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Royal Mail Holdings plc

Report and Accounts Year Ended 25 March 2007



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Royal Mail Holdings plc

Royal Mail Group is unique in reaching everyone in the UK through its mails, Post Office® and parcels businesses – which directly employ nearly 185,000 people in the UK.

Every working day Royal Mail processes and delivers almost 83 million items to 27 million addresses for prices that are amongst the lowest in Europe; each week we serve over 24 million customers through our network of 14,219 Post Office® branches and each year our domestic and European parcels businesses – General Logistics Systems and Parcelforce Worldwide – handle some 360 million parcels.

Royal Mail Holdings plc

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Royal Mail Holdings plc

Chairman and Chief Executive's Statement

The Group delivered record quality of service to our customers in 2006-07 and secured a vital commercial funding package for the modernisation of the Company while profits fell as a result of a significant increase in pension costs. Looking to the future, if we are to continue on our journey to become the world's best and most trusted postal service we must now take action to meet the challenges of securing a viable pension scheme for our people, dealing with the impact of both substantially increased competition and falling mail volumes, and building a long term sustainable Post Office® network. Modernising our letters business remains central to our strategy as we are competing in an open competitive market where, despite all the improvements we have made, we are still 40% less efficient than our rivals – because they have already invested in the technology that provides more efficient operations.

For Royal Mail this has been a critical period during which we have worked to create the platform from which we can achieve success in the competitive market and secure a strong future for the business. The building blocks we have now put in place include:

- Around £4bn funding package from the Government to enable us to modernise the business
- Agreement with the unions on the flexibility and changes in working practices that are vital if we are to modernise successfully, and
- Support for the pension reform needed to allow us to become competitive and protect a Defined Benefit pension scheme for our existing employees

The Group's achievements so far

Remarkable progress has been made since we embarked on our transformation in 2002. Five years ago the Group was losing well over £1m every day, failing its quality of service targets and facing a downward cycle of decline unless it cut costs and renewed its focus on customers. It was in no position to compete in a market that was moving towards full competition in January 2006.

Today, it's clear that we have come a long way. As the table below illustrates we have achieved significant cost savings with the Company employing 45 000 fewer people. At the same time customers have received the best letters quality of service performance against target on record, with targets achieved for both First and Second Class stamped mail as well as for business mail. Operating profit in 2006-07 was in line with expectations at £233m, although this was down on the previous year as a result of increased pension costs.

	Employees at financial year end	First Class stamped and meter mail Quality of Service	Operating profit/(loss)* £m
2001-02	229,400	91.6%	(318)
2002-03	212,800	91.7%	(197)
2003-04	202,300	90.1%	220
2004-05	196,400	91.4%	537
2005-06	193,000	94.1%	355**
2006-07	184,800	94.0%	233

* Accounting basis changed from UK GAAP to IFRS from 2005-06 onwards. Prior to this reported results shown as "(loss)/profit from operations", which excluded benefits/charges relating to pension funding surpluses/deficits.

** Equivalent to profit from operations of £609m consistent with UK GAAP accounting policies as applied in 2004-05.

In addition, Parcelforce Worldwide has made an operating profit for the second year running after more than 15 consecutive years of losses. Meanwhile the Group's European parcels business, General Logistics Systems (GLS), has continued to build on its reputation as a leading player in the European market place and has increased its revenues and profits. A series of operational changes have been embedded in Royal Mail Letters including the move to a single daily delivery nearly two decades after it was first mooted. In the Post Office® network new products and services have been launched to help replace lost revenue from traditional Government business.

Funding

Finalising with our Shareholder, the Government, the details of nearly £4 billion of investment for the Group was a major task over the last 18 months. Crucially this has at last put in place the financing to carry out the modernisation that's essential for us to compete effectively against intensifying competition – not just from rival mail companies but also from other forms of communication including broadband internet. In addition, the Government has allowed us to allocate 20% of the value generated through the efforts of everyone in the business over the next few years in the form of ColleagueShares. The ColleagueShare scheme, which is worth up to £5,300 for each of our people over five years depending on performance, is a recognition of the critical role they will play in the modernisation of the Group and in achieving the stretching targets we have set ourselves. The table below summarises the funding package.

Debt facility on commercial terms to modernise Royal Mail Letters operations	£1.2 billion
Restructuring and supporting the Post Office® network	£1.7 billion
Security for the pension fund trustees	£1.0 billion

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Chairman and Chief Executive's Statement (continued)

2006-07 Financial Performance

Our financial performance in 2006-07 was adversely impacted by a number of factors including rising competitor activity, falling mail volumes, mail customers trading down to lower-priced services and the continuing losses in the Post Office® network. However, the single largest negative impact has been the rise in pension fund costs, which continue to represent a long-term risk for the Group. The table below summarises financial performance in 2006-07.

Business unit performance	External revenue		Operating profit/(loss)	
	2007 £m	2006 £m	2007 £m	2006 £m
Royal Mail Letters	6,857	6 859	194	344
General Logistics Systems	1,082	1 037	115	100
Parcelforce Worldwide	337	314	10	5
Post Office Limited	868	838	(99)	(111)
Other businesses	35	8	13	17
Group	9,179	9,056	233	355

Looking in more detail at the Group's performance in 2006-07

- Group external revenue rose 1.4% to £9.2 billion, boosted by strong performances by Parcelforce Worldwide and GLS, which together contributed just over half of the revenue increase.
- Group operating profit fell by a third to £233m. However, operating profit included the benefit for the first time of £75m from the Government's Social Network Payment to support loss-making Post Office® branches – from the half-year point onwards this payment is treated as revenue. Underlying profit in 2006-07 was £158m – less than half the previous year's £355m profit on a like-for-like basis.
- Inland addressed mail volumes fell by 2.3% – the first decline after many years of growth. The growth in email undoubtedly played a key factor in the fall and the realistic prospect facing the Company is for further volume decline. The peak in mail volumes looks likely to be behind us.
- Post Office Limited continued to grow revenues from new products and services but further declines in its traditional Government business, leading to lower customer footfall and sales, meant its underlying revenues – excluding the benefit of the £75m Social Network Payment – last year fell by £45m. Its underlying loss on the same basis increased by 57% to £174m.
- Parcelforce Worldwide grew its revenue by 7.3% in a market that became even tougher, and delivered a record operating profit of £10m; and
- GLS grew its revenues by 4.9% in a very competitive market and its operating profit increased to £115m. The results of both GLS and Parcelforce Worldwide demonstrate the Group's potential in areas where it is allowed to compete freely without regulatory constraint.

The challenges facing the Group have been underlined in the first part of the new financial year (2007-08) which shows a distinct deterioration in Royal Mail Letters revenue.

The challenge of rising pension fund costs

The cost of servicing the Company's pension plans rose steeply in 2006-07 by £193m to £722m and accounted for the bulk of the drop in the Group's profit. In addition, the Group faces making cash payments to the pension fund of around £800m annually for 17 years to cover both ongoing contributions and the funding of the deficit. At the year-end the deficit stood at £5.0 billion in accounting terms. Against this backdrop it is clear that if the Group is to be successful as a business in the future it must tackle its long-term pension fund obligations.

That's why we have recently outlined a series of proposals on which we are shortly to consult our people and other stakeholders – and which now have the support of the unions as part of our agreements on pay, modernisation and pension reform. Our number one priority is to protect our existing people's pensions in a way that is affordable to the Company and which does not expose our people or the business to unacceptable risk going forward. The outline of the proposals is:

- No increase in employee contributions
- Keeping a defined benefit scheme for existing employees
- An increase in the normal retirement age from 60 to 65 with effect from 1 April 2010. Employees could still retire at 60 if they chose but any pension earned from April 2010 would be reduced if taken before the age of 65.
- Pension benefit earned from 1 April 2008 would be calculated on a Career Average Revalued Earnings basis, an approach that has emerged from our discussions with the unions over recent months.
- Pension benefits earned to 1 April 2008 would remain in place with the rate at which they grew in future continuing to be linked to final salaries, and
- Closing the current defined benefit plan to new members on 31 January 2008 with a defined contribution scheme to replace it.

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Chairman and Chief Executive's Statement (continued)

We anticipate that the Company's current level of contributions to the pension plan – equivalent to 30% of the pensionable pay bill – will reduce to 22% in five years time still well ahead of the average UK contribution

The challenge of increased competition and a declining market

It is clear that competition has developed much more quickly than anyone forecast. When the tough control on our prices was fixed Postcomm forecast that rivals in 2006-07 would be handling around 1.9 billion letters under access arrangements to Royal Mail Letters delivery network. In fact the competition picked up 2.4 billion letters in 2006-07 – one in every eight posted – and we expect from current volumes that rivals will this year be handling around 4 billion letters, around one letter in every five posted. This was a level Postcomm had forecast would not be reached until 2010. At the same time the average 13p revenue Royal Mail Letters receives for delivering access mail does not cover our costs and this has generated a loss of £44m in 2006-07 heavily driven by the growth in competition through access to our delivery network.

The 2.3% overall decline in the UK inland addressed mail market this year mirrors emerging trends in many other European countries. The expectation in Europe and elsewhere is for a continuing decline of 2-3% a year. The fall in the market is at odds with the prediction for a 1-2% annual rise in volumes on which the control on Royal Mail Letters prices was set.

It is not surprising therefore given that mail volumes have in fact fallen under a pricing regime that anticipated volume increases that for the first time, Royal Mail Letters made a loss – of £12m – in the sector which is price controlled. This area, comprising revenues of just under £6 billion is by far the biggest part of the mails business and the loss contrasts with a profit of £197m the previous year. The pressures on the business were further underlined by the thin profit of just £27m we made in 2006-07 delivering the one-price-goes-anywhere Universal Service. This is despite Royal Mail Letters achieving a 3% year on year efficiency gain.

In summary the reality we face is

- The mail market in the UK is declining by around 2.5% per year
- Royal Mail is losing 40% of bulk business mail to rival postal operators
- Overall this year rivals will handle one in five of all letters posted in the UK
- Our rivals are 40% more efficient not because their people work harder but because they have already modernised – as we must now do – and have much more technology and
- Our rivals pay their people 25% less than we do at Royal Mail

The challenge of building a sustainable Post Office® network

The loss on operations in 2006-07 was £99m. This result included, for the first time, six months worth of the Government's £150m annual Social Network Payment to support the costs of loss-making branches. Without this sum the underlying loss was £174m – £63m higher than the previous year.

Even with this added Government revenue which Post Office Limited has warmly welcomed, losses at the current level are clearly unsustainable and the business has embarked on a wide-ranging plan to create a strong and viable network in the long-term with the £1.7 billion financing provided by the Government.

A key priority is to address the Crown network, where £70m was lost in 2006-07. Following a successful trial in 2006-07 involving a retail partnership under which six Crown branches were transferred to WH Smith branches, agreement was reached in April 2007 to the transfer of a further 70 branches to the retailer. However, this is just one step of many that have to be taken across the whole of the network. Another key challenge in the current year is to implement the closure programme agreed with Government, with our role being to ensure the most accessible network possible within the stringent criteria laid down by the Government. We will do our utmost to ensure that as many people as possible are as close as possible to a Post Office® branch.

Underlying revenues fell last year by £45m. This reflected the continuing effects of payments of benefits directly into bank accounts, a decline in the number of car tax licences issued in branches as motorists stepped up their use of the DVLA web site, the replacement of the E111 forms with the issue of the European Health Insurance Card and the loss of the BBC Licence contract. However, the revenue loss was partly offset by increased income from new products and services. Post Office Limited now covers 1 in 50 of all cars insured in the UK, while strong revenue growth for HomePhone, the Post Office®'s telephony business brought in new income. The Instant Saver accounts also performed well with a keenly competitive high interest rate that attracted almost £2 billion of deposits in the year. The Post Office® has now won more than one million financial services customers making it the fastest growing financial services provider in a highly competitive market.

Our current trading and outcome of industrial action

The current year has seen a sharp fall in revenues in the letters business with income in the first five months of 2007-08 to the end of August down £78m on the same period in the previous year. The revenue fall came despite a rise in postage prices in April 2007. Overall revenue across the Group fell £39m excluding the impact of the Government's Social Network Payment to support loss-making Post Office® branches.

The emerging picture is that the combination of pension costs, revenue decline through losses to competition and the overall fall in mail volumes means that Royal Mail's letters business is heading towards breakeven in the current financial year. Combined with the continued losses we will see in the Post Office® network and expected profits from Parcelforce Worldwide and GLS, this means that the Group as a whole is expected to be near breakeven in the current financial year or return a small profit. Without the contribution from GLS, the Group could again become loss-making.

Royal Mail Holdings plc

Chairman and Chief Executive's Statement (continued)

The immediate outlook is difficult. The UK postal market has changed for ever under competition and Royal Mail Letters stark choice is to modernise or face stagnation and decline. We continue to make progress with much-needed changes to our operations but we must move faster and further and we know the importance of bringing our people with us as we transform the Company.

This therefore has been a critical period in the history of Royal Mail. On top of securing the £4 billion package from our Shareholder to fund our modernisation a major milestone in the history of Royal Mail was achieved in October this year when the Company reached agreement with the Communication Workers Union on pay modernisation and pension reform. The agreement gives us the flexibility we need to transform our operations so that we can compete effectively against rivals who have already modernised and so have lower costs and prices. Some key points in the agreement include:

- Full cooperation and support on the deployment of new technology
- Ensuring all our peoples paid work hours are utilised
- Covering for one another within a unit - and within paid hours - to help absorb colleagues absence or an increase in workload
- Rebalancing the normal working pattern to reflect the traffic profile (such as higher or lower levels of mail on certain days of the week) and
- The agreement with the CWU also secures their support for the Company's overall proposed pension reform as outlined earlier

Once again we would like to apologise to our customers for the problems they have experienced in recent months because of the industrial action and assure them that we will all be working hard together to restore the great quality of service they have come to expect.

The only option is to modernise

To meet the challenge of improving our efficiency and productivity the only option for Royal Mail Letters is to modernise. There is no way to avoid this challenge. There has been under-investment for decades and we now have a unique opportunity to use the £1.2 billion available at commercial interest rates from our Shareholder to replace obsolete equipment, accelerate the pace of new technology and provide our postmen and women with the tools to work efficiently.

The agreement from our Shareholder for a ColleagueShare scheme will play a significant role in ensuring our people are rewarded for their efforts as we transform the business. The first batch of ColleagueShares has just been issued and the twice-yearly updates on their value will be important indicators of the progress we are all making as well as demonstrating to our people the tangible effect of their efforts to modernise the Company.

Much has already been achieved to transform our business but with the increasing pace of competition and the decline in mail volumes we are all too aware of the scale of the challenges ahead. We are therefore at a unique moment in the development of the Company. With our financing in place an incentive plan for our people launched, consultations underway on significant changes to our pension plan and a ground breaking agreement reached with the CWU to modernise our business we can remain fully confident that the Company will reach its goal of becoming demonstrably the world's best and most trusted postal service.

GRO

Allan Leighton

Chairman

26 October 2007

GRO

Adam Crozier

Chief Executive

26 October 2007

All references to operating profit are before exceptional items

Royal Mail Holdings plc

Annual Review 2006-07

This was the year the UK postal industry changed forever. The first full year of competition in the UK mail market saw major rival companies fighting to take business from Royal Mail. But our focus did not change – doing our best to serve our customers even more effectively and efficiently. Independently measured quality of service figures show world-class quality of service in 2006-07 with prices among the very lowest in Europe. At the same time investment for the future was agreed with the Government.

Our people – their year

We're continuing to engage with our people and listening to what they've got to say as part of our continuing commitment to make Royal Mail a great place to work. With the investment case now agreed there's a clear incentive to ensure we're in shape to provide an even better and more efficient service. Weekly Worktime Listening and Learning sessions remain an important way to do this.

Our programme to tackle absenteeism across the business made further progress with support for people who are off sick and rewards for those people who do not take any unplanned sick leave.

Over the 2006-07 financial year, absence rates continued to fall below 5%. Royal Mail's incentive-based approach and improvements in procedures to help people get back to work contributed to this performance. This was a key factor in Royal Mail being able to offer a consistently high quality of service to its customers while also cutting costs.

The winners in the last prize draw those who took no sick leave over the full year, qualified for £2,000 worth of holiday vouchers and 5 extra days off. Additionally the programme has also improved support for people who are on sick leave and ensures they receive prompt treatment and ongoing contact.

The number of accidents resulting in people having to take 3 days or more off work continued to decrease – for the fifth year running. Tailored training and enhanced safety management helped achieve this.

And there was further innovation in ways for our people to seek confidential advice and different forms of support. A new confidential and legal advice line called HELP (Health and emotional well-being, Employment advice, Legal services and Practical assistance) was launched. An average of 1,700 calls were made each month on issues ranging from childcare advice to how best to manage stress.

We also recognise our people for the support they give to people and their communities. Customers can nominate postmen and postwomen for the 1st Class People Awards. Nominees include champion charity fundraisers, community activists and lifesavers.

This year's overall winner was Grimsby postman Norman Walker, who helped save a man badly injured in a car crash. He's one of 4,500 people at Royal Mail who are trained first-aiders. Amongst the nominations were 28 examples of people saved by postmen and women – the emergency services said 19 of these people would not be alive today had it not been for someone from Royal Mail going to their aid.

And it's not just in the UK where our people are helping. In Afghanistan, eight Royal Mail employees who are members of the Territorial Army's 88 Postal and Courier Management Royal Logistics Corps joined the 22-strong team from the British Forces Post Office providing delivery, collection, sorting and counter service to 6,000 servicemen and women.

Giving to charity

The long-standing reputation of our people for their generosity and charity fund-raising has achieved another landmark this year. They have raised more than £1m for the Group's nominated charity, Help the Hospices, just two years into their partnership. The partnership, which was the result of a company-wide vote, has now been extended for a further year.

Much of this came through specially organised events, such as sponsoring the Help the Hospices team in the 2006 London marathon. 22 Royal Mail runners from across the UK, including Chief Executive Adam Crozier, completed the 26.3 miles cheered on by colleagues.

The company also donated £250,000 in matched funding after the money collected by our people surpassed this figure.

Over the last 16 years, our people have made a big impact, donating more than £30m through regular payroll giving to more than 200 charities. This earned Royal Mail a gold award from Pay Magazine in recognition of the continuing generosity of its people.

Postal innovation

The boom in internet shopping has also been an important development for Royal Mail. At Christmas, some 100 million items ordered online were delivered from e-retailers to customers. And the growth in online business has also led to more people using catalogues to make their selection. Catalogues also delivered by Royal Mail.

Royal Mail has also adapted to react to this demand. Customers can now buy online postage. By going to royalmail.com, they can pay for, download and print out their own stamps for letters and packets, a full internet postal solution. The same service is also available through the popular eBay website.

The way people pay for their mail changed in 2006-07 with the launch of Pricing in Proportion. This meant mail was classified not only by weight but by its dimensions as well in order to bring our prices more into line with the costs of handling it. Three categories were introduced in August – Letter, Large Letter and Packet. We spent £10m telling our customers about the change by sending a size-guide to every home and through a major media and advertising campaign. The change was an important step towards fairer prices so that they better reflected the true cost of handling items.

Royal Mail Holdings plc

Annual Review 2006-07 (continued)

Regular mystery shopper surveys have shown that the awareness campaign has been a success. We estimate that the number of letters and parcels for which postage has been underpaid is at the same level as it was before the move to Pricing in Proportion took place further supporting the findings of the survey.

Business customers were also able to take advantage of new products. The Automated Standard Tariff Large Letter offers a discount of between 6% to 9% to companies sending a minimum of 250 Large Letter-sized items that can be machine sorted. Cleanmail Advance will also make it easier for businesses sending more than 1 000 items with correct and machine-readable addresses to claim discounts.

Royal Mail took a significant step in shrinking the size of its carbon footprint by one-fifth. The business signed a three-year deal with EDF Energy to ensure that power for more than 2 000 Royal Mail buildings came from renewable sources. Other improvements included using double-deck trailers for long-haul mail journeys which are able to carry 50% more letters than regular trailers and mean fewer road journeys.

Celebrating stamps

Stamps continued to make headlines across the world and it was the collection celebrating the music of The Beatles that became like the band an international best-seller.

Canada Post offered the six stamp issue for sale across its own counters – the first time another country's postal service had done so with a Royal Mail issue. Postmen from the local St John's Wood delivery office recreated the iconic "Fab Four on the zebra crossing" from Abbey Road for a photo opportunity for the world's media. Sgt Pepper's Lonely Hearts Club Band and Let It Be also featured in the collection of album covers.

A set featuring football teams 'who had won the World Cup was also issued in June as the 2006 championship was beginning in Germany. Stamps dedicated to marine life and Great British inventions were also released.

Media coverage was also focused on the stamps released to commemorate the 200th anniversary of the abolition of the slave trade. They depicted William Wilberforce, Olaudah Equiano and other notable campaigners who fought to outlaw the trade.

Post Office® looking ahead

Detailed planning is underway to secure the long-term structure of the Post Office® following the Government's announcement in May 2007 of a funding package for Post Office Limited up to March 2011. The Government's Post Office® closure programme is designed to ensure as many people as possible are as near as possible to a branch and Post Office Limited will be doing all it can to ensure the most accessible network within the criteria laid down by the Government.

