories	1
Other current assets	2
Cash and cash equivalents	2
Assets held for sale	9
Equity and liabilities	
Current liabilities	
Trade payables	1
Other current liabilities	1
Liabilities related to assets held for sale	2

The figures as of December 31, 2016, relate to the sale of Random House Pte. Ltd., Singapore, and Penguin Books Malaysia Sdn Bhd, Malaysia, completed in the financial year 2017. Further information is presented above.

The disposal groups mentioned above were measured at fair value less costs to sell. These are to be allocated to level 3 of the hierarchy of non-recurring fair values. Valuations for level 3 are based on information from the contract negotiations. The impairment losses were recognized in profit or loss in the item "Other operating expenses."

Foreign Currency Translation

Transactions denominated in a currency other than a subsidiary's functional currency are recognized in the functional currency at the exchange rate applicable on the day of their initial accounting. At the end of the reporting period, monetary assets and liabilities denominated in foreign currency are revalued into the functional currency using the closing rate applicable at that time. Gains and losses from these foreign currency translations are recognized in profit or loss. Non-monetary balance sheet items in foreign currency are carried at the historical exchange rate.

The financial statements of subsidiaries, joint ventures and associates that were prepared in foreign currencies are translated into euros using the functional currency concept set out in IAS 21 before they are included in the Combined Financial Statements. Assets and liabilities are translated into the reporting currency at the closing rate at the end of the reporting period, while income statement items are translated at the average rate for the financial year. Foreign currency translation differences are recognized in other comprehensive income. Such differences arise from translating items in the balance sheet at a closing rate that differs from the previous closing rate and from using the average rate for the period and the closing rate at the end of the reporting period to translate the

Consolidation continued

Foreign Currency Translation continued

Group profit or loss. At the time of deconsolidation of Group companies, the respective accumulated exchange differences recognized in other comprehensive income and accumulated in a separate component of equity are reclassified from equity to the income statement. The following euro exchange rates were used for currency translation purposes for the most significant foreign currencies for Penguin Random House.

Euro Exchange Rates for Significant Foreign Currencies

		Average rates			Closing rates		
Foreign currency unit per €1		**2018**	2017	2016	**12/31/2018**	12/31/2017	12/31/2016
Australian dollar	AUD	**1.5799**	1.4733	1.4881	**1.6220**	1.5346	1.4596
Canadian dollar	CAD	**1.5301**	1.4645	1.4660	**1.5605**	1.5039	1.4188
British pound	GBP	**0.8847**	0.8766	0.8196	**0.8945**	0.8872	0.8562
US dollar	USD	**1.1817**	1.1295	1.1072	**1.1450**	1.1993	1.0541

Accounting and Measurement Policies

Recognition of Income and Expense

Since January 1, 2018, revenues from contracts with customers are recognized in accordance with IFRS 15. Under this standard, a contract-based five-step model is used to first identify and distinguish the relevant contracts with customers. In a next step, the separate performance obligations explicitly or implicitly stipulated in the contract are identified, and the contract is examined for fixed and variable consideration in order to use this as a basis for determining the respective transaction price. In doing so, constraining estimates of variable consideration are taken into account. If more than one separate performance obligation is identified in a contract, the transaction price is then allocated to the identified performance obligations using the method of relative stand-alone selling prices, which are generally determined as prices on the markets relevant for the respective customers. Revenue recognition occurs upon satisfaction of the performance obligation either at a point in time or over time, depending on the underlying business model. If necessary, the extensive principal-agent considerations presented in IFRS 15 are also taken into account in analyzing the contracts.

Based on the underlying revenue sources and on the design of the underlying business model in the Group, the following key aspects are taken into consideration for revenue recognition:

- Printed products: As a rule, the revenues resulting from these contracts are recognized at a point in time when control is transferred. Depending on the underlying respective terms of sale, this is generally upon delivery to the customer. Expected returns from sales of products, mainly from physical books, are shown as liabilities in the balance sheet position “Trade and other payables.” Return assets, if any, are presented in the balance sheet position “Other non-financial assets”.
- Digital products: Due to the nature of the underlying business models, contracts with customers have to be analyzed especially to determine whether revenue has to be recognized on a gross or net basis. Therefore, principal-agent considerations of IFRS 15 are taken into account. The most relevant aspects of these analyses are the questions of who is to be regarded as customer and which party is considered to have latitude in setting the end consumer prices. With respect to certain business models, an online retailer has to be regarded as agent of Penguin Random House when selling digital products to end consumers who are the customers. With respect of other digital business models an online retailer is to be regarded as Penguin Random House’s customer and therefore acts as principal, if an online retailer obtains control of the goods or services prior to their transfer to an end consumer and has sufficient latitude in setting end consumer prices. Revenues from digital product sales are recognized on the basis of these notifications by the online retailers in the month in which download of the e-book occured.
- Other revenues: These mainly result from the rendering of services and the granting of rights and licenses. Services are generally rendered over a period of time, and the revenue is recognized based on an appropriate output method or input method for measuring progress. If permissible, revenues are recognized in the amount of the invoice if this amount corresponds to the value of the performance provided. The timing of revenue recognition for business models generating revenue from licenses depends on whether the license represents a right to access the intellectual property through the entire licensing period or a right to use when the license is granted. While revenues from licenses granted for a right to use are realized at the date of the transfer of control, revenues from licenses for rights to access are realized over a period of time throughout the term of the contract.

IFRS 15 stipulates some practical expedients of which the following are applied in the Group:

- Costs of obtaining contracts are not capitalized if the underlying asset is amortized in no more than 12 months.
- The value of consideration is not adjusted for the effects of a material financing component if the financing component pertains to a period of no more than 12 months.

Recognition of Income and Expense continued

- For contracts with an original duration of not more than 12 months and for contracts for which revenue can be recognized according to the amount invoiced for simplification purposes, no disclosure of the aggregated transaction price is provided.

Payments received before satisfaction of the corresponding performance obligation are recognized as contract liability. If contractual provisions make the invoicing of services completed to date causally dependent on the need to provide further goods or services, a contract asset is recognized. As of January 1, 2018, and as of December 31, 2018, no significant contract assets were recognized. Receivables from contracts with customer are generally due in less than 12 months.

Accounting policy for revenues until December 31, 2017:

Revenues were measured at the fair value of the compensation received or receivable and reduced by anticipated reductions in price, trade discounts and similar other deductions. Revenues from the sale of goods were recognized when Penguin Random House had transferred the significant risks and rewards associated with ownership of the goods to the purchaser and the amount of revenue could be reliably measured. Revenues from printed product sales were recognized, net of provision for estimated returns and rebates, accordingly; when a printed product was initially published, revenues were recognized at the official publication date. Revenues from digital product sales (which mainly relate to e-book sales) for which Penguin Random House had sufficient, accurate and reliable data from certain retailers were recognized on the basis of these notifications by the retailers in the month in which download of the e-book occurred. In the absence of such data, revenues from e-book sales were recognized on the estimated basis done by Penguin Random House. Cooperating advertising fees directly linked to sales transactions were recognized as deductions from revenues. Revenues from services including distribution services were recognized based on their percentage of completion.

Interest income and expenses relating to financial assets measured at amortized cost are recognized on an accrual basis using the effective interest method in accordance with IFRS 9. Dividends are only recognized in profit or loss when the right to receive payment of the dividend is established. Other income is recognized when the economic benefits are probable and the amount can be measured reliably. Expenses are deferred on the basis of underlying facts or the period of time to which they relate.

Goodwill

Goodwill resulting from a business combination is recognized in accordance with IFRS 3 at the date of acquisition. Goodwill is subject to impairment testing at least annually by comparing the carrying amount of the cash-generating unit to which goodwill has been allocated, with the recoverable amount of the cash-generating unit. If the carrying amount of a cash-generating unit exceeds its recoverable amount, an impairment loss is immediately recognized in profit or loss. Impairment, including impairment losses recognized during the year, is not reversed. Goodwill is tested for impairment each year as of December 31, as outlined in the section "Impairment Losses," and if a triggering event arises.

Other Intangible Assets

Non-current internally generated intangible assets are capitalized at cost, if the requirements set out in IAS 38 have been met. Intangible assets acquired separately are carried at acquisition cost less accumulated amortization and accumulated impairment losses. Intangible assets acquired as part of a business combination are initially recognized at fair value at the acquisition date in accordance with IFRS 3. Intangible assets with finite useful life are amortized on a straight-line basis over their estimated useful life. Impairment losses and reversal of

Other Intangible Assets continued

impairment losses are determined by applying the requirements for impairment testing (IAS 36). In general, capitalized software has a useful life of between three and five years. The estimate of useful life and amortization methods is reviewed annually and prospectively adjusted to reflect changes in expectations.

Intangible assets with indefinite useful life are not amortized. Instead, they are subject to at least annual impairment testing and written down to their recoverable amount if applicable. No significant intangibles with indefinitely useful lives exist.

Property, Plant and Equipment

Items of property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. The cost of items of property, plant and equipment produced internally within Penguin Random House includes direct attributable costs, including, among others, cost of material, labor and other inputs used in the construction of the asset. For qualifying assets in accordance with IAS 23, borrowing costs are capitalized. The amounts involved are insignificant to Penguin Random House. All other borrowing costs are expensed in the period in which they occurred. Maintenance costs are carried as expenses of the period, whereas expenses for activities that lead to a longer useful life or improved use are generally capitalized. Items of property, plant and equipment are depreciated on a straight-line basis over their estimated useful life. Estimates of useful life and the depreciation method are reviewed annually in line with IAS 16 and are adjusted prospectively according to the changed expectations. In the financial years 2018, 2017 and 2016, depreciation is generally based on the following useful lives:

- buildings: 10 to 50 years
- technical equipment and machinery: four to 15 years
- other equipment, fixtures, furniture and office equipment: three to 15 years

Land is not subject to depreciation.

Impairment Losses

Goodwill and intangible assets with indefinite useful life are tested for impairment at least annually. Intangible assets with a finite useful life and property, plant and equipment are tested for impairment at the end of each reporting period in accordance with IAS 36, if there are any indications of impairment.

An impairment loss is recognized when the recoverable amount of a cash-generating unit has fallen below its carrying amount. The recoverable amount is the higher of fair value less costs of disposal and value in use. Fair value less costs of disposal and the value in use are generally determined using the discounted cash flow method, which is based on future cash flow forecasts, which are part of company forecasts. For determining the value in use, estimated future cash inflows or outflows from future restructurings or from improvement or enhancement of the cash-generating units' performance are excluded unless, as of the end of the reporting period, the cash-generating unit is committed to the restructuring and related provisions have been made. For assets held for sale, only fair value less costs to sell is used as a basis for comparison.

As long as an active market exists, the market price or the price in the most recent comparable transaction is used for measuring fair value. If there is no active market, fair value less costs of disposal is generally calculated using the discounted cash flow method. If it is not possible to allocate cash flows to assets, the relevant impairment losses are determined on the basis of cash flows attributable to the cash-generating unit to which the assets belong. Projected cash flows are based on internal estimates for three planning periods. Generally, two further

Impairment Losses continued

detailed planning periods are applied in addition. Based on historical data, the company's internal forecasts take into account expectations relating to the market development. For periods beyond this detailed horizon, a perpetual annuity is recognized, taking into account individual business-specific growth rates. Discounting is generally based on the weighted average cost of capital (WACC) after tax. Specific WACCs are derived for cash-generating units with different risk profiles. Management estimates of cash flow are based on factors including assumptions of economic trends and the associated risks, the regulatory environment, the competitive environment, market share, investments and growth rates. The growth rates applied are based on long-term real growth figures for the relevant economies, growth expectations for the relevant sectors and long-term inflation forecasts for the countries in which the cash-generating units operate. The values allocated to the key assumptions are in line with external sources of information. The figures obtained using the respective discount rates reflect the recoverable amount of the cash-generating units. Material changes in market or competitive environment may impair the value of cash-generating units. If the reasons for an impairment loss recognized in prior periods no longer exist, the impairment loss is reversed up to a maximum of the carrying amount of the respective asset if the impairment loss had not been recognized. The latter does not apply to goodwill.

Leases

The operating leases entered into by Penguin Random House primarily relate to rental agreements for buildings. Based on the substance of transaction, the leased assets are allocated to the lessor. The lease installments constitute expenses for the period and are carried as "Other operating expenses" using the straight-line method over the term of the lease. If Penguin Random House bears all material rewards and risks as part of leasing agreements and is thus to be regarded as the economic owner (finance lease), the leased item is capitalized at its fair value at the inception of the lease term or the lower net present value of the future minimum lease payments. Payment obligations arising from finance leases are recognized as financial liabilities in the same amount. No material finance lease arrangements exist.

Financial Assets

In accordance with the IFRS 9 classification and measurement approach for financial assets, there are three classification categories for financial assets in the Group:

- at amortized cost,
- at fair value with changes in fair value through profit or loss (FVTPL) and
- at fair value with changes in fair value through other comprehensive income (FVOCI).

The allocation to the respective classification categories is based on the following criteria:

- the entity's business model for managing the financial assets and
- contractual cash flow characteristics of the financial asset.

Financial assets are recognized initially at fair value, taking into account transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets recognized at fair value through profit or loss are expensed in profit or loss.

Subsequent measurement of financial instruments depends on the classification categories:

- At amortized cost: Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest on the principal amount outstanding are measured at amortized cost. This category mainly comprises trade receivables and other financial receivables. Any gain or loss arising on derecognition and impairment losses is recognized directly in profit or loss.

- FVOCI: Financial assets that are held for collection of contractual cash flows and for selling, where the assets' cash flows represent solely payments of principal and interest on the principal amount outstanding, are measured at fair value with changes in fair value through other comprehensive income. Penguin Random House held no debt instruments measured at fair value through other comprehensive income. Penguin Random House exercises the option for measurement of equity instruments at fair value through other comprehensive income mainly for individual immaterial investments. With deferred taxes taken into consideration, the gains and losses resulting from fluctuations in the fair value of these equity instruments are recognized through other comprehensive income. Gains and losses from the fair value are not reclassified to the income statement after derecognition of the equity instruments. Dividends from such equity instruments continue to be recognized in profit or loss.
- FVTPL: Financial assets that do not meet the criteria for amortized cost or FVOCI are measured at fair value through profit or loss. With deferred taxes taken into consideration, the gains and losses resulting from fluctuations in the fair value are recognized in profit or loss.

Impairment and measurement of expected credit losses:

Penguin Random House applies for debt instruments at amortized cost and for contract assets the expected credit loss (ECL) model in accordance with IFRS 9. Accordingly, the amount of expected credit losses recognized as a loss allowance depends on the extent to which the default risk has deteriorated since initial recognition. According to the so-called general approach, a distinction is made between the following two measurement bases:

- 12-month ECLs: At initial recognition and if the default risk has not increased significantly from the initial recognition of the debt instrument, a loss allowance is recognized for expected credit losses within the next 12 months.
- Lifetime ECLs: If the default risk has increased significantly, a loss allowance for expected credit losses is recognized for the entire life of the debt instrument.

A default on a financial asset is assumed at the latest when the counterparty fails to make contractual payments within 90 days of when they fall due, unless reasonable and supportable information is available that justifies a different time of overdue payment.

