

## Post Office Board Agenda

|              |                                          |             |                          |                 |                                    |
|--------------|------------------------------------------|-------------|--------------------------|-----------------|------------------------------------|
| <b>Date:</b> | <b>Tuesday 30 April 2019<sup>1</sup></b> | <b>Time</b> | <b>14.30 – 16.30 hrs</b> | <b>Location</b> | <b>1.19 Wakefield and by phone</b> |
|--------------|------------------------------------------|-------------|--------------------------|-----------------|------------------------------------|

| Present                          |                                                        | Other Attendees                                               |                                   |               |
|----------------------------------|--------------------------------------------------------|---------------------------------------------------------------|-----------------------------------|---------------|
| • Tim Parker (Chairman)          | • Tim Franklin                                         | • Veronica Branton (Head of Secretariat)                      |                                   |               |
| • Alisdair Cameron (Interim CEO) | • Shirine Khoury-Haq                                   | • Jonathan Lewis (Head of Strategy and Corporate Development) |                                   |               |
| • Ken McCall                     | • Carla Stent                                          |                                                               |                                   |               |
| • Tom Cooper                     |                                                        |                                                               |                                   |               |
| Apology: Paula Vennells          |                                                        |                                                               |                                   |               |
|                                  |                                                        |                                                               |                                   |               |
|                                  |                                                        |                                                               |                                   |               |
| Agenda Item                      |                                                        | Action Needed                                                 | Lead                              | Timings       |
| 1.                               | Welcome and Conflicts of Interest                      | Noting                                                        | Chairman                          | 14.30 – 14.35 |
| 2.                               | CEO Report                                             | Noting and Input                                              | Interim CEO                       | 14.35 – 14.50 |
| 3.                               | 2019/20 Annual Strategic Plan and Budget               | Approval                                                      | Interim CEO/<br>Jonathan Lewis    | 14.50 – 15.30 |
| 4.                               | Succession Planning                                    | Noting and Input                                              | Interim CEO/ Group<br>Director HR | 15.30 – 16.20 |
| 5.                               | Any Other Business                                     | Noting and Input                                              | Chairman                          | 16.20 – 16.30 |
| 6.                               | Date of next meeting<br>28 May 2019: 11.30 – 16.30 hrs | Noting                                                        | Chairman                          |               |

<sup>1</sup> This meeting is in addition to the scheduled meetings and ordinary business, such as minutes and matters arising, have been carried over to the scheduled Board meeting on 28<sup>th</sup> May 2019.

**STRICTLY CONFIDENTIAL**

POST OFFICE LIMITED  
THE BOARD OF DIRECTORS

DISCUSSION PAPER

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## CEO Report

Author: Al Cameron

Meeting date: 30 April 2019

### The GLO (subject to legal privilege)

Our request for leave to appeal on the recusal and the claimants' counter-argument have been submitted to the Court of Appeal.

To ensure we have sufficient, full-time advice, experienced in litigation and capable of testing the views of advisors, we have asked Herbert Smith to lead the GLO, reporting to the Board sub-committee. There are no plans to amend the rest of the team other than standing down Norton Rose.

The sub-committee met on Wednesday and debated the grounds for appeal on the common issues trial and whether we should accelerate that appeal, requesting that the two appeals be heard together. On balance and against the QC's advice, we decided to proceed with two separate appeals, although ultimately it will be a matter for the Court of Appeal to determine how it wishes to hear them.

Consequently, POL will first apply for permission to appeal in respect of the common issues trial on 16 May 2019 before Justice Fraser. On 23 May 2019 it will be determined how the costs of the common issues trial should be apportioned. The Horizon issues trial will recommence on 10 June through to the first week of July.

Various workstreams are underway to agree changes to the way we work in line with the objectives of serving agents better and reducing legal risk in our contractual relationships. This is already changing the structure in Chesterfield with a Tier 2 contact centre team created to focus on disputes. A full update will be presented to the Board in May.

The GLO has received limited media attention. For the most part it has escaped the public's attention: only around 10pc are aware of having seen or heard something about Post Office in the media recently. However, within this group, negative sentiment about the business increased significantly.

### Commercial Performance

In our management accounts, we reported a trading profit for 2018-19 of £61.5m, broadly in line with expectations.

Gross revenue grew 2% year-on-year to £968m, £3m ahead of budget. This included Mails trading up 6% including some stamp buy-forward ahead of the price rise. Banking income grew 15% offset by declines in Payment Services, POCA and Postal Orders. Identity grew its trading profit 33% to £34m, a peak before the changes in UKVI and Identity pricing flow through. Insurance grew its revenue by 15% but trading profit by just 1%.

Change spend of £272m exceeded the Q4 forecast by £7.6m, although half of this related to non-cash onerous lease provisions. Benefits of £37.5m were delivered, in line with forecast but £2.7m below budget.

On cash, we ended the year with £747m in use, £135m better than the previous year-end. £90m of the lower usage was in branch.

## Delivery

### Network.

Network location numbers grew to 11,638 at year-end, subject to audit. This is an increase of 91 in 2018-19, a significant achievement. We opened 328 New Network Locations in areas that didn't have any Post Office provision, increasing convenience for customers. We also exited 67 DMBs, leaving 188 remaining.

A team from Post Office attended the recent NFSP conference. The audience and NFSP leadership recognised that change was underway, including higher sales incentives for telecoms and insurance, greater ability to sell travel insurance in Locals, higher pay on banking deposits and we waived the clause preventing the NFSP from criticising us in public. Our new field leadership structure is also now in place.

