



Shareholder  
Executive

HM Government

# **POST OFFICE LIMITED (“POL”)**




**MEETING WITH PAULA VENNELLS, CHIEF EXECUTIVE OFFICER**

**BRIEFING ANNEXES AND SUPPORTING INFORMATION**

*JUNE 2015*

RESTRICTED – POLICY & COMMERCIAL

## A ANNEX A: POSSIBLE AGENDA POINTS FOR DISCUSSION

| TOPIC   | COMMENTARY   |
|---|--|
| <b>FINANCIAL PERFORMANCE</b><br>           | <ul style="list-style-type: none"> <li>▪ POL beat operating profit targets for the year ending March 2015 (outturn of £100m vs. budget of £99m) although revenue fell short of budget by £55m. Results were therefore mainly driven by cost control.</li> <li>▪ Paula may reflect on this, particularly after a very difficult start to the 2014/15 financial year. It shows that the business is willing to take hard decisions and focused action to respond to underperformance.</li> <li>▪ POL's annual report is scheduled to be published at the end of this month. Furthermore the new financial year has also started well, and after one month POL is ahead of budget in revenue and operating profit.</li> </ul> |
| <b>LONG TERM STRATEGY</b><br>              | <ul style="list-style-type: none"> <li>▪ POL is working on a refresh of its strategic plan and expects to present this to HMG mid-year. Although it is likely to move away from existing targets POL is confident of operating in line with available funding.</li> <li>▪ Paula might want to talk about the progress POL have made in their plan to date, including highlighting the main challenges faced and those ahead.</li> </ul>  |
| <b>NETWORK TRANSFORMATION ("NT")</b><br> | <ul style="list-style-type: none"> <li>▪ Paula may want to update you on NT; progress has been strong and to date more than 75 per cent. of eligible branches have been modernised or are contractually committed to be transformed.</li> <li>▪ Paula may also want to talk about actions being taken to complete NT by the planned end-date in 2018. This includes communicating with a number of branches in coming weeks of changes to contract terms.</li> </ul>   |
| <b>NATIONAL FEDERATION OF SUBPOSTMASTERS ("NSFP")</b>   | <ul style="list-style-type: none"> <li>▪ Paula may update you on progress to agree a new funding model for the NFSP, who are the representative body for subpostmasters and who boast a membership of &gt;6,000 operators of branches.</li> <li>▪ This new model looks to move the NFSP away from being a subscription based organisation, negotiating on behalf of subpostmasters, to one where its interests are better aligned with POL.</li> </ul>   |



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## A ANNEX A: POSSIBLE AGENDA POINTS FOR DISCUSSION (CONT'D)

| TOPIC                           | COMMENTARY  |
|---------------------------------|---|
| <b>PREMIUM BONDS / NS&amp;I</b> | <ul style="list-style-type: none"> <li>▪ NS&amp;I has confirmed that it is not renewing its contract with POL for the sale of Premium Bonds. This is an iconic product which POL has sold for &gt;60 years, and it will be withdrawn from branches from August.</li> <li>▪ From a shareholder perspective this is disappointing. The contract delivers £8.5m revenue per year and its loss will very likely trigger hostile reactions – focused on HMG – from stakeholders and the press.</li> <li>▪ You have been sighted on advice provided to Baroness Neville-Rolfe on 9 June; following this a call is being scheduled between the Minister and Harriett Baldwin at HMT to discuss the situation.</li> <li>▪ Paula may also use this issue to prompt a discussion about POL's business with Government more generally (e.g. traditional Government services revenues are declining with the move to digital).</li> </ul> |
| <b>BANKING SERVICES</b>         | <ul style="list-style-type: none"> <li>▪ POL are working with the BBA and high street banks to develop a standardised service to all personal and SME current account customers in the UK (e.g. withdrawals and deposits). This is important as with banks continuing to shut branches POL is increasingly the only provider of these services in many communities.</li> <li>▪ Discussions have slowed in the past few weeks although negotiations are continuing. Paula might want to seek your views on this topic, and on access to finance (and POL's role here) more generally.</li> <li>▪ You have been sighted on advice provided to Anna Soubry on 10 June; this seeks guidance on what role BIS should play in this area after some negative press coverage following the General Election.</li> </ul>   |
| <b>HORIZON IT SYSTEM</b>        | <ul style="list-style-type: none"> <li>▪ There continues to be no evidence of systemic fault with POL's IT system and the mediation scheme is ongoing. This remains independent of Government, and POL are supportive of this approach.</li> <li>▪ Paula may want to discuss POL's handling of the Horizon mediation scheme and the forthcoming BBC Panorama programme on this, which is tentatively scheduled for Monday 29 June.</li> </ul>   |



