

RESTRICTED – COMMERCIAL AND MANAGEMENT

Not to be circulated outside the investment review committee
Post Office Ltd Annual Review – 29 November 2011

ATTENDEES

Anthony Odgers
Tim Martin
Craig Lester
Nathan Phillips
Will Gibson
Adrian Martin (Minutes)

Susannah Storey
Mike Whitehead
Jane Hoy
Peter Batten
Katie Wake

ISSUES DISCUSSED

- Developing the network. The POL team noted the importance of the network improvement plan to the entire POL strategy. In particular, the team highlighted improvements to services (Mail, Government and Financial services) including, for mail, key changes to the current customer experience: (i) reducing of queue times; (ii) extension of opening hours; and (iii) improving the in-branch experience of customers. These will all be key to supporting an improved packets offering in the context of declining traditional mail.

Changes to the current cost model were also discussed. A main aspect of the costs reduction drivers relates to new agent contacts, which will remove fixed pay for agents and replace it with variable agency pay linked directly to the level of business experienced by those agents.

It was discussed whether in the long term a “**bidding**” process / **positive franchise fee** could be considered for agents whose branch is located in a high business area in order to capture (carefully) the currently untapped value of POL franchises (noting that current policy does not allow for this).

Additionally, the panel questioned why pay costs were projected to increase in spite of moving to a variable model. It was noted that a political decision had been made recognising this potential value leakage. However, there was also a more complicated cost message than headline numbers suggested (see actions).

- Developing pipeline of new products. POL has identified opportunities to develop new propositions. In particular, management are targeting opportunities for Government entailing a face-to-face transaction, either for those who cannot access services online or where a face-to-face element is still required (e.g. capturing a digital photos). These opportunities include; (i) UK Border Agency; (ii) DVLA; and (iii) the IPS. Other, less clear, opportunities have also been flagged, including; (i) ID Services working with the Cabinet Office; and (ii) support of universal

RESTRICTED – COMMERCIAL AND MANAGEMENT

credit with DWP. The support of universal credit is seen as a major new proposition as it could offer future, significant revenue growth. However, the universal credit plans have not been clearly defined by DWP. POL is also exploring expanding financial services revenues, a key part of which will be renegotiating the existing joint venture contract with the Bank of Ireland.

It was highlighted that POL may currently have an 'attitude of expectation' with regards to new work / development of new products. POL will have to learn how to market its services in order to remain competitive and look into possibly partnering with innovative private sector companies. The panel noted that the case study of FSS highlights how incumbent government businesses do not always make the required transition.

- Further information on Post Office Ltd financial information. The panel raised a number of questions on the POL financials, specifically on the underlying profitability of the model and how this evolves going forward. A number of additional items/revisions were requested - see action points below.
- Separation of Post Office Ltd and Royal Mail is underway and currently approaching finalisation of commercial terms. A chair's letter is currently being drafted.
- Mutualisation. The team outlined current thinking on POL becoming mutual over time (no direct Government stake and self funding from its own commercial activities). The panel noted challenges in achieving financial stability and delivering the current business strategy to support this. There was recognition of the balance of incentives against any negative effects (such as the alienation of the current management). These would need to be taken into account when considering the mutualisation.
- ShEx resourcing was discussed, noting that the team will look to add a G6 from a financial background

ACTIONS

- The Post Office Ltd team to consider the following areas:
 - "bidding" process / franchise fee should be considered for agents whose branch is located in a high business area.
 - Case study of Forensic Science Service, which demonstrates that private firms can provide competition to Government-owned companies.
- The Post Office Ltd team to update the review materials for the following:
 - Further Revenue information (p.14-15);
 - * Split contribution and cost between Agent and Crown (sub-postmaster pay and contribution).

RESTRICTED – COMMERCIAL AND MANAGEMENT

- * Revenue / Operating profit figure excluding all Government funding and subsidy;
 - Further information on costs and agency pay (p.15);
 - * Provide allocation / granularity of costs over time against planned performance.
 - * Delivery and geographical issues related to variable agency pay,
 - * Detail and explain why agency pay has increased overall as a % of revenue (P.15);
 - Further detail on negative EBIT (pre-exceptionals) for Financial Services and Government Services in 2011A figures (P.14):
 - * Provide details on projected future figures;
 - Show contribution margin for each business pillar (Mail, Financial, and Government services) as a proportion of revenue (P.14);
 - Operating performance: cash flow (P.16):
 - * Match the trade actuals to the statutory accounts (i.e. explain the accounting policies used by POL),
 - * Further details on components of capital expenditure (e.g. funding for modernisation), reserves, provisions and exceptionals – and how this links to P&L projections;
 - Detail of Borrowings (P.22):
 - * Show Net Debt against forecast Net Debt (annual basis),
 - * Link the Net Debt position to mutualisation and how the future, potential mutual would be funded;
- Provide details on the management incentive plan when it becomes available to HMG after separation from Royal Mail, linking “golden thread” of key drivers, incentives and remuneration / bonuses of management.