For trade receivables and contract assets, Penguin Random House uses a risk scoring model based on qualitative and quantitative risk factors for its major customers. For insignificant customers Penguin Random House uses a simplified approach to measure expected credit losses on trade receivables and contract assets. According to this, the loss allowance is measured using lifetime expected credit losses. For this purpose, impairment matrices based on historic bad debt losses, maturity bands and expected credit losses reflecting the ability of the customers to settle the receivables were prepared. The impairment matrices were created for business-unit-specific groups of receivables, each with similar default patterns. In addition, separate risk assessments are performed. Contract assets have substantially the same risk characteristics as trade receivables for the same types of contracts so that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for contract assets.

Accounting policy for financial assets until December 31, 2017:

Financial assets were recognized initially at fair value, taking into account transaction costs that were directly attributable to the acquisition of the financial asset. In the case of financial assets that were recognized at fair

Financial Assets continued

value through profit or loss, transaction costs were recognized directly in the income statement. Regular purchases and sales of financial assets were recognized on the trade date – the day on which Penguin Random House entered into an obligation to buy or sell the asset.

For subsequent measurement, financial assets were classified into the following categories and subcategories:

- *available-for-sale financial assets*
- *financial assets recognized at fair value through profit or loss*
  - *primary and derivative financial assets held for trading*
  - *financial assets initially recognized at fair value through profit or loss*
- *loans and receivables*
  - *originated loans and trade receivables*
  - *cash and cash equivalents*

Available-for-sale financial assets: The available-for-sale category primarily included current and non-current securities and equity investments not classified as held-to-maturity investments, as loans and receivables, or at fair value through profit or loss. In accordance with IAS 39, available-for-sale financial assets were measured at their fair value at the end of the reporting period to the extent that this value could be reliably measured. Otherwise these were measured at cost. With deferred taxes taken into consideration, gains and losses resulting from fluctuations in the fair value were recognized in other comprehensive income. However, if there was objective evidence of impairment, this was recognized in profit or loss. A significant or prolonged decline in the fair value of an equity instrument below its acquisition cost was also to be regarded as objective evidence of impairment. If these assets were sold, the accumulated gains and losses previously recognized in other comprehensive income were reclassified from equity to the income statement.

Primary and derivative financial assets held for trading: In general, this category included derivatives that do not meet the formal requirements of IAS 39 for hedge accounting. They were measured at their fair value. Gains or losses from changes to the fair values were recognized in profit or loss.

Financial assets initially recognized at fair value through profit or loss: This category included financial assets that were designated upon initial recognition at fair value through profit or loss. Changes in fair value were recognized in the other financial result.

Originated loans and trade receivables: Originated loans and trade receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were carried at amortized cost using the effective interest method. Long-term interest-free or low-interest loans and receivables were discounted. Foreign currency items were translated using the closing rate. If there was objective evidence of impairment, the carrying amount was reduced through use of an allowance account and the loss was recognized in profit or loss. No material originated loans existed.

Penguin Random House had no held-to-maturity investments.

Impairment losses and reversals: The carrying amounts of financial assets not recognized at fair value through profit or loss were examined at the end of each reporting period to determine whether there was objective evidence of impairment. Such evidence existed in the following cases: information concerning financial

Financial Assets continued

difficulties of a customer or a group of customers; default or delinquency in interest or principal payments; the probability of being subject to bankruptcy or other financial restructuring; and recognizable facts that point to a measurable reduction in the estimated future cash flows, such as an unfavorable change in the borrower's payment status or the economic situation that corresponds to the delayed performance. In the case of financial assets carried at amortized cost, the loss in case of impairment corresponded to the difference between the carrying amount and the present value of the anticipated future cash flows – discounted using the original effective interest rate for the financial asset. If it was established that the fair value had increased at a later measurement date, the impairment loss previously recognized was reversed up to a maximum of amortized cost in profit or loss. Impairment losses were not reversed in the case of unlisted equity instruments that were classified as available-for-sale assets and carried at cost. In case of impairment on available-for-sale assets carried at cost, the amount of the impairment loss was measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted using the risk-adjusted interest rate.

Measurement at Fair Value

In the case of financial assets and financial liabilities measured at fair value, the valuation technique applied depends on the respective inputs present in each case. If listed prices can be identified for identical assets on active markets, they are used for valuation (level 1). If this is not possible, the fair values of comparable market transactions are applied, and financial methods that are based on observable market data are used (level 2). If the fair values are not based on observable market data, they are identified using established financial methods or on the basis of observable prices obtained as part of the most recently implemented qualified financing rounds taking into account the life and developmental cycle of the respective entity (level 3).

Inventories

Inventories – consisting principally of physical books – are recognized at the lower of historical cost and net realizable value at the end of the reporting period. Both raw materials and finished goods inventory are accounted for using the FIFO (first-in, first-out) cost-flow assumption. Weighted average costing can be used if it results in approximately the same cost as FIFO. Inventories originating from intragroup suppliers are adjusted to eliminate intragroup earnings and are measured at Penguin Random House's cost.

Inventories are tested for recoverability at the end of each reporting period. For this purpose, net realizable value is determined. Net realizable value is defined as the estimated sales price less expected costs to complete and estimated selling expenses. A write-down is recognized if the net realizable value is lower than its historical cost. Write-downs are reversed if the circumstances causing their recognition no longer exist. The new carrying amount then represents the lower of historical cost and adjusted net realizable value. An inventory obsolescence reserve for finished goods is calculated on a title-by-title basis. The consumption of inventories, changes in inventories of work in progress and finished goods, and own costs capitalized are recognized in the income statement in the position "Cost of materials."

Income Taxes

In accordance with IAS 12, current tax expense and income are determined based on the respective domestic taxable earnings of the year (taxable income). Current and deferred taxes are determined based on applicable regulations and tax laws of the countries in which the companies included in the Combined Financial Statements are domiciled. The presentation is based on the legal approach for own tax liabilities as they arise in the normal

Income Taxes continued

way. Current and deferred taxes for tax-transparent entities (e.g., partnerships, which are not taxed in their own right) are therefore recognized on the level of the respective owners based on their share of the tax-transparent entity's profits. The income tax relating to tax-transparent entities is therefore not included in the income tax line of the Combined Financial Statements. Deferred tax assets and liabilities are recognized for temporary differences between the tax base and the carrying amounts shown on the IFRS combined balance sheet, and for as yet unused tax loss carryforwards and tax credits.

Deferred tax assets are recognized only to the extent it is probable that taxable income will be available against which the deductible temporary difference can be utilized. Deferred tax assets that are unlikely to be realized within a clearly predictable period are reduced by valuation allowances. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets and liabilities resulting from business combinations are recognized with the exception of temporary differences on goodwill not recognizable for tax purposes. The tax rates applied for computation are based on the country-specific tax rates and tax laws that have been enacted or substantively enacted at the end of the reporting period and whose applicability is expected as of the date of reversal of the temporary differences and the use of tax loss carryforwards and tax credits, respectively. In general, deferred taxes are recognized in profit or loss unless they relate to items recognized in other comprehensive income. In this case, deferred taxes are recognized in other comprehensive income.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income includes net exchange differences and gains and losses from the fair value measurement of equity instruments with changes through other comprehensive income (IFRS 9 classification category FVOCI) and of derivatives used to hedge future cash flows (cash flow hedges) in accordance with IFRS 9.

In addition, in accordance with IAS 28.10, changes in other comprehensive income for entities accounted for using the equity method are recognized. Remeasurement effects of defined benefit pension plans (actuarial gains and losses on the defined benefit obligation, differences between actual investment returns and the return implied by the net interest cost on the plan assets, and effects of the asset ceiling) are recognized in the retained earnings in the year in which these gains and losses have been incurred as part of the reconciliation of total comprehensive income for the period in the statement of changes in equity. Deferred taxes on the aforementioned items are recognized directly in other comprehensive income.

Accounting policy for accumulated other comprehensive income until December 31, 2017:

Accumulated other comprehensive income included foreign exchange gains and losses and unrealized gains and losses from the fair value measurement of available-for-sale financial assets and derivatives used in cash flow hedges in accordance with IAS 39.

Provisions

Provisions for pensions and similar obligations are calculated using the projected unit credit method in accordance with IAS 19. This method involves the use of biometric calculation tables, current long-term market interest rates and current estimates of future increases in salaries and pensions.

The net interest expense included in pension expense is recognized in the financial result. Remeasurement effects of defined benefit pension plans (actuarial gains and losses on the defined benefit obligation, differences between

Provisions continued

actual investment returns and the return implied by the net interest cost on the plan assets, and effects of the asset ceiling) are recognized immediately in equity under other comprehensive income and are not reclassified to profit or loss in a subsequent period (recycled).

With the exception of the other personnel-related provisions calculated in accordance with IAS 19, all of the other provisions are established on the basis of IAS 37 where there is a legal or constructive obligation to a third party, the outflow of resources is probable and it is possible to reliably determine the amount of the obligation. Provisions are measured in the amount of the most likely outcome.

Long-term provisions are discounted. The discount rates take into account current market expectations and, if necessary, specific risks for the liability. Income from the reversal of provisions is generally included in the income statement line item to which the provision was previously charged.

Financial Liabilities

Trade payables and other primary financial liabilities are initially measured at their fair value less transaction costs. Subsequent measurement is based on amortized cost using the effective interest method, unless the financial liability is classified as initially recognized at fair value through profit or loss. Foreign currency liabilities were translated at the exchange rate at the end of the reporting period. Finance lease liabilities, which were also recognized under financial liabilities, were carried at their net present value in accordance with IAS 17.

Derivative Financial Instruments

As set out in IFRS 9, all derivative financial instruments are recognized at fair value on the balance sheet. Derivative financial instruments are recognized as of the transaction date. When a contract involving a derivative is entered into, it is initially determined whether it serves to hedge future cash flows (cash flow hedge). Some derivatives do not meet the requirements included in IFRS 9 for recognition as hedges despite this being their economic purpose. Changes in the fair values of derivatives are recognized as follows:

1. Cash flow hedge: The effective portion of the changes in the fair value of derivatives used to hedge future cash flows is recognized in other comprehensive income. The amounts carried here are included in the initial measurement when an underlying, non-financial asset or a non-financial liability is received (basis adjustment). In other cases, the reclassification of the previously recognized gains and losses from equity to the income statement is performed when the hedged underlying transaction affects profit or loss. The ineffective portion of the changes in the fair value of the hedging instrument are recognized in profit or loss.
2. Stand alone hedge: Changes in the fair value of derivatives that do not meet the criteria for recognition as hedges is recognized in profit or loss.

In the financial years 2018, 2017 and 2016, no hedge transactions were recognized with fair value hedges or to hedge a net investment in foreign operations.

Non-Current Assets Held for Sale and Related Liabilities

Non-current assets or disposal groups are classified as held for sale if the associated carrying amount will be recovered principally through a sale transaction and not from continued use. These non-current assets and the associated liabilities are presented in separate line items in the balance sheet in accordance with IFRS 5. They are measured at the lower of the carrying amount and fair value less costs to sell. Depreciation/amortization is not recognized if a non-current asset is classified as held for sale or forms part of a disposal group that is classified as held for sale.

Non-Current Assets Held for Sale and Related Liabilities continued

Components of entities that fulfill the requirements of IFRS 5.32 are classified as discontinued operations and thus are carried separately in the income statement and cash flow statement. All of the changes in amounts made during the reporting period that are directly connected with the sale of a discontinued operation in any preceding period are also stated in this separate category. If a component of an entity is no longer classified as held for sale, the results of this entity component that were previously carried under discontinued operations are reclassified to continuing operations for all of the reporting periods shown.

Significant Accounting Judgements, Estimates and Assumptions

The preparation of Combined Financial Statements requires the use of accounting judgments, estimates and assumptions that may impact the carrying amounts of assets, liabilities, income and expenses recognized. Amounts actually realized may differ from estimated amounts. The following section presents accounting judgements, estimates and assumptions that are material in the Penguin Random House Combined Financial Statements for understanding the uncertainties associated with financial reporting.

- Recognition of income and expense: In the event of return rights, mostly for print products, estimates are made with regard to the anticipated return volume as revenues are recognized taking the anticipated returns into account. Return curves and average return rates are used to identify the anticipated returns. The accounting assessment of advertising grants paid to the customers of Penguin Random House includes different factors and they are therefore deducted from revenue. The transaction prices to be determined using the contract-based five-step model defined in IFRS 15 often include both fixed and variable consideration. The variable components are determined on the basis of estimates, which are made and updated in accordance with constraint conditions. For business models involving other parties, e.g. relating to sales of digital products, qualitative estimates must be made as part of principal-agent considerations as to who is to be regarded as a customer of a Penguin Random House company and whether a Penguin Random House company is to be regarded as principal or agent in a transaction.
- All advanced payments for royalties are recorded as assets and a liability is recorded for all outstanding obligations not yet paid but for which a legal obligation to pay exists. Sales estimates and assumptions on future sales success are made in connection with advances paid to authors to secure exploitation rights in their publications.
- Author royalty earnings are applied against any outstanding advance until the total unearned advance is reduced to zero. Author royalty earnings after that point are recognized as a payable.
- Published and unpublished advances are tested for impairment based on management estimates of future sales volumes and price changes considering the current market conditions and using historical data, if appropriate, like past sales of similar books or books by the same author, and other relevant factors in estimating sales. Penguin Random House has a long history of providing authors with royalty advances, and it tracks each advance earned with respect to the sale of the related publication. Penguin Random House applies this historical experience to its existing outstanding royalty advances to estimate the likelihood of recovery. Additionally, Penguin Random House management regularly reviews its portfolio of royalty advances to determine if individual royalty advances are not recoverable for discrete reasons, such as the death of an author prior to completion of a title or titles, a Penguin Random House decision to not publish a title, poor market demand or other relevant factors that could impact recoverability. Based on this information, the portion of any advance that Penguin Random House believes is not recoverable, is expensed.
- Trade and other receivables: Calculation of loss allowance for accounts receivables is based on historical credit loss rates for groups of financial assets with similar credit risk characteristics and on forward looking information, including customer-specific information and forecasts of future economic conditions.