The areas we discussed aligned with the results of the survey they had undertaken with 1,000 Postmasters, prioritising concerns around pay and competition. While our change of tone was appreciated, it also underlined the extent to which Postmasters have felt neglected – a typical question was “Do you view us as an asset at all?” – and how much there is to do in delivering our strategy of “Making it easier for Postmasters to earn more money for less effort.” We confirmed that we will be undertaking a review of Postmaster remuneration for the Board in October.

The publication of the survey did generate some press attention and the strap line that 20% of Postmasters are thinking of handing the keys in will continue to gain attention. This reinforces our strategy and we should not complain about the NFSP trying to put us and Government under pressure to do more. We do, however, think that they are a little naïve and the story predictably played into the hands of the CWU.

We challenged the NFSP from the platform to recruit more active members, ensuring that they remain representative of Postmasters.

### Banking Framework 2.

We continue to have 25 Banks signed up for BF2, with three more expected to join at the end of May: RBS; Barclays; and the Co-op. RBS has just requested additional and legally binding commitments in areas like change spend. Our response is that with 25 banks on board we are beyond the negotiation period and they need to re-join or stay out. Barclays has said that it no longer views PCI as an issue for BF2.

Bank of Ireland.

The Board sub-committee has agreed to the commercial construct for Credit cards with CapOne. Details will be provided at the May Board. We expect to sign both the CapOne agreement and the associated back book agreement with BoI in early May. New CapOne-backed PO branded credit cards will be launched by the end of October.

Following agreement of Heads of Terms on the new relationship with BoI, work is underway to agree a new FSJVA. We are driving for completion by the end of May but it may slip into June, given the number of outstanding legal complexities.

I am meeting Francesca McDonagh straight after this Board meeting.

Back Office Transformation.

Progress has been made resolving reconciliation through to our financial system with failure rates much reduced. Cash depots continue to count physical cash weekly, confirming a match to Transtrack. The inventory team has reduced excess cash in the network close to expected levels. The Phase 2 forecasting solution for sterling cash went live over Easter weekend and is now being tested in parallel run. We continue to work closely with PwC on the year-end audit.

Security.

Following the known exploit of a number of our email accounts, we shared our Office 365 data from October 2018 to February 2019 with the National Cyber Security Centre (NCSC). The NCSC noted high activity during December 31, 2018 and February 23, 2019 but were unable to identify any credible malicious activity. It is satisfied with the controls and monitoring systems implemented in December.

For PCI, as set out in a separate paper, progress is being made on the deployment of point-to-point encryption on all pin-pad devices across our branch estate. This will meet our PCI compliance for retail transactions ie using your card for mails or bill payment transactions.

The challenge to the overall timeline relates to the estimated work to the back-end systems for processing banking services transactions. An alternative solution design is being urgently investigated that would remove our back-end systems from the scope of PCI, processing transactions directly via the Ingenico/ Vocalink networks. This will take some weeks to work through but has obvious advantages.

POCA

POCA customers are expected to decline from c.1.2m today to c.0.5m in March 2021 when the current contract ends. DWP then plans to terminate the provision for 350k customers, forcing them onto bank accounts and is about to tender provision for the remaining 150k who are unlikely to be offered a bank account.

We have requested a meeting with Amber Rudd and are writing to her and to DWP officials. We are recommending that the tender process properly reflects the vulnerability of these customers many of whom are elderly, resistant to normal communications and anxious. We also believe that space should be left for a single solution that could encompass all 0.5m customers.

In addition, it seems appropriate to highlight that although POCA is marginal for our finances, it is important to some Post Offices. Removing the product from Post Office may be interpreted as anti-Postmaster by the NFSP and may lead individual Postmasters to hand the keys in, making Government policy harder to deliver. The overall impact on remuneration over the next few years is substantial with 200 Post Offices badly hit and around 20 becoming loss-making, especially in Northern Ireland.

## Compliance and regulation:

### Select Committee

We have been invited to attend a BEIS Select Committee on the future of Post Office on 21 May. We will submit evidence by 6 May. This is in draft and will be shared with Government in advance.

We have also worked with BEIS colleagues to support our minister through a further House of Commons debate, this time on the sustainability of the branch network.

### Team

As the Board is aware, Jane MacLeod is leaving at the end of May, focusing on GLO handover before then. Ben Foat is promoted to General Counsel, leading Legal, Compliance and Company Secretary, with the latter being undertaken by Veronica Branton. Audit & Risk will move to the CFO, with disaster recovery moving to Operations. We will follow the process with NomCo and RemCo for Ben to become a member of GE.

Afua Kyei is still expecting to join us as CFO and should resign her current position on 1 May. She requested one contractual change, backdating LTIP if she is appointed to the permanent position. UKGI consider this unlikely and we are seeking other ways to provide equivalent compensation in this circumstance. We are understandably anxious that this might make her vulnerable to a counter offer from Barclays.

Rob Houghton has, with our support, been appointed a Non-Executive of the new NHS Supply Chain vehicle.

Jonathan Lewis has been appointed Head of Strategy and Corporate Development on a fixed term contract.

## Decisions for today

**Budget.** We have amended the budget for the Board's feedback and for changes arising from the GLO judgement. We are seeking Board approval, subject to agreeing the recent changes, as the details are finalised, with UKGI.

**Succession.** As requested, we are submitting a paper setting out risks and actions around GE succession. No specific decisions are required.