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## **B ANNEX B: BIOGRAPHIES OF POL ATTENDEES**

**GRO**

### **PAULA VENNELLS, CHIEF EXECUTIVE OFFICER**

Paula has worked for Post Office Limited since 2007 in a number of senior roles including Managing Director. She became Chief Executive on 1 April 2012. Previously Paula spent five years with Whitbread plc latterly as Group Commercial Director. She began her career with Unilever and L'Oreal and held directorships in sales and marketing with a number of major retailers including Dixons Stores Group and Argos. She is currently a Non-Executive Director and Trustee for Hymns Ancient and Modern Group.

**GRO**

### **AL CAMERON, CHIEF FINANCIAL OFFICER**

Al became the Chief Financial Officer of Post Office in January 2015. He is also a non-executive on the Board of Oxford University Hospitals. From 2002-14 Al worked in a variety of roles for Centrica plc, a FTSE 100 company, including Director of Audit & Risk, Group Financial Controller, Finance Director of British Gas and Managing Director of British Gas Enterprise. Previously he was a partner with Arthur Andersen and served as a trustee of the e-Learning Foundation.

**Note:** Richard Callard and Tim McInnes will join the meeting from The Shareholder Executive. Richard is a Non-Executive on the Board of POL and has led the shareholder team for about 14 months, and Tim has worked on The Shareholder Executive team for 3-years with primary a focus on financial monitoring, funding, State aid and strategy.

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# ***SUPPLEMENTARY INFORMATION***



## RESTRICTED – POLICY &amp; COMMERCIAL

# 1 OVERVIEW OF POL

POL operates a network of c.11,700 Post Office branches, and delivers a wide range of services across mails and retail, financial services, Government services and telephony markets. This network is larger than all the branches operated by the high street banks combined.

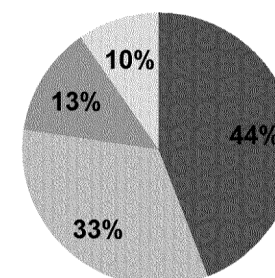
The business owns and operates about 300 of its branches, known as Crowns, which account for c.15 per cent. revenue. The remaining 11,400 branches are managed by independent entrepreneurs known as subpostmasters, who operate standalone post office branches or branches that are co-located in other retail premises (e.g. convenience or grocery).

POL has c.6,700 direct employees who mainly work in its c.300 owned branches, its cash management operation and its network support function. It is however also responsible for the employment of more than 50,000 additional people via its subpostmasters and their employees.

In 2014/15 POL generated revenue of **£870m** (£1,030m including Network Subsidy) and an operating profit of **£100m**. POL's most significant cost is payments made to subpostmasters – in 2014/15 **£435m** was paid out to **c.11,400** subpostmasters, averaging **c.£38,000** per branch. After subpostmaster payments, POL's largest expenditures are: Staff Costs (**c.£234m**); IT (**c.£104m**); and Property (**c.£53m**).

