

OFFICIAL COMMERCIAL SENSITIVE

23 November 2022

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Post Office Limited (POL): Quarterly update

Issue

1. This quarterly update on POL highlights good progress in litigation and governance matters. However, POL is facing an increasingly challenging financial environment driven by responding to the Inquiry, a difficult market position, and the new IT system roll out. This is leading to a significant deterioration in its financial position beyond FY22/23.

Recommendation

2. For noting.

Background

3. As the sole shareholder in POL, BEIS supported by UKG held the latest Quarterly Shareholder Meeting on 31 October focused on current issues and next steps.

Considerations

4. POL should deliver against the FY22/23 budget (it is currently £16m ahead of budgeted year to date Trading Profit), but the outlook is challenging. POL is facing a number of significant risks:
 - **Financial position.** POL's forecast financial position has significantly deteriorated since the Spending Review. This is mainly driven by a decline in the Mails business, increased IT, Inquiry and Historical Matters costs as well as wider macro and inflationary pressures. The company is revising its 3 Year Strategic Plan and assessing potential options (and their associated risks) to address a likely funding gap in its plan. POL has indicated it will require additional funding to help address any gap / finance longer-term cost reductions but the quantum and purpose of funding is to be confirmed. Preliminary engagement has begun with HMT ahead of any additional funding request. UKGI will scrutinise and challenge the revised 3 Year Plan once finalised.
 - **Governance.** Henry Staunton starts as the new POL Chair on 1 December. You will shortly receive a letter to send to Henry setting out the shareholder priorities for the rest of FY22/23. Executive succession planning remains a key risk. Recruitment for three NEDs to replace those leaving was approved by Minister Hunt in early September. POL is planning to complete interviews by mid-December and have a recommendation for SoS approval shortly afterwards.
 - **Culture.** POL has a plan to complete its response to the Fraser findings and embed the improvements. A number of potentially significant gaps remain as outlined in Tim Parker's letter to the Perm Sec dated 1 September. At management levels, the current combination of pressures from the Inquiry and financial difficulties is placing substantial demand on the team to deliver.

OFFICIAL COMMERCIAL SENSITIVE

- **Remuneration.** Levels of pay and aligning them to incentive mechanisms continues to be a contentious issue. The POL Chair sent a letter to SoS asking to nearly double the CEO's pay (at stretch performance). We also need to resolve the issue of the retrospective approval of the £30k increase in the CEO's bonus.
 - **Horizon replacement** POL has extended the Horizon contract by a year to March 2025 to help mitigate delivery risks. The POL Board is challenging the programme on significant (c.30%) potential cost growth caused by high inflation and Inquiry challenges. POL will revise its business case accordingly and take to BEIS PIC in the New Year after a government gateway review in January.
5. Litigation remains a key challenge, but good progress has been made:
- **Historical Shortfall Scheme (HSS)** As of 11 November, 90% of eligible applicants have received an offer (£76m offered; £40m paid). POL aims to issue 96% of offers by 8 December (the date of the next compensation hearings at the Horizon Inquiry). The remaining 4% of cases are the most complex, and many rely on third parties or further information from claimants before an offer can be issued. Therefore, these are unlikely to be resolved until early next year. In addition, following the announcement of government funding for late applications, POL has written to 227 late applicants to begin processing their cases. POL will report separately on these, with a target of 50 offers issued by March 2023, albeit this has been revised down from initial estimates due to the delay in the receipt of fully completed application forms. We will keep you sighted on progress.
 - **Overtaken Historical Convictions (OHC).** As of 10 November, 83 convictions have been overturned. Most of these have received an interim payment of £100k. In total, claimants have received c.£10m to date (incl. interim payments). An Early Neutral Evaluation (ENE) process took place over the summer for 10 claimants; this set a framework for non-pecuniary damages and has sped up progress with claims, offers and payments. We are now transitioning delegated authority to POL for the majority of non-pecuniary claims, whilst keeping oversight of exceptional cases. We are working with POL to move away from a negotiation model to a remediation model with an independent review function. This should increase compensation speed once it is up and running. The POL Board will decide on the proposed delivery model on 5 December. We will provide advice to Ministers in advance.
 - **Group Litigation Order (GLO).** A business case for the GLO compensation scheme went to PIC on 22 November. We hope to get Treasury clearance in time to announce it before the 8 December Williams hearing on compensation. The recent gateway review scored the project as "amber-red", largely on grounds of under-resourcing and the consequences for PPM. We plan to recruit five additional posts. The Project Assistance Team is providing us with help to upgrade our PPM. Our relationships with stakeholders are excellent, but they are rightly worried about the timescale for this project: our legal powers to pay compensation run out in August 2024.
 - **Postmaster Detriment.** In early December, POL is set to announce and start the new compensation scheme for the first Detriment area (Suspension Pay), following HMT approval in late October. BEIS is developing a submission and business case to address a further tranche of the remaining known areas of potential detriment (c.£16m).
 - **Inquiry and legal costs.** POL's Historical Matters Unit legal costs continue to put financial pressure on the business despite efforts by officials to increase POL's cost control and forecasting framework throughout 2022. POL has spent c.£80m with Herbert Smith Freehills (HSF) alone to date to deliver a number of ongoing high-profile

OFFICIAL COMMERCIAL SENSITIVE

programmes (Inquiry, OHC, HSS). The POL CFO has set another £35m cost challenge for the unit. Officials remain concerned about the efficiency and effectiveness of POL's spending on legal costs.