The Post Office® has continued to support new ways that villagers and people living in the countryside can continue to use its services. These include mobile Post Office® outlets – in specially adapted vans – and branches in pubs, village halls, tea rooms and churches.

WHSmith is following a long established practice of retailers incorporating a Post Office® outlet into their shop floor with the relocation of 70 Crown Offices into its network of High Street stores. The expansion of the partnership comes after a successful trial relocating 6 Post Office® branches in Shrewsbury, Altrincham, Ashton Under Lyne, Hammersmith, Slough and Swansea to nearby WHSmith branches. A further 15 Crown Offices have been identified as being suitable for a franchise partner while the remaining 373 Crown Offices will remain owned and managed by Post Office Limited.

Meanwhile, television presenter Lorraine Kelly hosted an award ceremony designed to recognise the great service, dedication and community spirit of the people who run the UK's 14 219 branches.

The overall winner of the 2006 Best Post Office® Competition in association with National Savings and Investments was Hungerford Road Post Office® in Crewe, Cheshire. Customers said the team at the branch was "the best in every way" in everything from serving customers efficiently to caring about them.

In everyday business, The Post Office® continued to strive to give its customers the best possible deal. Six new currencies, including the Namibian dollar and the Uruguayan peso, were added to the market-leading travel money portfolio to bring the total to 78. And the number of Post Office® branches in which customers could buy euros – the best-selling currency – over the counter without pre-ordering was expanded to 5,500.

Also added was a pre-paid PIN-protected Post Office® Travel Money Card. Customers can load this electronic wallet with cash to spend in restaurants and shops abroad without going into the red. Post Office® credit card holders also benefited from being able to use the card abroad without being charged commission – one of the few cards to offer this benefit.

Travel insurance was one of the fastest-selling products as the Post Office® cemented its reputation as the place to prepare for holidays and travel. This was recognised by the travel industry as the Post Office® beat 9 other companies to win Best Travel Insurance Direct Provider at the 2006 British Travel Awards.

The traditional connection of the Post Office® with savings was also reinforced with the Instant Saver Account which encouraged people to invest their savings with the Post Office®. Almost £2 billion was deposited as customers took advantage of one of the best high street rates on the market and one of the few products that swiftly adjusted its rates in line with the Bank of England's interest rate rises.

Other new products were added to its range of home and car insurance which offered people £50 cashback. One in every 50 cars in the UK is now insured with Post Office Limited – half of them using the Post Office® website. Small businesses bought specially-tailored van insurance which offered free physiotherapy for any drivers left with aches and pains after an accident.

Royal Mail Holdings plc

Annual Review 2006-07 (continued)

The Postal Order was modernised and revamped on its 125th anniversary. Customers can now ask them to be made out for any amount and printed out on the spot, instead of making up the figure the old way from 13 different printed postal order amounts and stamps to make up the odd penny. One new market that helped it reach more than £400m worth of sales was internet shopping as more customers paid for goods on online auctions using postal orders instead of electronic methods.

Parcelforce Worldwide

Parcelforce Worldwide became the first distribution company in the fiercely competitive non-regulated express parcel delivery sector to offer its customers a "carbon-neutral parcel". This offered the choice of paying 5p extra for domestic parcels and 10p for international packages to offset the carbon emissions generated by the journey of the parcel. There's been encouraging take-up reflecting concerns felt by customers about environmental issues.

Handling 49 million parcels a year to 239 countries and territories means driving is integral to the business and millions of miles are clocked up each year. Royal Mail's 1st Class People Awards 2006 saw Parcelforce Worldwide driver Steve Gilbey, who's based in Liverpool, win Driver of the Year. Steve volunteered to change his start and finish times so he could better serve a major customer. He also won the challenge of putting his technical driving skills to the test on a driving track in Oxfordshire along with 12 other finalists.

And more than 250 Parcelforce Worldwide colleagues took part in their own National Community Team Challenge Day to help local people. They gave up their own time to take part in a variety of projects ranging from refurbishing a flat for homeless people in Coventry to clearing and landscaping a public garden in Teesside.

General Logistics Systems

Royal Mail's European operation is General Logistics Systems (GLS). Set up eight years ago, the parcel delivery and logistics network covers 35 European states - the latest to become part of its integrated operation is Bulgaria after a partnership agreement was signed with Interlogistica in February 2007.

This year, the company turned over £1 082m and carried 311 million parcels. It uses 17 800 vehicles a day and employs over 12 000 people working from 31 hubs and 645 depots across Europe.

Royal Mail Holdings plc

Operating and Financial Review

Introduction

Royal Mail Holdings plc (the Company) is a public limited company wholly owned by the UK Government. It became a plc on 26 March 2001. The framework for change was the Postal Services Act 2000 that created a commercially focused company with a more strategic relationship with the Government. The Postal Services Act also established a new regulatory regime with an independent Regulator, Postcomm and a reformed consumer body, Postwatch. Royal Mail Holdings plc together with its subsidiaries, associates and joint ventures comprise 'the Group'.

The Group has over 370 years experience of providing the public with postal services - through our trusted brands we reach everyone every working day in mail, parcels and express services and through our Post Office® branches.

Our market place is, however, rapidly changing. Government revenue such as from benefit payments is being lost from Post Office Limited whilst the UK mails market has been fully liberalised since January 2006, resulting in full competition.

We continue to provide services to meet these challenges - from a range of Post Office® financial services including personal loans and a 'two-in-one' credit card to electronic 'stamps', online shopping fulfilment and mail-related data tools such as online electronic pricing news and product information to help companies improve their marketing performance.

Our continued aim is to put the customer at the heart of everything we do by

- increasing value through excellent quality of service
- our unique reach to every address in the UK,
- enhancing our trusted brands,
- becoming easier to do business with,
- expanding our profitable business and
- developing innovative products and services for our customers

Performance Highlights

In the following analysis all references to operating profit are before exceptional items.

Financial Highlights

Summary of Results £m unless stated otherwise	2007	2006
External revenue	9,179	9,056
Operating profit	233	355
<i>Return on sales (%)</i>	<i>2.5%</i>	<i>3.9%</i>
Net exceptional items	(125)	(143)
Profit before financing and taxation	108	212
Net finance income/(costs)	6	(1)
Net pensions interest	199	101
Profit before taxation	313	312
Taxation (charge)/credit	(27)	83
Profit after taxation	286	395

Key Non-Financial Highlights

Area	Key Performance Indicators	2007	2006
Customer Service	1 st Class Stamp & Meter Quality of Service	94.0%	94.1%
	No of Complaints (millions)	1.41	1.63
	Post Office Limited Customer Satisfaction Index	95%	94%
Great Place to Work	Employee Survey "Great Place to Work"	66%	64%
	RIDDOR Accidents/1000 staff	26.1	26.7
	Sick Absence	4.8%	4.9%
Good Corporate Citizen	CO ₂ Emissions/1000 items*	18.7	19.9
	Charitable Donations (£m)	1.2	1.3

*represents preceding year

Royal Mail Holdings plc

Operating and Financial Review (continued)

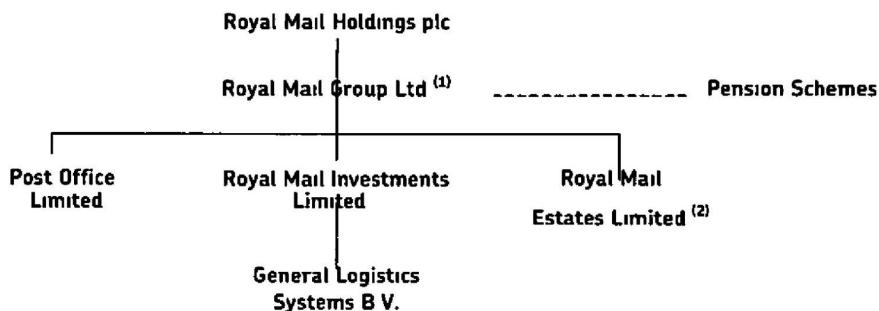
Governance

The EU Accounts Modernisation Directive (AMD) applies for all medium and large EU companies including listed companies and requires a mandatory addition to the existing Directors Report to provide an enhanced review of a company's business

The Directive states that the review should provide a balanced and comprehensive analysis of the development, performance and position of the Company's business including the principal risks and uncertainties facing the organisation. The analysis should include both financial and where appropriate non-financial key performance indicators (KPIs) relevant to the particular business including information relating to environmental and employee matters. It is recognised that to the extent that this information appears in the Operating and Financial Review (OFR) it is incorporated by reference into the Directors Report

Legal Structure

Royal Mail Holdings plc is directly owned by HM Government and is the ultimate parent company of the Group. The Group primarily operates within the United Kingdom having a number of subsidiaries, joint ventures and associates but also has presence in most European countries mainly through General Logistics Systems B.V. Its basic legal structure is as follows



⁽¹⁾ On 20 March 2007 Royal Mail Group plc had its name changed to Royal Mail Group Ltd (see note 2). The Royal Mail and Parcelforce Worldwide business units are not separate legal entities

⁽²⁾ Formed during the financial year – see Funding section

Further details on the principal subsidiaries are provided in note 29 to the accounts

Our Operating Units

The Group is organised into four principal operating units

Royal Mail

Royal Mail processes and delivers almost 83 million letters and packages to 27 million addresses every working day in line with its unique Universal Service Obligation (USO). It is also responsible for designing and producing the UK's stamps and philatelic products

General Logistics Systems B.V. (GLS)

GLS is a pan-European company providing reliable, high-quality parcel and express services as well as value-added logistics solutions

Parcelforce Worldwide

Parcelforce Worldwide is a leading provider of collection and delivery services for urgent packages and parcels within the UK and throughout the world providing both business and private addresses with a range of timed delivery options

Post Office Limited

The Post Office®'s national network of branches is at the heart of communities across the country. They provide a trusted access point for everyday products, services and information in postal services, financial services, travel, banking, telephony, bill payments, Government information, retail and the secure transportation of cash. Post Office Limited owns the Group's investments in Midasgrange Limited (50% associate, financial services) and First Rate Exchange Services Holdings Limited (50% joint venture, Bureau de Change services)

Other

Further details are provided under the operating unit facts and figures section

Our Pension Schemes

Royal Mail Group Ltd is the sponsoring employer for the Royal Mail Pension Plan and Royal Mail Senior Executive Pension Plan (both defined benefit schemes) and for the Royal Mail Retirement Savings Plan (a defined contribution scheme). Based on assets the Royal Mail Pension Plan is the sixth largest pension scheme in the UK

The assets and liabilities of the defined benefit schemes as measured under accounting standards are reported as a net pension deficit in the Group balance sheet. The gross assets and liabilities and the net deficit are significantly larger than any of the Group's other assets and liabilities. This results in the Group being one of the most exposed UK corporates to pension scheme volatility particularly with respect to movements in equity values and bond rates

Royal Mail Holdings plc

Operating and Financial Review (continued)

Operating Unit Facts and Figures

Unit and % of Group External Revenue	No. of Employees	Region	Revenue* (£m) Profit* (£m) Margin (%)	Facts and Figures	Vision
 74.7% of Group External Revenue	167 640	UK	Revenue £6.857m Profit £194m Margin 2.8%	<ul style="list-style-type: none"> • 115 000 pillar boxes • 69 Mail Centres • 1 400 delivery offices, • 30 000 vehicles • 33,000 bicycles, • Almost 83 million items handled every working day • Deliver to 27 million addresses a day • 1st Class Quality of Service - 94.0%, and • 2nd Class Quality of Service - 98.9% 	to be demonstrably the best and most trusted postal services company in the world'
 11.8% of Group External Revenue	12 137	Europe	Revenue £1 082m Profit £115m Margin 10.6%	<ul style="list-style-type: none"> • 31 hubs • 645 depots • 17 800 vehicles • 220 000 customers, • Over 1 million parcels handled every working day, • 20 Subsidiaries and • Covers 35 states in Europe 	to provide 'service quality and reliability with local expertise and knowledge of different cultures being integral to the end-to-end service'
 3.7% of Group External Revenue	4 176	UK	Revenue £337m Profit £10m Margin 3.0%	<ul style="list-style-type: none"> • 2 hubs (1 national 1 international), • 48 depots • 1 600 vehicles • 185 000 parcels delivered every day, 267,000 every day in December and • Parcelforce 24 Quality of Service - 96.2% delivered on time and with electronic proof of delivery 	to be the UK's most trusted worldwide carrier
 9.4% of Group External Revenue	9,990	UK	Revenue £868m Loss (£99m) Margin (11.4%)	<ul style="list-style-type: none"> • Equivalent 14p in every £1 transacted in the UK is handled through the Post Office® network • 14 219 branches including 458 Crown Offices • Over 60,000 customer facing colleagues - including those employed by Post Office Limited, by subpostmasters and/or by franchisees, • Over 24 million customers making over 36 million visits a week conducting almost 61 million transactions, • UK's leading supplier of foreign currency and • 95% of customers satisfied with their branch 	to sell products and services that are important to our customers simply and at a profit backed up by a business approach of being community minded and profit driven and putting customers at the heart of the business'

* Revenue is for subsidiaries only profit is before exceptional items

Royal Mail Holdings plc

Operating and Financial Review (continued)

Unit and % of Group External Revenue	No of Employees	Region	Revenue* (£m) Profit* (£m) Margin (%)	Facts and Figures	Vision
0.4% of Group External Revenue	2,961 Wholly owned subsidiaries 4,592 Part owned subsidiaries	UK	Revenue £35m Profit £13m	Including <ul style="list-style-type: none"> PostCap Guernsey Limited – captive insurers (100% subsidiary) Romec Limited- facilities management operation (51% subsidiary) NDC 2000 Limited - building engineering services operation (51% subsidiary) Quadrant Catering Limited – catering services (51% associate) Camelot Group plc - UK National Lottery operator (20% associate) Our Group Property unit - including Royal Mail Estates Limited and Central shared services for the UK and corporate centre - not a revenue or profit centre 	

*Revenue is for subsidiaries only profit is before exceptional items

Funding

Group excluding Post Office Limited

Following extensive negotiations between the Company and its Shareholder, a refinancing package for the Group (excluding Post Office Limited) was completed on 23 March 2007. The agreed package includes

- £900m senior debt facility repayable in 2014 at commercial interest rates
- £300m Shareholder loan repayable from 2016 at commercial interest rates
- £1 billion escrow established as security for the Royal Mail Pension Plan
 - £850m funded principally from the Mails Reserve (see section on Mails and Rural Network Reserves), and
 - £150m funded from Group resources
- An incentive package for employees based on ColleagueShares worth up to £5,300 per person and linked to performance

In relation to the above Royal Mail Estates Limited a wholly owned subsidiary was formed during the financial year. The security on the senior debt facility includes a fixed charge over shares in Royal Mail Estates Limited and a floating charge over all the assets of Royal Mail Estates Limited (see note 19). On the last day of the financial year Royal Mail Group Ltd transferred most of its directly held property assets to Royal Mail Estates Limited

Post Office Limited

On 14 December 2006 the Secretary of State for Trade and Industry made an announcement regarding the future of the Post Office® network which commenced a consultation process. On 17 May 2007 the Secretary of State announced the outcome of that consultation process including

- 1 A funding package for Post Office Limited up to March 2011
- 2 A closure programme involving the compulsory compensated closure of up to 2,500 Post Office® branches and
- 3 The imposition of certain geographic access criteria designed to ensure the continued maintenance of a national network of post office branches

During 2006-07 the following payments were made by Government to support the Post Office® network

- £145m to reimburse Royal Mail Group Ltd for amounts that had been advanced to Post Office Limited and
- £231m to fund the ongoing cash requirements of Post Office Limited to meet its debts as they fall due

In addition £150m was paid to Post Office Limited during the year to fund the maintenance of a rural network of post offices. £75m of this was paid during the first half of the year by way of a transfer from Royal Mail Group Ltd its immediate parent company. The remaining £75m was paid during the second half of the year by Government in the form of a subsidy and recorded within revenue as a Social Network Payment.

All of the above payments made during 2006-07 were made in accordance with approval received from the European Commission under relevant state aid rules

Royal Mail Holdings plc

Operating and Financial Review (continued)

Group Financial Analysis

In the following analysis all references to operating profit are before exceptional items

This year we report an operating profit of £233m compared to £355m for 2005-06 a fall of £122m (34.4%) mainly driven by the performance of Royal Mail. Most other operational business units contributed to offsetting this decrease with General Logistics Systems (GLS) improving profitability by £15m (15.0%) Post Office Limited by £12m (10.8%) and Parcelforce Worldwide by £5m (>100%)

External Revenue

Group external revenue increased by £123m (1.4%) from £9,056m to £9,179m driven by increases in GLS, Post Office Limited, Parcelforce Worldwide and Other, offset by a marginal decline in Royal Mail

Royal Mail revenue remained virtually flat declining by £2m (0.03%) despite an increase in average prices of around 5% for the regulated area. Revenue grew in International products and Special Delivery helping to maintain revenue year on year but these factors were wholly offset by declining market volumes losses to Downstream Access (DSA) and customers downtrading to cheaper products

General Logistics Systems increased its revenue by £45m (4.3%) from £1,037m to £1,082m driven by volume growth in domestic and export parcels. Parcelforce Worldwide increased its revenue by £23m (7.3%) from £314m to £337m through higher volumes particularly in the business to consumer market. Post Office Limited showed a revenue increase of £30m (3.6%) from £838m to £868m, although removing the impact of the £75m Social Network Payment (SNP) received from Government there was an underlying decline in revenue of £45m to £793m. This reduction is due to the revenue decline in Government and financial services exceeding the growth in revenue from the telephony products stream

Costs (excluding exceptional items)

Total costs of £8,985m have increased from £8,733m by £252m (2.9%)

People costs of £6,145m represent 68.4% of the Group's cost base and have increased year on year by £177m (3.0%). This is primarily due to an increase in the Group's pensions cost of £193m. This increase mainly relates to the higher cost of employing members of the schemes principally due to an allowance for increased life expectancy and lower long-term interest rates. The majority of front line staff received a 2.9% pay award effective from 3 April 2006 and an additional 1.0% productivity payment from 5 June 2006. This has been more than offset by a decline in headcount in UK wholly owned subsidiaries of over 8,000 since March 2006 (primarily in Royal Mail). As a result, underlying wages and salaries have actually fallen by £19m over the year

Distribution and conveyance costs of £1,237m representing 13.8% of the Group's cost base, have increased by £19m (1.6%) driven mainly by GLS and Parcelforce Worldwide, and their associated costs of volume growth

Other operating costs of £1,603m, representing 17.8% of the Group's cost base have increased by £56m (3.6%). This rise is driven by £46m cost of sales relating to Post Office Limited's HomePhone product, an increase in strategic initiative spend (£54m) aimed at increasing the efficiency of operations, and depreciation costs (£19m), both primarily within Royal Mail. The rise is partially offset by focused cost savings in other non-people expenditure categories, in areas such as computers, marketing and compensation across the Group

Royal Mail Holdings plc

Operating and Financial Review (continued)

Pensions

Pension charges within operating profit	2007 £m	2006 £m
Within operating profit before exceptionals	722	529
Within exceptionals (relating to redundancy)	51	24
Within operating profit	773	553

Pension costs (pre-exceptionals) have increased by over 36% from £529m to £722m. Of this £193m increase £16m relates to past service. The balance some £177m mainly relates to the increased cost of employing members of the schemes, principally due to an allowance for increased life expectancy and lower long-term interest rates

The balance sheet pension deficit has decreased from £5 588m in March 2006 to £4 985m. The decrease in the deficit of £603m

principally relates to an actuarial gain of £340m and net pensions interest of £199m. The majority of the actuarial gain arose due to investment returns on the schemes assets being in line with market performance and therefore higher than the long-term expected rate of return. This gain is recorded in the statement of recognised income and expense. The net pensions interest reflects the long-term expected rate of return on the schemes assets, less the unwinding of the discount on the schemes liabilities. Although liabilities are higher than assets, the expected rate of return on these assets (biased toward equities) is substantially higher than the discount rate for liabilities (high quality corporate bond rate) resulting in a net interest credit. This interest is recorded in the income statement after profit before financing and taxation

As part of the new funding package the Group established £1bn of investments in escrow shortly before year end as security for the Royal Mail Pension Plan, in support of the 17 year deficit recovery period from 31 March 2006

Pension cash funding Group contributions	2007 £m	2006 £m
Regular pension contributions	543	343
Funding of pension deficit	243	113
Payments relating to redundancy	74	209
Net cash payments	860	665

Regular pension contributions increased by over 58% from £343m to £543m. This additional £200m cash outflow has been principally driven by the regular rate of employer contributions for the Royal Mail Pension Plan increasing from 12.6% to 20.0% of pensionable pay, effective from the beginning of the current year. Key elements of this increase are an allowance for increased life expectancy and lower expected long-term investment returns. A rate of 12.6% applied throughout the prior year. The regular rate of employee contributions for the Royal Mail Pension Plan remains unchanged at 6.0%