## Strategy

At the May Board, we will bring back the outcomes from the McKinseys work, to fill capability gaps, deliver cost reductions and simplify the organisation. In addition, we will revert on the Mails negotiations and on our plans for Insurance.

We have started a formal tender process for the future of the Telco supply chain and a smaller, private RFP to test a sale of the business.

In July, we will revert with our financial strategy, taking us beyond 2021. We will also bring back a recommendation on the future of Telco; how we manage the incumbency trap for Travel Money; the opportunity to support a cash utility; the future of Identity; and a forward strategy roadmap.

# 2019/20 Budget

Author: Jonathan Lewis Sponsor: Al Cameron

Meeting Date: 30 April, 2019

## Executive Summary

### Context

In January, the Board reviewed a draft budget for 2019/20. Normally, we would have presented a final budget for review and sign off in March. However, we agreed to postpone the review until this special April meeting given the potential implications of the Judgement in the Common Issues Trial.

The January draft proposed an underlying trading profit of £77m with further upside expected from lease accounting changes. With £92m of Government support, a change plan of £170m and with working capital, interest and GLO costs largely netting off, the budget would have been broadly cash neutral. The Three Year Plan had £66m for trading profit and was also cash neutral over the three years.

This paper sets out our proposed budget for 2019-20, with implications for STIP targets.

### Questions addressed in this report

1. What is our current commercial plan and assumptions within the budget?
2. What is the impact of the GLO decision and Project Blueprint on our Change Plan?
3. What are the other implications of the GLO findings?
4. What does this mean for the 19/20 budget?

### Conclusions

Following the additional work and conversation with UKGI, we are proposing three changes to the budgeted trading profit: £3m of additional stretch; £9m upside for the lease accounting change; and £12m of additional costs to support the accelerated agent agenda. The budgeted trading profit target for 2019/20 would therefore remain at £77m.

The improved performance from 2018/19's draft trading profit of £61.5m is made up as follows:

- The lease change nets off with costs moving from right to left hand column as we end Network Transformation. The net impact of accounting changes is nil.
- The major contractual changes net off to a £2m reduction in profit as the benefit of one quarter's Banking Framework is more than offset by the termination of the UKVI contract, the reduction in Verify pricing and the impact of the new Bank of Ireland deal.
- After taking account of the loss of the 53<sup>rd</sup> week's trading, the underlying improvement in performance is c. £17m as the benefits of change outweigh the ongoing reductions in traditional products such as POCA and Postal Orders, as well as £12m of costs to improve agent relationships.
- This includes ungrounded challenges of £12m.

In response to the GLO findings, we have recommending a re-prioritised 2019/20 Change Plan. Making changes for the agent agenda, especially on Horizon, is currently estimated to consume £12m of cost in year and we have allocated more funding for potential redundancies on the back of Project Blueprint and £8m for the cost of the litigation itself. With other smaller changes, we envisage some £30m of additional spend.

We are also recommending changes to the timing of other spend. In particular, we cannot make consistent agent oriented changes to Horizon in 2019-20 AND materially migrate Belfast data centres to the cloud. Postponing cloud migration would save £11m and we are re-looking at the proposed changes to Swindon (£4m) and believe we can shave £3m off Identity costs in year without losing strategic momentum. In total we could largely mitigate the increased spend if we slowed DMB migrations across year-end, saving £5m and losing benefits of £0.7m. However, our preference would be to spend an additional £5-10m and we will still believe we will be cash neutral for the year.

2019/20 will be a transitional year as we work through the implications of the GLO, manage Postmaster pressures and the politics around them, with the business benefiting from the full year impact of BF2 in 2020-21. The 2-3 year trading profit trajectory is therefore very positive and we will discuss future financial strategy in July. It could be argued that it is more important this year to manage the strategic issues than to drive to a particular number but we obviously recognise that with bonuses linked to trading profit everyone must be satisfied that the plan is stretching.

We had proposed STIP as follows: 11,500 branch locations remains the gateway; 90% on trading profit and 10% change benefit delivery; with on target trading profit of £77m. On the gap from minimum to stretch, we have been operating 20% either side. So for 2018-19, with On Target at £50m, minimum was £40m and stretch £60m.

We had discussed narrowing the range, or holding it at £10m either side of On Target but the shareholder's preference is to retain the 20%. So at £77m, the range would be £61.6m and stretch £92.4m. If the feeling was that this made minimum too close to 2018-19 and stretch too hard, we could split the difference at £12m and a range from £65m to £89m.

A detailed deck with the individual business plans is in the Reading Room, supporting the initial £77m. We are working through the detailed plans for the recommended changes.

### Input Sought

The Board is asked to review and approve the proposed budget, subject to confirmation with UKGI, as we share the detailed plans for the recommended changes and agreement at Remco on the final STIP targets.