Significant Accounting Judgements, Estimates and Assumptions continued

- Impairment losses: Goodwill and intangible assets with indefinite useful life are tested for impairment at least annually. Intangible assets with finite useful life and property, plant and equipment are tested for impairment in accordance with IAS 36 if there are indications that an asset may be impaired. Impairment loss has occurred when the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use. Fair value less costs of disposal and the value in use are generally determined using the discounted cash flow method, which is based on future cash flow forecasts, which are part of company forecasts. The cash flow forecasts are based on the management's best possible estimates with regard to future performance. Penguin Random House has used a combination of long-term trends, industry forecasts and in-house knowledge, with special emphasis on recent experience, in forming the assumptions about the development of the various relevant markets in which Penguin Random House operates. This is an area highly exposed to the general economic conditions. Penguin Random House´s business development is still subject to risks. In particular, the unclear conditions of Brexit and the associated uncertainty could adversely impact Penguin Random House's economic environment and thus increase the risk from economic developments. The subdued growth expectations in the United Kingdom reflect the significant uncertainty over the outcome of the Brexit negotiations and future economic relations. Moreover, the devaluation of the local currency after the referendum on EU membership is having an increasingly adverse effect on the consumer climate. The state of the relevant market is just one of the key operational drivers Penguin Random House uses when assessing individual business models. The most important assumptions include estimated growth rates, the weighted average cost of capital and tax rates. All of these different elements are variable, interrelated and difficult to isolate as the main driver of the various business models and respective valuations. Changes to these estimates as a result of more recent information could have a material impact on the amount of the possible impairment. Penguin Random House performs sensitivity analyses on the cash-generating units, especially on those where the headroom between the recoverable amount and the carrying value is low. Detailed information on the assumptions and estimates that are used in impairment testing for intangible assets (including goodwill) in Penguin Random House is presented in note 10 "Intangible Assets."
- Pension obligations: Pension obligations are measured using the projected unit credit method. Using this approach, biometric calculations, the prevailing long-term capital market interest rates and, in particular, assumptions about future salary and pension increases are taken into account.
- Provisions for onerous contracts and warranties are also based to a significant extent on management estimates with regard to their amount and probability of occurrence. Assessments of whether there is a present obligation, whether an outflow of resources is probable and whether it is possible to reliably determine the amount of the obligation are generally based on the expertise of in-house or third-party specialists. More recent information could change the estimates and thus impact the financial position and financial performance of Penguin Random House. With regard to risk provisioning, a provision for potential losses from litigation is recognized when the risks of a loss are considered to be probable and when a reliable estimate of the anticipated financial impact is possible. For significant contingent liabilities for which the possibility of a future loss is more than remote but less than probable, Penguin Random House estimates the possible loss where the Group believes that an estimate can be made. At the end of the reporting period, there were no reportable contingent liabilities from litigation. Management regularly reviews the recognition, measurement and use of provisions and the disclosure requirements for contingent liabilities.

In the case of purchase price allocations, assumptions are also made regarding the measurement of assets and liabilities assumed as part of business combinations. This applies in particular with regard to the acquired intangible assets, as measurements are based on fair value. In general, this is the present value of the future cash

Significant Accounting Judgements, Estimates and Assumptions continued

flows after taking into account the present value of the tax amortization benefit. In addition, the definition of uniform useful lives within Penguin Random House is based on management's assumptions. General information on useful lives is presented in the sections "Other Intangible Assets" and "Property, Plant and Equipment."

Assessments of the ability to realize uncertain tax positions and future tax benefits are also based on assumptions and estimates. Recognition of an asset or liability from an uncertain tax position is performed in accordance with IAS 12 if payment or refund of an uncertain tax position is probable. Measurement of the uncertain tax position is at its most likely amount. Deferred tax assets are only carried to the extent that it is probable that they can be utilized against future taxable profits. When assessing the probability of the ability to use deferred tax assets in the future, various factors are taken into account, including past earnings, company forecasts, tax forecast strategies and loss carryforward periods. Information relating to the ability to realize tax benefits is presented in note 9 "Income Taxes."

Assumptions are also made for measuring fair values of financial assets and financial liabilities. In this regard, Penguin Random House uses various financial methods that take into account the market conditions and risks in effect at the end of the respective reporting periods. The inputs to these models are taken from observable markets where possible, but where this is not feasible, measuring fair values is based on assumptions by management. These assumptions relate to input factors such as liquidity risk and default risks.

Estimates and the underlying assumptions are reviewed on an ongoing basis. In general, adjustments to estimates are taken into account in the period in which the change is made and in future periods.

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet

1 Revenues

In the financial year 2018, Penguin Random House derives revenue from contracts with customers in the following major revenue sources and geographical areas:

Revenue from Contracts with Customers

in € millions	2018
Revenue Sources	
Revenues from printed products	**2,254**
Revenues from digital products	**736**
Other revenues	**144**
	3,134
Geographical Areas	
North America	**2,110**
United Kingdom	**365**
Other countries	**659**
	3,134

Revenues from printed products mainly include revenues from physical book sales, whereas revenues from digital products mainly relate to revenues from e-books sales. The revenues comprise in the reporting period performance obligations fulfilled at a certain point in time of €3,039 million and performance obligations fulfilled over a certain period of time of €95 million. No revenues result from performance obligations that were already satisfied in previous periods. If revenue is recognized at a point in time, the timing of revenue recognition is determined by the contractually agreed terms of sale. For performance obligations satisfied over time, a sufficient measure of progress is determined generally based on output methods to recognize revenue accordingly. Input methods are used to determine revenue recognition in business models for which they more accurately measure progress. Penguin Random House makes use of practical expedients set out in IFRS 15 and does not disclose any unsatisfied performance obligations for contracts with an original duration of no more than 12 months and for contracts for which revenue can be recognized according to the amount invoiced for simplification purposes.

The following table shows the comparatives in the financial years 2017 and 2016:

in € millions	2017	2016
Revenues from printed products	2,354	2,358
Revenues from digital products	572	615
Other revenues	149	127
	3,075	3,100

Also in prior years, revenues from printed products mainly included revenues from physical book sales, whereas revenues from digital products mainly related to revenues from e-books sales.

The item “Other revenues” mainly comprises revenues from third party distribution activities in the amount of €88 million (2017: €86 million; 2016: €86 million) and subrights income in the amount of €53 million (2017: €55 million; 2016: €41 million).

Notes to the Income Statement and the Balance Sheet continued

2 Other Operating Income

in € millions	2018	2017	2016
Income from sideline operations	**22**	24	46
Income from reimbursements	**3**	2	1
Gains from disposals of non-current assets	**2**	—	—
Foreign exchange gains	**2**	—	3
Sundry operating income	**2**	7	6
	31	33	56

3 Cost of Materials

in € millions	2018	2017	2016
Consumption of finished goods and merchandise	**601**	616	665
Consumption of raw materials and supplies	**15**	14	14
	616	630	679

4 Personnel Costs

in € millions	2018	2017	2016
Wages and salaries	**571**	581	583
Statutory social security contributions	**42**	50	49
Expenses for pensions and similar obligations	**35**	33	37
Other employee benefits	**57**	51	54
	705	715	723

5 Amortization, Depreciation, Impairment and Reversals on Intangible Assets and Property, Plant and Equipment

in € millions	2018	2017	2016
Amortization/depreciation, impairment and reversals on			
– intangible assets	**46**	47	48
– property, plant and equipment	**25**	28	28
	71	75	76

Further details on amortization, depreciation, impairment and reversals are presented in note 10 "Intangible Assets" and note 11 "Property, Plant and Equipment."

6 Other Operating Expenses

in € millions	2018	2017	2016
Selling expenses	**246**	101	108
Administrative expenses	**236**	235	253
Loss allowances on receivables, loans and non-financial assets	**154**	149	148
Advertising costs	**97**	112	101
Consulting and audit fees	**17**	24	19
Operating taxes	**11**	10	10
Losses on disposals of non-current assets	**2**	—	—
Foreign exchange losses	**—**	5	—
Sundry operating expenses	**28**	19	9
	791	655	648

In accordance with IFRS 15, the item "Selling expenses" comprises, among others, €147 million commissions for online retailers. The item "Administrative expenses" includes, among others, payments recognized as expenses from operating leases of €51 million (2017: €60 million; 2016: €63 million) and associated services and incidental costs of €4 million (2017: €3 million; 2016: €3 million). In addition, an immaterial amount of contingent lease payments is included in this item (2017: €0 million; 2016: €0 million).

7 Interest Income and Interest Expenses

in € millions	2018	2017	2016
Interest income			
Interest income on cash and cash equivalents	**1**	1	1
Other interest income	**—**	2	—
	1	3	1
Interest expenses			
Interest expenses on financial debt	**(44)**	(10)	(1)
Other interest expenses	**(1)**	(3)	(3)
	(45)	(13)	(4)

The increase of the item "Interest expenses on financial debt" is mainly due to the financing of Penguin Random House by Bertelsmann PRH Finance, Inc. Further information is presented in note 21 "Financial Debt" and note 26 "Related Party Disclosures."

8 Other Financial Income and Expenses

in € millions	2018	2017	2016
Other financial income			
Non-operating foreign exchange gains	**—**	—	2
Other	**3**	1	—
	3	1	2
Other financial expenses			
Net interest on defined benefit plans	**—**	(1)	—
Other	**(6)**	(7)	(3)
	(6)	(8)	(3)

To better reflect the economic content, income and expenses from non-operating foreign currency hedging transactions are offset against the results from the measurement of the economically hedged items in foreign currency, and are recognized as non-operating foreign exchange gains or losses. In the financial year 2018, losses from these non-operating hedged items in foreign currency of €-6 million (2017: €0 million; 2016: €0 million) were offset by income from foreign currency hedging transactions amounting to €13 million (2017: €7 million; 2016: €10 million). Gains from these hedged items in foreign currency of €1 million (2017: €2 million; 2016: €8 million) were offset by expenses from foreign currency hedging transactions amounting to €-8 million (2017: €-9 million; 2016: €-16 million).

9 Income Taxes

Income taxes, broken down into current and deferred income taxes, are as follows:

Income Taxes

in € millions	2018	2017	2016
Earnings before income taxes	**348**	376	400
Current income taxes	**(33)**	(24)	(26)
Deferred income taxes	**(1)**	14	(1)
Income taxes	**(34)**	(10)	(27)
Net income after income taxes	**314**	366	373

Tax loss carryforwards of €9 million (2017: €10 million; 2016: €5 million) were utilized in the financial year 2018, reducing current tax expenses by €2 million (2017: €3 million; 2016: €1 million). Of the tax loss carryforwards utilized, no amounts relate to US corporate income tax, an immaterial amount (2017: €1 million; 2016: €2 million) was due to UK corporate income tax and €9 million (2017: €9 million; 2016: €3 million) was due to other foreign income taxes. These amounts include no amounts (2017: €6 million; 2016: €1 million) for tax loss carryforwards for which no deferred tax assets were recognized in the past. These amounts related to other foreign income taxes in the past (2017: €6 million; 2016: €1 million) and to UK corporate income tax in the past (2017: €0 million; 2016: €0 million). This led to a reduction in current tax expense in the past (2017: €2 million; 2016: €0 million).

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet continued

9 Income Taxes continued

Income Taxes continued

Deferred tax assets and liabilities resulted from the following items and factors.

Deferred Taxes

in € millions	12/31/2018 Assets	12/31/2018 Liabilities	thereof recognized in profit or loss in the financial year	12/31/2017 Assets	12/31/2017 Liabilities	thereof recognized in profit or loss in the financial year	12/31/2016 Assets	12/31/2016 Liabilities	thereof recognized in profit or loss in the financial year
Intangible assets	**2**	**22**	**1**	5	25	5	6	30	3
Property, plant and equipment	**4**	**3**	**1**	4	3	—	3	3	(1)
Financial assets	**1**	**3**	**2**	1	5	2	—	6	—
Inventories	**4**	**1**	**—**	4	1	—	4	1	1
Receivables	**8**	**2**	**1**	8	1	(1)	9	1	1
Advance payments and other assets	**6**	**—**	**—**	7	—	2	5	1	3
Provisions	**15**	**13**	**(2)**	20	12	—	23	11	(3)
Liabilities	**—**	**3**	**(1)**	—	3	—	—	2	(3)
Advance payments and other liabilities	**5**	**1**	**(1)**	7	3	—	7	2	(2)
Loss carryforwards/tax credits	**18**		**(2)**	20		6	14		—
Total	**63**	**48**	**(1)**	76	53	14	71	57	(1)
Offset	**(26)**	**(26)**		(34)	(34)		(40)	(40)	
Carrying amount	**37**	**22**		42	19		31	17	

No deferred tax liabilities were recognized for temporary differences in connection with investments in subsidiaries in the amount of €6 million (2017: €7 million; 2016: €7 million) as their reversal can be controlled, and it is probable that these temporary differences will not be reversed in the foreseeable future.

Current and deferred tax assets and liabilities are offset against each other if they relate to the same tax authority and meet the criteria for offsetting. The term of the deferred taxes on temporary differences is mostly long term.

Information on amounts of income tax relating to other comprehensive income is presented in note 18 “Equity.”

Deferred tax assets are recognized on temporary differences, tax loss carryforwards and tax credits when it is likely that they can be utilized in the foreseeable future. The recognizable amount is assessed primarily based on existing deferred tax liabilities from temporary differences and projected taxable income within a planning period.

9 Income Taxes continued

Deferred Taxes continued

Temporary differences, tax loss carryforwards and tax credits for which no deferred taxes have been recognized can be carried forward as follows:

Expiration

in € millions	12/31/2018	12/31/2017	12/31/2016
Tax loss carryforwards			
To be carried forward for more than 5 years	**3**	3	24
To be carried forward for up to 5 years	**2**	1	1
Temporary differences	**4**	2	8
Tax credits			
To be carried forward for more than 5 years	**—**	—	2
To be carried forward for up to 5 years	**1**	—	1

A reconciliation of expected tax result to actual tax result is shown in the following table:

Reconciliation to Actual Tax Expense

in € millions	2018	2017	2016
Earnings before income taxes	**348**	376	400
Income tax rate applicable to Penguin Random House (UK corporate income tax rate)	**19.00%**	19.25%	20.00%
Expected tax expense	**(66)**	(72)	(80)
The tax effects of the following items led to differences between the expected and actual tax expense:			
Adjustment to different national tax rates	**(21)**	(59)	(58)
Effect of changes in tax rate and tax law	**—**	3	(1)
Current income taxes for previous years	**(3)**	(2)	—
Deferred income taxes for previous years	**—**	3	1
Effects of measurements of deferred tax assets	**(1)**	12	4
Permanent differences	**1**	(7)	(5)
Taxes incurred on the level of shareholders in the United States	**60**	114	115
Other adjustments	**(4)**	(2)	(3)
Total of adjustments	**32**	62	53
Actual tax expense	**(34)**	(10)	(27)

The actual tax expense differs from the expected tax expense mainly due to differences between the applicable national tax rates to the tax rate applicable to the Combined Financial Statements (UK corporate income tax rate) and due to income taxes related to the tax-transparent entities of the legal group PRH LLC, United States, which are incurred on the level of the shareholders and are therefore not accounted for in the Combined Financial Statements. Included in the "Adjustment to different national tax rates" is mainly the tax differential to the United States nominal tax rate (2018: 26.20 percent; 2017: 38.10 percent; 2016: 38.80 percent).

9 Income Taxes continued

Applicable Income Tax Rate

The applicable tax rate corresponds to the applicable tax rate of the Penguin Random House Limited, United Kingdom, as parent company of the legal group PRH Limited, because the main parts of the reported tax relate to this legal group. The applicable tax rate in the financial year 2018 was 19.00 percent (2017: 19.25 percent; 2016: 20.00 percent) and corresponds to the enacted country-specific tax rate in the United Kingdom.

The income tax relating to the legal group PRH LLC, United States, is not material for the Combined Financial Statements as only state income taxes are included in the income tax line in profit or loss. Any other income tax, which derives from the profits of the legal group PRH LLC, is not shown as part of the Combined Financial Statements, as it is accounted for in the partner's financial statements.