Deficit recovery payments by the Group more than doubled increasing by £130m (115%). Of this increase £68m was due to the timing of the payments made with the balance (£62m) principally arising as a result of the latest full actuarial valuation of the Royal Mail Pension Plan. There have been no employee deficit contributions. The Group has been contributing an average of some £140m per year to fund the deficit in the Royal Mail Pension Plan lower in 2005-06 due to the timing of payments made. This will increase to an average of over £260m per annum from the beginning of 2007-08

Share of Profits in Joint Ventures and Associates

The Group's share of profits in joint ventures and associates of £39m (2006 £32m) comprises profits of £42m (2006 £41m) from Camelot (The National Lottery operator), Post Office Limited's Bureau de Change joint venture (First Rate Exchange Services Holdings Limited) and Quadrant our catering associate offset by a loss of £3m (2006 loss of £9m) from Post Office Limited's financial services venture (Midasgrange Limited). The losses from Post Office Limited's financial services venture were planned and are a result of sales and marketing expenditure to promote new products

Net Exceptional Items

Net exceptional items of £125m (2006 £143m) comprise operating exceptional costs of £243m (2006 £210m) partially offset by profits of £118m from property disposals (2006 £67m from property and business disposals). Operating exceptional costs include £180m (2006 £75m) for redundancy and £64m (2006 £44m) for impairments less a £1m (2006 £nil) net exceptional provision release for property. In addition the prior year included a £91m charge in respect of Share in Success (see note 7)

Of the profits from property disposals during the year £74m (2006 £nil) arose from the disposal of a property group. The disposal group consisted of both property related assets and liabilities. This disposal was structured as a sale and part leaseback, with related proceeds of £71m received during the year (see Cash Flow section)

Net Finance Income

Net finance income of £6m (2006 £1m costs) comprises interest earned on investments of £56m (2006 £48m) and other interest receivable of £6m (2006 £3m), offset by interest payable on DTI borrowings of £50m (2006 £48m) and other interest payable of £6m (2006 £4m). Interest payable on DTI borrowings increased by £2m due to higher average borrowing volumes to support our Post Office® network and higher average borrowing rates

Net pensions interest

Net pensions interest of £199m (2006 £101m) a non-cash item for the Group has increased by £98m mainly due to an increase in equity values during 2005-06

Taxation

The taxation charge of £27m (reported rate 9%) comprises £45m current tax payable with respect to UK operations, a £31m current tax charge on overseas profits a UK deferred tax credit of £59m and an overseas deferred tax charge of £10m. Last year a credit of £83m was recorded comprising £11m current tax charge with respect to UK operations, a £25m current tax charge on overseas profits a £112m UK deferred tax credit and a £7m overseas deferred tax credit. The low reported rate is mainly due to the increased amount of deferred tax asset recognised

Royal Mail Holdings plc

Operating and Financial Review (continued)

Cash Flow

The following table is a summary of the Group cash flow statement

Summary of cash flows	2007 £m	2006 £m	
Cash inflow/(outflow) from operations	117	(10)	Cash inflow from operations is £117m (2006 £10m outflow) which comprises
Dividends from joint ventures and associates	39	30	<ul style="list-style-type: none"> Earnings Before Interest Tax, Depreciation and Amortisation (EBITDA) inflows of £392m (2006 £497m)
Capital expenditure and disposals	(244)	(170)	<ul style="list-style-type: none"> Working capital inflows of £7m (2006 £17m)
Proceeds from sale of property group	71	-	<ul style="list-style-type: none"> Share in Success payments of £90m (2006 £218m) and
Business acquisitions and disposals	(20)	(17)	<ul style="list-style-type: none"> Other payments relating to exceptional items of £192m (2006 £306m), comprising pension top ups of £74m (2006 £209m) and further rationalisation costs of £118m (2006 £97m)
Acquisition and sale of financial assets	(318)	(1)	Dividends received from joint ventures and associates of £39m (2006 £30m including £1m Spring and £1m Camelot International Services Limited) are from First Rate Exchange Services Holdings Limited £23m (2006 £17m) Quadrant, £10m (2006 £4m) and Camelot, £6m (2006 £7m)
Proceeds from issue of ordinary shares	430	-	
Net repayment of borrowings and financing	(64)	(16)	
Tax interest and other	24	5	
Net cash inflow/(outflow)	35	(179)	

Capital expenditure and disposals of £244m (2006 £170m) comprises £309m (2006 £243m) of expenditure including motor vehicles of £73m, plant and equipment of £57m, £52m for GLS projects and £62m for property improvements with the remaining £65m on software and other intangibles offset by inflows of £65m (2006 £73m) mainly from surplus property disposals. In addition proceeds of £71m (2006 £nil) were received from the sale of a property group – see Net Exceptional Items section above

Acquisition and sale of financial assets of £318m (2006 £1m) represents the net of the investments made by the Group from cash and cash equivalent resources. It principally relates to the investment of £1bn (2006 £nil) in escrow provided as security for the Royal Mail Pension Plan partially funded by the realisation of other investments

During the period five ordinary shares in the Company were issued to the Secretary of State for Trade and Industry under section 63(1) of the Postal Services Act 2000. Of the consideration received £145m was used to reimburse Royal Mail Group Ltd for amounts that had been advanced to Post Office Limited. £231m was transferred to Post Office Limited to fund its ongoing cash requirements and £54m partly offset the transfer of £75m from the Mails Reserve to Post Office Limited earlier in the year

Net repayments of borrowings and financing of £64m (2006 £16m) comprises £63m (2006 £15m) net repayment of borrowings and £1m (2006 £1m) payment of capital element of obligations under finance leases and hire purchase contracts. The net repayment of borrowings comprises £60m (2006 £nil) net repayment of DTI loans to Post Office Limited and £3m (2006 £15m) net repayment of other loans

Provisions

Provisions at the end of March 2007 were £111m (March 2006 £111m). The zero net movement comprises cash spend of £128m, transfers to short-term pension creditors of £41m and the disposal of a property group with liabilities of £24m, offset by £193m of new provisions relating to rationalisation and onerous property contracts

Mails Reserve & Rural Network Reserve

During the year £75m was transferred to Post Office Limited from Royal Mail Group Ltd, its immediate parent company. This was transferred from the Mails Reserve and allocated by Post Office Limited to the Rural Network Reserve. In addition, Post Office Limited received £75m from the Government in the form of a subsidy, recorded within revenue as a Social Network Payment. Under the terms of an agreement, Post Office Limited allocated £75m to the Rural Network Reserve on receipt of the Social Network Payment. During the year, £150m of this reserve was applied towards the maintenance of a rural network of Post Office[®] branches

Under the new funding package the balance on the Mails Reserve shortly before year end, some £795m, was distributed by Royal Mail Group Ltd to Royal Mail Holdings plc, its immediate parent company, to enable an escrow of £850m to be established in Royal Mail Holdings plc as security for the Royal Mail Pension Plan. The balance of the funds was generated through interest (£1m) and the issue of 1 ordinary share in the Company to the Secretary of State for Trade and Industry under section 63(1) of the Postal Services Act 2000 (£54m). The consideration received for the share partly offset the transfer of the £75m from the Mails Reserve to Post Office Limited earlier in the year

An additional escrow of £150m was established by Royal Mail Group Ltd as security for the Royal Mail Pension Plan

Royal Mail Holdings plc

Operating and Financial Review (continued)

Group Strategy and Key Performance Indicators (KPIs)

Our success is measured by the four areas central to our operating units objectives. These key strategies and objectives are communicated widely across the Group embedded into its day-to-day activities and measured on a timely basis by appropriate KPIs and monitored by the Royal Mail Holdings plc Board and its sub Committees as highlighted below

Customer Service Our customers are at the heart of everything we do. The key to winning and keeping customers is to provide a consistently high quality of service. This has been the top priority of everyone in the business and is at the heart of our strategy moving forward. That means: <ul style="list-style-type: none">• delivering a high quality of service and mails integrity• developing products that match the needs of our customers, and• becoming easier to do business with	Great Place to Work This initiative established in 2003 works on the basis that we can only move forward and succeed as a business if we involve our people in making change happen. The plan focuses on engaging and involving people in managing and improving their workplace	Profitability and Cash Flow Funding from Government on commercial terms has now been secured enabling the Group (excluding Post Office Limited) to support the capital investment programme which addresses the historic underinvestment in the letters business. Post Office Limited and Government have agreed a long-term funding package which will maintain a national network and put Post Office Limited on a sustainable footing. Continuing to develop more efficient ways of working will empower us to succeed in a competitive marketplace allowing us to maintain sustainable profitability and cash flow to eventually generate a return for our stakeholders	Good Corporate Citizen Corporate Social Responsibility (CSR) is doing the right thing for our people, our business and the communities we operate in, as our <ul style="list-style-type: none">• customers want to buy from companies that share their values,• colleagues want to work for companies that provide a healthy and safe environment and whose values align to theirs, and• communities want companies that create the incomes, the jobs and contribute to the cohesion that builds the neighbourhoods where people want to live and work.
Customer	People	Financial	Environmental
QoS targets	Employee Survey	Turnover	CO ₂ Emissions/1000 items
Number of Complaints	Health & Safety	Operating profit*	Social & Community
Customer Satisfaction Index	RIDDORs (reportable accidents) /1000 staff	Return on sales*	Charitable Donations
	Sick Absence	Return On Total operating Assets [#]	
		Operating cash flow	

*before exceptional items

[#]as defined in the Directors Remuneration Report

With the exception of the introduction of the Return On Total operating Assets measure (defined in the Directors Remuneration Report) no change has been made to the sources of data or calculation methods used for the KPIs above

Royal Mail Holdings plc

Operating and Financial Review (continued)

Treasury Management

The Group operates a central Treasury function that manages some £1bn of financial asset investments (substantially all of which are now held in escrow in favour of the pension fund trustees) £1 2bn of cash and cash equivalent investments (including £768m cash in the Post Office® network funded mainly by a Government loan facility) and £811m of financial liabilities, in accordance with investment restrictions set by the Government. It also acts as internal banker for the Group's business units. The Group finances its operations largely through cash generated from its operations and borrowings.

Group Treasury derives its authority from the Royal Mail Holdings plc Board and provides quarterly monitoring reports for their review. The Treasury function only has the authority to undertake financial transactions relating to the management of the underlying business risks, it does not engage in speculative transactions and does not operate as a profit centre. All strategies are risk averse and the treasury policy has remained unchanged during the year. The principal financial instruments are deposits and long and short term borrowings.

At the balance sheet date the Group is financed from the following facilities provided by the DTI

Borrower	Purpose	Facility end date	Facility £m	Utilised £m	Average loan maturity date
Royal Mail Group Ltd	Acquisition funding	2021-2025	500	500	2023
Royal Mail Group Ltd	Capital Expenditure and Restructuring	2014	600	Nil	-
Royal Mail Group Ltd	General Purpose / Working Capital	2014	300	Nil	-
Royal Mail Group Ltd	General Purpose / Working Capital	*	300	Nil	-
Post Office Limited	Network cash repayable on demand	2010	1,150	300	2007

*Expires on the later of 2016 and the release of the pension escrow investments. This Royal Mail Group Ltd facility is subordinate to all other creditors.

The terms of the Government borrowing facility and the associated Framework Agreement impose strict constraints on the separation of cash funds within the Group and the purposes for which they can be used.

The Royal Mail Group Ltd undrawn facilities of £1 200m in total were agreed shortly before year end and replace the previous facility of £844m.

The principal treasury risks arising from the Group's activities are currency, counterparty, commodity (fuel) and liquidity risk. These are managed as follows:

- the Group is exposed to foreign currency risk due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, revaluation of the currency balances held to operate the Bureau de Change services within Post Office Limited and various sales and purchase contracts denominated in foreign currency. Hedging programmes managed by Group Treasury mitigate these risks. Where possible exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts.
- the Group's obligation to pay overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising of US Dollar (US\$), Japanese Yen, Sterling and euro. The Group has a policy of matching receipts and payments for individual currencies where possible and then hedging any material net exposure. The policy is that up to 80% of the forecast net exposure is hedged with agreement of the internal business unit. Group Treasury operates a rolling 18-month programme, which is subsequently reviewed on a quarterly basis. There has been no external hedge in place throughout the financial year 2006-07 due to there being no material net exposure.
- Bureau de Change balances are grouped into baskets of closely correlated currencies. Each currency basket (e.g. US\$ or euro) is then sold forward creating a liability to match the underlying asset.
- significant foreign currency risk arising from sales and purchase contracts primarily in US\$ and euro may be hedged up to 100% depending upon the reliability of the forecast of the underlying cash flows.
- the Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries.
- the Group is exposed to fuel risk arising from operating one of the largest vehicle fleets in Europe and a jet fuel risk from the purchasing of air freight services. The Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy operates within the parameters set by the Board which allow the use of over-the-counter derivative products to manage these exposures and.
- counterparty risk is managed by limiting aggregate exposure to any individual counterparty based on their financial strength.

These exposures are reviewed regularly and adjusted as appropriate.

The policies for financial assets – investments and derivative financial instruments – are shown in note 2.

Royal Mail Holdings plc

Operating and Financial Review (continued)

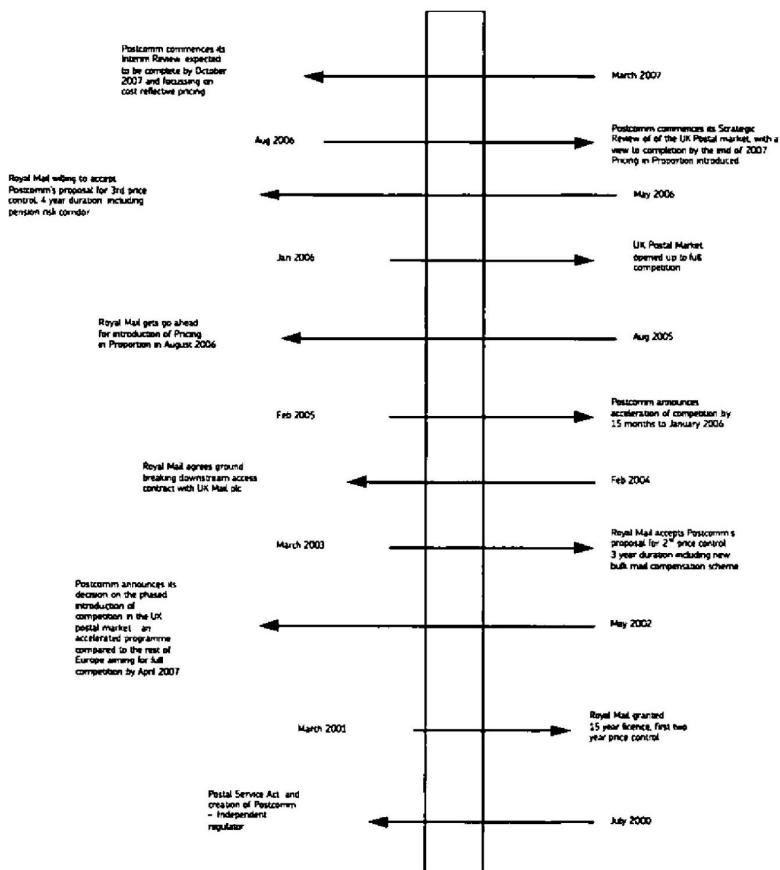
Business Environment

Regulation

Until the last few years Royal Mail had a monopoly status in the UK letters industry. However in 2000 the Postal Services Act created an independent postal Regulator – Postcomm – and allowed Royal Mail to have greater commercial freedom. Postcomm regulates the prices of nearly 90% of Royal Mail's letters business, controls the terms and conditions for nearly all its services, sets the quality of service targets and determines compensation arrangements.

Post Office Limited is increasingly subject to regulation in financial services (Financial Services Authority) and in telephony (Ofcom). Post Office Limited is an appointed representative of Bristol & West plc which in turn is regulated directly by the Financial Services Authority.

It is the Group's policy to be fully compliant with the regulatory framework in which we operate. During 2006-07 we continued to strengthen our compliance activities working in close liaison with our Regulators.



Competition

The Group's business units now all operate in a competitive marketplace. Parcelforce Worldwide and GLS have been operating in an open market since their inception. These units have demonstrated their ability to perform in a non-regulated and competitive environment which is reflected in their annual results.

Post Office Limited, due to a reduction in income from benefit payments and a significant and continuing decrease in Government use, has developed revenue streams from financial services products (including car insurance, a 'two-in-one' credit card and personal loans) and its HomePhone and directory enquiries services. These products are in direct competition with services offered by banks, insurance and telephony companies as are many of the services it has traditionally offered e.g. bill payments, renewal of car tax discs and travel services.

Royal Mail's operating environment has gradually been opened up to competition since February 2004, with the letters market fully liberalised in January 2006, well in advance of the rest of Europe. Competitors are now able to offer customers the opportunity of end-to-end service for the collection, sorting and delivery of their mail.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Major Regulatory Activity in 2006-07

In November 2006 the Group responded to Postcomm's Strategy Review and believes that four key regulatory principles need to be addressed which will result in a truly competitive industry whereby all stakeholders benefit

- Realign prices to underlying costs – to create transparency for business customers and to ensure that competition is sustainable. Some competitors in the UK are basing their entry strategies on unsustainable business models which target the historical cross-subsidies in Royal Mail's pricing structure but cross subsidies are fundamentally incompatible with an effectively functioning competitive market. Postcomm should allow Royal Mail to remove these cross-subsidies so that customers face the right pricing signals and competitor models going forward are based on efficiency.
- A narrower range of universal service products – focused on the needs of all social customers and fully funded through stamp prices. Business customers tell us they do not need the protection that the Universal Service Obligation (USO) provides – Postcomm describes many of these customers as "non-captive" and we agree given the ample choice they have across mail and other communications providers. The USO should therefore be refocused on stamped mail only and prices should reflect the true costs of this provision.
- Full retail deregulation of business products – the explosion in access competition, expected to represent 40% of bulk mail next year is encouraging business customers to demand more commercial and innovative responses from Royal Mail. However Royal Mail is prevented from responding rapidly by regulatory requirements such as an involved process for changing terms and conditions. Royal Mail envisages a near term future in which the intense competition in the business mail market replaces the need for regulation, and
- Continued operational integration of the postal network – we have put in place measures to ensure that competitors and customers have access to our network on fair and reasonable terms. Separation of the postal network would create confusion for customers introduce complex and costly interfaces, endanger quality of service and put at risk delivery of the transformation programme

In March 2007 Postcomm commenced an Interim Price Control Review and intend to make a final decision by November 2007. Royal Mail has asked Postcomm to consider the following pricing proposals in this review all of which are consistent with realigning prices to costs and entirely driven by the need to react to both the volume erosion and significant downtrading that has been evident for the last eighteen months

- Reducing the difference between Downstream Access (DSA) and the equivalent retail prices from a high level set to encourage competition to a level which reflects the underlying upstream costs because entry has been significantly higher than the Price Control assumptions
- Allowing Royal Mail's retail business to price its non-USO bulk mail products by zone, thereby making prices of cheap to deliver areas lower by up to 5% and prices of expensive to deliver areas higher by up to 5%. This does not change the price of the "one price goes anywhere" stamp, and
- Allowing Royal Mail to further rebalance its prices so that it has the flexibility it needs to keep up with the pace of change in the postal sector

Corporate Social Responsibility

Corporate Social Responsibility (CSR) is a key component in supporting the business to be recognised as a responsible organisation that seeks to optimise the beneficial impacts inherent in our business and reduce the negative impacts. Through improving our CSR performance and ensuring it is integrated into the way we work, we can make ourselves more productive and competitive, we are working to reduce the number of accidents, reduce our production of CO₂ and make our people healthier. We recognise that the route to achieving and sustaining our goals is through our people and our relationship with customers, business partners suppliers communities and other stakeholders

A more comprehensive overview of our CSR will be found in the 2007 Corporate Social Responsibility report due to be published in due course

Royal Mail Holdings plc

Operating and Financial Review (continued)

Key Relationships

The Group has several key relationships that are critical to its day-to-day activities and its overall success

People - Our people are the lifeblood of the organisation and brands. Without their continued support and dedication it will be impossible to function on a day-to-day basis and embrace the change within our markets. Training, diversity, flexible resourcing and making the business a great place to work are some of the ways we continue to improve this relationship.

Unions - The Communications Workers Union (CWU) represents non-managerial staff with the Communication Managers Association (CMA) representing managerial staff. The Group's policy is to work with the CWU and CMA to engage staff in the development and execution of business decisions.

Pension trustees - Our pension trustee board for the main pension plan comprises an independent chairman plus 10 people including employees, union representatives, pensioners and independent members. The trustee board is under review following the introduction of the member-nominated trustee regulations. They take external professional advice from Sacker & Partners LLP (legal), Watson Wyatt Limited (actuary) and PricewaterhouseCoopers LLP (financial). They are responsible for full and interim valuations and for reaching agreement with Royal Mail on appropriate funding for the pension schemes. There is a separate trustee board for the senior executives pension plan which is made up of 5 individuals which include employees, pensioners and an independent member. This board is also under review following the introduction of the member-nominated trustee regulations.