# The Report

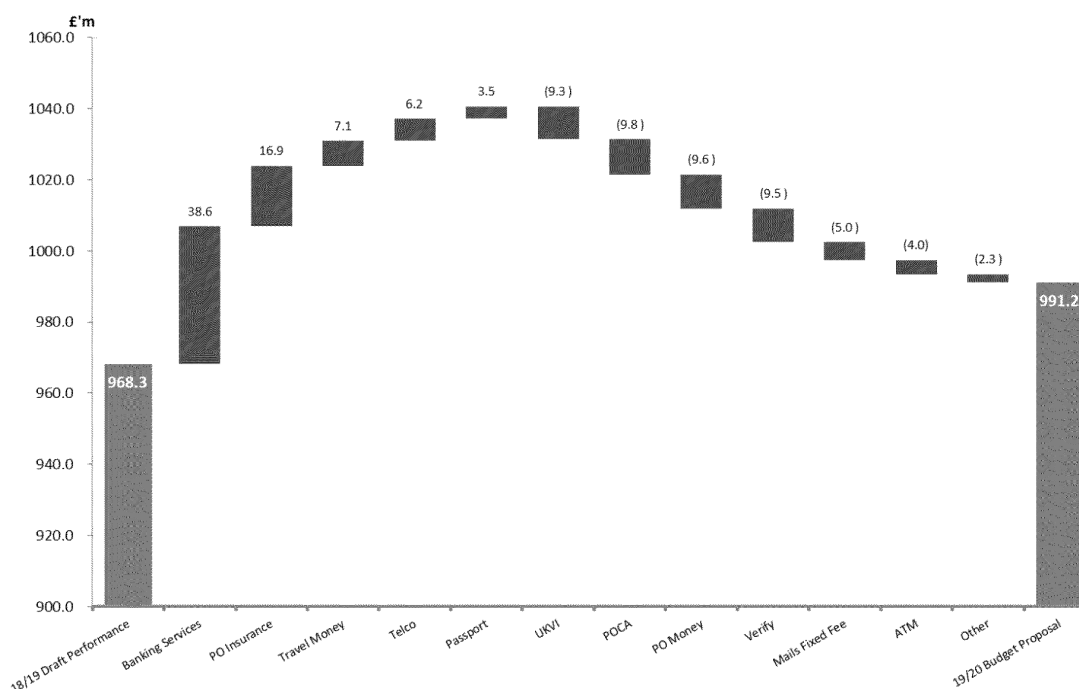
What is our current commercial plan and assumptions within the budget?

## Network strategy

1. Our critical deliverables are meeting the access criteria and having more than 11,500 branches. We remain uncomfortably close on branch numbers (currently having c. 11,638 made up of physical locations and outreach locations). The GLO findings increases the risk of greater disruption in our network.
2. Our plans, based on current trends, assumes that 500 branches will close, and that we will be able to reopen around 350 of these within the same community. In our latest version of the plan we are proposing to fund a further 220 new network locations which will help to maintain and increase the number of branches overall.
3. Our DMB strategy for 19/20 was to reduce DMB numbers by 77 (from 188 to 111). 35 of those reductions are already committed under the agreement with WHSmith. If we go with the £5m saving in the change plan, we would deliver a slightly reduced number of 69 this year.

## Gross Income and commercial background

4. Our gross income is on a slight upward trajectory of c. 2% a year for the first time. Income from Banking Services is strongly up given the renegotiation of the Banking Framework (one quarter benefit taken) as well as volume increases. Together with growth in Insurance and Travel Money, however, this only just offsets expected market declines in POCA and ATM, the loss of the UKVI work and the imposed rate reduction on Verify services.



5. For 20/21, we are expecting strong revenue growth driven by taking the full year benefit of the Banking Framework renegotiation, as well as growth in Insurance, to counter the continued decline in POCA, Verify, UKVI, ATM and other areas. We therefore have reason to believe that we are on the right path.

What is the impact of the GLO decision and Project Blueprint on our Change Plan?

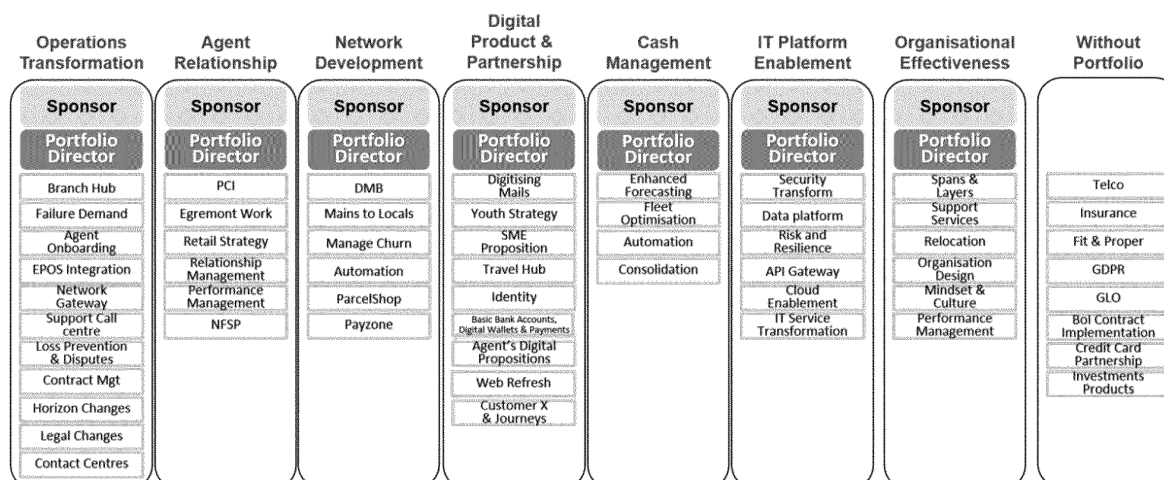
6. In light of the GLO decision, we have revisited the Change Plan to assess whether elements should be reprioritised, either to accelerate an improvement in agent relationships or to reduce delivery risk.