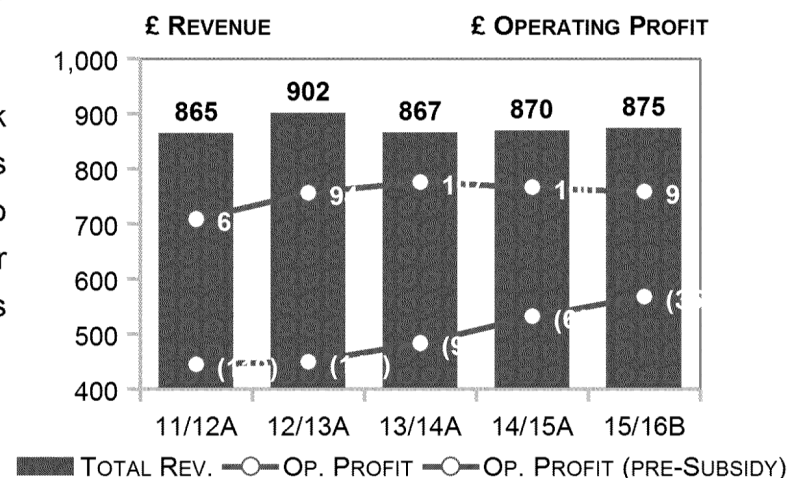
## REVENUE SPLIT (% REVENUE)

TOTAL 2014/15 REVENUE: £870M



■ MAILS AND RETAIL ■ FINANCIAL SERVICES  
■ GOVERNMENT SERVICES ■ TELEPHONY AND OTHER

## REVENUE & PROFIT PERFORMANCE





## RESTRICTED – POLICY &amp; COMMERCIAL

# 1 OVERVIEW OF POL – 2014/15 FINANCIAL PERFORMANCE

| £M                                    | 2014/15<br>ACTUAL | 2013/14<br>ACTUAL | £ VAR        | % VAR          |  |
|---------------------------------------|-------------------|-------------------|--------------|----------------|--|
| MAILS AND RETAIL                      | 383.5             | 385.8             | (2.3)        | (0.6%)         | Reassuring given weak start to the year however overall volumes were generally soft (e.g. in Labels, International, Special Delivery and Parcelforce). Partially offset by favourable "Signed For" sales.  |
| FINANCIAL SERVICES                    | 289.3             | 279.6             | 9.7          | 3.5%           |  |
| GOVERNMENT SERVICES                   | 113.0             | 114.9             | (1.9)        | (1.6%)         | Primarily due to growth in Personal Financial Services which continues to be a key growth driver and the renewal of Moneygram on favourable terms, partially offset by soft Bill Payment volumes.  |
| TELECOMS                              | 47.2              | 46.0              | 1.2          | 2.7%           |  |
| OTHER                                 | 37.0              | 40.5              | (3.5)        | (8.6%)         |  |
| <b>NET INCOME</b>                     | <b>870.0</b>      | <b>866.7</b>      | <b>3.3</b>   | <b>0.4%</b>    |  |
| STAFF COSTS                           | (234.0)           | (253.9)           | 19.9         | (7.8%)         | Continued decline in DVLA income due to new contract terms and Tax Disc changes, and continued shift to digital. Offset only partially by favourable POca revenue, due to higher customer accounts.  |
| POSTMASTER COSTS                      | (434.9)           | (447.6)           | 12.7         | (2.8%)         |  |
| NON-STAFF COSTS                       | (273.3)           | (264.8)           | (8.5)        | 3.2%           | Overall cost performance driven by widespread efficiency activities (e.g. Crown branches, IT outsourcing, redundancies, etc.) and certain one-off benefits, offset by increases in IT and marketing.   |
| ONE-OFF PROJECT COSTS                 | (23.2)            | (26.0)            | 2.8          | (10.9%)        |  |
| <b>TOTAL EXPENDITURE</b>              | <b>(965.4)</b>    | <b>(992.3)</b>    | <b>26.9</b>  | <b>(2.7%)</b>  |  |
| FOREIGN EXCHANGE JV INCOME            | 35.8              | 33.1              | 2.7          | 8.3%           |  |
| <b>EBITDAS</b>                        | <b>(59.6)</b>     | <b>(92.5)</b>     | <b>32.9</b>  | <b>(35.6%)</b> |  |
| DEPRECIATION                          | (0.4)             | (0.4)             | (0.0)        | 3.2%           | Year-on-year operating profit declined by £7m but on a pre-subsidy basis (i.e. adjusting for a £40m reduction in subsidy) losses were reduced by 35 per cent. or £33m. Primarily driven by strong and concerted cost management, supported by a robust top-line. |
| NETWORK SUBSIDY                       | 160.0             | 200.0             | (40.0)       | (20.0%)        |  |
| <b>OPERATING PROFIT</b>               | <b>100.0</b>      | <b>107.1</b>      | <b>(7.1)</b> | <b>(6.6%)</b>  |  |
| <b>OPERATING PROFIT (PRE-SUBSIDY)</b> | <b>(60.0)</b>     | <b>(92.9)</b>     | <b>32.9</b>  | <b>(35.4%)</b> |  |