10 Intangible Assets

in € millions	Goodwill	Other intangible assets: Other rights and licenses	Other intangible assets: Internally generated intangible assets	Other intangible assets: Total	Total
Cost					
Balance as of 1/1/2016	879	730	3	733	1,612
Exchange differences	(14)	(10)	—	(10)	(24)
Acquisitions through business combinations	—	—	—	—	—
Other additions	—	15	—	15	15
Reductions through disposal of investments	(1)	(1)	—	(1)	(2)
Other disposals	—	(1)	—	(1)	(1)
Reclassifications in accordance with IFRS 5	(1)	(4)	—	(4)	(5)
Reclassifications and other changes	—	2	—	2	2
Balance as of 12/31/2016	863	731	3	734	1,597
Exchange differences	(76)	(70)	(1)	(71)	(147)
Acquisitions through business combinations	31	11	—	11	42
Other additions	—	12	—	12	12
Reductions through disposal of investments	—	—	—	—	—
Other disposals	—	—	—	—	—
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	—	—	—	—
Balance as of 12/31/2017	818	684	2	686	1,504
Exchange differences	21	16	—	16	37
Acquisitions through business combinations	1	—	—	—	1
Other additions	—	10	—	10	10
Reductions through disposal of investments	(2)	(3)	—	(3)	(5)
Other disposals	—	(11)	—	(11)	(11)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	7	—	7	7
Balance as of 12/31/2018	**838**	**703**	**2**	**705**	**1,543**
Accumulated amortization					
Balance as of 1/1/2016	4	242	3	245	249
Exchange differences	—	(3)	—	(3)	(3)
Amortization	—	48	—	48	48
Impairment losses	—	—	—	—	—
Reversals of impairment losses	—	—	—	—	—

10 Intangible Assets continued

in € millions	Goodwill	Other intangible assets: Other rights and licenses	Other intangible assets: Internally generated intangible assets	Other intangible assets: Total	Total
Reductions through disposal of investments	—	(1)	—	(1)	(1)
Other disposals	—	(1)	—	(1)	(1)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	—	—	—	—
Balance as of 12/31/2016	4	285	3	288	292
Exchange differences	—	(28)	(1)	(29)	(29)
Amortization	—	46	—	46	46
Impairment losses	—	—	—	—	—
Reversals of impairment losses	—	—	—	—	—
Reductions through disposal of investments	—	—	—	—	—
Other disposals	—	—	—	—	—
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	(1)	1	—	1	—
Balance as of 12/31/2017	3	304	2	306	309
Exchange differences	—	7	—	7	7
Amortization	—	46	—	46	46
Impairment losses	—	—	—	—	—
Reversals of impairment losses	—	—	—	—	—
Reductions through disposal of investments	—	(2)	—	(2)	(2)
Other disposals	—	(11)	—	(11)	(11)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	8	—	8	8
Balance as of 12/31/2018	3	352	2	354	357
Carrying amount as of 12/31/2018	**835**	**351**	**—**	**351**	**1,186**
Carrying amount as of 12/31/2017	815	380	—	380	1,195
Carrying amount as of 12/31/2016	859	446	—	446	1,305

The carrying amount of the "Other rights and licenses" includes backlists and frontlists in the amount of €247 million (2017: €270 million; 2016: €326 million) and imprints in the amount of €75 million (2017: €79 million; 2016: €92 million).

As in the previous years, no intangible assets have been provided as collateral for liabilities as of the end of the reporting period 2018.

10 Intangible Assets continued

Goodwill is attributable to the following cash-generating units:

Goodwill by Cash-Generating Units

in € millions	12/31/2018	12/31/2017	12/31/2016
Penguin Random House North America	**516**	494	559
Penguin Random House United Kingdom	**168**	170	176
Dorling Kindersley	**14**	14	14
Spanish Speaking	**114**	115	87
Rest of the World	**23**	22	23
	835	815	859

For the purpose of impairment testing (IAS 36), goodwill from a business combination is allocated to the cash-generating units that are expected to benefit from the synergies of the business combination. Goodwill is tested for impairment at least annually and whenever there is an indication that it may be impaired, as outlined in the section "Accounting and Measurement Policies" and under the following assumptions. The recoverable amount is the higher of fair value less costs of disposal and value in use. For the cash-generating units, the recoverable amount equals the fair value, which is derived from discounted cash flows less costs of disposal, and which is based on level 3 of the fair value hierarchy. Projected cash flows were based on internal estimates for three detailed planning periods and, as a rule, two further detailed planning periods were applied. For periods after this detailed horizon, a perpetual annuity was applied, taking into account individual business-specific growth rates.

Management estimates of cash flow are based on factors including assumptions of economic trends and the associated risks, the regulatory environment, the competitive environment, market share, investments, EBITDA margins and growth rates. With regard to the individual cash-generating units bearing material goodwill, relating to the market development for the beginning of the detailed planning period, a stable development for the physical book markets in the United States, the United Kingdom, Spain and Germany has been assumed for financial year 2019. Regarding e-book sales, it is expected for the financial year 2019 that publishers' e-book sales in the United States and the United Kingdom will decline moderately. For audio download sales, a strong growth is expected for the financial year 2019 in the United States and the United Kingdom. The five-year sales forecasts use average nominal growth rates for Dorling Kindersley of 2.2 percent and for Spanish Speaking (including Latin American countries) of 2.7 percent.

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet continued

10 Intangible Assets continued

Goodwill by Cash-Generating Units continued

In addition, fair values, based on discounted cash flows, were measured using the following individual business-specific discount rates and growth rates for periods after the detailed planning period:

Overview of Growth and Discount Rates

	Growth rate in % for the year 12/31/2018	Discount rate in % for the year 12/31/2018	Growth rate in % for the year 12/31/2017	Discount rate in % for the year 12/31/2017	Growth rate in % for the year 12/31/2016	Discount rate in % for the year 12/31/2016
Penguin Random House North America	0.5	9.2	0.5	8.5	0.5	8.3
Penguin Random House United Kingdom	0.5	8.0	0.5	7.6	0.5	7.6
Dorling Kindersley	0.7	9.1	0.6	8.4	0.6	8.2
Spanish Speaking	3.0	12.1	4.6	13.0	5.0	12.8
Rest of the World	3.1	11.0	2.6	10.1	2.5	9.3

In the financial years 2018, 2017 and 2016, no impairment losses were recognized for goodwill.

As of December 31, 2018, the recoverable amount for the cash-generating unit Spanish Speaking exceeded the carrying amount by €1 million (2017: €3 million; 2016: €4 million). In the event of an increase in the discount rate by 0.1 percentage points, a reduction in the long-term growth rate by 0.1 percentage points or a reduction in the average nominal sales growth rate for the five-year detailed planning period by 0.2 percentage points, the recoverable amount is lower than the carrying amount for the first time.

As of December 31, 2018, the recoverable amount for the cash-generating unit Dorling Kindersley exceeded the carrying amount by €4 million (2017: €4 million; 2016: €3 million). In the event of an increase in the discount rate by 0.4 percentage points, a reduction in the long-term growth rate by 0.8 percentage points or a reduction in the average nominal sales growth rate for the five-year detailed planning period by 2.1 percentage points, the recoverable amount is lower than the carrying amount for the first time.

As of December 31, 2018, the goodwill of the cash-generating units Penguin Random House North America, Penguin Random House United Kingdom and Rest of the World was not subject to impairment even given a change by one of the two most important factors: discount rate (increase of 1.0 percentage point) and long-term growth rate (reduction of 1.0 percentage point).

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet continued

11 Property, Plant and Equipment

in € millions	Land, rights equivalent to land and buildings	Technical equipment and machinery	Other equipment, fixtures, furniture and office equipment	Advance payments and construction in progress	Total
Cost					
Balance as of 1/1/2016	111	94	213	4	422
Exchange differences	(5)	(6)	1	—	(10)
Acquisitions through business combinations	—	—	—	—	—
Other additions	4	2	5	4	15
Reductions through disposal of investments	—	—	—	—	—
Other disposals	(1)	(1)	(7)	—	(9)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	(1)	5	(6)	(2)
Balance as of 12/31/2016	109	88	217	2	416
Exchange differences	(9)	(7)	(22)	(1)	(39)
Acquisitions through business combinations	—	—	—	—	—
Other additions	1	1	8	11	21
Reductions through disposal of investments	—	—	—	—	—
Other disposals	—	—	(5)	—	(5)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	4	1	(3)	2
Balance as of 12/31/2017	101	86	199	9	395
Exchange differences	2	1	3	1	7
Acquisitions through business combinations	—	—	—	—	—
Other additions	3	2	4	18	27
Reductions through disposal of investments	—	—	(1)	—	(1)
Other disposals	—	(9)	(47)	—	(56)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	7	8	1	(11)	5
Balance as of 12/31/2018	**113**	**88**	**159**	**17**	**377**
Accumulated depreciation					
Balance as of 1/1/2016	43	57	132	—	232
Exchange differences	(1)	(5)	2	—	(4)
Depreciation	3	7	18	—	28
Impairment losses	—	—	—	—	—
Reversals of impairment losses	—	—	—	—	—
Reductions through disposal of investments	—	—	—	—	—
Other disposals	(1)	(1)	(7)	—	(9)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	(1)	1	—	—
Balance as of 12/31/2016	44	57	146	—	247
Exchange differences	(4)	(4)	(16)	—	(24)
Depreciation	3	6	19	—	28
Impairment losses	—	—	—	—	—

11 Property, Plant and Equipment continued

in € millions	Land, rights equivalent to land and buildings	Technical equipment and machinery	Other equipment, fixtures, furniture and office equipment	Advance payments and construction in progress	Total
Reversals of impairment losses	—	—	—	—	—
Reductions through disposal of investments	—	—	—	—	—
Other disposals	—	—	(6)	—	(6)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	—	—	—	—
Balance as of 12/31/2017	43	59	143	—	245
Exchange differences	1	1	3	—	5
Depreciation	3	6	16	—	25
Impairment losses	—	—	—	—	—
Reversals of impairment losses	—	—	—	—	—
Reductions through disposal of investments	—	—	(1)	—	(1)
Other disposals	—	(9)	(45)	—	(54)
Reclassifications in accordance with IFRS 5	—	—	—	—	—
Reclassifications and other changes	—	5	—	—	5
Balance as of 12/31/2018	**47**	**62**	**116**	**—**	**225**
Carrying amount as of 12/31/2018	**66**	**26**	**43**	**17**	**152**
Carrying amount as of 12/31/2017	58	27	56	9	150
Carrying amount as of 12/31/2016	65	31	71	2	169

At the end of the financial years 2018, 2017 and 2016, no property, plant and equipment was pledged as collateral for liabilities. No impairment losses were recognized for property, plant and equipment in the financial years 2018, 2017 and 2016.

12 Interests in Associates

At the end of the financial years 2018, 2017 and 2016, Penguin Random House holds an investment in one associate.

The following table shows summarized financial information on this associate. which management considers immaterial. The information given represents Penguin Random House's interest.

Summarized Financial Information on the Immaterial Associate

in € millions	**2018**	2017	2016
Earnings after taxes from continuing operations	**(2)**	—	—
Other comprehensive income	**(1)**	(2)	5
Total comprehensive income	**(3)**	(2)	5

In the financial year 2017, an impairment loss of €10 million was recognized for the associate due to the ongoing difficult economic situation in Brazil. The recoverable amount was determined using the fair value less costs of disposal on the basis of the discounted cash flow method with a long-term growth rate of 6.0 percent and a discount rate of 13.8 percent due to the business activities in the Brazilian market.

13 Other Financial Assets

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Current			
Derivative financial instruments	**4**	1	3
	4	1	3
Non-current			
Other debt instruments	**9**	n/a	n/a
Other investments	**n/a**	2	2
Securities and financial assets	**n/a**	7	5
	9	9	7

Information on credit risk, including impairment, is presented in note 24 "Additional Disclosures on Financial Instruments."

At the end of the financial years 2018, 2017 and 2016, financial assets in the amount of €2 million (2017: €0 million; 2016: €0 million) have been provided as collateral for liabilities. At the end of the financial years 2018, 2017 and 2016, no material financial assets were pledged with restrictions on disposal and no financial assets were provided as security for contingent liabilities to third parties.

14 Inventories

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Raw materials and supplies	**28**	13	15
Work in progress	**56**	55	52
Finished goods and merchandise	**194**	184	195
Advance payments	**1**	1	1
	279	253	263

In the financial year 2018, write-downs on inventories were recognized in the amount of €-6 million (2017: €-15 million; 2016: €-13 million). At the end of the financial years 2018, 2017 and 2016, no inventories have been pledged as collateral for liabilities.

15 Trade and Other Receivables

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Non-current			
Other receivables	**—**	4	5
Current			
Trade receivables	**1,100**	752	718
Other receivables	**13**	25	16

Trade receivables are due for payment generally within 12 months. The amount of trade receivables in previous years was offset by a provision for expected returns. Under IFRS 15 a refund liability for the expected refunds to customers is recognized as adjustment to revenue in the balance sheet position "Trade and other payables."

Information on credit risk, including impairment, is presented in note 24 "Additional Disclosures on Financial Instruments."

16 Other Non-Financial Assets

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Non-current			
Other non-financial assets	**377**	282	295
Current			
Other non-financial assets	**477**	430	452
– advance payments	**432**	387	412
– other tax receivables	**12**	12	10
– deferred items	**31**	30	29
– sundry non-financial assets	**2**	1	1

The non-current other non-financial assets in the amount of €329 million (2017: €259 million; 2016: €283 million) relate to advance payments for published or unpublished book titles. If a book title is expected to be published within the next 12 months, advance payments on it are considered current. Advances on book titles are initially capitalized within other non-financial assets when the advance is paid and subsequently expensed in the income statement position "Royalties" as related revenues are earned or when future recovery is not probable to adjust the advance to its net realizable value. The realizable value of royalty advances relies on a degree of management judgement in determining the profitability of individual author contracts. If the carrying amount is higher than the estimated realizable value of author contracts, these excess amounts will be written-off in the income statement position "Allowances on receivables, loans and non-financial assets." The recoverability of royalty advances is based upon a detailed management review of the age of the advance, the future sales projections for new authors and prior sales history of repeat authors. Costs for obtaining and fulfilling contracts with customers are immaterial, both individually and in total. The same applies to amount of amortization and impairment losses recognized for these costs in the reporting period.

17 Cash and Cash Equivalents

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Cash	**193**	375	310
Other securities < 3 months	**2**	1	2
	195	376	312

Cash includes bank balances and cash on hand. Cash equivalents include short-term, highly liquid securities with a term to maturity on acquisition of a maximum of three months. Foreign currency items are translated using the closing rate.

As of December 31, 2018, cash and cash equivalents in the amount of €1 million were used as collateral for liabilities (2017: €0 million; 2016: €0 million). At the end of the financial years 2018, 2017 and 2016, no cash and cash equivalents existed with restrictions on disposal.

18 Equity

The equity includes the combined equity, membership capital and combined retained earnings including share capital and share premiums attributable to the Penguin Random House Limited, in London, United Kingdom, LLC membership capital attributable to Penguin Random House LLC in the United States and the undistributed prior year net profits of those companies included in the Combined Financial Statements. Accumulated other

Notes to the Income Statement and the Balance Sheet continued

18 Equity continued

comprehensive income includes remeasurement effects of defined benefit pension plans (actuarial gains and losses on the defined benefit obligation, differences between actual investment returns and the return implied by the net interest cost on the plan assets, and effects of the asset ceiling) and accumulated other comprehensive income.