Customers - The Group's businesses and brands are used or recognised by almost everyone in the UK - from the largest of companies to individuals. However, the 30 largest customers generate 16% of Royal Mail's turnover and consequently the business is reliant on a small customer base. As competition increases the Group will have to continue to simplify ways of doing business and design products around customers' needs. Customers are offered standard terms and conditions for the markets and countries in which the Group operates.

Subpostmasters - The vast majority of Post Office Limited's 14,219 Post Office® branches are operated by subpostmasters and franchise partners. The National Federation of Subpostmasters (NFSP) represents the interests of all subpostmasters and currently has a membership of 10,020. Post Office Limited conducts annual remuneration negotiations with the NFSP and works closely with them to support a viable network. The NFSP is separately an active body lobbying Government regulators and consumer bodies.

There are several major retailers who are also significant partners operating between them around 2,400 branches across the country. Post Office Limited liaises closely with these companies to maintain successful working relationships. It is through effective partnership with these various organisations that the business takes into account the interests of agents and seeks to support the achievement of their sales potential and longer term network viability.

Suppliers - The Group has a wide range of suppliers, with its primary reliance on those relating to outsourcing of non-core services such as IT support. It works in partnership with its suppliers to ensure the right products and services are delivered at the right time at competitive costs. A central purchasing team monitors compliance to Group policy in awarding contracts or new business and adheres to agreed credit terms.

The consumer body Postwatch - Postwatch's role is to act as a consumer advocate in postal matters. Its public views on the effect of Royal Mail's policies and management actions on customers can have an adverse impact on Royal Mail's reputation regardless of the quality of service achieved.

The Regulator Postcomm - Nearly 90% of Royal Mail letters' revenues are price-controlled and the Price Control is set periodically by Postcomm in the form of a cap on the average price of a basket of products. The price increases or reductions allowed by Postcomm through the Price Control have a very material impact on the likely levels of cash flow the Company can generate. Postcomm also investigates compliance with licence conditions and has broad powers to publicly reprimand or fine Royal Mail if it finds it in breach of those conditions.

Shareholder - The Company is a plc that is 100% owned by the Government. The Shareholder Executive (within the Department of Trade and Industry) manages the shareholder relationship with the Company as a commercial shareholder. While management of the Group therefore lies with the Company's Board of Directors, the Shareholder is kept up-to-date through quarterly performance reviews and is asked annually to approve the Group's business plan. Any new funding required by the Group (apart from short term borrowings of less than one year) can only be approved by Government if it meets commercial principles.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Segmental Analysis – Revenue and Profitability

In the following analysis all references to operating profit are before exceptional items

Group external revenue of £9,179m (2006 £9,056m) and operating profit before exceptions of £233m (2006 £355m) are made up as follows

Business unit performance	External revenue		Operating profit/(loss)	
	2007 £m	2006 £m	2007 £m	2006 £m
Royal Mail	6,857	6,859	194	344
General Logistics Systems	1,082	1,037	115	100
Parcelforce Worldwide	337	314	10	5
Post Office Limited	868	838	(99)	(111)
Other businesses	35	8	13	17
Group	9,179	9,056	233	355

A further analysis of results by business unit is shown below

	2007 £m	2006 £m
Royal Mail		
External revenue	6,857	6,859
Operating profit before exceptions	194	344

External revenue fell by £2m to £6,857m despite an average price increase on regulated products in April 2006 of around 5%. The expected improvement from price increases was more than offset by a reduction in volumes increased losses to competition and switches by customers to lower priced products. For the Addressed Inland products market revenue actually declined by 1.1%.

Overall Addressed Inland volumes saw a 2.3% fall against last year with a significant loss of associated revenue. Downstream Access (DSA) volumes rose by 1.3bn items compared to the prior year bringing the full year to 2.4bn items. The financial impact on Royal Mail income of the switch to DSA was a dilution of £71m. Other switches to lower price products further reduced revenue by £84m. The 2006 results include the impact of the general election and European elections which generated £27m in revenue.

The decrease in revenue contributed to an operating profit decline of £150m (43.6%) to £194m. This profit decline was primarily driven by increased pension costs (up £164m) and an increase in the level of expenditure on strategic initiatives, aimed at creating a more modern and efficient operation. The level of operational efficiency savings delivered in the year has more than offset inflation impacting on both our payroll and third party procurement expenditure.

	2007 £m	2006 £m
General Logistics Systems		
External revenue	1,082	1,037
Operating profit before exceptions	115	100

External revenue rose by £45m (4.3%) from £1,037m to £1,082m including the £6m negative impact as a result of the weakening of the euro. The underlying growth of £51m (4.9%) results from higher domestic and export volumes across Europe with particularly strong growth achieved in international shipments reflecting the strength of the GLS European network.

Operating profit increased by £15m (15.0%) from £100m last year to £115m. This represents a strong performance despite challenging trading conditions in Germany and the significant network and operational changes implemented to adapt the French network to the new speed limit law in France which came into effect on 1 January 2007.

	2007 £m	2006 £m
Parcelforce Worldwide		
External revenue	337	314
Operating profit before exceptions	10	5

External turnover rose by £23m (7.3%) with volume growth of 11.2% driven by UK contracts. This was partly offset by continued decline in international standard and economy products. This mix reduced average unit prices by 3.1%.

The high volume during Christmas (and the New Year) was driven by exceptional business to consumer volumes. Growth was underpinned by strong quality of service results (PF24 product 96.2% and premium timed service 96.7% exceeded prior year results) and improved customer service focus.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Operational efficiency improved by over 4% compared to last year. Total costs increased by £18m, nearly 6% to support 11.2% volume growth.

2006-07 saw Parcelforce Worldwide achieve record profits and volumes. Operating profit of £10m has improved by £5m. These outstanding results have been achieved through unit cost efficiency in a year of strong volume growth whilst improving quality of service.

Post Office Limited	2007 £m	2006 £m
Turnover	793	838
Social Network Payment	75	-
External revenue	868	838
Operating loss before exceptionals	(99)	(111)

Revenue shows an increase of £30m (3.6%) over the prior year however 2007 includes £75m of Social Network Payment (SNP) from Government. This SNP has been recognised as revenue and relates to a Government grant to match the related costs during the second half of the year of providing the network of public post offices that the Secretary of State considers appropriate and which would otherwise not be provided.

Underlying trading revenue decreased by £45m (5.4%) due to a number of factors including the loss of TV Licensing work from the BBC, migration of motoring volumes to the DVLA web application, the

replacement of E111 forms with the issue of European Health Insurance Card (EHIC) and the effects of the change to direct payment of benefits. These have been partly offset by increases in Post Office Limited's new commercial products of which HomePhone revenue is significantly higher than last year. The business continues to expand its presence in the Financial Services sector with the launch of the Post Office® Instant Saver account which has been exceptionally well received in the instant access savings market.

The underlying loss of £174m which increased by £63m includes £150m of costs for maintaining the uneconomic part of the rural network, for which funding from Royal Mail Group Ltd and Government was received during the year, £75m of which was recorded as revenue.

Overall expenditure increased mainly driven by subpostmasters pay costs associated with new commercial products and increased pension costs. These were partially offset by cost reductions in staff costs via headcount reductions, IT costs through revised contracts and tight control of all discretionary spending.

Other businesses	2007 £m	2006 £m
External revenue	35	8
Operating profit before exceptionals	13	17

External revenue from other subsidiaries has increased to £35m (2006 £8m) and includes the consolidation of Romec Services Limited. Operating profit is £4m lower primarily due to decreased profits in Romec our facilities management operation (a 51% subsidiary).

Principal Risks and Uncertainties

The Group uses a business-wide framework for the identification, assessment, treatment, monitoring and reporting of risk. The process helps support the business objectives by linking into business strategy, identifying and reacting to emerging risks, developing cost effective solutions to risk.

The following Group-level risks have been identified and are being managed to support the long-term sustainability of the Group. The impact of some of these risks could be impairment to the value of the Group's brands - Royal Mail, Post Office® and Parcelforce Worldwide which are some of the most well known and trusted brands in the UK and major intangible assets of the Group.

The Government is the Company's only shareholder and the Group may be affected by any future change in Government policy.
The influence of public policy considerations on Government may adversely affect the Group's ability to promote an effective business strategy. This is particularly significant for Post Office Limited that is required to run its branch network as a commercial business. Subject to EC approval, the Government has agreed a support package for the social branch network. If Government failed to deliver this support package, this may have a prejudicial effect on Post Office Limited's ability to run an efficient and profitable retail network.

Group revenues and profit are subject to several uncertainties

The postal market is rapidly evolving as a result of liberalisation. Competitors are being increasingly aggressive and target our business customers where Royal Mail derives most of its profit. Additionally business customers may "downdate" and use less profitable products. The loss of key business customers is exacerbated by the Universal Service Obligation (USO). The USO obliges Royal Mail to maintain a national collection and delivery network and consequently incur fixed costs which our competitors do not have to bear.

There is also uncertainty as to how the licence and regulatory regime will affect Royal Mail in the future. Unless the regulatory restraints are changed to permit Royal Mail to recover from the imbalance of business mail subsidising stamped mail, there is a risk that Royal Mail will always lose money on stamped mail whilst its competitors cream-off more profitable business mail without the requirements of a USO. The USO does however ensure that Royal Mail has the largest distribution network in the country - which may present future opportunities.

Royal Mail Holdings plc

Operating and Financial Review (continued)

The Group is subject to regulatory restrictions on its operations and the risk of penalties for non-compliance

Royal Mail's postal operator's licence contains material restrictions on the operation of the business. These include

- Obligations over the delivery and collection of mail
- Restrictions over the freedom to set prices, and
- Obligations to give competitors access to its network

In addition to its postal operator's licence the Group is also subject to oversight by other regulators. This affects Post Office Limited which as an appointed representative of Bristol & West plc who are authorised and regulated by the FSA has to satisfy the FSA that it is meeting the relevant regulatory requirements. It is also subject to anti-money laundering regulations issued under the Proceeds of Crime Act 2002 and enforced by HM Revenue and Customs. Post Office Limited is also licensed as a telephone service provider by Ofcom. Ofcom requires service providers to issue and adhere to Codes of Practice. If Royal Mail breaches certain licence conditions and its regulatory requirements it may be subject to financial penalties.

The financial restructuring package agreed with the Government needs to be managed effectively

The business has agreed a financial restructuring package that will allow it to restructure the business, invest in new equipment and address the pension fund deficit that has a major impact on Group profit and the balance sheet. The effective management of the restructuring package is crucial in light of the major challenges that the business faces in terms of the impact of competition, pricing and regulation, capital investment and fluctuations in equity markets adversely affecting the pension fund deficit. Unless the business remains within the agreed financial restructuring parameters, sanctions or penalties could ensue.

Without a continued change of culture within the organisation future development may be impeded

The business has undergone, and will continue to undergo, a significant amount of change. Additionally the changing and uncertain postal market place the impact of competition and regulation and increased customer expectations place major challenges on all employees to adapt and improve productivity to levels that will allow the business to compete effectively.

These challenges need to be met by ongoing cultural change within the organisation. Without a flexible, efficient and cooperative culture Royal Mail could become loss-making as mail volumes decline and labour rates increase. Significant industrial action could have a major detrimental effect on the Group's reputation and profits.

If the UK's economy slows or goes into recession it is likely to have a detrimental impact on the Group's profits

Ongoing changes in the global economy pose challenges and opportunities for the UK and all advanced economies. Historically there has been a correlation between the state of the UK economy and level of mails revenue. If the economy weakens or goes into recession this will have a direct impact on mail volumes and consequently on Group profit.

The increasing substitution by alternatives could lead to declining profitability and volumes, which would have an adverse impact on profit

Delivering business mail for major customers is a vital part of our business. Technologies can be used to send information or make information available faster and, in many cases, at a lower cost than traditional mail services. If substitution continues, mail volumes will decrease resulting in an associated fall in profit.

Ineffective investment in the operational network could affect productivity levels and our ability to compete effectively

The business is about to embark on a major investment programme to replace equipment and technology that is nearing the end of its life cycle. The investment programme needs to be effectively deployed and ongoing investment in the Group's operational network in future years secured to ensure the Group's ability to compete effectively in the open market.

The Group's business activities are time critical and if key infrastructure facilities were disrupted it could have an impact on results

The business is subject to a number of operational risks to its nationwide delivery and retail outlet networks that are largely outside its control including natural disasters, fire, flood, explosion, possibility of work stoppages or civil unrest, transport infrastructure disruption, power failures, unavailability of key supplies, breakdown or failure of equipment, health pandemics, terrorism and the normal hazards associated with running a complex infrastructure. A major disruption could have an adverse impact on business and operating results.

The Group is a major energy consumer and may be affected by future environmental and fiscal measures

The Group operates a large vehicle fleet and a substantial property portfolio that consume large amounts of energy. Although the Group is disposing of surplus property and is deploying a Carbon Management Programme it may be affected by future environmental measures and adverse fiscal impact from increased taxation.

The Group operates a substantial treasury operation and is exposed to foreign currency risk and fuel price risk

The Group is exposed to foreign currency risk and fuel price risk. The former is due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, the balances held to operate the Bureau de Change services and various sales and purchase contracts denominated in foreign currency. The fuel price risk arises from operating a large vehicle fleet and an aviation fuel risk from purchasing air freight services. If the treasury strategy is inappropriate to cover the Group's exposures, this could result in funds not being readily available when required or having a negative impact on profit due to increased costs.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Way forward

The Group has experienced a difficult trading year with revenues continuing to fall below expectations in core markets and with profits declining for the first time in five years. Our operating profit has reduced to £233m compared to £355m last year. The combined impacts of additional pensions charges, falling volumes and the effects of competition have squeezed margins in Royal Mail. Post Office Limited's losses have reduced to £99m from £111m, but the inclusion of £75m of Social Network Payment within operating profits for 2006-07 masks an underlying worsening, a consequence of further losses in traditional income from Government not being fully offset by new commercial product revenues. There is better news in our non-regulated parcels businesses where both GLS and Parcelforce Worldwide continue to improve their revenue and profit performance year on year.

On 14 December 2006 the Government announced a long-term funding arrangement for Post Office Limited with the final contracts agreed in May 2007. Certain elements of this package remain subject to State Aid approval. This package will enable the reshaping of the network and ultimately allow the business to deliver a significantly improved performance.

On 8 February 2007 the Group announced that it would consult on the future of its defined benefit pension scheme. A series of proposals has been outlined recently and consultation with our people is to commence shortly. It is anticipated that any changes to be made will help the Company to ensure it can continue to provide attractive pension benefits for employees.

On 23 March 2007 a package to fund the transformation of the Royal Mail business was agreed with the Shareholder. At the same time, an Employee ColleagueShare Scheme was also approved providing an opportunity for the business to engage its people in the large scale change that is required. With both these enablers in place it is management's challenge to ensure that the investment is used to deploy the initiatives and improvements that will underpin long-term operational transformation.

Moving forward the major challenges that face the Group are

- Increased competition within the communications sector and continuing letter market decline, and
- Transformation and modernisation of our operations in order to improve our efficiency and productivity

Despite the challenges, with the full support of our people the Group is now well placed to accelerate its transformation in order to provide improved service and increased value to all our stakeholders.



GRO

Ian Duncan

Group Finance Director

26 October 2007

Understanding the OFR

Statement of compliance

This OFR is intended to develop the Group's narrative reporting to meet many of the recommendations of the Accounting Standards Board's Reporting Statement of Best Practice on the OFR. This OFR ensures compliance with the legal requirement under the Companies Act to provide a Business Review and is referenced from the Directors' Report.

We will continue to review the narrative disclosures we provide in the annual Report and Accounts to ensure that the disclosures provided meet the requirements of our stakeholders.

Cautionary statement

The OFR focuses on matters that are relevant to the interest of the Shareholder of the Company. The purpose of the OFR is to assist the Shareholder of the Company in assessing the strategies adopted by the Company and the potential for those strategies to succeed. It should not be relied on by any other party or for any other purpose.

Where this OFR contains forward looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with appropriate caution due to the inherent uncertainties underlying any such forward looking information.

Royal Mail Holdings plc

Royal Mail Holdings plc Board

Non Executive Directors

ALLAN LEIGHTON (54) joined the Board in April 2001 as a Non Executive Director, becoming Chairman in March 2002. He is also a Director of Post Office Limited and a member of the GLS Supervisory Board. Allan began his career with Mars Confectionery and moved to Pedigree Petfoods as Sales Director. In 1992 he became Group Marketing Director of Asda Stores Limited and Chief Executive in 1996 becoming President and CEO of Wal-Mart Europe when Wal-Mart bought Asda in 1999. He is currently Chairman of BHS Limited Non Executive Director of BSkyB, Selfridges & Co, and George Weston Ltd. Allan is also Chairman of Race for Opportunity.

DAVID FISH (59) joined the Board in January 2003. He is Chairman of the Remuneration Committee and a member of the Nomination Committee. David was a member of the Mars Inc Operating Board from 1994 to 2001 and Joint President of Masterfoods Europe. He has also been President of Snackfoods Europe and held European Vice-President positions in marketing and personnel. He is currently Executive Chairman of United Biscuits Group and Chairman of Christian Salvesen.

RICHARD HANOVER (61) joined the Board in January 2003. He is Chairman of the Nomination Committee and a member of the Remuneration Committee. Richard was Chairman of WH Smith plc until January 2005. He is also a Non Executive Director of the Nationwide Building Society.

SIR MICHAEL HODGKINSON (63) joined the Board in January 2003. He is the Senior Independent Director and a member of the Remuneration Committee. In May 2003 he was appointed Chairman of Post Office Limited and Chair of the Corporate and Social Responsibility Governance Committee, and was Post Office Limited's nominated director on the Bank of Ireland Board until 31 July 2006. Sir Mike was Chief Executive of BAA plc until retiring in June 2003. He is currently a Board Member and Chairman of the Finance Committee of Transport for London, a Non Executive of FKI plc and Non Executive Chairman of First Choice Holidays plc.

JOHN NEILL CBE (60) joined the Board in January 2003 and is a member of the Audit and Risk Committee. John has been Group Chief Executive and Deputy Chairman of the Unipart Group of companies since 1987. He was formerly a Director of the Court of the Bank of England and is Non Executive Director of Charter plc. He is also Vice-President of the Society of Motor Manufacturers and Traders and a Director of the SMMT industry forum and Business in the Community.

BARONESS MARGARET PROSSER OBE (70) joined the Board in November 2004 and is a member of the Nomination Committee and Audit and Risk Committee. Margaret has been a Member of the House of Lords since 2004. She is a Non Executive Director of the Trade Union Funds Managers and has been Chair of the Women and Work Commission since July 2004. She is also Deputy Chair of the Commission for Equality and Human Rights.

HELEN WEIR (45) joined the board in January 2006 and is Chair of the Audit & Risk Committee. Helen has been Group Finance Director at Lloyds TSB Group since 2004. Prior to that she was Group Finance Director of Kingfisher. She is a member of the Accounting Standards Board.

Executive Directors

ADAM CROZIER (43) joined the Company in February 2003. He is Group Chief Executive and leads the Group Executive Team. He also has direct day-to-day control of the Letters Business. He is a director of Debenhams plc and Camelot Group plc. Adam was Chief Executive of the Football Association from 2000-2003. Between 1988 and 1999 he held a number of senior roles at Saatchi and Saatchi Advertising including that of Joint Chief Executive from 1995.

DAVID BURDEN (60) joined the Company in November 2002 was appointed to the Board in July 2004, and is Group Technology Director. He is a member of the Group Executive Team. David was previously Group Executive General Manager Technology and Services at Qantas Airways Ltd in Sydney, responsible for IT, purchasing, property, motor transport and fuel services. He was a member of the Executive Committee throughout the transition from Government ownership to a successful listed public company.

ALAN COOK CBE (54) joined the Company in March 2006 as Managing Director of Post Office Limited, having been a non-executive Director of Post Office Limited since February 2005. He is a member of the Group Executive Team. Before joining as Managing Director of Post Office Limited Alan was Chief Executive of National Savings and Investments prior to which he had been Chief Operating Officer of the Prudential Assurance Company. Alan is also currently serving on the Council of the Institute of Financial Services.

IAN DUNCAN (46) Ian Duncan was appointed as Finance Director of Royal Mail Group in September 2006. He joined from Westinghouse Electric Company based in the USA where he had been Chief Financial Officer since 1999. Prior to joining Westinghouse, Ian was Corporate Finance Director at British Nuclear Fuels plc. Before that Ian was in corporate finance with Dresdner Kleinwort Benson Ltd and Lloyds Merchant Bank Ltd. He started his career with Deloitte & Touche in London. He is a member of the Institute of Chartered Accountants of England and Wales.

TONY McCARTHY (51) joined the Company in January 2003 and is Group Director People and Organisational Development. He is a member of the Group Executive Team, the Pensions Committee and the Corporate and Social Responsibility Governance Committee. Tony had previously been Group Human Resources Director of BAE Systems where he had worked in a variety of HR roles since 1978. He is also a member of the Council of the University of Lancaster and a member of the Home Office Reform Group.