*Reprioritisation of Change Plan*

7. Our revised plan assumes a greater investment in 19/20 on:
- a. Back Office operations changes; specifically in how we manage losses and how we onboard agents.
  - b. Branch Hub acceleration to digitise the agent process and also to reduce costs in operations.
  - c. Systems Changes to perform more defensive programming, reduce common failure scenarios and to accelerate operational changes required.
  - d. Additional spend on outreach to ensure we maintain our branch numbers through this period where we may experience additional churn
  - e. Continued investment to support the Telecoms business to expand in fibre while we consider (i) a new contracting model; and (ii) whether we should market the business for sale. The budget assumed fibre investment only until the end of July.
  - f. Project Blueprint implementation costs
  - g. Litigation costs
8. At the same time, however:
- We could slightly reduce our DMB plan commitment from 77 to 69 branches due to our assessment of feasibility to deliver in 19/20. We did investigate reducing our commitment to a much lower number for reduced publicity and political impact but believe our strategy and plan is correct. We remain committed to the strategy of removing all DMBs to the maximum extent possible.
  - We have significantly reduced our plan commitments on IT spend:
    - i. We have postponed the migration of Horizon into the cloud architecture. We believe this is a high operational risk programme that we don't have the appetite to take in a period of prioritised focus on agents. Furthermore, the resource to undertake this programme is critical to delivering other IT programmes that will improve agent relationships. The migration to cloud remains an important programme for us to improve resilience and reduce cost, and will be addressed as part of the prioritisation work for 20/21.
    - ii. We will extend the ComputaCenter contract by a further year – and use the year to fully prepare for a tender process and any opportunity sourcing plans
    - iii. We have reduced our spend and ambition on implementing the integration hub
  - We have reduced our investment in the identity programme and reprioritised this work into 20/21. While there is a potential risk that we miss an opportunity in the market on Digital Identity, we will monitor on an ongoing basis and adjust our plans accordingly.
  - We will limit our ParcelShop opportunity in 19/20 to a pilot only and perform no further rollout (while the cost saving is small, expanding ParcelShop further would compete with PostMasters).
9. This reprioritisation will push a number of change activities out of 19/20 and into 20/21 – further work is being undertaken to assess how best to manage this increase in change workload in 20/21 and whether additional funding may be required.

*How we will organise and lead the changes*

10. We have further considered how we organise the delivery of the change portfolio and made the decision to organise the portfolio into 8 strategic programmes as outlined below. The entire portfolio will be overseen by the Strategic Portfolio Officer and governed by the GE. Operational Sponsors and dedicated programme managers will be committed onto the programme activities:



11. We are expecting that this structure will also enable us to reduce the number of programme managers we have in the business.

*Blueprint*

12. We have asked McKinsey to review our operating model and propose changes taking into account:
- the reduced size of the business following the DMB programme
  - additional skills that we are likely to need to ensure we can respond to and take advantage of future trends
  - simpler structures to ensure we can act more efficiently and with greater agility
13. Their current estimate is that cost savings of £80-120m are possible over a 5 year timeframe, with around half of that amount coming from IT non-staff costs. Substantial contractual, process and systems changes are required to release this. Furthermore, there is some overlap between the McKinsey analysis and our own change plan which we are reviewing. The McKinsey work does, however, confirm our view that there is around £50-100m of cost to be taken out of the business over 3-5 years following conclusion of the DMB programme.
14. This year, we will be performing an exercise on spans and layers and support structures and will revert to the May Board with the future cost plan. We have allowed £9m in our change plan to accommodate redundancy and other implementation costs, with any savings earmarked against meeting our ungrounded cost challenge for 19/20.

*Impact on costs and benefits in the Change Plan*

15. In total Change Plan costs have increased by £3m in 19/20 to £173m or, if we were to maintain the DMB programme, to about £180m. However around £30m of activity has been removed – work is underway to determine how much of this should come back and in which year, and therefore what the result will be for the total 3 year Change Plan spend.
16. We will continue to reprioritise the 19/20 Change Plan over the year but holding within the overall agreed cost envelope. In particular, we will need to free up resources for central

consulting spend to cover work on the Future of Cash, the Future Financial Strategy, Travel Money strategy, Telecoms RFP process, Insurance acquisition scan etc.

17. Bottom-up calculations suggest that the impact of deferring these programmes, particularly in DMB, Identity and an extension of the ComputaCenter contract, will reduce Change benefits by about £4m in 19/20.