The change in other comprehensive income after taxes is derived as follows:

Changes to Components of Other Comprehensive Income after Taxes

in € millions	2018				
	Before-tax amount	Taxes	Net-of-tax amount	Attributable to Penguin Random House shareholders	Attributable to non-controlling interests
Items that will not be reclassified subsequently to profit or loss					
Remeasurement effects on defined benefit plans	**26**	**(5)**	**21**	**21**	**—**
Changes in fair value of equity instruments	**(2)**	**—**	**(2)**	**(2)**	**—**
Share of other comprehensive income of investments accounted for using the equity method	**—**	**—**	**—**	**—**	**—**
Items that will be reclassified subsequently to profit or loss when specific conditions are met					
Exchange differences	**14**	**—**	**14**	**14**	**—**
Cash flow hedges	**—**	**—**	**—**	**—**	**—**
Share of other comprehensive income of investments accounted for using the equity method	**(1)**	**—**	**(1)**	**(1)**	**—**
Other comprehensive income net of tax	**37**	**(5)**	**32**	**32**	**—**

in € millions	2017				
	Before-tax amount	Taxes	Net-of-tax amount	Attributable to Penguin Random House shareholders	Attributable to non-controlling interests
Items that will not be reclassified subsequently to profit or loss					
Remeasurement effects on defined benefit plans	25	(5)	20	20	—
Share of other comprehensive income of investments accounted for using the equity method	—	—	—	—	—
Items that will be reclassified subsequently to profit or loss when specific conditions are met					
Exchange differences	(161)	—	(161)	(161)	—
Cash flow hedges	(1)	—	(1)	(1)	—
Share of other comprehensive income of investments accounted for using the equity method	(2)	—	(2)	(2)	—
Other comprehensive income net of tax	(139)	(5)	(144)	(144)	—

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet continued

18 Equity continued

Changes to Components of Other Comprehensive Income after Taxes continued

in € millions	2016				
	Before-tax amount	Taxes	Net-of-tax amount	Attributable to Penguin Random House shareholders	Attributable to non-controlling interests
Items that will not be reclassified subsequently to profit or loss					
Remeasurement effects on defined benefit plans	(26)	5	(21)	(21)	—
Share of other comprehensive income of investments accounted for using the equity method	—	—	—	—	—
Items that will be reclassified subsequently to profit or loss when specific conditions are met					
Exchange differences	(19)	—	(19)	(18)	(1)
Cash flow hedges	(1)	—	(1)	(1)	—
Share of other comprehensive income of investments accounted for using the equity method	11	—	11	11	—
Other comprehensive income net of tax	(35)	5	(30)	(29)	(1)

In the financial year 2018, €-1 million cash flow hedge effects recognized in other comprehensive income were reclassified to the income statement (2017: €0 million; 2016: €0 million). These are amounts before tax.

19 Provisions for Pensions and Similar Obligations

in € millions	**12/31/2018**	12/31/2017	12/31/2016
Defined benefit obligation	**19**	23	46
Obligations similar to pensions	**2**	1	1
	21	24	47

Penguin Random House operates various pension plans for current and former employees and their surviving dependents mainly in the United Kingdom, the United States and Canada. The model of such plans varies according to the legal, fiscal and economic environment of the country concerned. These company pension plans include both defined contribution and defined benefit plans.

In the case of defined contribution plans, the company makes payments into an external pension fund or another welfare fund through a statutory, contractual or voluntary model. The company has no obligation to provide further benefits once it has made these payments, so no provisions are recognized. Expenses for defined contribution plans in the amount of €23 million were recognized in the financial year 2018 (2017: €21 million; 2016: €26 million). The contributions paid by employer to state pension plans in the financial year 2018 amount to €36 million (2017: €36 million; 2016: €36 million).

All other pension plans are defined benefit plans. The US and Canadian companies' obligations for healthcare costs for employees after they retire (medical care plans) are also defined benefit obligations and are included in the provisions on the balance sheet. For all of the retirement benefit plans, a distinction must be made as to whether or not these are financed through an external investment fund.

19 Provisions for Pensions and Similar Obligations continued

Net Defined Benefit Liability Recognized in the Balance Sheet

in € millions	12/31/2018	12/31/2017	12/31/2016
Present value of defined benefit obligation of unfunded plans	**17**	21	21
Present value of defined benefit obligation of funded plans	**400**	434	440
Total present value of defined benefit obligation	**417**	455	461
Fair value of plan assets	**(446)**	(455)	(426)
Net defined benefit liability /(asset) recognized in the balance sheet	**(29)**	—	35
thereof provisions for pensions	**19**	23	46
thereof other assets	**(48)**	(23)	(11)

As in the previous years, in the financial year 2018, the asset ceiling prescribed by IAS 19.64 did not impact other comprehensive income. The other assets are disclosed under non-current non-financial assets.

Provisions are recognized for these defined benefit plans. These are mostly final salary plans.

Defined Benefit Plans

in € millions	12/31/2018	12/31/2017	12/31/2016
Final salary plans	**337**	366	378
Career average plans	**15**	15	15
Other commitments given	**50**	56	50
Medical care plans United States	**7**	7	8
Medical care plans Canada	**8**	11	10
Present value of defined benefit obligation	**417**	455	461
– thereof capital commitments	**—**	—	—

The obligations and plan assets available for the existing pension plans are, in some cases, exposed to demographic, economic and legal risks. The demographic risks are primarily the longevity risk for pensioners. Economic risks include, in this respect, mostly unforeseeable developments on the capital markets and the associated impacts on plan assets and pension obligations. Legal risks can result from restrictions to investments and minimum funding requirements.

The plans in the United Kingdom are subject to the "Pensions Act 2004," which includes reviewing the full financing of the pension plan from an actuarial perspective every three years with annual monitoring and, if necessary, eliminating any deficits that may have arisen by means of further additions to plan assets. There are no other material regulatory conditions over and above the minimum funding regulations in the United States and United Kingdom.

The provisions are determined using actuarial formulas in accordance with IAS 19. The amount of provisions depends on employees' length of service with the company and their pensionable salary. Provisions are computed using the projected unit credit method, in which the benefit entitlement earned is allocated to each year of service, thus assuming an increasing cost of service in comparison to the entry age normal method. When identifying the present value of the pension obligation, the underlying interest rate is of material importance. For Penguin Random House, this is based on the "Mercer Yield Curve Approach." With this approach, separate spot rate yield curves are created for the United Kingdom, the United States and Canada on the basis of high-quality corporate bonds. To appropriately present the time value of money in accordance with IAS 19.84, the basis does not consider either spikes for which the risk estimate may be substantially higher or lower or bonds with embedded options that distort interest rates.

Further significant actuarial assumptions are assumed as follows:

Actuarial Assumptions

	12/31/2018		
	United States	**United Kingdom**	**Other**
Discount rate	**4.30%**	**2.90%**	**3.64%**
Rate of salary increase	**n/a**	**2.74%**	**2.85%**
Rate of pension increase	**n/a**	**2.86%**	**1.50%**

	12/31/2017		
	United States	United Kingdom	Other
Discount rate	3.90%	2.50%	3.50%
Rate of salary increase	n/a	2.86%	3.00%
Rate of pension increase	n/a	2.94%	n/a

	12/31/2016		
	United States	United Kingdom	Other
Discount rate	4.51%	2.60%	4.01%
Rate of salary increase	n/a	2.97%	3.02%
Rate of pension increase	n/a	3.12%	n/a

An increase or decrease in the assumptions set out above compared to the assumptions actually applied would have had the following effects on the defined benefit obligation as of December 31, 2018:

Effect of Actuarial Assumptions

in € millions	Increase	Decrease
Effect of 0.5 percentage point change in discount rate	(33)	38
Effect of 0.5 percentage point change in rate of salary increase	7	(6)
Effect of 0.5 percentage point change in rate of pension increase	11	(10)
Effect of change in average life expectancy by one year	14	(12)

To determine the sensitivity of the longevity, the mortality rates for all beneficiaries were reduced or increased evenly, so that the life expectancy of a person of a country-specific retirement age increases or decreases by one year.

Effect of Actuarial Assumptions continued

Changes in the present value of defined benefit obligations and plan assets in the reporting period were as follows:

Development of the Defined Benefit Plans

	Defined benefit obligation (I)			Fair value of plan assets (II)			Net defined benefit balance (I)-(II)		
in € millions	2018	2017	2016	2018	2017	2016	2018	2017	2016
Balance as of 1/1	**455**	461	425	**455**	426	411	**—**	35	14
Current service cost	**10**	11	10	**—**	—	—	**10**	11	10
Interest expenses	**12**	12	15	**—**	—	—	**12**	12	15
Interest income	**—**	—	—	**12**	11	15	**(12)**	(11)	(15)
Past service cost	**—**	(3)	—	**—**	—	—	**—**	(3)	—
Income and expenses for defined benefit plans recognized in the combined income statement	**22**	**20**	**25**	**12**	**11**	**15**	**10**	**9**	**10**
Income/expense on plan assets excluding amounts included in net interest income and net interest expenses	**—**	—	—	**(21)**	26	54	**21**	(26)	(54)
Actuarial gains (-) and losses (+)									
– changes in financial assumptions	**(35)**	5	98	**—**	—	—	**(35)**	5	98
– changes in demographic assumptions	**(4)**	(11)	(11)	**—**	—	—	**(4)**	(11)	(11)
– experience adjustments	**(7)**	7	(6)	**—**	—	—	**(7)**	7	(6)
Remeasurements for defined benefit plans recognized in the combined statement of comprehensive income	**(46)**	**1**	**81**	**(21)**	**26**	**54**	**(25)**	**(25)**	**27**
Contributions to plan assets by employer	**—**	—	—	**13**	16	17	**(13)**	(16)	(17)
Contributions to plan assets by employees	**2**	2	2	**2**	3	3	**—**	(1)	(1)
Pension payments	**(14)**	(11)	(14)	**(14)**	(11)	(14)	**—**	—	—
Changes in foreign exchange rates	**(4)**	(18)	(58)	**(4)**	(16)	(60)	**—**	(2)	2
Other changes	**2**	—	—	**3**	—	—	**(1)**	—	—
Other reconciling items	**(14)**	**(27)**	**(70)**	**—**	**(8)**	**(54)**	**(14)**	**(19)**	**(16)**
Balance as of 12/31	**417**	455	461	**446**	455	426	**(29)**	—	35
thereof									
United Kingdom	**383**	420	427	**432**	443	414	**(49)**	(23)	13
Canada	**24**	28	26	**11**	12	12	**13**	16	14
United States	**7**	7	8	**—**	—	—	**7**	7	8
Ireland	**3**	—	—	**3**	—	—	**—**	—	—

19 Provisions for Pensions and Similar Obligations continued

Development of the Defined Benefit Plans continued

Employer contributions to plan assets are expected to amount to €12 million in the next financial year. Of the expenses for defined benefit plans in the amount of €10 million (2017: €9 million; 2016: €10 million), €10 million (2017: €8 million; 2016: €10 million) was recognized under the item "Personnel costs" and an immaterial amount under "Other financial expenses" and "Other financial income" (2017: €1 million; 2016: €0 million). The past service cost and losses from settlements recognized under "Personnel costs" were also immaterial (2017: €-3 million; 2016: €0 million).

The expenses are broken down as follows:

Expenses for Defined Benefit Plans

in € millions	2018	2017	2016
Current service cost	**10**	11	10
Past service cost and impact from settlement	**—**	(3)	—
Net interest expenses	**—**	1	—
Net pension expenses	**10**	9	10

The portfolio structure of plan assets is composed as follows:

Portfolio Structure of Plan Assets

in € millions	12/31/2018	12/31/2017	12/31/2016
Equity instruments[1)]	**120**	154	181
Debt instruments[1)]	**228**	210	161
Other funds	**76**	68	67
Qualifying insurance policies	**6**	3	4
Cash and cash equivalents	**5**	12	7
Real estate	**11**	8	6
Derivatives	**—**	—	—
Other	**—**	—	—
Fair value of plan assets	**446**	455	426

1) For almost all equity and debt instruments, market prices are listed on an active market.

All plan assets are used exclusively for the fulfillment of benefit obligations. In order to avoid a concentration of risk, plan assets are invested in various classes of investments.

19 Provisions for Pensions and Similar Obligations continued

Portfolio Structure of Plan Assets continued

The weighted average duration of the pension obligations as of December 31, 2018, was 20 years (2017: 19 years; 2016: €20 years). The maturity profile of the anticipated non-discounted pension payments is presented in the following table:

Maturity Profile of Pension Payments

Year	Expected pension payments in € millions
2019	**11**
2020	**11**
2021	**11**
2022	**13**
2023	**12**
2024-2028	**75**

Obligations similar to pensions relate to severance payments at retirement in the amount of €2 million (2017: €1 million; 2016: €1 million). Provisions for severance payments at retirement are recognized in the same way as defined benefit plans, but with actuarial gains and losses recognized in profit or loss.

20 Other Provisions

in € millions	1/1/2018	of which > 1 year	Additions	Reversal	Usage	Other effects	Change of consolidation scope	Accrued interest	12/31/2018	of which > 1 year
Restructuring	**1**	**—**	**5**	**—**	**(2)**	**—**	**—**	**—**	**4**	**—**
Onerous contracts	**33**	**27**	**19**	**(2)**	**(5)**	**7**	**—**	**1**	**53**	**39**
Litigation	**3**	**—**	**—**	**(1)**	**—**	**(1)**	**—**	**—**	**1**	**—**
Sales and distribution	**1**	**—**	**1**	**—**	**—**	**—**	**—**	**—**	**2**	**—**
Other employee benefits	**5**	**—**	**2**	**—**	**(1)**	**—**	**—**	**—**	**6**	**—**
Other	**6**	**2**	**1**	**(2)**	**(4)**	**3**	**—**	**—**	**4**	**2**
	49	**29**	**28**	**(5)**	**(12)**	**9**	**—**	**1**	**70**	**41**

in € millions	1/1/2017	of which > 1 year	Additions	Reversal	Usage	Other effects	Change of consolidation scope	Accrued interest	12/31/2017	of which > 1 year
Restructuring	—	—	3	—	(2)	—	—	—	1	—
Onerous contracts	28	26	9	(1)	—	(4)	—	1	33	27
Litigation	3	—	1	(1)	—	—	—	—	3	—
Sales and distribution	4	—	1	(3)	(1)	—	—	—	1	—
Other employee benefits	7	—	2	(1)	(2)	(1)	—	—	5	—
Other	2	1	3	(1)	—	1	1	—	6	2
	44	27	19	(7)	(5)	(4)	1	1	49	29

20 Other Provisions continued

in € millions	1/1/2016	1/1/2016 of which > 1 year	Additions	Reversal	Usage	Other effects	Change of consolidation scope	Accrued interest	12/31/2016	12/31/2016 of which > 1 year
Restructuring	4	2	1	—	(5)	—	—	—	—	—
Onerous contracts	2	—	25	—	—	1	—	—	28	26
Litigation	3	—	1	(1)	—	—	—	—	3	—
Sales and distribution	4	—	1	—	(1)	—	—	—	4	—
Other employee benefits	6	—	2	—	(1)	—	—	—	7	—
Other	4	1	1	(1)	—	(2)	—	—	2	1
	23	3	31	(2)	(7)	(1)	—	—	44	27

The onerous provision mainly relates to the onerous lease contracts and onerous royalty arrangements. In August 2016, Penguin Random House signed a new lease contract for its offices at 1745 Broadway, New York, United States. The new lease started on July 1, 2018, with an eight-month rent-free period, and the lease term lasts until June 2033. The new contracts comprise additional floors and therefore give the opportunity to consolidate originally from three locations into one. Under consideration of possible subleases, an onerous lease provision of €38 million (2017: €25 million, 2016: €26 million) was recognized at the end of the reporting period. The increase of the onerous provision in 2018 is attributable mainly to two effects: the adjusted sublease estimations downwards the onerous lease calculation and to a provision for negative contribution on unpublished titles.