Royal Mail Holdings plc

Royal Mail Holdings plc Board (continued)

Company Secretary

JONATHAN EVANS OBE (55) joined the Company directly from university in 1974 and has been Company Secretary since 1999 having held a wide range of management positions throughout the Group. He is a member of the Group Executive Team and Pensions Committee, Secretary to the Audit and Risk, Remuneration and Nomination Committees, a Trustee Director of the Royal Mail Pension Plan, a Trustee of the Royal Mail Senior Executive Pension Plan and a member of the GLS Supervisory Board.

Director who resigned during the year

BOB WIGLEY resigned with effect from 31 October 2006

Directors who left or were appointed after the year end

DAVID BURDEN retired 31 July 2007

IAN GRIFFITHS resigned with effect from 30 April 2007

SIR MICHAEL HODGKINSON contract ended 31 August 2007

JOHN NEILL contract ended 31 August 2007

STEPHEN CARTER appointed 1 September 2007

Royal Mail Holdings plc

Directors' Report

The Directors present the Group accounts for Royal Mail Holdings plc. These accounts relate to the 52 weeks ended 25 March 2007 (2006 52 weeks ended 26 March 2006).

Principal activities

The Group provides a nationwide and international distribution service, principally of mails and parcels. The Group also provides access to a wide range of financial and retail services through its network of Post Office® branches across the United Kingdom.

Review of the business and future developments

A review of the Group's business and future developments is presented in the Chairman's Statement and Chief Executive's Statement, Annual Review and the Operating and Financial Review.

Results and dividends

The profit before taxation amounted to £313m (2006 £312m). After taxation, the profit was £286m (2006 £395m). Of the profit after taxation £nil (2006 £nil) is attributable to minority interests. The Directors do not recommend a dividend (2006 nil dividend).

Political and charitable contributions

During the year the Group made charitable contributions of £1m (2006 £1m). No political contributions were made in the year (2006 £nil).

Research and development

Research and development expenditure during the year amounted to £1m (2006 £1m).

Policy on the payment of suppliers

The policy of the Company and its principal operating subsidiaries is to use their purchasing power fairly. Payment terms are agreed in advance for all major contracts. For lower value transactions the standard payment terms of the supplier apply. It is the Company's policy to abide with the agreed terms. The Company and its principal operating subsidiaries in the UK have sought to comply with the Department for Trade and Industry's (DTI) Better Payment Practice Code. Copies of this can be obtained from the DTI. As the Company is a non-operating company the creditor days are zero. The creditor days of the operating subsidiaries are set out in their accounts.

Land and buildings

The net book value of the Group's land and buildings based upon a historic cost accounting policy and excluding fit-out, is £667m (2006 £691m). In the opinion of the Directors, the aggregate market value of the Company's land and buildings exceeds this net book value by £798m (2006 £679m).

Financial instruments

Details of financial instruments and financial risk management objectives and policies are shown in note 24 and note 23 respectively.

Directors and their interests

The Directors of the Company and details of changes during the year are given on pages 27 and 28. The Secretary of State appoints the Chairman; all other Directors are appointed by the Company with the Secretary of State's consent.

HM Government is the Company's sole Shareholder and accordingly the Directors have no interest in shares of the Company.

Audit information

The Directors confirm that so far as they are aware there is no relevant audit information of which the auditors are unaware and that each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

Qualifying third party indemnity provisions for Directors

At the time the Directors' Report was approved under section 234A of the Companies Act 1985 a partial qualifying third party indemnity provision was and remains in force for the benefit of all Directors of the Company and was and remains in force for the benefit of one or more persons who were then Directors of the Company. The indemnity is granted under article 129 of the Company's Articles of Association. The indemnity is partial in that it does not allow the Company to cover the costs of an unsuccessful defence of a third party claim.

People

The Group employs almost 185 000 people (2006 almost 193,000) in our UK wholly owned subsidiaries. A reconciliation to the Group headcount is shown in note 4 to the accounts. Our people are our strategic strength and competitive advantage.

The Group's policy is to encourage effective communication and consultation between our people, particularly on matters relating to strategy, financial and economic factors that may influence the Group's performance. This is achieved through the use of an extensive range of communication channels including magazines, briefings, open forums and an intranet website. Our people have various bonus schemes, significant elements of which are based on business-related targets.

We actively encourage continuous training and skill development for all our people to ensure achievement of corporate and individual objectives. Management development and training programmes have been designed to attract and retain the best. The Group has worked with the unions to introduce several innovative working practices to improve efficiency.

An Equal Opportunities policy is maintained in all respects including disability, age, religion, colour, sex, nationality, ethnic origin, sexual orientation, race, creed and marital status.

Royal Mail Holdings plc

Directors' Report (continued)

In 2003 the Chairman created a programme to make Royal Mail Group a 'Great Place to Work' and made it a priority for everyone across the business. The purpose of the programme is to encourage people to contribute to improving their working environment, to equip our people with the skills they need to develop pride in and understanding of the business and to drive respect for colleagues - in short, to ensure people considerations are at the heart of all major business decisions. The programme is ongoing and will remain an integral part of our people strategy.

Our people strategy will ensure we realise our potential as an organisation through the strength of our people by developing a high-performing sustainable culture where everyone feels involved and valued. It focuses on seven key areas:

- creating interesting meaningful jobs with more flexible working patterns
- identifying and developing in all our people a set of core behaviours that determine how we treat each other, our customers and our Shareholder
- building a fluid, innovative and adaptive organisation to improve our response to environmental and market changes
- developing a high-performance culture in which everyone understands their contribution and is motivated to achieve their full potential.
- defining, recruiting and developing the core capabilities we need to thrive in a competitive, deregulated market
- recruiting, attracting and developing the leadership and management capability we need to deliver our goals and
- enhancing our ability to attract and retain the talent required to compete successfully

Our intention is to underpin our people strategy with a measurement system that will objectively demonstrate the value of our people and their contribution to the success of our business.

Currently, the way we monitor our progress towards becoming a 'Great Place to Work' is by using 'Have Your Say', our employee opinion survey launched in January 2003. This is carried out on a rolling basis across all employees and the results are reviewed monthly right through the business - from local level up to Board level.

Corporate Social Responsibility

The Group is committed to carrying out its activities in a socially responsible manner in respect of the environment, employees, customers and local communities. A Corporate and Social Responsibility (CSR) Governance Committee reports to the Board, which publishes an annual report of its activities. Further details of our CSR governance structure and activities will be available in our 2007 CSR Report, due to be published in due course.

Disabled employees

The Group's policy is to give full consideration to applications for employment from disabled persons. Employees who become disabled whilst employed receive full support through the provision of training and special equipment to facilitate continued employment where practicable. The Group provides training, career development and promotion to disabled employees wherever appropriate.

Going concern

After analysis of the financial resources available and cash flow projections for the Group, the Directors consider that it is appropriate to prepare the financial statements on a going concern basis. Further details are provided under funding in note 2 to the accounts.

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the Annual General Meeting.

By Order of the Board

GRO

Jonathan Evans

Company Secretary

26 October 2007

Royal Mail Holdings plc

Corporate Governance

Statement by the Directors on compliance with the Combined Code

The Board is committed to high standards of Corporate Governance and supports the Combined Code on Corporate Governance (the Code), published in July 2003 and revised in June 2006. The following statement is intended to explain our governance policies and practices in light of the Code principles and provisions in so far as they are appropriate to a public company with a single Shareholder and to provide insight into how the Board and management run the business for the benefit of the Shareholder. The Company has fully complied with the provisions of the Code.

The Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance. The Board currently comprises a Non Executive Chairman, five Executive Directors and six Non Executive Directors. The biographies of each of the Directors setting out their current roles, commitments and previous experience are on pages 27 and 28. The Board usually meets monthly, and has defined those matters that are reserved exclusively for its consideration. These include the approval of financial statements, acquisitions and disposals, material agreements, non-recurring projects, major capital expenditure and strategic plans. It also delegates responsibilities to the Board Committees detailed below. For each scheduled meeting of the Board the Company Secretary, on behalf of the Chairman, collates and circulates the papers, aiming to allow sufficient time for the Directors to review the information provided. The Board is confident that all its members have the knowledge, talent and experience to perform the functions required of a Director of the business. Executive Directors have rolling 12-month contracts and Non Executive Directors are generally appointed for a three-year term.

The Board considers that each of the six Non Executive Directors is independent. This means that in the view of the Board, they have no links to the Executive Directors and other managers, and no business or other relationship with the Company that could interfere with their judgement. Sir Michael Hodgkinson is the Senior Independent Director. There is also a clear division of responsibilities between the Chairman and the Chief Executive. Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis. The Board initiated a systematic approach to the evaluation of the effectiveness of the Board, its Committees and individual Directors. This was undertaken by the Chairman and implemented in collaboration with the Committee Chairmen and with the support of the Company Secretary. The evaluation was conducted by way of a formal questionnaire that enabled Directors' perspectives on the effectiveness of the Board and Committees to be fed back to the Chairman and the full Board. Performance evaluations of Board Committees were conducted on behalf of the Chairman by the Chairmen of the respective Board Committees. The Non Executive Directors, led by the Senior Independent Director, reviewed the performance of the Chairman and the Executive Directors.

Directors may take independent professional advice in the furtherance of their duties, at the Group's expense. All Directors have access to the advice and services of the Company Secretary, the appointment and removal of whom is a matter for the Board as a whole.

All Directors appointed by the Board are required by the Company's Articles of Association to be elected by the Shareholder at the first AGM after their appointment. On appointment the Directors take part in an induction programme where they receive information about the Group, the role of the Board and matters reserved for its decision, the terms of reference and membership of the principal Board Committees, the Group's Corporate Governance arrangements and the latest financial information about the Group. This is supplemented by visits to key business locations. The Group engages in two-way communication with the Shareholder to discuss information on its strategy, performance and policies. The Board receives feedback on these meetings from the Directors attending them.

Royal Mail Holdings plc

Corporate Governance (continued)

During the year the Directors attended the following number of meetings of the Board and its main Committees

Number of meetings	Board	Audit and Risk Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	12	6	6	7
Non Executive Chairman				
Allan Leighton	12			
Executive				
Adam Crozier	12			
David Burden	12			
Alan Cook	12			
Ian Duncan ⁽¹⁾	7			
Ian Griffiths	12			
Tony McCarthy	11			
Non Executive				
David Fish	12		6	7
Richard Handover	12		6	7
Sir Michael Hodgkinson	12		6	
John Neill	12	6		
Baroness Margaret Prosser	12	4		7
Helen Weir	10	6		
Former Directors				
Bob Wigley ⁽²⁾	5	2		

⁽¹⁾ Attended all Board meetings since becoming a Director during the year

⁽²⁾ Resigned 31 October 2006

Outside appointments

The Board believes that there are significant benefits to both the Group and the individual from Executive Directors accepting Non Executive Directorships of companies outside of the Group and for which the Director may retain the fees (see the Directors Remuneration Report on page 43 for details) The Board's policy is normally to limit Executive Directors to no more than one Non Executive Directorship

Board Committees

The following Committees deal with specific aspects of the Group's governance The terms of reference for each of the principal Committees are available on the Company's website (www.royalmailgroup.com) or on written request from the Company Secretary The details of Committee membership are as at 25 March 2007

Royal Mail Holdings plc

Corporate Governance (continued)

Group Executive Team

Chair	Adam Crozier Group Chief Executive
Membership	The Group Executive Team comprises David Burden (Group Chief Information Officer) Alan Cook (Managing Director Post Office Limited), Ian Duncan (Group Finance Director) Jonathan Evans (Company Secretary) Mary Fagan (Group Corporate and Government Affairs Director) Ian Griffiths (Managing Director Letters) Tony McCarthy (Group Director People and Organisational Development) Alex Smith (Director of Strategy) and David Smith (Managing Director Parcelforce Worldwide)
Role	<p>The Committee's responsibilities include</p> <ul style="list-style-type: none">▪ to develop and monitor deployment of the Group's strategy, annual operating plans and budgets for Board approval▪ to review operational activities and set policies where these are not reserved to the Board and▪ to allocate resources both people and financial across the Group <p>The Holdings Board has delegated authority to the Investment Committees of the Group Executive Team to make investment decisions of up to £20m</p>

Audit and Risk Committee

Chair	Helen Weir from 1 November 2006
	Bob Wigley was Chairman of the Audit and Risk Committee until he resigned as a Director of the Company on 31 October 2006
Membership	John Neill Baroness Margaret Prosser, Helen Weir until appointed to Chair 1 November 2006
	The Board is confident that the collective experience of the Audit and Risk Committee members enables them as a group to act as an effective Audit and Risk Committee. The Committee also has access to the financial expertise of the Group and its auditors and can seek further professional advice at the Company's expense if required
Role	<p>The Committee which is assisted by the Group Risk Committee provides a forum for reporting by both internal and external auditors and is responsible for a wide range of matters including</p> <ul style="list-style-type: none">▪ to monitor the integrity of the financial statements of the Group▪ to review the Group's internal financial control system and unless addressed by the separate Risk Management Committee or by the Board itself internal control and risk management systems▪ to monitor and review the effectiveness of the Group's Internal Audit function▪ to make recommendations to the Board for Shareholder approval in general meetings in relation to the appointment of the external auditors and to approve the remuneration and terms of engagement of the external auditors▪ to monitor and review the external auditors' independence, objectivity and the effectiveness of the audit process▪ to develop and implement policy on the engagement of the external auditors to supply non-audit services and▪ where the Audit and Risk Committee's monitoring and review activities reveal cause for concern or scope for improvement to make recommendations to the Board on action needed to address the issue or to make improvements

Royal Mail Holdings plc

Corporate Governance (continued)

Remuneration Committee

Chair	David Fish
Membership	Richard Handover Sir Mike Hodgkinson
Role	<p>The Committee's responsibilities include</p> <ul style="list-style-type: none">▪ to determine and recommend for the Board's approval, the framework for the remuneration of the senior executives of the Group,▪ to determine the individual remuneration packages for the Chairman, the Executive Directors and the Company Secretary, subject where necessary to the consent of the Secretary of State for Trade and Industry (the Secretary of State), and▪ to agree the targets for any performance-related incentive schemes applicable to Executive Directors and senior executives

Nomination Committee

Chair	Richard Handover
Membership	Baroness Margaret Prosser David Fish
Role	<p>The Committee's responsibilities include</p> <ul style="list-style-type: none">▪ to lead a formal rigorous and transparent process both for appointments to the Board of the Company and for appointments to the boards of subsidiaries Some appointments will be subject to the consent of the Secretary of State as provided in the Articles▪ to advise the Board on succession planning for the positions of Chairman, Chief Executive and all other Board appointments and other senior appointments and▪ to keep under review the balance of membership and ensure that the Boards have the required mix of skills knowledge and experience

In addition to the principal Committees above there are also the following Committees

Corporate and Social Responsibility Governance Committee

Chair	Sir Mike Hodgkinson
Membership	Tony McCarthy, Group Director People and Organisational Development Director of Corporate and Social Responsibility Head of Environment Head of Health Head of Safety other senior executives across the Group
Role	<p>The Corporate and Social Responsibility Governance Committee reports to the Board and has responsibilities including</p> <ul style="list-style-type: none">▪ to act on behalf of the Group Executive Team to provide an overview of the social environmental and ethical impacts of the Group's activities and▪ to make recommendations on minimum Corporate and Social Responsibility standards and policies

Royal Mail Holdings plc

Corporate Governance (continued)

Pensions Committee

Chair Ian Duncan

Membership Tony McCarthy Jonathan Evans

Role The Committee's responsibilities include

- to review funding benefits scheme structure and strategic developments impacting on the Group's occupational pension schemes and
- to represent the Group in discussions with the Trustees of the Group's occupational pension schemes

Non-audit services provided by the external auditors

In some cases the nature of advice required makes it more timely and cost effective to select the external auditors who already have a good understanding of the Group. In order to maintain the objectivity and independence of the external auditors the Board has determined what work can be provided by the external auditors and the approval processes associated with them. The Audit and Risk Committee monitors the level of non-audit fees paid to the external auditors.

Royal Mail Holdings plc

Internal control

Overview

The Directors are responsible for the Group's system of internal control and risk management as well as the timely review of its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Group's approach to internal control is based on the underlying principle of line management accountability for control and risk management. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group in accordance with the guidance detailed by the Turnbull Committee as part of the Code, including financial and operational risks and risks to reputation. The Board regularly reviews this process. The process has been in place throughout the year and up to the date of approval of these accounts. The responsibility for joint ventures and associates rests on the whole with the senior management of those operations. The Company monitors its investments and exerts influence through Board representations.

The Board has reviewed the effectiveness of the system of risk management and internal control. The key elements include a review of Internal Audit reports, regular confirmations from local management and communications from the Chair of the Audit and Risk Committee on the outcome of Audit and Risk Committee meetings.

Audit and Risk Committee

The Committee reports to the Board and meets as a minimum on a quarterly basis to monitor and review the effectiveness of the risk management processes and the control environment. The Committee reviews the scope of work, authority and resources of the Internal Audit and Risk Management function. The Audit and Risk Committee regularly reviews the Group risk profile.

Key control processes

The key processes used to assess the effectiveness of systems are ongoing and include the following:

- the business units have authority to manage within the limits set by the Board and within the scope of reserved powers. The Group's Code of Business Standards sets the principles of professionalism and integrity for our people.
- discussion and approval by the Board of the strategic direction, plans and objectives of the Group and each operating company and the risks to achieving them.
- reviews and approval by the Board of budgets and forecasts.
- monthly reviews of performance by reference to key performance indicators, updated forecasts and information on the key risk areas.
- at least quarterly reviews by the Audit and Risk Committee of the scope and results of internal audit work across the Group. The scope of the work covers all key activities of the Group and concentrates on higher risk areas.
- reviews of the scope of the work of the external auditors by the Audit and Risk Committee and any significant issues arising.
- reviews by the Audit and Risk Committee of accounting policies and delegated authority levels and
- consideration by the Audit and Risk Committee of the major risks facing the Group and procedures to manage them.

Risk Management process

The process consists of:

- formal identification by management at each level of the Group through a self assessment process of the key risks to achieving their business objectives and the controls in place to manage them. The likelihood and potential impact of each risk is evaluated.
- certification by management that they are responsible for managing the risks to their business objectives and that the internal controls are such that they provide reasonable but not absolute assurance that the risks are appropriately identified, evaluated and managed and
- independent assurance by Internal Audit as to the existence and effectiveness of the risk management activities described by management.

The system of internal control and risk management is embedded into the operations of the Group and the actions taken to mitigate any weaknesses are carefully monitored.

Royal Mail Holdings plc

Directors' Remuneration Report

This report provides the information required by the Directors' Remuneration Report Regulations 2002 (the Regulations). The Company's remuneration policy follows the Combined Code and common practice in other UK organisations. The Royal Mail Group strategic plan commits to extensive transformational change to ensure that customers are offered high quality and cost effective services. The Board believes that an effective remuneration strategy is essential to support the plan by ensuring that the Company has people of the right calibre and skills to meet the considerable challenges the Company faces. Incentives which create an identity of interest between employees and the Shareholder form a vital part of this strategy.

The elements of this report that have been audited are

- Directors' emoluments with respect to 2006-07
- Performance-related personal annual bonuses outturn for 2006-07
- Company Awards and Bonus Awards accruing in respect of the 2005-06 to 2007-08 Long Term Incentive Plan and
- Pensions

Directors' emoluments with respect to 2006-07

Directors' remuneration excluding pensions was as follows

	Current annual salary/fees £000	Salary/fees £000	Annual performance bonus		Annual performance bonus paid £000	Waived bonus from prior years £000	Benefits £000	Total excluding pensions	
			Performance-related bonus £000	Waived into LTIP* £000				2007 £000	2006 £000
Non Executive Chairman									
Allan Leighton	20	20	180	-	180	-	-	-	200
Executive									
Adam Crozier	633	629	469	(257)	212	-	18	-	859
David Burden	283	281	168	(92)	76	-	13	-	370
Alan Cook ⁽¹⁾	257	255	165	(93)	72	-	19	-	346
Ian Duncan ⁽²⁾	300	175	101	(55)	46	-	143	-	364
Ian Griffiths ⁽³⁾	500	500	226	-	226	18	69	-	813
Tony McCarthy	344	342	204	(112)	92	-	25	-	459
Non Executive									
Sir Michael Hodgkinson	83	83	-	-	-	-	-	-	83
David Fish	45	45	-	-	-	-	-	-	45
Richard Handover	45	45	-	-	-	-	-	-	45
John Neill	35	35	-	-	-	-	-	-	35
Baroness Margaret Prosser	40	40	-	-	-	-	-	-	40
Helen Weir ⁽²⁾	43	38	-	-	-	-	-	-	38
Former Directors									
Marisa Cassoni ⁽³⁾	-	-	-	-	-	-	-	-	656
David Mills ⁽³⁾	-	-	-	-	-	-	-	-	816
Bob Wigley ⁽⁴⁾	-	25	-	-	-	-	-	-	25
Total 2007	2,628	2,513	1,513	(609)	904	18	287	0	3,722
Total 2006	2,326	2,135	1,031	(463)	568	-	115	865	-

* The annual performance bonus waived into LTIP is explained on page 40

⁽¹⁾ Ian Duncan joined the Board on 1 September 2006

⁽²⁾ Helen Weir and Alan Cook joined the Board on 1 January 2006 and 1 March 2006 respectively

⁽³⁾ Marisa Cassoni and David Mills left the Board on 17 November 2005 and 31 December 2005 respectively

⁽⁴⁾ Bob Wigley left the Board on 31 October 2006

⁽⁵⁾ Ian Griffiths joined the Board on 7 February 2006 and resigned on 30 April 2007

As noted above there have been a number of changes to the Board. New executive members have been recruited at lower base salary levels than their predecessors and on a like-for-like basis executive Directors' base pay was 2.7% lower than previously.