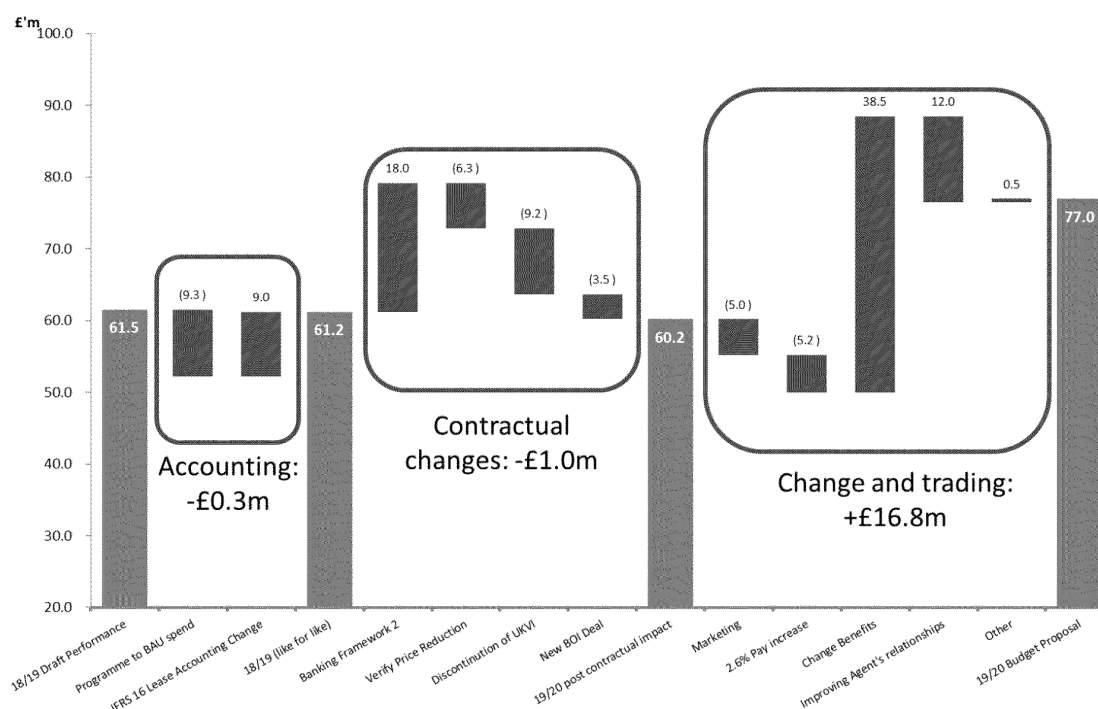
What are the other implications of the GLO findings?

18. We are currently performing a strategic review of Agents Remuneration which will report to Board later in the year. Whilst we formulate a longer term view and assess the financial impacts, we should assume that some provision should be made to cover tactical or early adoption of any recommendations – our current estimate is that this could amount to £5m.
19. In direct response to the GLO findings, we are also currently investigating:
- a. Whether we should pay suspended PostMasters while we investigate financial discrepancies (£2m estimated impact). In parallel, we are working to drive down the time taken for investigations so that we limit the amount we pay any fraudulent PostMasters (currently we do not pursue PostMasters for losses given the GLO background).
  - b. Remediation plans in Network Operations (£2m)
- We are keen to ensure that whatever package of measures we develop are seen as reasonable and fair rather than kneejerk and piecemeal.
20. While we are further developing our precise response plan, we believe that it is worth allowing £12m in the budget to cover increases in Agents Remuneration and any other operational impacts.

What does this mean for the 19/20 budget?

- 21. We are proposing a 19/20 trading profit target of £77m.**

22. Versus the 18/19 outturn of £61.5m, the movements are as follows:



- a. There are **two material accounting changes which net off**.
- The impact of the lease accounting standard is to reduce operating costs at the trading profit level by £9m, subject to audit, with corresponding increases in interest and depreciation.
  - As we shut down material programmes, reducing costs and as set out in the Three Year Plan, some transfer of roles and cost to BAU is required. In major programmes like NT, or in new work like GDPR, the full time programme team will cover some activity which, when they leave, has to be carried on as part of the BAU business. In 2019-20 this totals £9.3m, comprised of:
    - £4.9m – network development and network transformation staff roles to Finance and Operations BAU, Marketing and Retail BAU, especially in the Field teams
    - £2.7m – IT non-staff costs (Licences, Customer Hub, SUF additional support)
    - £1.7m – Digital and Innovation staff costs and Hub non-staff costs to FS&T BAU
- b. The **net impact of contractual changes (-£1m)** with the £18m benefits of the Banking Framework (Q4 forecast income uplift assuming everyone joining net of 6 months of higher agent pay for deposits and £2m of Supply Chain costs to cope with volumes) being eaten up by the costs to the business of the Verify price reduction (£6m), UKVI discontinuation (£9m) and the Bol deal.
- The new Bol deal results in a negative £3.5m year on year movement in profit compared to a “no-deal” decline of £8.5m. The reduction is primarily caused by declining savings balances. The new deal better aligns incentives between POL and Bol, and gives us commercial freedom to pursue deals with other partners for non-balance sheet products. The budget assumes that a new deal is in place for June. We are finalising whether an additional profit share will be taken in 2018-19. If it does it is excluded for

bonus purposes in 2018-19 and would, as a non-recurring item, increase the £3.5m year on year change.

- c. **The net benefits of trading, change and other movements exceed the trading declines in POCA and ATMs by £29m showing ongoing commercial progress, allowing £12m of opex to be allocated to improving agent relationships (net +£17m).** It is important to note that the profit target now includes £12m of ungrounded challenge, increased by a further stretch of £3m.
- i. The Marketing increase of £5m is driven primarily by greater spend on Travel and Protection, Telco Fibre, new credit card communications, and Identity
  - ii. The budget embeds the following expected cost increases:
    1. £2.1m for Growth in Call Centres primarily as a result in Insurance growth
    2. £0.9m for Mail Pouches Price Increase
    3. £0.5m for Telco Price Change & Regulatory
    4. £1.0m HMRC fee
    5. £1.7m Verizon (Bandwidth Increase)
  - iii. The £12m opex for improving agent relationships is described in paragraph 20

#### Costs

23. Overall, staff costs are predicted to decline sharply primarily as a result of the DMB programme with a corresponding increase in Agents' Pay.