21 Financial Debt

Carrying amounts of financial debt are calculated as follows:

Current and Non-Current Financial Debt

	Current			**Non-current**				
				Remaining term in years				
in € millions	**12/31/2018**	12/31/2017	12/31/2016	1 to 5 years	> 5 years	**12/31/2018**	12/31/2017	12/31/2016
Liabilities to banks	**15**	21	21	—	—	**—**	—	—
Lease liabilities	**—**	—	—	2	—	**2**	3	1
Other financial debt	**274**	417	82	918	—	**918**	663	—
	289	438	103	920	—	**920**	666	1

At initial recognition within the scope of IFRS 9, the financial debt is recognized at fair value including transaction costs, and the subsequent measurement is based on amortized cost using the effective interest method. Foreign currency liabilities are translated using the exchange rate at the end of the reporting period. In the financial year 2013, Penguin Random House entered into a Revolving Credit Agreement with Bertelsmann SE & Co. KGaA and Pearson plc. Under this shareholder loan agreement, the Group has access to a revolving facility of up to US$250 million. This facility was amended in October 2017 and in May 2018 and is valid until October 2022. In the second amendment, it was agreed that the facility is not available until the later of June 1, 2019, or full repayment of all outstanding amounts under the Revolving Credit Agreements with Bertelsmann PRH Finance, Inc. and Bertelsmann SE & Co. KGaA from 2018. The interest rates for loans under the revolving facility are applicable LIBOR plus a margin of 2.00 percent per year. The loan drawdown is in either US dollars or British pounds. As of December 31, 2018, the loan which was recognized in the position "Other financial debt" amounted to €0 million (2017: €208 million; 2016: €82 million).

Penguin Random House Venture Combined Financial Statements

Notes to the Income Statement and the Balance Sheet continued

21 Financial Debt continued

Current and Non-Current Financial Debt continued

In October 2017, Penguin Random House entered with Bertelsmann PRH Finance, Inc., a subsidiary of Bertelsmann SE & Co. KGaA, into a Term Loan Agreement of US$795 million, valid until October 2022. The term loan bears interest at 4.25 percent per year. As of December 31, 2018, the term loan balance amounted to €694 million (2017: €663 million), which was included in the position "Other financial debt."

In October 2017, Penguin Random House entered with Bertelsmann UK Limited, a subsidiary of Bertelsmann SE & Co. KGaA, into a Term Loan Agreement of GBP200 million, valid until April 2023. The term loan bears interest at 3.20 percent per year. In March 2018, the Term Loan Agreement was transferred from Bertelsmann UK Limited to Bertelsmann Business Support S.à r.l., a subsidiary of Bertelsmann SE & Co. KGaA. As of December 31, 2018, the term loan balance amounted to €224 million, which was included in the position "Other financial debt."

Penguin Random House entered with Bertelsmann PRH Finance, Inc. into a Term Loan Agreement of US$250 million in December 2017. This agreement was valid until March 30, 2018. The interest rate for the loan was applicable LIBOR plus a margin of 2.00 percent per year. As of December 31, 2018, the term loan was completely repaid (2017: €208 million).

In May 2018, Penguin Random House entered with Bertelsmann PRH Finance, Inc., a subsidiary of Bertelsmann SE & Co. KGaA, into a Revolving Credit Agreement of US$175 million, valid until May 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year. As of December 31, 2018, the loan amounted to €21 million, which was also included in the position "Other financial debt."

In addition, in May 2018, Penguin Random House entered with Bertelsmann SE & Co. KGaA into a Revolving Credit Agreement of US$200 million, valid until May 2019. This facility was amended in December 2018 for an additional loan commitment of US$90 million. The additional commitment is valid until February 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year. As of December 31, 2018, the loan amounted to €253 million, which was also included in the position "Other financial debt."

In the position "Liabilities to banks," the amount of €2 million (2017: €2 million; 2016: €2 million) relates to the supply-chain financing arrangements (reverse factoring). The substance and nature of such arrangements, involving the provision of finance linked to the supply of goods or services, lead to the reclassification of the original liability presented as a trade payable to the debt liability.

Financial debt is generally unsecured.

22 Liabilities

in € millions	12/31/2018	12/31/2017	12/31/2016
Non-current			
Trade payables	**13**	—	—
Payables from royalties	**98**	88	114
Other financial payables	**2**	2	—
Other non-financial liabilities	**15**	32	32
Current			
Trade payables	**376**	364	378
Payables from royalties	**468**	433	458
Refund liabilities	**324**	n/a	n/a
Derivative financial instruments	**1**	5	3
Other financial payables	**53**	305	77
Contract liabilities	**11**	n/a	n/a
Other non-financial liabilities	**129**	124	145
– tax liabilities	**3**	2	2
– social security liabilities	**7**	6	6
– personnel-related liabilities	**110**	93	111
– deferred items	**4**	17	21
– other	**5**	6	5

With the first-time application of IFRS 15, reclassifications were mainly made from “Deferred items” to “Contract liabilities” in the amount of €2 million. In accordance with IFRS 15, the item “Refund liabilities” mainly comprises liabilities for expected returns of €255 million. The item ”Contract liabilities” includes payments received by Penguin Random House in advance; that is, prior to satisfaction of the contractual obligations in accordance with IFRS 15. They are recognized as revenue as soon as the contractual obligation has been rendered. Accordingly, revenues were recognized in insignificant amounts in the financial year 2018, which were included in the balance of contract liabilities at the beginning of the financial year.

As of December 31, 2017, the current other financial payables included a dividend liability to the Penguin Random House shareholders of €226 million, which was paid in the financial year 2018. Further details are presented in the section “Background.”

23 Off-Balance-Sheet Liabilities

Contingent Liabilities and Other Commitments

in € millions	12/31/2018	12/31/2017	12/31/2016
Rental and lease commitments for already used real estate and movables	**532**	565	685
Commitments from assets under construction	**62**	39	—
Other commitments	**791**	702	738
	1,385	1,306	1,423

Commitments from assets under construction result from lease contracts for assets, which were not completed at the end of the reporting period. The right of use will begin in future periods. The commitments relate in the amount of €21 million to periods between one and five years (2017: €8 million; 2016: €0 million) and in the amount of €41 million to periods of more than five years (2017: €31 million; 2016: €0 million). The amount primarily relates to one contract entered into during the financial year 2017. The increase in 2018 is due to the leasing of additional office space under this lease. It essentially consists of obligations to lease a building in London, United Kingdom, which is expected to be completed in the second half of 2019.

The total amount of other commitments represents the portion of obligations to authors for which no payments have yet been made, where future payments are contingent upon other events (such as delivery and acceptance of manuscripts). At the end of the financial years 2018, 2017 and 2016, Penguin Random House had no commitments for the acquisition of property, plant and equipment.

The following minimum lease payments exist from all long-term rental commitments classified as operating leases:

Minimum Lease Payments for Operating Leases

in € millions	12/31/2018	12/31/2017	12/31/2016
Nominal amount			
Up to 1 year	**57**	59	65
1 to 5 years	**192**	200	228
Over 5 years	**283**	306	392
	532	565	685
Present value	**402**	447	548

These commitments mainly concern tenancy. They were partially offset by expected minimum lease payments from subleases with a nominal value €5 million in 2017 and €18 million in 2016. There was no offsetting in the financial year 2018. The net present values calculated considering country-specific interest rates show all of the net payments required to settle the obligation. The existing leases have varying terms and include renewal options in some cases.

In August 2016, Penguin Random House has signed a new lease contract for its offices at 1745 Broadway, New York, United States. The new contracts comprise additional floors and therefore give the opportunity to consolidate originally from three locations into one. The new lease started July 1, 2018, with an eight-month rent-free period, and the lease term lasts until June 2033.

Notes to the Income Statement and the Balance Sheet continued

24 Additional Disclosures on Financial Instruments

Both of the following tables show the carrying amounts and measurement categories of financial assets and financial liabilities in accordance with IFRS 9 as of December 31, 2018:

Carrying Amounts and Measurement Categories of Financial Assets

in € millions	12/31/2018
Financial assets measured at amortized cost	
– trade receivables	**1,100**
– sundry financial receivables	**13**
– cash	**193**
– other securities < 3 months	**2**
Primary financial assets measured at fair value through profit or loss	**9**
Derivative financial instruments	**4**
	1,321

Carrying Amounts and Measurement Categories of Financial Liabilities

in € millions	12/31/2018
Financial liabilities measured at amortized cost	
– liabilities to banks	**15**
– other financial debt	**1,192**
– trade payables	**389**
– payables from royalties	**566**
– sundry financial payables	**376**
Primary financial liabilities measured at fair value through profit or loss	**3**
Derivative financial instruments	**1**
	2,542

The carrying amounts of the financial assets and liabilities measured at amortized cost represent a reasonable approximation of fair value.

24 Additional Disclosures on Financial Instruments continued

Carrying Amounts and Measurement Categories of Financial Liabilities continued

Both of the following tables show the carrying amounts and measurement categories of financial instruments in accordance with IAS 39 measurement categories as of December 31, 2017:

in € millions	Category according to IAS 39 and measurement	12/31/2017	12/31/2016
Other investments	Available-for-sale; at cost	2	2
Securities and financial assets	Financial assets initially recognized at fair value through profit or loss	7	5
Derivative financial instruments	Financial assets held for trading; fair value recognized in profit or loss	1	2
Derivative financial instruments	Derivatives with hedge relation	—	1
Trade receivables	Loans and receivables; at amortized cost	752	718
Other receivables	Loans and receivables; at amortized cost	29	21
Cash	Loans and receivables; at amortized cost	375	310
Other securities < 3 months	Loans and receivables; at amortized cost	1	2
		1,167	1,061

As of December 31, 2017, and December 31, 2016, other investments that were classified as available-for-sale within financial assets were measured at cost as they do not have a quoted price on an active market and a reliable estimate of the fair value is not possible. No plan had been made to sell holdings of the other available-for-sale investments in the near future. For all other financial assets and financial liabilities, their carrying amount represented a reasonable approximation of fair value.

in € millions	Category according to IAS 39 and measurement	12/31/2017	12/31/2016
Liabilities to banks	Financial liabilities; at amortized cost	21	21
Lease liabilities	Payables out of scope of IAS 39	3	1
Other financial debt	Financial liabilities; at amortized cost	1,080	82
Trade payables	Financial liabilities; at amortized cost	364	378
Payables from royalties	Financial liabilities; at amortized cost	521	572
Derivative financial instruments	Financial liabilities held for trading; fair value recognized in profit or loss	5	3
Other financial payables	Financial liabilities; at amortized cost	303	77
Other financial payables	Financial liabilities initially recognized at fair value through profit or loss	4	—
		2,301	1,134

The fair value measurements of the Group's financial assets are categorized within level 1 and level 2 of the fair value hierarchy. The different levels have been defined as follows:

Level 1: quoted prices (unadjusted) in active markets for identical assets

Level 2: inputs other than quoted prices included within level 1 that are observable for the asset, either directly (i.e., prices) or indirectly (i.e., derived from prices)

Level 3: inputs for the asset that are not based on observable market dates (unobservable inputs.)

24 Additional Disclosures on Financial Instruments continued

Carrying Amounts and Measurement Categories of Financial Liabilities continued

Fair value of investments in mutual funds measured at fair value through profit or loss is based on quoted market prices for actively traded investments similar to those held by the Group and thus these instruments are included in the level 1 of the fair value hierarchy.

For measuring the fair value of unlisted derivatives, Penguin Random House uses various financial methods reflecting the prevailing market conditions and risks at the respective balance sheet dates. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity-specific estimates. As all significant inputs required to estimate fair value of derivatives are observable, the instruments are included in level 2 of the fair value hierarchy. Irrespective of the type of financial instrument, future cash flows are discounted at the end of the reporting period based on the respective market interest rates and yield curves at the end of the reporting period. The fair value of forward exchange transactions is calculated using the average spot prices at the end of the reporting period and taking into account forward markdowns and markups for the remaining term of the transactions.

For contingent consideration financial liabilities presented in the item "Sundry financial payables" (2017 and 2016: "Other financial payables"), no observable market data is available, therefore measuring fair values is based primarily on cash flow-based valuation techniques and on the significant unobservable inputs (e.g., forecast revenue growth rates or market multiples). Due to the significant unobservable inputs, these financial liabilities are classified within level 3 of the fair value hierarchy.

The measurement of financial assets and financial liabilities according to level 2 and level 3 requires management to make certain assumptions about the model inputs including cash flows, discount rate and credit risk. In the financial year 2018, no reclassifications were performed between levels 2 and 3.

In the financial year 2018, net losses on financial instruments recognized at fair value through profit or loss amount to €8 million (2017: €-5 million; 2016: €-12 million).

The requirements for offsetting the financial instruments reported on the balance sheet are not met so that no material offsetting was carried out as of December 31, 2018, 2017 and 2016.

Credit Risk

For trade receivables and contract assets, Penguin Random House uses a risk scoring model based on qualitative and quantitative risk factors for its major customers. For insignificant customers Penguin Random House uses a simplified approach to measure expected credit losses on trade receivables and contract assets. According to this, the loss allowance is measured using lifetime expected credit losses. For this purpose, impairment matrices based on historic bad debt losses, maturity bands and expected credit losses reflecting the ability of the customers to settle the receivables were prepared. The impairment matrices were created for business-unit-specific groups of receivables, each with similar default patterns. In addition, separate risk assessments are performed. Contract assets have substantially the same risk characteristics as trade receivables for the same types of contracts so that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for contract assets. As of December 31, 2018, no significant contract assets were recognized.

Credit Risk continued

Based on this, loss allowance as of December 31, 2018, was determined as follows for both trade receivables and contract assets:

Credit Risk for Trade Receivables and Contract Assets

in € millions	Collective impairment					Individual impairment
	Not overdue	Overdue				
		≤ 1 month	2 to 3 months	3 to 6 months	> 6 months	
Expected loss rate	0.89%	3.70%	9.09%	14.29%	16.67%	n/a
Trade receivables and contract assets	337	27	11	7	6	750
Loss allowance for expected credit losses	(3)	(1)	(1)	(1)	(1)	(31)
Balance as of 12/31/2018	334	26	10	6	5	719

The expected loss rates correspond to the average rates for the respective for business-unit-specific groups of receivables.