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## 2 OVERVIEW OF POL FUNDING

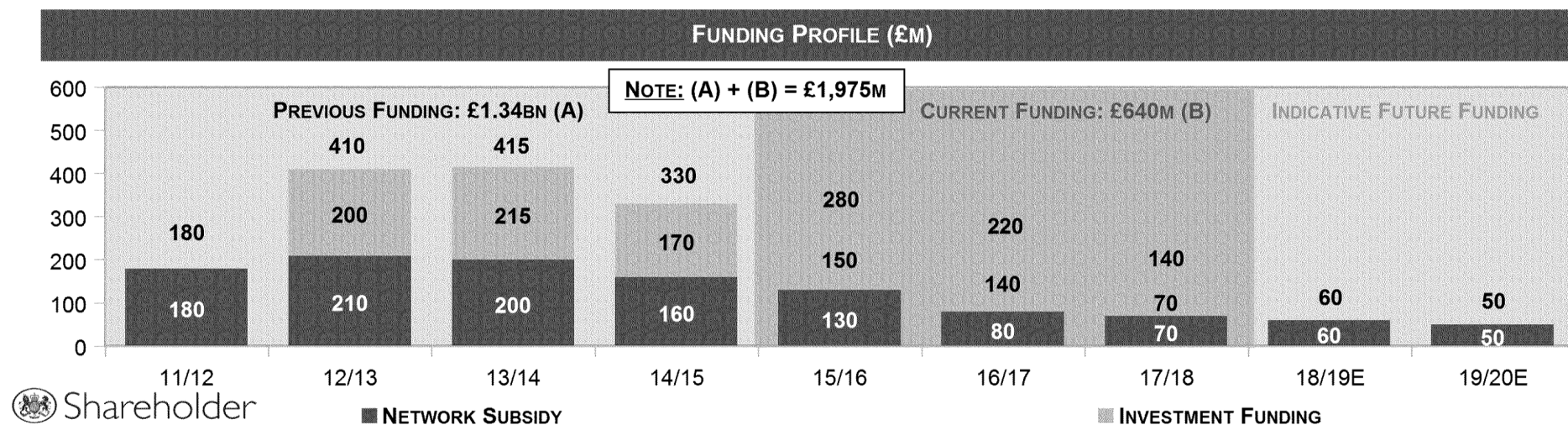
Government provides funding to POL in order to maintain a network **beyond its optimal commercial size and footprint, and to make this network more efficient**. Currently the requirement is for POL to operate a network of more than 11,500 branches which meets 5 clearly defined access criteria (e.g. 99% of the UK population must live within 3 miles of their nearest post office). There is a legally-binding funding agreement between Government and POL linked to this.

Since 2010 Government has committed £1,975m to POL. This has been focused on two areas:

**NETWORK SUBSIDY (£1,030M):** Payment to maintain a network of post offices in line with Government's requirements. This is recognised by POL as revenue in its accounts.

**INVESTMENT FUNDING (£945M):** Funding for POL to invest in its network, to make it more efficient and less reliant on taxpayer funding. This is recognised by POL as a direct cashflow in its accounts.

As a result of its network modernisation strategy, cost efficiencies and revenue growth POL anticipates being able to reduce its recurring funding requirement to around £50m from 2019/20. This would support >3,000 branches which serve a "social" purpose but which would not be financially viable in their own right.