| Post Office FY19      |                       |                        |             |            |
|-----------------------|-----------------------|------------------------|-------------|------------|
|                       | 19/20 Budget Proposal | 18/19 Current Forecast | YoY (£m)    | FY19 YoY % |
| Revenue               | 991.2                 | 968.3                  | 22.9        | 2%         |
| Cost Of Sales         | (134.9)               | (128.4)                | (6.5)       | 5%         |
| <b>Net Income</b>     | <b>856.3</b>          | <b>839.9</b>           | <b>16.4</b> | <b>2%</b>  |
| Agent's Pay           | (386.2)               | (365.0)                | (21.2)      | 6%         |
| Staff Cost            | (168.0)               | (191.7)                | 23.7        | -12%       |
| Non Staff Cost**      | (270.9)               | (270.4)                | (0.5)       | 0%         |
| FRES                  | 29.6                  | 33.0                   | (3.4)       | -10%       |
| Other Income (POCa)   | 12.1                  | 14.4                   | (2.3)       | -16%       |
| Payzone*              | 4.1                   | 1.3                    | 2.8         | 215%       |
| <b>Trading Profit</b> | <b>77.0</b>           | <b>61.5</b>            | <b>15.5</b> | <b>25%</b> |

\*Payzone has been included at trading profit level. There is no Payzone element included in revenue.

\*\*Includes impact of IFRS16

NB Assumes DMB programme reduced to 69 in 2019/20

24. Over the course of 19/20, we expect over 600 people to leave the business, primarily as a result of the DMB programme. We would expect this number to increase as we ground the ungrounded challenge. In addition, we have over 400 people in Change – as the Change programme matures we would expect this number to reduce.

|                    | 18/19        | 19/20        | YoY          | Comments                            |
|--------------------|--------------|--------------|--------------|-------------------------------------|
| DMBs               | 1,847        | 1,256        | (591)        | -32% DMB programme                  |
| Retail             | 120          | 124          | 4            | 3% New roles                        |
| FS&T               | 161          | 183          | 22           | 14% Change of marketing structure   |
| PO Insurance       | 51           | 47           | (5)          | -9%                                 |
| Identity           | 22           | 26           | 4            | 19% Business development roles      |
| F&O                | 1,379        | 1,351        | (28)         | -2% Restructure driven efficiencies |
| IT                 | 75           | 69           | (6)          | -8%                                 |
| HR                 | 141          | 133          | (9)          | -6% HR Target operating model       |
| LRG                | 85           | 93           | 7            | 9%                                  |
| Communications     | 45           | 37           | (8)          | -18%                                |
| Central            | 5            | 5            | -            | 0%                                  |
| Sub-TOTAL          | 2,084        | 2,066        | (18)         | -1%                                 |
| <b>GRAND TOTAL</b> | <b>3,931</b> | <b>3,322</b> | <b>(610)</b> | <b>-16%</b>                         |

*UKGI Interaction*

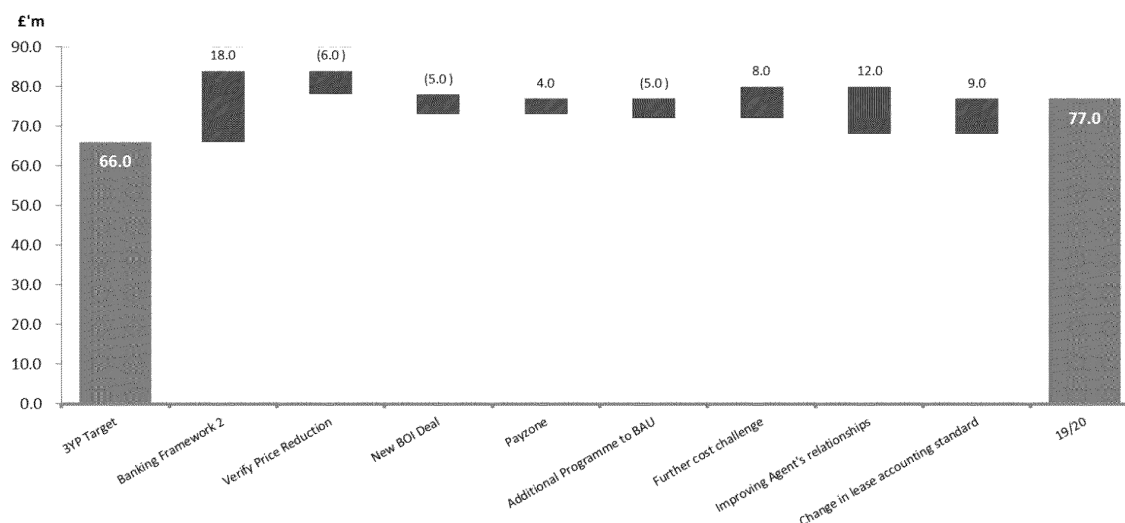
25. POL Finance Directors have separately met on the 11<sup>th</sup> April with the UKGI represented by Tom Cooper and Alex Cole to walk them through the most recent FY19/20 Budget submission to provide further context and clarity. Whilst there were some requests for additional information, Tom has shared his appreciation for the time spent and left with improved levels of understanding and confidence after having meticulously reviewed each area of the Business.
26. We will need to continue to liaise with UKGI as we continue to develop and refine the reprioritisation of the Change Programme, and the precise operational response to the GLO findings.