The figures in the table represent emoluments earned and receivable as Directors during the financial year whenever paid. Such emoluments are normally paid in the same financial year with the exception of the annual performance-related bonus which is paid in the year following that in which it is earned and the amount deferred into LTIP which is not paid until the LTIP matures.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

In addition some Directors receive supplements in lieu of pension contributions (see page 43)

	Cash supplement in lieu of pension (see page 43)		Total excluding pensions but including cash supplement in lieu of pension	
	2007 £000	2006 £000	2007 £000	2006 £000
Adam Crozier	140	-	999	790
Alan Cook	100	8	446	30
Ian Duncan	45	-	409	-
Ian Griffiths	157	24	970	130
David Mills	-	137	-	953
	442	169		

The total Directors remuneration excluding pensions and Long-Term Incentive Plan including cash supplement in lieu of pension is £4,164 000 (2006 £3 852 000)

These payments are consistent with the policy of the Remuneration Committee. The following sections describe the constitution of the Committee, its general policy and the main constituents of remuneration

The Remuneration Committee

The Board retains overall accountability for the framework and costs of executive remuneration and the terms of the service contracts offered to all Executive Directors, which require the consent of the Secretary of State for Trade and Industry. The Secretary of State also gives consent for the remuneration arrangements for Non Executive Directors. The Remuneration Committee's role is to develop the remuneration policy for Executive Directors and their immediate reports and specifically to make recommendations on their salary, benefits, bonuses and other terms and conditions of employment. The Committee also recommends appropriate compensation on the cessation of employment, giving careful consideration to what compensation should be paid taking into account the circumstances of the particular case and the ability of the individual to mitigate

The Remuneration Committee is made up wholly of independent Non Executive Directors. Membership of the Committee is disclosed on page 34. The Chief Executive Adam Crozier, and the Director People & Organisational Development Tony McCarthy may attend these meetings by invitation but are not present at the discussion of their own remuneration

Advice to the Remuneration Committee

The Committee calls for information and advice from inside and outside the Group. It takes advice from those independent professional organisations that are best able to assist its consideration of the particular topics under discussion

During 2006-07 advice on the performance of key executives was given by the Chairman and the Chief Executive. Information on the external marketplace was given by Monks Partnership (a trading name of PriceWaterhouse Coopers), Deloitte & Touche LLP and Watson Wyatt Limited. Internal support is primarily provided by the Director People & Organisational Development, Tony McCarthy, and from the Company Secretary, Jonathan Evans. Other advice and information has been provided by specialists from People & Organisational Development and Finance

During the year advice was given to the Company by Watson Wyatt Limited on pension and actuarial matters

Remuneration policy

The Company's policy on Directors' remuneration is that

- the overall remuneration package should be sufficiently competitive to attract and retain executives of the necessary quality in a complex business and a competitive market place who will deliver success for the Shareholder and high levels of customer service, safety and environmental performance
- a significant proportion of the remuneration package should be dependent on performance in both the short and the long-term and
- the system of remuneration should establish an identity of interest between senior executives, customers and the Shareholder

The policy for senior executives takes into account pay and employment conditions elsewhere in the Group

The Committee regularly reviews the structure of the package and its competitiveness against appropriate marketplaces. The Committee aims to ensure that the package is proportionate and effective, and that it is developed in accordance with accepted best practice

The main components of remuneration

The main components for Executive Directors are basic salary, an annual performance-related bonus, a Long-Term Incentive Plan (LTIP), pension and other benefits. The Committee believes that there should be a continuing emphasis on those elements of remuneration that are performance-related

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Base salaries

The Committee believes that base salaries should be set at levels that are sufficient to recruit and retain high calibre executives. In making its judgement the Committee is informed by a variety of data aimed at making a fair comparison with enterprises of a similar size and complexity to Royal Mail. This data is provided by independent consultancies. Increases are recommended where the Committee believes that it is necessary to reflect contribution, increased individual responsibilities and market levels. The Secretary of State's consent is required for all material changes to Directors' remuneration.

Last year the increase applied was 2.9% which was below the market movement for jobs of this size but in line with increases applied elsewhere in the Company. It has been decided that for 2007-08 the increase in base salaries for Executive Directors will be zero.

Performance-related, personal annual bonus 2006-07

For 2006-07 the annual bonus plan followed the model of the previous year except that:

- all Business roles had a weighting of 30% on Group Performance and 70% Business. This applied to the Managing Directors of Letters and Post Office Limited and
- all Group roles had an additional 10% weighting given to Post Office Limited's performance in view of the importance of supporting the recovery of that business. This applied to all Executive Directors except for the Managing Directors of Letters and Post Office Limited.

The following tables show the make up of the annual bonus plan as percentages of annual salary.

Maximum levels	Profit	Service Quality	Total
Chief Executive	60	40	100
Other Executive Directors	48	32	80

On-target levels	Profit	Service Quality	Total
Chief Executive	30	30	60
Other Executive Directors	24	24	48

Threshold levels	Profit	Service Quality	Total
Chief Executive	15	15	30
Other Executive Directors	12	12	24

The financial target was based on Group profit.

The Service Quality measures were:

- First Class stamped and metered
- Second Class stamped and metered
- Mailsort 2
- Mailsort 3
- Special Delivery
- 2nd Class PPI
- Parcelforce 24 and
- A Post Office Limited Customer Service Effectiveness measure

In addition Post Office Limited has a measure of new products sold.

Long-Term Incentive Plans

Last year it was noted that a Long-Term Incentive Plan with similar characteristics to the previous one was being discussed with Government.

After the discussion of various options a three year LTIP is in place for 2005-06 to 2007-08. A further three year LTIP for the period 2007-08 to 2009-10 will be put in place. This arrangement will allow the last plan to come to an end at the same time as the next PostComm review.

Performance is measured by Return on Total Assets.

For the three years 2005-06 to 2007-08 the principles of the plan are as follows:

(a) Annual Company Performance Awards which accrue on a sliding scale above a threshold level of performance and begin at 12.5% of annual base salary. For on-target performance, the Company Award is 25% of annual base salary and for exceptional performance this rose in accordance with a stepped scale to a maximum of 37.5%. For 2007-08 the potential awards are half of these - i.e. they would begin at 6.25% of annual base salary with 12.5% for on-target performance and 18.75% for exceptional performance.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

(b) Bonus Awards A Bonus Award can be made each year by the Remuneration Committee. These are only made in situations where the Director waives a proportion of their annual bonus and do not exceed the amount waived. A Director has the discretion to waive a maximum of one half of any annual bonus up to the on-target level. Any decision to waive must be taken in the first quarter of the relevant year. If a bonus above on-target would otherwise be payable then three quarters of this additional amount will be compulsorily waived. For 2007-08, the Bonus Award would be one half of the normal level. If a proportion of annual bonus is waived then a Bonus Award may be made within the LTIP not exceeding that value.

(c) A Multiplying factor Company Awards may be increased by a factor which measures Return on Total Assets across the plan. If the on-target level is achieved for the relevant period then each of the Company Awards to which it applies may be increased by an additional one third. In the case of exceptional performance then up to a maximum addition of 100% can be added.

Payments under the plan will be made in June 2008.

The 2007-08 to 2009-10 LTIP will have the same principles as the previous LTIP, with 2007-08 also counting for one half of the normal amount in that plan. Any Company and Bonus Awards for 2007-08 are effectively shared equally between the two plans.

The performance targets for the 2007-08 to 2009-10 plan are still under discussion with the Government.

The proposals are being structured such that:

- three year plans could be used while aligning the maturity of the second plan with the next PostComm review and
- there is a connection between the two plans through the common year with one half of the 2007-08 bonus award being carried forward

Company Awards

These are measured against an annual Return On Total operating Assets target (ROTA). ROTA incentivises the productive value of the business and emphasises the need to make efficient use of all operational assets. It covers the need to make a proper return both on any new investments that are made and on the existing asset base.

For 2005-06 the ROTA target was 11.2% and the Company's achievement was 13.7% 22% above the target and above the proposed stretch of 13.4%. This resulted in Company Awards of 37.5%.

For 2006-07 the following table against annual ROTA applied:

Royal Mail ROTA achievement	Percentage of Base Salary
Below 3.8%	Nil
3.8-4.1%	12.5%
4.2-4.7%	25.0%
4.8-5.3%	27.5%
5.4-7.1%	pro-rata 30.0% to 37.5%
7.1% and above	37.5%

The outturn was 5.4% but the Committee made an award of 25% of base salary for 2006-07.

Bonus Awards

As described above a Director may waive a maximum of one half of any annual bonus up to the on-target level and must waive three quarters of any bonus earned above the on-target level. If a proportion of annual bonus is waived then a Bonus Award may be made within the LTIP, not exceeding that value.

Multiplying Factor

The Multiplying Factor is dependent upon cumulative ROTA over 2005-06 to 2007-08.

The cumulative ROTA works as follows. Targets for the end of the third year are 15.9% at the threshold level, 17.4% at the on-target level and 25.7% at the maximum. To ensure consistency of performance there are intermediate targets at March 2007 of 13.6% at the threshold level, 15.1% at the on-target level and 20.3% at the maximum. If the on-target level of cumulative ROTA is exceeded at the end of March 2007 the percentage multiplier at that position on the performance scale is applied to the awards made so far and the final outcome is applied to the awards made in the last year only and in this case is subject to Remuneration Committee discretion.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

The performance scale for the Multiplier is as follows

	Award enhanced by
Below threshold	0%
On-target	33%
Maximum stretch	100%

With intermediate levels of performance attracting pro-rata awards The outturn for 2006-07 was 19.0% resulting in a factor of 84%

Benefits

Benefits include the provision of company cars health insurance relocation costs or the cash equivalent of any benefits not taken

Pensions

The Group has a liability to pay pensions in respect of Directors' services and for some Executive Directors makes contributions to pension schemes for this purpose. The Company has set up a retirement pension arrangement which will provide benefits to Directors whose contributions to the Company scheme are restricted by the Inland Revenue earnings cap. Following the recent changes in pensions legislation the Company will continue to apply the previous earnings cap indexed by inflation each year as a constraint on the amount of salary which is pensionable through the Company scheme.

The Company has announced a review of its pension provisions for all employees. The results of this review once it is concluded will affect Executive Directors.

Fixed and performance-related elements of Executive Directors' remuneration (excluding pensions)

For 2006-07, 26% of Directors' potential annual earnings related to fixed elements whilst 74% related to annualised performance elements for the Group Chief Executive 24% was fixed and 76% was variable. The element of remuneration at risk to performance is that available through the Long-Term Incentive Plan and the performance-related personal annual bonus.

Service contracts

The Committee's policy is that Executive Directors appointed to the Board are offered notice periods of one year. The Committee has a defined policy on compensation and mitigation to be applied in the event of a Director's contract being prematurely terminated. In such circumstances steps would be taken to ensure that poor performance is not rewarded.

The rolling service contracts and letters of appointment of the Directors include the following terms as at 25 March 2007

	Date of contract	Expiry date of current service contract ⁽¹⁾	Unexpired term (months)
Non Executive Chairman			
Allan Leighton	25 March 2005	25 March 2008	12
Executive Directors			
Adam Crozier	1 February 2003		12
Ian Duncan	1 September 2006		12
Ian Griffiths	6 February 2006		12
Alan Cook	1 March 2006		12
Tony McCarthy	6 January 2003		12
David Burden	1 July 2004	31 July 2007	4

The Non Executive Directors do not have service contracts. The dates of the current Non Executive Director appointments are as follows

Non Executive Directors

Sir Michael Hodgkinson ⁽³⁾	1 January 2003	31 August 2007	5
David Fish ⁽²⁾	1 January 2003	30 September 2008	18
Richard Handover ⁽²⁾	1 January 2003	30 September 2008	18
John Neill ⁽³⁾	1 January 2003	31 August 2007	5
Baroness Margaret Prosser	1 November 2004	31 October 2007	7
Helen Weir	1 January 2006	31 December 2008	21
Bob Wigley ⁽⁴⁾	1 April 2003	31 October 2006	-

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

⁽¹⁾ All Executive Directors have a contracted 12-month notice period from the Company. The Director must give six-months notice. The standard term for compensation for loss of office is a maximum payment of 12-months basic salary which may be subject to mitigation. David Burden retired from the Company with effect from 31 July 2007. The Company is committed for the full three-year term for Non Executive Directors, including the Chairman.

⁽²⁾ During the year the Secretary of State agreed contract extensions of up to 27 months.

⁽³⁾ During the year the Secretary of State agreed contract extensions of up to 4 months. John Neill and Sir Michael Hodgkinson's contracts came to an end on 31 August 2007.

⁽⁴⁾ Bob Wigley resigned on 31 October 2006. During the year the Secretary of State agreed a contract extension of up to 6 months.

Stephen Carter was appointed as a Non-executive Director on 1 September 2007.

Non Executive Directors

The fees paid to the Non Executive Directors are determined by the Executive Directors and approved by the Secretary of State. Independent market surveys are consulted in determining them. Fees may comprise a basic fee for Board membership and, as appropriate, additional fees for the membership or chairmanship of the Audit and Risk, Remuneration and Nomination Committees. Details of the fees are given below.

Performance-related, personal annual bonuses outcome for 2006-07

The details of the scheme are outlined on page 39. For 2006-07 the Remuneration Committee concluded that the financial performance was between the on-target and the maximum and that all of the quality of service targets set for the Group had been met or exceeded, triggering payment of 74.1% of maximum bonus potential to Adam Crozier, David Burden, Ian Duncan and Tony McCarthy, 80.5% of maximum bonus potential to Alan Cook and 56.4% of maximum bonus potential to Ian Griffiths. As the Company had exceeded its financial target and had overall exceeded its quality targets it was decided to award the Non-Executive Chairman a bonus of £180 000.

Company Awards and Bonus Awards Accruing in respect of the 2005-06 to 2007-08 Long Term Incentive Plan

The Remuneration Committee policy is that a high proportion of total remuneration is at risk to performance.

Awards made under this plan are not payable until 2008, except in the case of leavers in good standing.

	Bonus Awards held at 27 March 2006 £000	Awards Transferred to remuneration in 2006-07 £000	Company Awards in respect of 2005-06 £000	Bonus Awards in respect of 2006-07 £000	Company Awards in respect of 2006-07 £000	Application of Multiplier £000	Total Awards Held £000	Company LTIP award excluding individual Bonus Awards £000
Executive								
Adam Crozier	248	-	231	257	158	751	1 645	1 140
David Burden ⁽¹⁾	89	-	103	92	70	298	652	471
Alan Cook	-	-	8	93	65	139	305	212
Ian Duncan	-	-	-	55	43	82	180	125
Ian Griffiths	18	(18)	-	-	-	-	-	-
Tony McCarthy	108	-	126	112	86	362	794	574

⁽¹⁾ David Burden waived his LTIP payment before the value was determined.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)**Non Executive Directors**

The fees of the Chairman and the Non Executive Directors are agreed with the Secretary of State and are currently £20 000 per annum and £30 000 per annum respectively

Sir Michael Hodgkinson receives additional fees of £37 500 (2006 £37,500) for his position as Chairman of Post Office Limited and £10 000 for his role as Senior Independent Director. The annual fee for committee membership is £5 000. £10 000 for chairmanship and £12,500 in the case of the chairman of the Audit and Risk Committee

Executive Directors' outside appointments

The Executive Directors may retain fees from their Directorships. The annual fees due to Executive Directors in respect of their Non Executive Directorships are shown in the table below

Directorship	2007 £	2006 £
Adam Crozier Debenhams plc	40 000	-
Ian Griffiths Ultra Electronics Holdings plc	34 000	33 000

Pensions

The Group normally offers its most senior people membership of the Royal Mail Senior Executive Pension Plan (RMSEPP). Details of the RMSEPP are set out in note 25 to the accounts. The Plan is a funded Inland Revenue-registered final salary occupational pension scheme. The scheme provides for a two-thirds final pensionable salary at a normal retirement age of 60 subject to the necessary pensionable service and scheme specific earnings cap (previously the Inland Revenue earnings cap). Pensions in payment are increased annually in line with Retail Prices Index (RPI) subject in some cases to a cap. Pensions are also payable to dependants on the death of the member and a lump sum is payable if death in service occurs.

For senior executives whose membership of the RMSEPP is restricted by the earnings cap, pension provision is made by a combination of the Company scheme and a cash pension supplement or its equivalent. From April 2006 there are no further contributions into the Funded Unapproved Retirement Benefits Scheme (FURBS). Ian Griffiths, Ian Duncan and Adam Crozier (since August 2006) receive a cash supplement of 40% of base pay above the earnings cap. Alan Cook is not a member of the Company scheme and receives a cash supplement of 40% of base pay less the equivalent member pension contributions payable under the Company scheme. The Company has made provision for retirement pension arrangements at a rate of 40% of base pay above the earnings cap for David Burden and for Adam Crozier until July 2006. A reserve has been established for the additional pension for Tony McCarthy to provide the total retirement pension including the pension from his previous employer's pension scheme, of two-thirds of base pay at normal retirement age. During the year the provision of £645 911 for Adam Crozier was released to a private Fund (provision held at 2006 £574 439). The total provision for Tony McCarthy and David Burden at the year end is £1 169 933 (2006 £847,008). The Company decided at its discretion to make a pension contribution payment for David Burden of £652,277. This contribution is of equal value to the Long Term Incentive Plan and bonus payments waived by David Burden and does not therefore represent any additional cost to the company than had such incentive payments been made.

Disclosure of Directors' pension transfer values is required under two separate requirements:

- Stock Exchange Listing Rules: the requirements are the same as disclosed in last year's accounts and are designed to indicate the increase in the value of Directors' accrued benefits during the period. The transfer value is calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes Directors' contributions and
- Directors' Remuneration Report Regulations 2002: this is designed to assess the change in transfer values during the year, taking into account movement in investment market conditions. Falls in market values may generate a negative movement in the transfer values.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

The pension entitlements (under Stock Exchange Listing Rules) of the Directors at the year end were

	Age at Year end	Accumulated accrued benefit at 25 March 2007 £000	Increase in accrued benefits during the period £000	Increase in accrued benefits during the period (net of inflation) £000	Transfer value of increase before inflation less Directors' contributions £000
Executive Directors					
Adam Crozier	43	65	5	3	32
David Burden	60	16	4	4	67
Ian Duncan ⁽¹⁾	46	2	2	2	24
Ian Griffiths	56	4	4	4	59
Tony McCarthy	50	59	8	6	92

⁽¹⁾ Appointed on 1 September 2006

	Age at Year end	Transfer value at 26 March 2006 or at date of appointment to Board if later £000	Plus transfers- in received £000	Sub total £000	Transfer value at 25 March 2007 £000	Movement in the period less Directors' contributions £000
Executive Directors						
Adam Crozier	43	581	-	581	796	208
David Burden	60	247	-	247	335	82
Ian Duncan	46	-	-	-	28	24
Ian Griffiths	56	8	-	8	74	59
Tony McCarthy	50	720	-	720	1,068	334

The transfer values disclosed represent a potential liability of the pension plan rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.

By Order of the Board

GRO

Jonathan Evans

Company Secretary

26 October 2007

Royal Mail Holdings plc

Statement of Directors' responsibilities in relation to the Group financial statements

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards (IFRSs) as adopted by the European Union

The Directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period

In preparing those Group financial statements the Directors are required to

- select suitable accounting policies in accordance with IAS 8 'Accounting Policies Changes in Accounting Estimates and Errors' and then apply them consistently
- present information including accounting policies in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions other events and conditions of the Group's financial position and financial performance and
- state that the Group has complied with IFRSs subject to any material departures disclosed and explained in the financial statements

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Royal Mail Holdings plc

Independent Auditors' Report to the members of Royal Mail Holdings plc

We have audited the Group financial statements of Royal Mail Holdings plc for the year ended 25 March 2007 which comprise the Group income statement, Group statement of recognised income and expense, Group balance sheet, Group cash flow statement and the related notes 1 to 30. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Royal Mail Holdings plc for the year ended 25 March 2007 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members as a body in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the Group financial statements. The information given in the Directors' Report includes that specific information presented in the Group Operating and Financial Review that is cross-referred from the Review of the business and future developments section of the Directors' Report.

In addition we report to you if, in our opinion we have not received all the information and explanations we require for our audit or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman and Chief Executive's Statement, the Annual Review, the Operating and Financial Review, the Directors' Report, the Corporate Governance statement, the Internal Control statement, the unaudited part of the Directors' Remuneration Report and the Statement of Directors' Responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination on a test basis of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

Opinion

In our opinion

- the Group financial statements give a true and fair view in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 25 March 2007 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation, and
- The information given in the Directors' Report is consistent with the Group financial statements.