In the financial year 2018, impairment losses and reversals of €-6 million were recognized on trade receivables and contract assets. The following table shows a reconciliation from the opening balance to the closing balance of loss allowances for trade receivables and contract assets in the financial year 2018:

Reconciliation of Loss Allowance for Trade Receivables and Contract Assets

in € millions	Trade receivables and contract assets
Balance as of 1/1	(36)
Additions	(15)
Usage	4
Reversal	9
Balance as of 12/31	(38)

Penguin Random House applies the general approach for all other financial assets that are subject to the expected credit loss model. The loss allowances for the respective financial instruments for the financial year 2018 was immaterial. The impairment loss identified in the financial year 2018 for cash and cash equivalents was also immaterial.

24 Additional Disclosures on Financial Instruments continued

Reconciliation of Loss Allowance for Trade Receivables and Contract Assets continued

The following table shows a maturity analysis of trade receivables as of December 31, 2017, and December 31, 2016:

		Not individually impaired as of the reporting date and past due by:					
in € millions	Neither impaired nor past due on the reporting date	< 1 month	1 to 3 months	3 to 6 months	6 to 12 months	> 12 months	Gross value of accounts receivable individually impaired
Trade receivables 12/31/2017	669	34	15	6	1	4	59
Trade receivables 12/31/2016	681	24	7	4	1	2	70

In the financial years 2017 and 2016, impairment reversals on trade receivables amounted to €27 million and €30 million, respectively. No loss allowance was recognized for unsettled receivables not yet due as of the end of the prior reporting periods, as there was no indication of default.

Reconciliation of changes in impairment in accordance with IFRS 7 as of December 31, 2017, and December 31, 2016, is shown in the following table:

in € millions	Balance as of 1/1	Additions	Usage	Reversal	Change of consolidation scope	Exchange rate effect	Balance as of 12/31
Trade receivables 12/31/2017	(71)	(8)	6	36	(4)	5	(36)
Trade receivables 12/31/2016	(109)	(17)	6	47	—	2	(71)

Default risks arising from trade receivables from major customers are partially mitigated through credit collateralization. In the financial year 2018, Penguin Random House has obtained credit collateralization in the amount of €540 million (2017: €484 million; 2016: €441 million) for these receivables. The carrying amount of all receivables, loans and securities constitutes Penguin Random House's maximum default risk.

Reconciliation of Loss Allowance for Trade Receivables and Contract Assets continued

The following table presents the remaining contractual maturity of the financial liabilities. The figures are based on undiscounted cash flows at the earliest date at which Penguin Random House can be held liable for payment.

Maturity Analysis for Financial Liabilities

		Undiscounted cash flows			
in € millions	Carrying amount	Up to 1 year	1 to 5 years	Over 5 years	Total
Liabilities to banks	**15**	**15**	**—**	**—**	**15**
Lease liabilities	**2**	**—**	**2**	**—**	**2**
Other financial debt	**1,192**	**274**	**918**	**—**	**1,192**
Trade payables	**389**	**376**	**7**	**6**	**389**
Payables from royalties	**566**	**468**	**97**	**1**	**566**
Derivative financial instruments	**1**	**1**	**—**	**—**	**1**
Other financial payables	**379**	**377**	**2**	**—**	**379**
Balance as of 12/31/2018	**2,544**	**1,511**	**1,026**	**7**	**2,544**
Liabilities to banks	21	21	—	—	21
Lease liabilities	3	—	3	—	3
Other financial debt	1,080	417	663	—	1,080
Trade payables	364	364	—	—	364
Payables from royalties	521	433	82	6	521
Derivative financial instruments	5	5	—	—	5
Other financial payables	307	305	2	—	307
Balance as of 12/31/2017	2,301	1,545	750	6	2,301
Liabilities to banks	21	21	—	—	21
Lease liabilities	1	—	1	—	1
Other financial debt	82	82	—	—	82
Trade payables	378	378	—	—	378
Payables from royalties	572	458	106	8	572
Derivative financial instruments	3	3	—	—	3
Other financial payables	77	77	—	—	77
Balance as of 12/31/2016	1,134	1,019	107	8	1,134

Cash outflows from financial obligations include payments of principal and interest. Current cash outflows from financial obligations are offset by planned cash inflows from receivables and other financial assets. To cover current cash outflows, Penguin Random House also has adequate financial reserves in the amount of cash and cash equivalents in place at the end of the reporting period.

Risk Management of Financial Instruments

Penguin Random House is part of the Bertelsmann Group. Therefore, Penguin Random House is generally included in the financial risk policy and procedures of Bertelsmann. The principles of these financial risk policy are described below.

Financial Risk Management

Penguin Random House is exposed to various forms of financial risk through its international business operations. Above all, this includes the effects of changes in foreign exchange rates and interest rates. Penguin Random House's risk management activities are designed to effectively mitigate these risks. The Executive Board of Penguin Random House establishes basic risk management policy, outlining general procedures for hedging currency and interest rate risk and the utilization of derivative financial instruments. The Bertelsmann Group Treasury advises subsidiaries on operating risk and hedges risks using derivative financial instruments as necessary. However, subsidiaries are not obliged to use the services provided by this department for their operating risks.

Currency Risk

Penguin Random House is exposed to an exchange rate risk in various foreign currencies. The exchange rate effects on loans and receivables as well as financial liabilities at amortized cost amount to €-6 million in the financial year 2018 (2017: €0 million; 2016: €16 million). Its subsidiaries are advised, but not obliged, to hedge themselves against foreign currency risks in the local reporting currency by signing forward agreements with banks that have a high credit rating. Loans within Penguin Random House that are subject to currency risk are hedged using derivatives. If foreign currency transactions designated as hedged items adequately meet effectiveness requirements, hedge accounting as defined by IFRS 9 is applied under the cash flow hedge model.

Interest Rate Risk

In case of any external financing and of significant interest-bearing assets, interest rate risk in the Penguin Random House Group is analyzed centrally and managed on the basis of the Group's planned net financial debt. A key factor in this management is the Groups's interest result over time and its sensitivity to interest rate changes. The Group aims for a balanced relationship between floating rates and long-term fixed interest rates, depending on the absolute amount, forecast performance of the interest-bearing liability and interest level. This is implemented using underlying and derivative financial instruments for control.

Penguin Random House's interest rate risk arises primarily from loans payable, financing agreements with Bertelsmann SE & Co. KGaA, Pearson plc and Bertelsmann PRH Finance, Inc., a subsidiary of Bertelsmann SE & Co. KGaA. and from cash and cash equivalents. In the financial year 2013, Penguin Random House entered into a Revolving Credit Agreement with Bertelsmann SE & Co. KGaA and Pearson plc. Under this shareholder loan agreement, the Group has access to a revolving facility of up to US$250 million. This facility was amended in October 2017 and May 2018 and is valid until October 2022. In the second amendment it was agreed, that the facility is not available until the later of June 1, 2019, or full repayment of all outstanding amounts under the Revolving Credit Agreements with Bertelsmann PRH Finance, Inc. and Bertelsmann SE & Co. KGaA from 2018. The interest rates for loans under the revolving facility are applicable LIBOR plus a margin of 2.00 percent per year. In May 2018, Penguin Random House entered with Bertelsmann PRH Finance, Inc. into a Revolving Credit Agreement of US$175 million, valid until May 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year. In addition, in May 2018, Penguin Random House entered with Bertelsmann SE & Co. KGaA into a Revolving Credit Agreement of US$200 million, valid until May 2019. This facility was amended in December 2018 for an additional loan commitment of US$90 million. The additional commitment is valid until February 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year.

24 Additional Disclosures on Financial Instruments continued

Liquidity Risk

Liquidity risks may arise through a lack of rollover financing (liquidity risk in a narrower sense), delayed receipt of payment and unforeseen expenditure (budgeting risk). Budgeting risk is determined by comparing deviations in actual spending with budget and reserve amounts. In a narrower sense, liquidity risk depends on the volume of debt due within a given period.

Counterparty Risk

Penguin Random House is exposed to default risks in the amount of the invested cash and cash equivalents and the positive fair value of the derivatives in its portfolio. Cash transactions and transactions involving other financial instruments are exclusively conducted with Bertelsmann Group Treasury or a defined group of banks with a high credit rating. Penguin Random House has obtained credit collateralization in the amount of €540 million (2017: €484 million; 2016: €441 million) for trade receivables from major customers.

Capital Management

The capital management of Penguin Random House is embedded in the financial management of the Bertelsmann Group, considering the shareholder agreements between Bertelsmann SE & Co. KGaA and Pearson plc. Within this framework, Penguin Random House considers the legal requirements regarding equity and liquidity needs.

Interest Rate and Currency Sensitivity

For the analysis of interest rate risk, a distinction is made between cash flow and present value risks. Financial debt, cash and cash equivalents are subject to a greater degree of cash flow risk, as changes in market interest rates impact the Group's interest result almost immediately. In contrast, medium- and long-term interest rate agreements are subject to a greater degree of present value risk. The accounting treatment of present value risks depends on the respective financial instrument or a hedging relationship documented in conjunction with a derivative (micro-hedge).

Upon initial recognition, originated financial debt is measured at fair value less transaction costs. Subsequent measurement is based on amortized cost. Changes in fair value are limited to opportunity effects, as changes in interest rates have no effect on the balance sheet or the income statement. The recognition of originated financial debt at fair value is only permitted for transactions for which a micro-hedge is documented in accordance with IFRS 9 in conjunction with the conclusion of an interest rate or exchange rate hedge transaction involving derivatives. In this case, changes in the fair value of the respective items are recognized in the income statement in order to substantially balance out the offsetting effects of the fair value measurement of the related derivatives.

For derivative financial instruments, the effects of changes in interest rates are recognized in the income statement. In the case of documented hedging relationships (cash flow hedges), however, these effects are taken directly to equity.

24 Additional Disclosures on Financial Instruments continued

The cash flow or present value risks existing at the end of the reporting periods are analyzed using a sensitivity calculation as an after-tax observation. A parallel shift in the interest rate curve of +/-1 percent is assumed for all significant currencies. The analysis is performed on the basis of financial debt, cash and cash equivalents and derivatives at the end of the reporting period. The results are shown in the following table:

Sensitivity Analysis of Cash Flow and Present Value Risks

	12/31/2018		12/31/2017		12/31/2016	
in € millions	**Shift +1%**	**Shift -1%**	**Shift +1%**	**Shift -1%**	**Shift +1%**	**Shift -1%**
Cash flow risks (income statement)	**(1)**	**1**	—	—	1	(1)
Present value risks (income statement)	**—**	**—**	—	—	—	—
Present value risks (equity)	**—**	**—**	—	—	—	—

The analysis of foreign currency sensitivity includes the Group's financial debt and operating transactions at the end of the reporting period and the hedging relationships entered into. The calculation is performed for the unsecured net exposure on the basis of an assumed 10 percent appreciation of the euro versus all foreign currencies and is presented after tax. A uniform devaluation of foreign currencies would have resulted in a change in the carrying amount recognized in profit or loss of less than €1 million (2017: €2 million; 2016: €2 million). Thereof, more than €-1 million (2017: less than €1 million; 2016: less than €1 million) relates to fluctuations in the US dollar exchange rate with a net exposure of US$6 million (2017: US$-4 million; 2016: US$-2 million). Shareholders' equity would have experienced no decline (2017: €-5 million; 2016: €-6 million) as a result of fluctuations in the fair values of documented cash flow hedges. Thereof in previous years (2017: €-4 million; 2016: €-4 million) related to fluctuations in the US dollar exchange rate on the basis of a documented cash flow hedge volume (2017: US$64 million; 2016: US$65 million). If there had been a uniform increase in the value of foreign currencies, this would have led to opposite changes in these amounts for Penguin Random House.

Accounting of Derivative Financial Instruments and Hedges

All derivatives are recognized at their fair value. When a contract involving a derivative is entered into, it is determined whether that contract is intended to serve as a fair value hedge or as a cash flow hedge. Some derivatives, however, do not meet the requirements for recognition as hedges, even though they function as such in financial terms.

Penguin Random House documents all relationships between hedging instruments and hedged items and its risk management objectives and strategies in connection with the various hedges. This method includes linking all derivatives used for hedging purposes to the underlying assets, liabilities, firm commitments and forecasted transactions. Furthermore, Penguin Random House assesses and documents the degree to which changes in the fair values or cash flows of hedged items are effectively offset by changes in the corresponding hedging instruments, both when the hedges are initiated and on an ongoing basis.

Financial Derivatives

Penguin Random House uses standard market financial derivatives, unlisted (OTC) instruments. These include, in particular, forward agreements and currency swaps. Transactions are entered into solely with Bertelsmann Group Treasury or banks with a high credit rating. In general, the transactions with banks are only performed with banks approved by the Chief Financial Officer. The nominal volume is the total of all underlying buying and selling amounts of the respective transactions.

Financial Derivatives continued

The majority of the financial derivatives at the end of the reporting period are used to hedge currency rate risks from intercompany financing activities (2018: 80 percent; 2017: 62 percent; 2016: 33 percent). A total of €40 million (2017: €129 million; 2016: €133 million) (2018: 20 percent; 2017: 38 percent; 2016: 67 percent) is due to financial derivatives used to hedge currency rate risks from operating business as of the end of the reporting period. Financial derivatives are used exclusively for hedging purposes. The maturity bands correspond to the remaining maturities of the financial derivatives.

Nominal Amounts and Fair Values of Financial Derivatives

	12/31/2018				
	Nominal volume			**Fair value**	
in € millions	< 1 year	1 to 5 years	> 5 years	**Total**	
Currency derivatives					
Forward contracts and currency swaps	205	—	—	**205**	**3**
	205	—	—	**205**	**3**

	12/31/2017				
	Nominal volume			**Fair value**	
in € millions	< 1 year	1 to 5 years	> 5 years	**Total**	
Currency derivatives					
Forward contracts and currency swaps	319	21	—	**340**	**(4)**
	319	21	—	**340**	**(4)**

	12/31/2016				
	Nominal volume			**Fair value**	
in € millions	< 1 year	1 to 5 years	> 5 years	**Total**	
Currency derivatives					
Forward contracts and currency swaps	176	23	—	**199**	**—**
	176	23	—	**199**	**—**

Fair values are netted. Further details are presented in the following table ”Derivative Financial Instruments.”

Some of the derivatives were recognized in previous years as hedging instruments in connection with cash flow hedges. The effective portion of changes in the fair value of cash flow hedges was recognized in other comprehensive income until the effects of the hedged underlying transaction affect profit or loss.

24 Additional Disclosures on Financial Instruments continued

Nominal Amounts and Fair Values of Financial Derivatives continued

The following table provides an overview of carrying amounts of Penguin Random House's derivative financial instruments, which correspond to their fair values. A distinction is made between derivatives that are included in an effective hedging relationship in accordance with IFRS 9 (2017, 2016: in accordance with IAS 39) and those that are not.