*Critical decisions underpinning the budget*

27. In producing this proposed budget, we have made some critical decisions of which the board should be aware:
- The budget assumes a slight slowdown in the DMB programme to ensure we have sufficient operational capacity to land the 69 remaining for the year
  - We are delaying the Solaris migration to cloud – partly to ensure we have sufficient IT change capacity to address other critical initiatives that are being accelerated as a result of the GLO findings, but also to reduce the potential for negatively impacting agent relationships through service outages etc.
  - By delaying some change from 19/20, we have increased the burden on 20/21 – we will need to undertake a prioritisation exercise to ensure 20/21 is deliverable
  - We have taken investment away from Identity Services – not only will this slow delivery of the product, but could increase the risk of competitors entering the space potentially reducing the overall opportunity for us
  - Change Plan activities to improve relationships with agents are currently a placeholder of £10m – further work is underway to determine precisely how this will be spent and we will revert to the Board with this detailed plan.
  - There is £12m of ungrounded challenge in the budget that needs to be addressed by the BUs as a matter of urgency.
  - Savings from Project Blueprint (which could help address a portion of the ungrounded challenge) are only achievable with further work on process and systems redesign and will need to be verified.

*Profit vs 3YP*

28. Versus the 3YP, this budget is £11m positive. While the Banking Framework and the change in lease accounting has been beneficial, we are also investing in Agent relationships, accepting commercial downsides in Verify and Bol, and bringing additional costs into BAU from the change programme. Achieving the £77m target, therefore, implies a £8m cost challenge versus the 3YP.

*Cashflow*

29. The Balance Sheet, Cash and Headroom positions have been prepared with the following key assumptions:

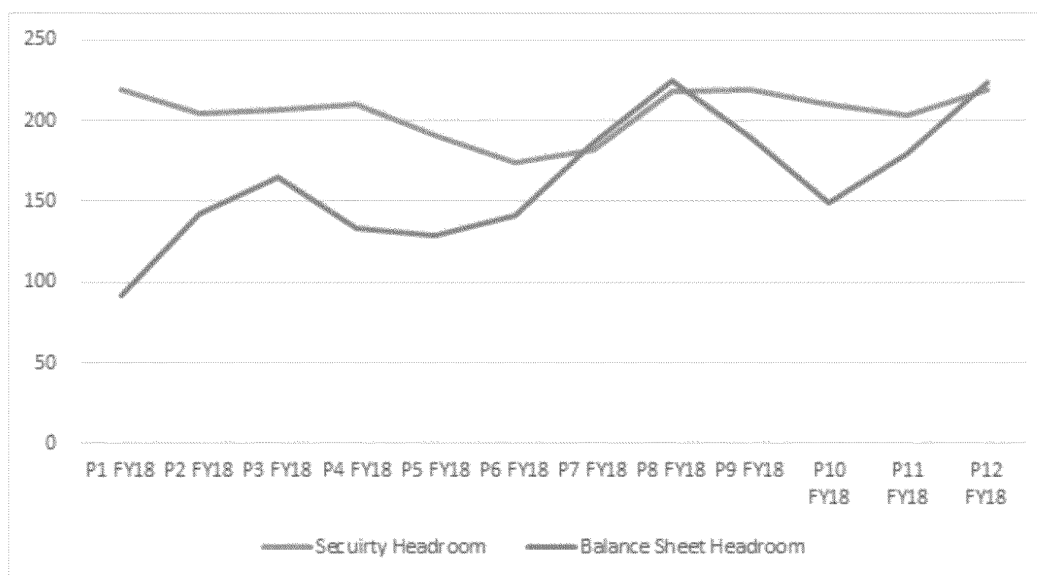
- Trading Profit of £77m, with the caveats set out above
- £50m Network Subsidy payments will be drawn down on a quarterly basis in line with previous years and £42m investment funding will be drawn in Q1 in line with the proposed spending pattern.
- Branch holdings are reduced down to c. £500m, including the adverse impact of banking framework by end of next year vs. 2018-19 YTD avg. of £520m.
- Cash centre balances are held at current levels, subject to seasonal fluctuations.

30. The net inflow for the year is c. £28m which will be kept as a contingency for Group Litigation.

|                                   | <b>FY1920</b> |
|-----------------------------------|---------------|
| Trading Profit                    | 77.0          |
| Non-Cash IFRS16 impact            | (9.0)         |
| Interest Expense                  | (8.5)         |
| Change Spend (incl. PayZone Acq.) | (173.0)       |
| o/w non-cash                      | 2.6           |
| Investment Funding (UKGI)         | 42.0          |
| NSP                               | 50.0          |
| Incremental Working Capital       | 46.9          |
| <b>Available funding</b>          | <b>28.0</b>   |

The above assumes that the DMB programme is slowed down to 69 this year – keeping it at 77 and investing further in improving agent relationships could increase cash spend by £10m, though the budget would still remain cash generative.

31. The incremental working capital improvement is mainly as a result of how the year end dates fall within the calendar month (31-Mar-19 v 29-Mar-20) which increases the payables balances for 2019-20; specifically agents pay and salary payables balances.
32. The month-end government loan balance is not expected to exceed the £750m threshold but as always this will tighten over the Christmas period and will need to be closely monitored.



#### *STIP target recommendation*

33. Our 2018-19 STIP targets is made up of 80% trading profit and 20% delivering key change initiatives (POLSAP, HRSAP, HNGX and Customer Hub) along with a gateway criteria of retaining 11,500 branch locations.
34. Based on feedback from the Board, we propose to have the similar pattern for 2019-20 STIP targets.
  - a. Gateway: retaining 11,500 branch locations
  - b. Performance:
    - i. 90% Trading Profit of £77m with (+/-) up to 20% range in each side.
    - ii. 10% Delivery of change benefits with (+/-) 20% range in each side.