GRO

Ernst & Young LLP

Registered auditor

London

26 October 2007

Royal Mail Holdings plc

Group income statement for the years ended 25 March 2007 and 26 March 2006

	Notes	2007 £m	2006 £m
Continuing operations			
Turnover		9,104	9,056
Social Network Payment		75	-
Revenue		9,179	9,056
People costs		(6,145)	(5 968)
Royal Mail Group people			
Wages and salaries		(4,511)	(4 530)
Pensions	5(a)	(722)	(529)
Social security		(320)	(326)
Subpostmasters		(534)	(507)
Temporary resource		(58)	(76)
Distribution and conveyance operating costs	5(b)	(1,237)	(1 218)
Other operating costs	5(c)	(1,603)	(1 547)
Share of post tax profit from joint ventures and associates	14	39	32
Operating profit before exceptional items		233	355
Operating exceptional items	7	(243)	(210)
Operating (loss)/profit		(10)	145
Profit on disposal of businesses		-	6
Profit on disposal of property group		74	-
Profit on disposal of property plant and equipment		44	61
Profit before financing and taxation		108	212
Finance costs	8	(56)	(52)
Finance income	8	62	51
Net pensions interest	25	199	101
Profit before taxation		313	312
Taxation (charge)/credit	9	(27)	83
Profit for the financial year from continuing operations		286	395
Profit attributable to			
Equity holder of the parent company		286	395
Minority interest		-	-

Royal Mail Holdings plc

Group statement of recognised income and expense for the years ended 25 March 2007 and 26 March 2006

	Notes	2007 £m	2006 £m
Translation differences on foreign currency net investments	27	(2)	-
Actuarial gains/(losses) on defined benefit schemes	25/27	340	(1 659)
(Losses)/gains on cash flow hedges deferred into equity	24/27	(9)	3
Losses/(gains) on cash flow hedges released from equity to income	24/27	4	(10)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	24/27	-	(1)
Taxation on items taken directly to equity	9/27	27	(26)
Net income/(expense) recognised directly in equity		360	(1 693)
Profit for the financial year from continuing operations	27	286	395
Total recognised income/(expense) for the period		646	(1,298)
Attributable to:			
Equity holder of the parent company		646	(1 298)
Minority interest	27	-	-
Effects of changes in accounting policy			
Loss on first time adoption of IAS 32 and IAS 39	27	-	(3)

Royal Mail Holdings plc

Group balance sheet at 25 March 2007 and 26 March 2006

	Notes	2007 £m	2006 £m
Non-current assets			
Property, plant and equipment	10	1,619	1 594
Goodwill	11	143	132
Intangible assets	12	64	42
Investments in joint ventures and associates	14	114	124
Financial assets - pension escrow investments	24	1,000	-
- other investments	24	-	5
Other receivables		4	6
Deferred tax assets	9	403	393
		3,347	2 296
Non-current assets held for sale	15	7	11
Current assets			
Inventories	16	26	27
Trade and other receivables	17	1,031	1 093
Financial assets - investments	24	17	694
- derivatives	24	-	3
Cash and cash equivalents	18/24	1,196	1 161
		2,270	2 978
Total assets		5,624	5 285
Current liabilities			
Trade and other payables	21	(1,924)	(2,013)
Financial liabilities - interest bearing loans and borrowings	19/24	(301)	(361)
- obligations under finance lease and hire purchase contracts	19/24	-	(1)
- derivatives	19/24	(7)	(3)
Income tax payable		(29)	(7)
Provisions	20	(69)	(58)
		(2,330)	(2 443)
Non-current liabilities			
Financial liabilities - interest bearing loans and borrowings	19/24	(502)	(505)
- obligations under finance lease and hire purchase contracts	19/24	(1)	(1)
Provisions	20	(42)	(53)
Retirement benefit obligation - pension deficit	25	(4,985)	(5.588)
Other payables	22	(25)	(31)
Deferred tax liabilities	9	(3)	(3)
		(5,558)	(6 181)
Total liabilities		(7,888)	(8 624)
Net liabilities		(2,264)	(3 339)
Equity			
Share capital	26	-	-
Share premium	27	430	-
Retained earnings	27	(2,775)	(4 270)
Reserves	27	78	927
Equity attributable to equity holder of parent company		(2,267)	(3 343)
Minority interest	27	3	4
Total equity		(2,264)	(3 339)

The accounts on pages 47 to 92 were approved by the Board of Directors on 26 October 2007 and signed on its behalf by

GRO

Adam Crozier

GRO

Ian Duncan

Royal Mail Holdings plc

Group cash flow statement for the years ended 25 March 2007 and 26 March 2006

	Notes	2007 £m	2006 £m
Cash flow from operating activities			
Operating profit before exceptional items		233	355
Add back			
Depreciation and amortisation	5	198	174
Share of post tax profit from joint ventures and associates	14	(39)	(32)
		392	497
Working capital and other non-cash movements		7	17
Decrease in inventories	16	1	-
Decrease/(increase) in receivables		42	(130)
(Decrease)/increase in payables		(49)	22
Decrease in client debtors	17	17	134
Increase/(decrease) in client creditors	21	55	(75)
Net (decrease)/increase in retirement benefit obligation		(64)	72
Net increase/(decrease) in derivatives		2	(11)
Increase in non-exceptional provisions		4	8
Other movements		(1)	(3)
Cash payments in respect of operating exceptional items (see note (a) below)		(282)	(524)
Share in Success		(90)	(218)
Other		(192)	(306)
Cash inflow/(outflow) from operations		117	(10)
Income tax recovered		13	4
Net cash inflow/(outflow) from operating activities		130	(6)
Cash flows from investing activities			
Dividends received from joint ventures and associates	14	39	30
Finance income received		67	53
Proceeds from sale of property group		71	-
Proceeds from sale of property plant and equipment		65	73
Purchase of property, plant and equipment		(244)	(210)
Proceeds from sale of businesses		-	6
Acquisition of businesses net of cash acquired		(17)	(1)
Purchase of intangible assets		(65)	(33)
Payment of deferred consideration in respect of prior years acquisitions		(3)	(22)
Net movement in financial assets investments (non-current)	24	(995)	2
Net movement in financial assets investments (current)	24	677	(3)
Net cash outflow from investing activities		(405)	(105)
Net cash outflow before financing activities		(275)	(111)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	27	430	-
Finance costs paid		(55)	(52)
Payment of capital element of obligations under finance lease contracts		(1)	(1)
Net repayment of borrowings		(63)	(15)
Dividend paid to minority interest	27	(1)	-
Net cash inflow/(outflow) from financing activities		310	(68)
Net increase/(decrease) in cash and cash equivalents		35	(179)
Cash and cash equivalents at the beginning of the period		1,161	1,340
Cash and cash equivalents at the end of the period	18/24	1,196	1,161

Royal Mail Holdings plc

(a) Cash flows relating to operating exceptional items charged to the income statement in current and prior years

The net cash outflows relating to the above were as follows

Net cash outflow relating to	2007 £m	2006 £m
Current year operating exceptional items	114	38
Prior years operating exceptional items	168	486
Total	282	524

The net cash outflow of £282m (2006 £524m) comprises £118m (2006 £96m) relating to cash utilised to settle exceptional provisions £27m (2006 £1m) relating to current year pension redundancy liabilities £47m (2006 £208m) relating to prior year pension redundancy liabilities £nil (2006 £1m) in respect of other costs which were recorded within creditors and £90m (2006 £218m) Share in Success payment in respect of the prior year

Royal Mail Holdings plc

Notes to the Group accounts

1 Authorisation of financial statements and statement of compliance with IFRSs

The Group's financial statements for the year ended 25 March 2007 were authorised for issue by the Board on 26 October 2007 and the balance sheet was signed on the Board's behalf by Adam Crozier and Ian Duncan

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and as they apply to the financial statements of the Group for the year ended 25 March 2007. The principal accounting policies adopted by the Group are set out in note 2

2 Accounting policies

Basis of preparation and accounting

The Group comprises Royal Mail Holdings plc (the Company) - which is wholly owned by HM Government - and its subsidiaries. The Company is incorporated in the United Kingdom under the Companies Act 1985 (the Act) and the accounts are produced in accordance with the Act and applicable International Financial Reporting Standards (IFRSs)

On 20 March 2007 Royal Mail Group plc, a wholly owned subsidiary of the Company, had its name changed to Royal Mail Group Ltd following an agreement between the Company and its Shareholder on a new funding package (see below). All previous references to Royal Mail Group plc (including comparative information) have been changed to reflect the name change to Royal Mail Group Ltd

The Group financial statements are presented in sterling and all values are rounded to the nearest £m except where otherwise indicated

Royal Mail Group Ltd, a wholly owned subsidiary of the Company, is exposed to the risk of being fined by its industry Regulator and of being required to pay compensation to certain customers as a result of failing to meet operational targets set by the Regulator in its licence. The amount of such fines and compensation will be determined by the Regulator after further representations from Royal Mail Group Ltd and no further information is being disclosed on the grounds that it can be expected to prejudice the outcome of that process

Key sources of estimation uncertainty

The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year relate to the measurement of the defined benefit pension obligations and deferred tax. Measurement of these defined benefit obligations requires certain assumptions to be made including on life expectancy, future changes in salaries, inflation and a suitable discount rate. The size of these obligations, and therefore the pension deficit, is materially sensitive to the assumptions adopted. The major assumptions are disclosed in note 25. Assessment of the deferred tax asset requires an estimation of future profitability. Such estimation is inherently uncertain in a market subject to various competitive pressures. Should estimates of future profitability change in future years, the amount of deferred tax recognised will also change accordingly

Funding

Royal Mail Group Ltd

Royal Mail Group Ltd is profitable even after bearing losses relating to stamped mail and carrying out its Universal Service Obligations, but it now faces considerable cash requirements with respect to its proposed investment in plant and equipment and funding its pension deficit at a time when the market has been opened up to full competition

On 23 March 2007 the Company completed an agreement with its Shareholder for a new funding package which will enable the transformation of Royal Mail Group Ltd to take place and has enabled the establishment of investments in escrow of £1bn provided as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006

The European Commission has launched an investigation under the EC Treaty's rules on state aid into a series of funding measures taken by the United Kingdom Government in its capacity as Shareholder in favour of Royal Mail between 2001 and 2007, including the recent funding package. In its response to the EC in relation to this investigation the United Kingdom Government has stated that it believes that the measures being investigated by the EC were concluded on commercial terms

Post Office Limited

Post Office Limited had net liabilities as at 25 March 2007 and, as explained in the Operating and Financial Review, has operated at a loss during 2006-07 and prior years, primarily because of supporting the loss-making rural network.

To become viable in the longer term new business areas continue to be developed to replace the lost contribution from traditional income sources and significant cost reduction programmes continue to be implemented

During the year Post Office Limited has updated its five-year strategic plan and its future financing is underpinned by

- rural network funding of £75m received as a Government grant in the second half of 2006-07 in addition to the £75m received during 2006-07 from Royal Mail Group Ltd (its immediate parent company) and £150m received on 2 April 2007 for 2007-08. State aid approval for these payments was received in February 2006
- short-term funding of £231m received in the second half of 2006-07 to meet the ongoing cash requirements of Post Office Limited. State aid approval for this funding was received in May 2003, and
- a funding agreement with Government announced on 17 May 2007 which provides, amongst other matters, for a payment from Government by 31 July 2007 of £313m to compensate Post Office Limited for the other net costs of providing certain specified "services of general economic interest". State aid approval for that payment of £313m was received in March 2007

Royal Mail Holdings plc

2 Accounting policies (continued)

The funding agreement addresses the following areas all of which are subject to state aid approval

- the extension to March 2016 of the existing working capital facility of £1 15bn
- providing network subsidy payments of around £150m per annum in each of the three financial years 2008-09 to 2010-11 for the purposes of meeting up to a specified limit the net costs of maintaining certain loss-making parts of the network and
- the provision of funding to compensate Post Office Limited for the other net costs of providing certain specified "services of general economic interest"

After careful consideration and having regard among other factors, to the Government funding package and the requirement to obtain state aid approval for certain elements of this package the Directors believe that Post Office Limited will be able to meet its liabilities as they fall due over the foreseeable future

Conclusion

After analysis of the financial resources available and cash flow projections for the Group including consideration of the financing arrangements outlined above the Directors consider that it is appropriate to prepare the financial statements on a going concern basis

Basis of consolidation

The consolidated financial statements comprise the accounts of the Company and its subsidiary undertakings. The financial statements of the major subsidiaries are prepared for the same reporting year as the Company using consistent accounting policies

All intragroup balances and transactions including unrealised profits arising from intragroup transactions have been eliminated in full. Transfer prices between business segments are set on a basis of charges reached through a negotiation with the respective businesses

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which control is no longer held by the Group. Where the Group ceases to hold control of a subsidiary the consolidated financial statements include the results for the part of the reporting year during which the Group held control

Minority interests represent the portion of profit/loss gains/losses and net assets relating to subsidiaries that are not attributable to members of the Company. The minority interests balance is presented separately within equity in the consolidated balance sheet separately from parent shareholders' equity

Investments in joint ventures and associates

The Group's investments in its joint ventures and associates are accounted for under the equity method of accounting. Under the equity method the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the joint ventures/associates less any impairment in value. The income statement reflects the Group's share of post tax profits from the joint ventures/associates

Any goodwill arising on acquisition of an associate representing the excess of the cost of the investment compared to the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is included in the carrying amount and not amortised. To the extent that the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is greater than the cost of the investment a gain is recognised and added to the Group's share of the associate's profit or loss in the period in which the investment is acquired

Revenue

Revenue reported in the income statement comprises of Turnover and the Social Network Payment. Turnover principally relates to the rendering of services

Royal Mail

Account revenue is derived from specific contracts and recognised when the mail delivery is substantially complete. Prepaid revenue mainly relating to stamp and meter income is recognised when the sale is made adjusted to reflect a value of stamp and meter credits held but not used by the customer

Parcelforce Worldwide

Account revenue is derived from specific contracts and recognised when the delivery of an item is substantially complete

Post Office Limited

Revenue is recognised when retail and financial services are provided

General Logistics Systems

Revenue is derived from specific contracts and is recognised at the time of delivery

The Social Network Payment is Government grant revenue recognised to match the related costs of providing the network of public post offices that the Secretary of State for Trade and Industry considers appropriate and which would otherwise not be provided

Distribution and conveyance

Distribution and conveyance costs relate to third party costs incurred in carrying mail. These include conveyance by rail, road, sea and air together with costs incurred by international mail carriers and Parcelforce Worldwide delivery operators. These costs are disclosed separately on the face of the income statement

Operating profit before exceptional items

Operating profit is the profit arising from the normal, recurring operations of the business. This incorporates revenue, people costs, distribution and conveyance costs, other operating costs and the Group's post tax share of profits from joint ventures and associates. Operating exceptional items are separately identified

Royal Mail Holdings plc

2. Accounting policies (continued)

Operating exceptional items

Operating exceptional items are material items of income and expenditure arising from the operations of the business which, due to the nature of the events giving rise to them, require separate presentation on the face of the income statement to allow a better understanding of financial performance in the year in comparison to prior years

Operating profit

Operating profit is the profit arising from the normal recurring operations of the business and after charging operating exceptional items defined above. It excludes the non operating exceptional items for profit or loss on disposal of businesses and profit or loss on disposal of property plant and equipment. These items are not part of the normal recurring operations of the business but are material, so are presented separately on the face of the income statement to allow a better understanding of financial performance in the year in comparison to prior years

Goodwill

Business combinations on or after 29 March 2004 are accounted for under IFRS 3 'Business Combinations' using the purchase method. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition is recognised in the balance sheet as goodwill and is not amortised.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill arising from business combinations is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

For the purpose of such impairment reviews, goodwill is allocated to the relevant cash generating units.

Goodwill arising on the acquisition of equity accounted entities is included in the cost of those entities and therefore not reported in the balance sheet as goodwill.

Intangible assets

Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition. Intangible assets acquired separately or development costs that meet the criteria to be capitalised are initially recognised at cost and are assessed to have either a finite or indefinite useful life. Those with a finite life are amortised over their useful life and those with an indefinite life are reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the income statement. The useful lives of such intangible assets are in the range of 1-6 years.

Research and development

Expenditure on research is written off in the year it is incurred. Development costs are capitalised where they meet the criteria required under IFRSs. If these criteria are not met, then the costs are recognised in the income statement as they are incurred.

Property, plant and equipment

Property, plant and equipment is recognised at cost, including attributable costs in bringing the asset into working condition for its intended use. Depreciation of property, plant and equipment is provided on a straight-line basis by reference to net book value and to the remaining useful economic lives of assets and their estimated residual values. The useful lives and residual values are reviewed annually and adjustments where applicable are made on a prospective basis. The lives assigned to major categories of property, plant and equipment are:

Range of asset lives	
Land and buildings	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	3-15 years
Motor vehicles and trailers	1-12 years
Fixtures and equipment	2-15 years

An individual property that the Group has identified as surplus is reclassified as non-current assets held for sale, a separate category on the balance sheet, when a sale is highly probable. This has been determined to be when authority to market the property has been approved and the property is vacant and therefore available for immediate sale and occupation by a third party. Such properties are expected to generate economic cash flow primarily by sale of the asset rather than by operational activities, and are expected generally to be disposed of within a year.

For a disposal group of properties or other assets and liabilities, the requirements of IFRS 5 'Non-current assets held for sale and discontinued operations' are applied to the specific circumstances of the disposal group.

Impairment reviews

Unless otherwise disclosed in these accounting policies, assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Group assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Royal Mail Holdings plc

2 Accounting policies (continued)

Leases

Finance leases where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or if lower at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expenses over the lease term on a straight-line basis.

Inventories

Inventories are carried at the lower of cost and net realisable value after adjusting for obsolete or slow-moving stock. Cost includes all costs in bringing each item to its present location and condition and comprises weighted average cost for supplies and materials and purchase cost for merchandise.

Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity date of three months or less. In addition the Group uses Money Market funds as a readily available source of cash, which are bought and sold on a daily basis to meet the cash requirements of the business. These funds are also categorised as cash equivalents.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above net of bank overdrafts.

Financial assets - investments

Financial assets within the scope of IAS 39 'Financial Instruments - Recognition and Measurement' are classified as financial assets at fair value through the income statement, loans and receivables held to maturity investments, or as available for sale financial assets, as appropriate. The Group determines the classification of its financial assets at initial recognition and re-evaluates this designation at each financial year end. When financial assets are recognised initially, they are measured at fair value being the transaction price plus in the case of financial assets not at fair value through the income statement any directly attributable transactional costs.

The subsequent measurement of financial assets depends on their classification as follows:

Financial assets at fair value through the income statement (held for trading)

Financial assets are classified as held for trading if they are acquired for sale in the short term. Derivatives are also classified as held for trading unless they are designated as hedging instruments. Assets are carried in the balance sheet at fair value with gains or losses recognised in the income statement.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as 'held to maturity' when the Group has the positive intention and ability to hold to maturity. Held to maturity investments are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in the income statement when the investments are derecognised or impaired as well as through the amortisation process. Investments intended to be held for an undefined period are not included in this classification.

Loans and receivables

Non-derivative financial assets with fixed or determinable payments that are not quoted on an active market do not qualify as trading assets and have not been designated as either 'fair value through the income statement' or 'available for sale'. Such assets are carried at amortised cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired as well as through the amortisation process.

Available for sale financial assets

'Available for sale financial assets' are non-derivative financial assets that are designated as such or are not classified in any of the three preceding categories. After initial recognition available for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is deemed to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable issue costs. After initial recognition interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired as well as through the amortisation process.

Borrowing costs are recognised as an expense when incurred.

Royal Mail Holdings plc

2 Accounting policies (continued)

Derivative financial instruments

The Group uses derivative instruments such as foreign currency contracts in order to manage the risk profile of any underlying risk exposure of the Group, in line with the Group's treasury management policies. Such derivative financial instruments are initially stated at fair value

For the purpose of hedge accounting, hedges are classified as cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecasted transaction

In relation to cash flow hedges to hedge the foreign exchange risk of firm commitments that meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to relate to an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement

When the hedged firm commitment results in the recognition of a non financial asset or non financial liability then at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit/loss for example when the future sale actually occurs

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement in the period

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer qualifies for hedge accounting. At that point in time any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the year

Fair value measurement of financial instruments

The fair value of quoted investments is determined by reference to bid prices at the close of business on the balance sheet date. Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions, reference to the current market value of another instrument which is substantially the same and discounted cash flow analysis and pricing models. Specifically in the absence of quoted market prices, derivatives are valued by using quoted forward prices for the underlying commodity/currency and discounted using quoted interest rates (both as at the close of business on the balance sheet date)

For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date

Derecognition of financial instruments

A financial asset or liability is derecognised when the contract that gives rise to it is settled, sold, cancelled or expires

Income tax and deferred tax

The charge for current taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using rates that have been enacted or substantively enacted at the balance sheet date

Deferred tax is provided using the liability method on all temporary differences at the balance sheet date, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes

Deferred income tax liabilities are recognised for all taxable temporary differences except

- initial recognition of goodwill
- the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss, and
- taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures where the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future

Other than stated below, deferred tax assets are recognised for all deductible temporary differences carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences carry-forward of unused tax assets and unused tax losses can be utilised. Deferred tax assets are not recognised in respect of

- deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss, and
- deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures except to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference will be utilised

The carrying amount of deferred tax assets is reviewed at each balance sheet date and increased or reduced to the extent that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. Deferred tax balances are not discounted

Royal Mail Holdings plc

2 Accounting policies (continued)

Current and deferred tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity. Otherwise it is recognised in the income statement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate.