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## 3 LONG TERM STRATEGY

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POL's strategy was developed in 2013 and covers the period to March 2020. It represented a continuation of POL's previous plan and forms part of the basis on which POL secured Government's recent £640m funding commitment. It is focused on delivering a financially sustainable POL, less reliant on subsidy, and is centred on three core pillars.

### PILLAR I: NETWORK TRANSFORMATION

- **Aim:** Complete the network investment strategy, modernising branches to improve customers' experience and making them less reliant on taxpayer support.
- **Status:** Generally has progressed in line with plans.

### PILLAR II: REVENUE GROWTH

- **Aim:** Increased sales in existing areas and launch of new products and services, focusing on particular strengths in mails and retail, financial services and Government services.
- **Status:** Slower than expected progress, with low demand growth, fewer new contracts than expected (particularly in Government Services) and intense competition.

### PILLAR III: TRANSFORMATION AND EFFICIENCY

- **Aim:** Reduce costs through a significant transformation of POL's IT infrastructure and a restructuring of the corporate overhead.
- **Status:** Again, progress has been slower than expected, particularly due to frequently volatile or hostile relations with key stakeholders including subpostmaster and employee representatives.

POL has been working on a refresh of its strategic plan for the past few months, which is expected to be presented to Government in mid-2015. We expect that the main objectives and pillars of this will remain the same, but that some details might change and financial targets will be reduced. However, POL is confident that it will be able to deliver the refreshed strategy in line with the available funding.



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## 3 LONG TERM STRATEGY – NETWORK TRANSFORMATION

NT was developed in 2010 as a strategy to transform and modernise both the Crown post offices and agency post offices operated by subpostmasters. The aim of NT, by adopting new operating models and subpostmaster contracts, is to:

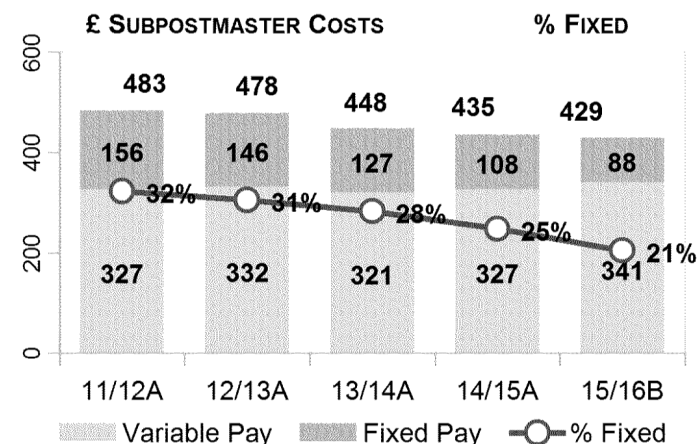
- (i) Improve customer experience by investing in branch environments;
- (ii) Improve operator performance with increased footfall and efficiency;
- (iii) Make POL's costs more flexible, so costs move with revenue; and
- (iv) Reduce POL's reliance on taxpayer support.

To date more than 75 per cent. of eligible branches have transformed or have contracted to do so. Key performance indicators include:

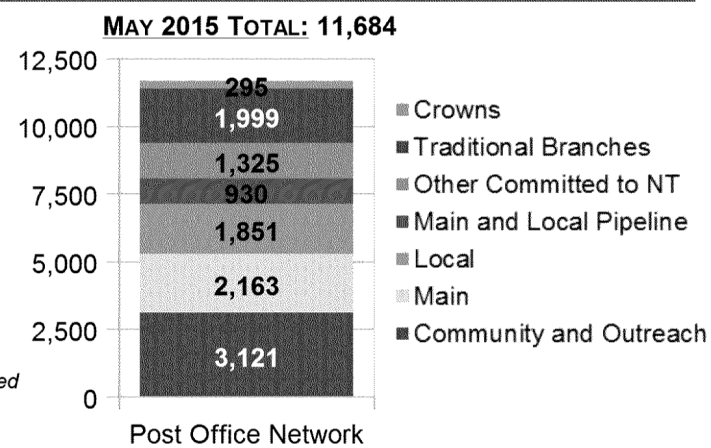
- c.4,300 branches have transformed and a further c.2,255 have contractually committed to modernise (i.e. pipeline of transformations)<sup>(1)</sup>;
- > 3,000 further “last shop” branches are protected, making sure communities that need to access services continue to have access;
- > 125,000 opening hours have been added across the Post Office network and > 2,500 branches are now open on Sundays;
- Customer satisfaction ratings with the new branches are 98 per cent. And operator satisfaction ratings are above 80 per cent.; and
- Transformed Post Offices are seeing average increases in retail sales of 7 per cent., making branches more sustainable.