Presentation and handling

6. No presentation or handling requirements.

Annex

Annex A: Financial performance FY22/23 - Year to Date until Period 6: EndSeptember

	Period 6							YTD				
	Actual	Budget	Variance	Forecast	Variance	YoY	YoY %	Actual	Budget	Variance	YoY	YoY %
Mails	22.0	24.3	(2.3)	21.9	0.1	(3.5)	(14%)	152.4	160.1	(7.6)	(18.3)	(11%)
PUDO	0.1	0.4	(0.2)	0.2	(0.1)	0.1	n/a	0.7	1.5	(0.7)	0.7	n/a
Retail/Lottery & Gift Cards	2.2	2.2	0.1	2.1	0.1	(0.3)	(11%)	14.6	14.2	0.4	(1.8)	(11%)
Government Services	2.1	1.9	0.2	1.9	0.2	0.3	17%	12.5	12.3	0.2	2.6	26%
Banking Services	17.3	17.1	0.3	17.3	0.1	1.5	9%	117.2	115.1	2.1	12.0	11%
ATMs	2.0	2.3	(0.3)	2.1	(0.1)	1.2	137%	13.3	14.2	(0.9)	7.6	134%
Transactional Financial Services	5.6	4.9	0.7	5.5	0.2	0.9	18%	36.5	31.8	4.7	7.5	26%
Payment Services & Payzone	2.5	1.9	0.6	2.2	0.3	0.4	18%	15.5	12.6	2.8	1.9	14%
POCA	0.3	0.1	0.2	0.3	0.0	(0.4)	(59%)	3.2	1.8	1.4	(2.0)	(39%)
Mortgages, Savings & Loans	1.3	1.3	0.0	1.3	0.0	0.0	0%	7.5	7.5	0.0	(0.7)	(8%)
Credit Cards	0.2	0.2	0.0	0.2	(0.0)	(0.0)	(4%)	1.9	1.3	0.6	(0.7)	(28%)
PO Insurance	3.7	3.9	(0.2)	4.4	(0.6)	0.4	13%	29.1	25.7	3.3	13.7	89%
Identity Services	0.5	0.5	0.1	0.4	0.1	(0.4)	(45%)	3.3	3.2	0.1	(2.6)	(44%)
Supply Chain/Other	1.0	1.2	(0.2)	1.0	0.0	0.1	8%	6.4	7.1	(0.7)	0.3	5%
Total Revenue	61.0	62.0	(1.0)	60.7	0.3	0.2	0%	414.0	408.5	5.5	20.1	5%
Cost of Sales	(3.5)	(3.6)	0.1	(3.8)	0.3	0.3	(8%)	(22.5)	(21.3)	(1.2)	(0.3)	1%
Postmasters Rem Variable Costs	(25.4)	(26.1)	0.7	(25.7)	0.3	(0.1)	0%	(167.4)	(167.1)	(0.3)	(5.6)	3%
Postmasters Rem Fixed and Other Costs	(4.7)	(4.8)	0.2	(4.9)	0.2	(0.4)	9%	(34.8)	(29.1)	(5.7)	(6.6)	24%
FRES	3.8	1.0	2.8	2.4	1.4	2.9	318%	20.4	6.2	14.3	21.0	3,390%
POCA Income	0.0	0.0	0.0	0.0	0.0	(0.1)	(100%)	0.7	0.4	0.3	0.4	126%
Gross Margin	31.2	28.5	2.7	28.7	2.5	2.9	10%	210.3	197.5	12.8	29.0	16%
Staff Costs	(14.5)	(15.0)	0.6	(15.7)	1.3	(1.3)	10%	(86.5)	(87.3)	0.8	(5.8)	7%
Non Staff Costs	(16.8)	(18.4)	1.5	(18.8)	1.9	(1.2)	8%	(107.4)	(111.6)	4.3	(16.9)	19%
Total Overheads	(31.3)	(33.4)	2.1	(34.5)	3.2	(2.5)	9%	(193.9)	(199.0)	5.1	(22.7)	13%
Trading Profit	(0.1)	(4.9)	4.8	(5.8)	5.7	0.4	83%	16.5	(1.4)	17.9	6.3	62%

Latest outlook

The 2022/23 budget forecast total revenues of £869m and a trading profit of £35m, compared to actual revenues of £834m and trading profit of £39.5m generated in 2021/22. At the half year point (P6) trading profit is substantially ahead of budget (£16.5m profit v £1.4m budgeted loss). Outperformance driven by FRES and Insurance in particular. However, both are strongly linked to travel and therefore consumer spending– POL is already seeing reversion to lower levels and anticipate continuation of this trend with whole year outlook still towards a £35m trading profit. Mails underperformance is a continued known but problematic trend

Annex B: Network access criteria and branch numbers as at end October 2022

Performance Against Access Criteria at the end of October 2022

Criteria	Number of branches	Total Population within 3 miles	Total Population within 1 mile	Deprived Urban Population within 1 mile	Urban Population within 1 mile	Rural Population within 3 miles	Postcode Districts less than 95% Population within 6 miles
Target	11,500	99%	90%	99%	95%	95%	0
Oct	11,684	99.6%	92.6%	99.3%	97.8%	98.1%	0

OFFICIAL COMMERCIAL SENSITIVE

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Branch numbers at the end of October 2022

Type	Mains	Local	DMB	Traditional	Outreach	Total
Number	3,339	4,252	117	1,938	1,938	11,684