Derivative Financial Instruments

in € millions	Carrying amount as of 12/31/2018	Carrying amount as of 12/31/2017	Carrying amount as of 12/31/2016
Assets			
Forward contracts and currency swaps	**4**	1	3
Without hedge relation	**4**	1	2
In connection with cash flow hedges	**—**	—	1
Equity and liabilities			
Forward contracts and currency swaps	**1**	5	3
Without hedge relation	**1**	5	3
In connection with cash flow hedges	**—**	—	—

The following table presents the remaining terms of the contractual amounts to be exchanged in a derivative financial instrument for which gross cash flows are exchanged:

Liabilities from Derivatives with Gross Settlement

in € millions	Remaining term of liabilities		
	Up to 1 year	1 to 5 years	Over 5 years
Cash outflow	**(155)**	**—**	**—**
Cash inflow	**154**	**—**	**—**
Balance as of 12/31/2018	**(1)**	**—**	**—**
Cash outflow	(309)	(22)	—
Cash inflow	304	22	—
Balance as of 12/31/2017	(5)	—	—
Cash outflow	(69)	—	—
Cash inflow	66	—	—
Balance as of 12/31/2016	(3)	—	—

25 Statement of Cash Flows

Penguin Random House's combined statement of cash flows has been prepared in accordance with IAS 7 and is used to evaluate its ability to generate cash and cash equivalents. Cash flows are divided into those relating to operating activities, investing activities and financing activities. Cash flows from operating activities are presented using the indirect method, whereby EBIT is adjusted for the effects of a non-cash nature, any deferrals or accruals of past or future operating receipts or payments as well as items of income or expenses associated with investing cash flows. In addition, cash flows arising from income taxes are classified as cash flows from operating activities as well as other cash flows that are neither investing nor financing. Contributions to pension plans are a cash outflow reported as a separate item in the cash flow from operating activities. The change in

25 Statement of Cash Flows continued

provisions for pensions and similar obligations represents the balance of personal expenses for pensions and similar obligations and company payments for these obligations (further explanations are presented in note 19 "Provisions for Pensions and Similar Obligations"). The management of Penguin Random House utilizes indicators that include operating EBITDA and is thus before interest and taxes as well as depreciation, amortization and impairment and special items. Operating results and the resulting cash flow from operating activities should therefore be consistent and comparable. Accordingly, the net balance of interest paid and interest received in the financial year is shown in the cash flow statement as part of financing activities.

Cash flows from investing activities are determined directly in accordance with IAS 7. Investing activities include payments for fixed assets and purchase price payments for consolidated investments acquired as well as proceeds from the disposal of non-current assets and participations. Further explanations concerning acquisitions made in the financial year are presented in the section "Acquisitions and Disposals." Disposals in the financial year are also presented separately in that section. No financial debt was assumed in the financial years 2018 and 2016 (2017: €1 million).

Cash flow from financing activities includes changes in equity, financial debt and dividend payments affecting cash, as well as interest paid and interest received. In the financial year 2018, the item "Proceeds from other financial debt" relates to receipts in the amount of €492 million from the shareholder Bertelsmann and its related subsidiaries Bertelsmann PRH Finance, Inc. and Bertelsmann Business Support S.a.r.l. During the financial year, shareholders' loans of €424 million were paid back. The repayments are included in the item "Redemption of other financial debt." In the financial year 2017, the item "Proceeds from other financial debt" related to receipts in the amount of €1,266 million from the shareholder Bertelsmann and its related subsidiary as well as from the shareholder Pearson. During the financial year 2017 shareholders' loans of €199 million were paid back. The repayments were included in the item "Redemption of other financial debt." In the financial year 2017, the item "Dividends to Penguin Random House shareholders" included cash outflows of €792 million form special dividend distributions in connection with the acquisition of another 22 percent interest in Penguin Random House by Bertelsmann from Pearson. Further details are presented in the section "Background." In the financial year 2017, the item "Change in equity" mainly included capital contributions to Penguin Random House as presented in note 26 "Related Party Disclosures."

The combined statement of cash flows includes the effects of changes in foreign currencies and changes in the scope of consolidation. Items in the combined statement of cash flows thus cannot be compared to changes in items disclosed on the combined balance sheet.

The following table shows the cash changes and non-cash changes of financial debt.

Changes in Financial Debt

				Non-cash changes		
in € millions	12/31/2016	12/31/2017	Cash changes	Acquisitions through business combinations	Exchange rate effect	**12/31/2018**
Liabilities to banks	21	21	(5)	—	(1)	**15**
Lease liabilities	1	3	(1)	—	–	**2**
Other financial debt	82	1,080	68	—	44	**1,192**
Total financial debt	**104**	**1,104**	**62**	**—**	**43**	**1,209**

26 Related Party Disclosures

For Penguin Random House, related parties as defined in IAS 24 are those persons and entities that control or exercise a significant influence over Penguin Random House, as well as those persons and entities controlled or jointly controlled by Penguin Random House, or over which it exercises a significant influence. Accordingly, all legal entities controlled or jointly controlled by the ultimate parent company of Penguin Random House preparing consolidated financial statements for public use Bertelsmann SE & Co. KGaA, or over which it exercises a significant influence, all legal entities controlled or jointly controlled by Pearson plc and key management personnel of Penguin Random House and all its parents including close members of their families and the companies that are controlled or jointly managed by them, are defined as related parties.

The ultimate parent company of Penguin Random House preparing consolidated financial statements, Bertelsmann SE & Co. KGaA, includes in its consolidated financial statements those of Penguin Random House. Bertelsmann SE & Co. KGaA is a company incorporated under German law whose registered office is established at Carl-Bertelsmann-Strasse 270, D-33311 Gütersloh, Germany. Consolidated financial statements for Bertelsmann SE & Co. KGaA can be obtained at its registered office.

Remuneration for key management personnel includes:

Remuneration for Key Management Personnel

in € millions	**2018**	2017	2016
Short-term employee benefits	**5**	6	7
Termination benefits	**—**	1	—
Post-employment benefits	**—**	—	—
Other long-term benefits	**2**	2	2

The remuneration shown includes remuneration for activities by the members of the management who have responsibility for planning, directing and controlling and by the members of the Board of Directors of both PRH LLC and PRH Limited. Companies of the Bertelsmann Group and the Pearson Group have granted post-employment benefits to the key management personnel of Penguin Random House. There were no associated expenses in the financial year 2018 (2017: €0 million; 2016: €4 million). At the end of the reporting period, the related defined benefit obligation amounts to €7 million (2017: €7 million; 2016: €7 million).

26 Related Party Disclosures continued

Remuneration for Key Management Personnel continued

Transactions with subsidiaries included in the scope of consolidation are eliminated and are not further disclosed. In addition to transactions with consolidated subsidiaries, the following transactions with related parties and entities were conducted in the reporting period:

Transactions with Related Parties

in € millions	Parents	Entities with significant influence	Key members of management	Joint ventures	Associates	Other related parties
2018						
Goods delivered and services provided	**—**	**—**	**—**	**—**	**—**	**13**
Goods and services received	**—**	**—**	**—**	**—**	**—**	**(146)**
Receivables against	**—**	**—**	**—**	**—**	**—**	**6**
Amounts owed to	**12**	**—**	**6**	**—**	**—**	**1,235**
2017						
Goods delivered and services provided	—	—	—	—	—	15
Goods and services received	—	—	—	—	—	(119)
Receivables against	—	—	—	—	—	7
Amounts owed to	173	—	7	—	—	1,125
2016						
Goods delivered and services provided	—	—	—	—	—	17
Goods and services received	—	—	—	—	—	(121)
Receivables against	—	—	—	—	—	6
Amounts owed to	3	—	6	—	—	124

Transactions with parent companies contain transactions with PRH Holdings, Inc. as well as Bertelsmann UK Limited as these entities are the direct parent companies of Penguin Random House. PRH Publication, Inc. and Pearson PRH Holdings Limited are entities that have significant influence over Penguin Random House. In the financial years 2018, 2017 and 2016, no transactions with the latter two companies have occurred. Transactions with all other entities of the Bertelsmann Group including its subsidiaries, joint ventures and associates as well as transactions with all other entities of the Pearson Group including its subsidiaries and joint ventures have been presented as transactions with other related parties.

Goods delivered and services provided to related parties mainly include income from rental services and revenues from selling goods and providing diverse services. Received goods and services from related parties primarily contain expenses for print services, rental and lease expenses and expenses for acquiring goods and receiving sundry services. The outstanding receivables against related parties mainly obtain trade receivables. Trade payables and loans payable from a revolving credit agreement and from a term loan agreement are the main content of the amounts owed as well as dividends payable to related parties at each balance sheet date.

In 2013 Penguin Random House entered into a revolving credit agreement with Bertelsmann SE & Co. KGaA and Pearson plc. The credit facility was amended in October 2017 and in May 2018 and limits amounts to a dollar equivalent of US$250 million. Committed borrowings may be denominated in US dollars, British pounds or euros. This facility is valid until October 5, 2022. In the second amendment, it was agreed that the facility will not be available until the later of June 1, 2019 or full repayment of all outstanding amounts under the Revolving Credit Agreements with Bertelsmann PRH Finance, Inc. and Bertelsmann SE & Co. KGaA from 2018. The interest rate is defined depending on the used currency. In case of US dollar or British pound denominated loans

Transactions with Related Parties continued

made or outstanding during any interest period will have applied the LIBOR per annum equal to the applicable Screen Rate for three months on the date of this agreement and each interest payment date thereafter. In the case of euro-denominated loans made or outstanding during any interest period, they will have applied the EURIBOR per annum equal to the applicable Screen Rate for three months on the date of this agreement and each interest payment date thereafter. All loans subject to the above respective interest rate for the interest period in effect plus 2.00 percent are to be calculated on the basis of a year of 360 days and actual days elapsed. Within this revolving credit agreement, Penguin Random House received loans payable in the amount of €218 million (2017: €383 million; 2016: €179 million) from Bertelsmann SE & Co. KGaA and Pearson plc during the financial year 2018. As of December 31, 2018, the total of revolving loans amounted to €0 million (2017: €208 million; 2016: €82 million). The outstanding liability is part of the table concerning the transactions with related parties.

In October 2017, Penguin Random House entered with Bertelsmann PRH Finance, Inc., a subsidiary of Bertelsmann SE & Co. KGaA, into a Term Loan Agreement of US$795 million, valid until October 2022. The term loan bears interest at 4.25 percent per year. As of December 31, 2018, the term loan balance amounts to €694 million (2017: €663 million). The outstanding liability is also part of the table concerning the transactions with related parties.

In October 2017, Penguin Random House entered with Bertelsmann UK Limited, a subsidiary of Bertelsmann SE & Co. KGaA, into a Term Loan Agreement of GBP200 million, valid until April 2023. The term loan bears interest at 3.20 percent per year. In March 2018 the Term Loan Agreement was transferred from Bertelsmann UK Limited to Bertelsmann Business Support S.à r.l., a subsidiary of Bertelsmann SE & Co. KGaA. At December 31, 2018, the term loan balance amounted to €224 million. The outstanding liability is also part of the table concerning the transactions with related parties.

In May 2018, Penguin Random House entered with Bertelsmann PRH Finance, Inc., a subsidiary of Bertelsmann SE & Co. KGaA, into a Revolving Credit Agreement of US$175 million, valid until May 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year. At December 31, 2018, the loan amounted to €21 million. The outstanding liability is also part of the table concerning the transactions with related parties.

In addition, in May 2018, Penguin Random House entered with Bertelsmann SE & Co. KGaA, into a Revolving Credit Agreement of US$200 million, valid until May 2019. This facility was amended in December 2018 for an additional loan commitment of US$90 million. The additional commitment is valid until February 2019. The interest rates for loans are applicable LIBOR plus a margin of 2.00 percent per year. At December 31, 2018, the loan amounted to €253 million. The outstanding liability is also part of the table concerning the transactions with related parties.

The shareholders made capital contributions for reimbursement of payments made by Penguin Random House for liabilities relating to periods before Penguin Random House`s formation in the financial years 2017 and 2016. In the financial year 2017, Bertelsmann UK Limited made a capital contribution in the amount of €9 million (2016: €12 million) and Pearson PRH Holdings Limited paid less than €1 million (2016: less than €1 million). The amount of the capital contribution in 2017 included the reimbursement for deficit pension contributions of €11 million (2016: €6 million). No capital contributions were made in the financial year 2018.

Bertelsmann SE & Co. KGaA and Pearson plc entered into a revolving deposit agreement with Penguin Random House in 2014. This agreement was amended in October 2017 and May 2018 and is valid until October 5, 2022. In the second amendment, it was agreed, that no deposits will be made under the agreement until the later of

Transactions with Related Parties continued

June 1, 2019 or full repayment of all outstanding amounts under the Revolving Credit Agreements with Bertelsmann PRH Finance, Inc. and Bertelsmann SE & Co. KGaA from 2018. The currency of the deposit is in US dollars from Penguin Random House LLC and British pounds from Penguin Random House Ltd. and shall be in a principal amount of 10,000,000 units of the relevant currency or multiples thereof. US dollar denominated deposits shall bear interest at a per-annum rate equal to the Fed Funds Rate (Federal Reserve Bank of New York) in effect for the interest period of the deposit plus 0.10 percent on a basis year of 360 days. British pound denominated deposits shall bear interest at a per annum rate equal to the Base Rate as administered by the Bank of England for the interest period in effect for the deposit minus 0.10 percent on a basis year of 365 days. Within this revolving deposit agreement. Penguin Random House granted no loans receivable to Bertelsmann SE & Co. KGaA and Pearson plc in the financial year 2018 (2017: €106 million; 2016: €81 million).

In the financial years 2018, 2017 and 2016, no expenses were recognized for bad or doubtful debts due from related parties. Dividends amounting to €180 million were distributed to Bertelsmann parent companies (2017: €822 million; 2016: €168 million). Pearson entities that have significant influence over Penguin Random House received dividends in the amount of €130 million (2017: €613 million; 2016: €149 million). Penguin Random House has obligations to other related parties from operating leases in the amount of €13 million (2017: €24 million; 2016: €37 million). These commitments toward Pearson are related to the lease of a building of Penguin Random House in London. They were partially offset by expected minimum lease payments from sublease with other Bertelsmann companies with a nominal value of €1 million in 2017 and €3 million in 2016. There was no offsetting in the financial year 2018.

In the financial year 2016, Bertelsmann SE & Co. KGaA issued an additional lease guarantee for Penguin Random House, as Penguin Random House entered into a new lease for its offices in 1745 Broadway, New York, United States. The new contracts comprise an extension of the lease term of the existing floors for 10 years and include additional floors and therefore give the opportunity to consolidate from three locations into one. The new lease for the additional floors started July 1, 2018, with an eight-month rent-free period, and the lease term lasts until June 2033. The lease guarantee totals €715 million (2017: €704 million; 2016: €824 million). In the financial year 2018, a guarantee commission of €4 million was paid (2017: €4 million; 2016: €3 million). No guarantees were entered into for other related parties during the financial years 2018, 2017 and 2016.

As of December 31, 2018, no provisions for onerous contracts were made for other related parties. As of the end of the financial years 2017 and 2016, provisions for onerous contracts for other related parties amounted to less than €1 million.

27 Events after the Reporting Period

Sequent to the balance sheet date, no events of special importance occurred that could have a material impact on the financial position and financial performance of Penguin Random House.

SIGNATURES

The registrant hereby certifies that it meets the requirements for filing a Form 20-F and that it has caused and authorized the undersigned for sign this annual report on its behalf.

Pearson plc

/s/ Coram Williams

Coram Williams
Chief Financial Officer

Date: April 4, 2019