<sup>(1)</sup> Transformed include: Main, Local, and Crowns. Contractually committed include: Main and Local Pipeline; and Other Committed to NT. Together these are >75 per cent. of the eligible branches (i.e. total Network less Community and Outreach)

### DEVELOPMENT OF SUBPOSTMASTER COSTS



### CURRENT NETWORK PROFILE



Note: Traditional Branches have not engaged with NT or are in the early stages of doing so. POL is taking action in 2015/16 with these branches



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## 4 HORIZON SYSTEM AND MEDIATION SCHEME

Following complaints from a small number of (mostly former) subpostmasters about the Horizon IT system, in 2012 the Post Office commissioned an independent firm, Second Sight, to examine the system for systemic flaws that could cause accounting discrepancies.

Second Sight's interim report, published in July 2013, and final report, published in April 2015, both make clear that **there is no evidence of system-wide problems with Horizon**.

The interim report raised some questions about the training and support offered to some subpostmasters, and Post Office implemented a series of measures to improve its processes and also created a mediation scheme to consider individual subpostmasters' cases.

A working group was created to set up the mediation scheme, consisting of POL, Second Sight and the Justice for Subpostmasters Alliance ("JFSA") and with an independent Chair: Sir Anthony Hooper, a former Court of Appeal judge.

Each case in the scheme was subject to a re-investigation by POL and independent review by Second Sight, after which the case could proceed to mediation overseen by an independent mediator. Mediation is voluntary and requires the consent of both parties. It is **not** a compensation scheme, although an outcome of mediation could be for POL to offer some compensation.

Individuals who had criminal convictions (usually for theft or false accounting) were eligible for the scheme, but on the basis that mediation cannot overturn a Court judgment. POL consider whether to mediate these applications on a case-by-case basis. Any individual who feels their conviction is unsafe can pursue legal avenues, regardless of whether they enter into mediation.

POL hopes to complete mediation on all remaining cases by the end of 2015. However JFSA are attempting to delay any future mediations and are campaigning for a new independent scheme.

POL's Horizon System and Mediation Scheme has received some coverage in printed and broadcast media, mostly driven by the JFSA. In particular it has featured on the BBC's "The One Show" and regional airings of "Inside Out".

An episode of Panorama on this topic is due to be broadcast on 29 June. This will mainly be a matter for POL but officials have been working closely with POL, Ministers and SPADs to make sure any risks related to this are managed appropriately..

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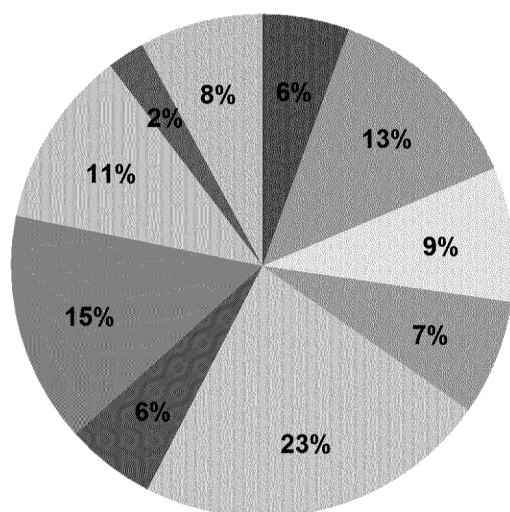


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## 5 POL REVENUE SPLIT

### MAILS AND RETAIL REVENUE (£M)

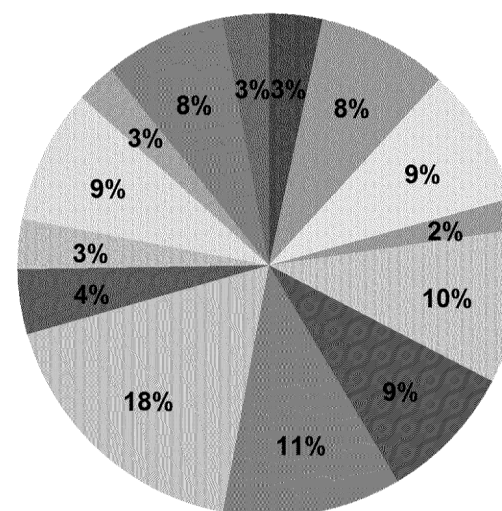
TOTAL 2014/15 REVENUE: £383.5M



- PARCELFORCE
- INT'L PRIORITY & STANDARD
- LABELS (1ST & 2ND CLASS)
- RM MAIL FIXED
- HOME SHOPPING RETURNS
- SPECIAL DELIVERY
- STAMPS (1ST & 2ND CLASS)
- RM SIGNED FOR
- RETAIL & LOTTERY
- MAILS OTHER

### FINANCIAL SERVICES REVENUE (£M)

TOTAL 2014/15 REVENUE: £289.3M



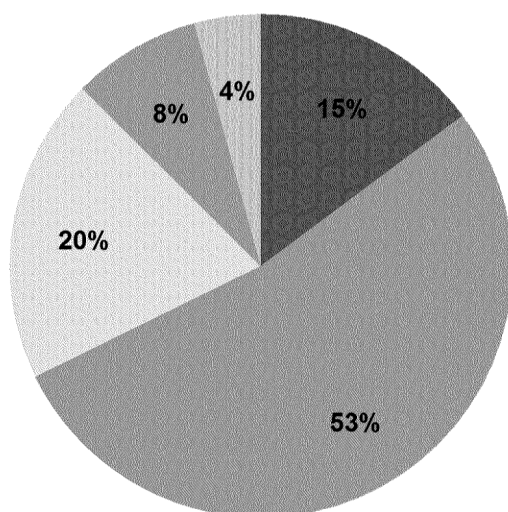
- BILL PAYMENT SERVICES DIRECT
- POSTAL ORDERS
- PERSONAL BANKING CLIENTS
- BUSINESS BANKING
- PFS-SAVINGS
- PFS-LENDING
- TRAVEL INSURANCE
- NS&I
- BILL PAYMENT SERVICES RESELLER
- PAYMENT SERVICES
- DWP EXCEPTIONS
- ATM
- PFS-INSURANCE
- BUREAU
- MONEYGRAM
- OTHER

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## 5 POL REVENUE SPLIT (CONT'D)

### GOVERNMENT SERVICES REVENUE (£M)

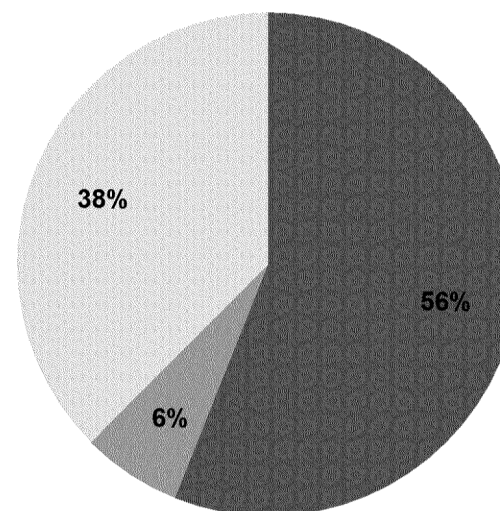
TOTAL 2014/15 REVENUE: £113.0M



- MOTERING SERVICES
- CARD ACCOUNT
- CHECK AND SEND
- AEI (DVLA & UKBA)
- OTHER

### TELEPHONY AND OTHER REVENUE (£M)

TOTAL 2014/15 REVENUE: £84.2M



- TELEPHONY
- SUPPLY CHAIN
- OTHER