Pensions and other post-retirement benefits

Membership of occupational pension schemes is open to most permanent UK employees of the Group. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme. Overseas subsidiaries make separate arrangements for the provision of pensions and other post-retirement benefits.

The pension plans assets for the defined benefit schemes are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet. Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and with appropriate updates and accounting adjustments at each balance sheet date form the basis of the deficit disclosed.

For defined benefit schemes the amounts charged to operating profit are the current service costs and any gains and losses arising from settlements, curtailments and past service costs. The net difference between the interest costs and the expected return on plan assets is recognised as net pensions interest in the income statement. Actuarial gains and losses are recognised immediately in the statement of recognised income and expense (SORIE). Any deferred tax movement associated with the actuarial gains and losses is also recognised in the SORIE.

For defined contribution schemes the Group's contributions are charged to operating profit within people costs in the period to which the contributions relate.

Foreign currencies

The functional and presentational currency of Royal Mail Holdings plc is sterling (£). The functional currency of the overseas subsidiaries in Europe is mainly the euro (€).

The assets and liabilities of foreign operations are translated at the rate of exchange ruling at the balance sheet date. The trading results of foreign operations are translated at the average rates of exchange for the reporting period, being a reasonable approximation to the actual transaction rate. The exchange differences arising on the translation, since the date of transition to IFRSs, are taken directly to the foreign currency translation reserve in equity.

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Currently hedge accounting is not claimed for any monetary assets and liabilities. All differences are therefore taken to the income statement except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment occurs, at which time they are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value is determined.

Contingent liabilities and financial guarantee contracts

Financial guarantee contracts are initially measured at fair value and subsequently at the higher of amounts under IAS 37 or the amounts initially recognised less when appropriate cumulative amortisation recognised in accordance with IAS 18 Revenue.

Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote.

Royal Mail Holdings plc

2 Accounting policies (continued)

Segment information

The Group's primary reporting format is by business segments and its secondary format is by geographical segments. The business segments are organised and managed separately according to the nature of the products and services provided with each segment representing a business unit that offers different products and serves largely different markets. The five business segments are:

Royal Mail Delivers letters to all addresses in the United Kingdom. Royal Mail offers a number of products to both business and domestic users.

Parcelforce Worldwide The parcels business unit operating within the UK

Post Office Limited A limited company responsible for the network of Post Office® branches offering a series of retail services

General Logistics Systems The European parcels business which via its subsidiaries and partners offers its services in 35 European states

Other businesses Includes PostCap Guernsey Limited a wholly owned subsidiary, Romec Limited and NDC 2000 Limited both part owned subsidiaries, investments in the following associates - Quadrant Catering Limited, Camelot Group plc and Camelot International Services Limited and our Group Property unit. The Group Property unit includes Royal Mail Estates Limited a wholly owned subsidiary.

Transfer prices between business segments are set on a basis of charges reached through negotiation with the respective businesses.

The two geographical segments are UK operations and European operations. The latter consists of the GLS business segment. The former includes the other four business segments plus Corporate representing central shared services for the UK and the corporate centre. Corporate is not a revenue or profit centre but incurs certain costs on behalf of the business segments which are passed on and manages certain assets and liabilities of the Group.

Accounting standards and interpretations not applied

The International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) have issued accounting standards and interpretations with an effective date for accounting periods beginning on or after the date of these financial statements. Of these the Group has not applied the following:

International Accounting Standards (IAS/IFRSs)		Effective date
IFRS 7	Financial Instruments Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IAS 1	Amendment – Presentation of Financial Statements Capital Disclosures	1 January 2007

International Financial Reporting Interpretations Committee (IFRIC)

IFRIC 8	Scope of IFRS 2	1 May 2006
IFRIC 9	Reassessment of Embedded Derivatives	1 June 2006
IFRIC 10	Interim Financial Reporting and Impairments	1 November 2006
IFRIC 11	IFRS 2 Group and Treasury Share Transactions	1 March 2007
IFRIC 12	Service Concession Arrangements	1 January 2008

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's primary financial statements. Certain of the above standards will require amendment to disclosures in the period of initial application.

Royal Mail Holdings plc

3 Segment information

Analysis of segment revenue and segment result by class of business and geographic area

Year to 25 March 2007	UK operations					European operations		Total revenue from continuing operations £m
	Royal Mail £m	Parcelforce Worldwide £m	Post Office Limited £m	Other businesses £m	Total £m	General Logistics Systems £m		
External revenue	6,857	337	868	35	8,097	1,082		9,179
Revenue between segments	106	5	348	-	459	-		459
Segment revenue	6,963	342	1,216	35	8,556	1,082		9,638
Operating profit before exceptional items	194	10	(99)	13	118	115		233
Less share of post tax profits from joint ventures and associates	-	-	(27)	(12)	(39)	-		(39)
Operating exceptional items	(154)	(1)	(88)	-	(243)	-		(243)
Profit on disposal of property group	-	-	-	74	74	-		74
Profit on disposal of property plant and equipment	-	-	15	29	44	-		44
Segment result	40	9	(199)	104	(46)	115		69
Share of post tax profits from joint ventures and associates	-	-	27	12	39	-		39
Segment result after share of post tax profits from joint ventures and associates	40	9	(172)	116	(7)	115		108

Not included in segment result after share of post tax profits from joint ventures and associates is net pensions interest of £199m (2006 £101m) finance income of £62m (2006 £51m) finance costs of £56m (2006 £52m) and a taxation charge of £27m (2006 a credit of £83m) which when added reconciles to the 'profit for the financial year from continuing operations' in the income statement of £286m (2006 £395m)

Year to 26 March 2006	UK operations					European operations		Total revenue from continuing operations £m
	Royal Mail £m	Parcelforce Worldwide £m	Post Office Limited £m	Other businesses £m	Total £m	General Logistics Systems £m		
External revenue	6 859	314	838	8	8 019	1 037		9 056
Revenue between segments	107	5	336	-	448	-		448
Segment revenue	6,966	319	1 174	8	8 467	1 037		9 504
Operating profit before exceptional items	344	5	(111)	17	255	100		355
Less share of post tax profits from joint ventures and associates	(1)	-	(19)	(12)	(32)	-		(32)
Operating exceptional items	(152)	(2)	(56)	-	(210)	-		(210)
Profit on disposal of business	6	-	-	-	6	-		6
Profit on disposal of property plant and equipment	-	-	8	53	61	-		61
Segment result	197	3	(178)	58	80	100		180
Share of post tax profits from joint ventures and associates	1	-	19	12	32	-		32
Segment result after share of post tax profits from joint ventures and associates	198	3	(159)	70	112	100		212

Profits on disposal of properties held by our Group Property unit previously allocated between Royal Mail (£53m) and Parcelforce Worldwide (£nil) are now disclosed within the Other businesses segment

Royal Mail Holdings plc

3 Segment information (continued)

Analysis of net assets/(liabilities) by class of business and geographic area

Year to 25 March 2007	UK operations						General Logistics Systems	European operations	
	Royal Mail	Parcelforce Worldwide	Post Office Limited	Other businesses	Corporate*	Total		Total unallocated assets/ (liabilities)	Total assets/ (liabilities)
	£m	£m	£m	£m	£m	£m		£m	£m
Assets	1,443	82	1,026	661	61	3,273	520	1,831	5,624
Liabilities	(5,222)	(337)	(913)	(179)	(194)	(6,845)	(198)	(845)	(7,888)

Year to 26 March 2006	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets	1 452	75	1 078	713	49	3 367	455	1 463	5 285
Liabilities	(5 746)	(366)	(929)	(215)	(313)	(7 569)	(173)	(882)	(8 624)

*In the context of the above table Corporate as defined in the accounting policies note, holds certain assets and liabilities that do not form part of any business segment but which do form part of the UK geographic segment.

Assets include Non-current assets held for sale of £7m (2006 £11m) relating to Other businesses

Unallocated assets and liabilities comprise of the following items

	Year to 25 March 2007		Year to 26 March 2006	
	Unallocated assets £m	Unallocated liabilities £m	Unallocated assets £m	Unallocated liabilities £m
Cash and cash equivalents – interest bearing	411	-	361	-
Financial assets – investments	1,017	-	699	-
Loans and borrowings	-	(803)	-	(866)
Obligations under finance leases and hire purchase contracts	-	(1)	-	(2)
Derivative financial (liabilities)/assets	-	(7)	3	(3)
Interest (payables)/receivables	-	(2)	7	(1)
Income tax payable	-	(29)	-	(7)
Deferred tax assets/(liabilities)	403	(3)	393	(3)
Total	1,831	(845)	1 463	(882)

The above analysis has been restated for the inclusion of our Group Property unit within Other businesses and the separate identification of Corporate

Royal Mail Holdings plc

3 Segment information (continued)

Other segment information

Year to 25 March 2007	UK operations						European operations	
	Royal Mail	Parcelforce Worldwide	Post Office Limited	Other businesses	Corporate	Total	General Logistics Systems	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Additions								
Property, plant and equipment	154	4	8	34	12	212	52	264
Intangible assets	21	3	35	-	6	65	-	65
Non cash expenses								
Depreciation and amortisation	142	-	1	28	1	172	26	198
Impairment	14	-	50	-	-	64	-	64
Year to 26 March 2006								
	£m	£m	£m	£m	£m	£m	£m	£m
Additions								
Property plant and equipment	143	2	6	26	-	177	42	219
Intangible assets	19	-	15	-	8	42	-	42
Non cash expenses								
Depreciation and amortisation	122	-	1	26	-	149	25	174
Impairment	9	1	30	4	-	44	-	44

The above analysis has been restated for the inclusion of our Group Property unit within Other businesses and the separate identification of Corporate

4 People information

(a) Headcount

The number of people employed calculated on a headcount basis were

	Period end employees		Average employees	
	2007	2006	2007	2006
Royal Mail	167,640	174 202	170,127	176,415
Parcelforce Worldwide	4,176	4,092	4,141	4 183
Post Office Limited	9,990	11 327	10,640	11 774
Corporate and Group Property	2,961	3 348	3,181	3,588
UK wholly owned subsidiaries	184,767	192 969	188,089	195 960
UK partially owned subsidiaries	4,592	4 852	4,600	4 854
General Logistics Systems	12,137	11 045	11,749	10 671
Group total	201,496	208 866	204,438	211 485

	2007	2006
Number of subpostmasters at year end	11,494	11 608

(b) Directors' emoluments	2007	2006
	£000	£000
Directors' emoluments	4,164	3 852
Amounts receivable under Long-Term Incentive Plans	3,113	463

Number of Directors accruing benefits under defined benefit schemes	5	4
The Directors' Remuneration Report discloses full details of Directors' emoluments and can be found on pages 37 to 44		

Royal Mail Holdings plc

5 Operating costs

Operating profit before exceptional items is stated after charging

	2007 £m	2006 £m
(a)		
Pensions charge (see note 25)	722	529
Cash	543	343
Non-cash	179	186
(b)		
Distribution and conveyance operating costs	1,237	1,218
Operating lease charges on vehicles	64	66
Other distribution and conveyance	1,173	1,152
(c)		
Depreciation and amortisation	198	174
Depreciation of owned property plant and equipment	169	149
Depreciation of property plant and equipment under finance lease and hire purchase contracts	17	18
Total depreciation (see note 10)	186	167
Amortisation of intangible assets (see note 12)	12	7
Property facilities and maintenance costs	263	274
Computers and telephones costs	259	276
Consultancy marketing and legal fees	187	174
Operating lease charges on property plant and equipment (excluding vehicles)	148	179
Foreign currency exchange losses/(gains)	4	(6)
Research and development expenditure	1	1
Regulatory body costs	19	20
Postcomm	10	9
Postwatch	9	11
6 Auditors' remuneration		
	2007 £000	2006 £000
Audit of statutory financial statements	607	689
Other fees to auditors		
Statutory audits for subsidiaries	1,270	1,241
Other services supplied pursuant to such legislation	468	516
Taxation services	279	368
Corporate finance services	91	27
Litigation services	128	41
Other services	133	682
Total	2,976	3,564

The Group paid an additional £500,000 in 2007 relating to the 2006 audit.

Royal Mail Holdings plc

7 Operating exceptional items

	2007 £m	2006 £m
Operating exceptional items		
Share in Success	-	(91)
Provision for restructuring (note 20)	(179)	(75)
Impairment of property plant and equipment (note 10)	(15)	(17)
Impairment of intangible assets (note 12)	(39)	(15)
Impairment relating to associates (note 14)	(10)	(9)
Impairment of property subsequent to categorisation as non-current assets held for sale (note 15)	-	(3)
Total operating exceptional items	(243)	(210)

The restructuring charge is in respect of employee related redundancy costs of £180m (2006 £75m) resulting mainly from operational efficiency initiatives in Royal Mail and organisational design review in Post Office Limited net of £1m (2006 £nil) exceptional property provision release. Of the above impairments £50m (2006 £30m) relates to Post Office Limited £15m (2006 £15m) property plant and equipment and £35m (2006 £15m) intangible assets. Due to ongoing losses the carrying values of asset purchases made by Post Office Limited during the year have been impaired to recoverable amount. The £10m impairment relating to associates in the current year is in respect of G3 Worldwide Mail N V (Spring) (2006 £8m).

The Share in Success scheme was launched during 2002. Under the scheme, eligible employees received a one-off discretionary payment on the successful completion of the Group's three-year Renewal Plan. The cost of the three-year scheme was charged to the income statement in 2004-05. A second Share in Success scheme for one year was launched during 2005-06. Eligible employees and subpostmasters received a one-off discretionary payment on meeting a specific profit target for that year. There was no further Share in Success scheme in 2006-07.

8 Net finance income

	2007 £m	2006 £m
Interest payable on DTI borrowings	(50)	(48)
Other interest payable	(6)	(4)
Finance costs	(56)	(52)
Interest received on investments	56	48
Other interest receivable	6	3
Finance income	62	51
Net finance income/(costs)	6	(1)

All finance costs of £56m (2006 £52m) relate to financial liabilities that are not held at fair value through the income statement.

Of the £56m (2006 £48m) interest received on investments £55m (2006 £43m) relates to interest on financial assets not held at fair value through the income statement and £1m (2006 £5m) relates to interest on financial assets held at fair value through the income statement.

Royal Mail Holdings plc

9 Income tax

The major components of income tax expense/(credit) for the years ended 25 March 2007 and 26 March 2006 are

	2007 £m	2006 £m
Tax charged to the income statement		
Current income tax		
Current UK income tax charge	49	21
Foreign tax	31	25
Adjustments in respect of current income tax of prior years	(4)	(10)
	76	36
Deferred income tax		
Relating to origination and reversal of temporary differences	(49)	(119)
Income tax charge/(credit) reported in the income statement	27	(83)
Tax charged to equity		
Income tax related to items charged or credited directly to equity		
Current income tax relief for pension deficit recovery payment	(66)	(32)
Deferred income tax charge related to actuarial gains/(losses) on pension deficit	39	58
Income tax (credit)/expense reported in equity	(27)	26
Total taxation losses/(gains) recognised		
Current income tax charge	10	4
Deferred income tax (credit)	(10)	(61)
Income tax (credit)/expense reported in equity	-	(57)

A reconciliation between tax expense and the product of accounting profit multiplied by the UK rate of Corporation Tax for the years ended 25 March 2007 and 26 March 2006 is as follows

	2007 £m	2006 £m
Accounting profit before tax from continuing operations	313	312
At UK standard rate of Corporation Tax of 30%	94	93
Overseas current tax rates	5	8
Tax overprovided in prior years	(4)	(10)
Non-deductible expenses	8	19
Associates /joint ventures' profit after tax charge included in Group pre-tax profit	(12)	(7)
Net decrease in tax charge resulting from recognition of deferred tax assets	(23)	(169)
Profit from asset disposals eligible for relief	(37)	(17)
Other	(4)	-
Tax charge/(credit) in the income statement	27	(83)
Effective income tax rate	9%	(27%)

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9 Income tax (continued)

Deferred tax relates to the following

	Balance sheet		Income statement	
	2007 £m	2006 £m	2007 £m	2006 £m
Liabilities				
Accelerated capital allowances	(3)	(3)	-	2
Assets				
Deferred capital allowances	27	36	(9)	36
Provisions	10	11	(1)	(14)
Pensions temporary differences	345	317	67	93
Losses available for offset against future taxable income	6	10	(4)	1
Goodwill qualifying for tax allowances	15	19	(4)	1
Gross deferred tax assets	403	393		
Net deferred tax asset	400	390		
Consolidated income statement			49	119

The Group has unrecognised deferred tax assets of £1,159m (2006 £1,380m) relating to the retirement benefit obligation £272m (2006 £224m) relating mainly to fixed asset temporary differences and £101m (2006 £113m) relating to tax losses in subsidiaries that are available to offset against future taxable profits. The Group has capital losses carried forward, the tax effect of which is £13m (2006 £12m). The Group has rolled over capital gains of £86m (2006 £83m), no tax liability would be expected to crystallise should the assets into which the gains have been rolled be sold at their carrying value as it is anticipated that a capital loss would arise.

At 25 March 2007, there was no recognised or unrecognised deferred income tax liability (2006 £nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, associates or joint ventures as the Group has no liability to additional taxation should such amounts be remitted due to the availability of double taxation relief or other exemptions.

In his Budget on 21 March 2007 the Chancellor of the Exchequer announced a reduction of 2% in the main rate of corporation tax with effect from April 2008 together with changes to the capital allowances regime. In accordance with accounting standards the effect of the changes on deferred tax balances has not been reflected in these accounts due to the relevant legislation not having been substantively enacted at the balance sheet date. The effect of the reduction in the tax rate on the Group's deferred tax asset at the balance sheet date would be to reduce the recognised amount by £25m and the unrecognised amount by £101m.

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10 Property, plant and equipment

Cost	Land and buildings						2007
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
At 27 March 2006	1 490	260	494	794	230	811	4 079
Exchange movements	(2)	-	-	(1)	-	-	(3)
Reclassification	(9)	4	5	(2)	-	2	-
Additions	72	3	12	52	75	50	264
Acquisition of subsidiary	-	-	-	1	-	-	1
Disposals	(16)	(5)	(8)	(2)	(31)	(5)	(67)
Reclassification to non-current assets held for sale (see note 15)	(49)	(4)	-	-	-	-	(53)
At 25 March 2007	1,486	258	503	842	274	858	4,221
Depreciation and impairment							
At 27 March 2006	723	150	246	471	113	782	2 485
Exchange movements	-	-	-	(1)	-	(1)	(2)
Reclassification	-	-	-	(1)	-	1	-
Depreciation (see note 5)	45	6	28	55	39	13	186
Impairment (see note 7)	1	-	6	-	1	7	15
Disposals	(11)	(3)	(8)	(2)	(29)	(5)	(58)
Reclassification to non-current assets held for sale (see note 15)	(22)	(2)	-	-	-	-	(24)
At 25 March 2007	736	151	272	522	124	797	2,602
Net book value							
At 25 March 2007	750	107	231	320	150	61	1,619
At 27 March 2006	767	110	248	323	117	29	1 594

Depreciation rates are disclosed within accounting policies (note 2). No depreciation is provided on freehold land which represents £151m (2006 £131m) of the total cost of properties. The net book value of the Group's property, plant and equipment held under hire purchase contracts and finance leases amounts to £37m (2006 £54m) all relating to plant and machinery. The net book value of the Group's property, plant and equipment includes £112m (2006 £73m) in respect of assets in the course of construction. The net book value of the Group's land and buildings includes £429m (2006 £445m) in respect of building fit-out.

Cost	Land and buildings						2006
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
At 28 March 2005	1 498	254	476	743	199	798	3 968
Exchange movements	1	-	-	-	-	-	1
Reclassification	(10)	3	7	-	-	-	-
Additions	62	7	16	54	60	20	239
Disposal of subsidiaries	-	-	-	(1)	-	-	(1)
Disposals	(14)	-	(5)	(2)	(29)	(7)	(57)
Reclassification to non-current assets held for sale	(47)	(4)	-	-	-	-	(51)
At 26 March 2006	1 490	260	494	794	230	811	4 079
Depreciation and impairment							
At 28 March 2005	704	147	220	423	111	772	2 377
Exchange movements	-	-	-	-	-	-	-
Reclassification	-	-	-	-	-	-	-
Depreciation (see note 5)	42	7	25	51	30	12	167
Impairment (see note 7)	6	-	6	-	-	5	17
Disposal of subsidiaries	-	-	-	(1)	-	-	(1)
Disposals	(8)	-	(5)	(2)	(28)	(7)	(50)
Reclassification to non-current assets held for sale	(21)	(4)	-	-	-	-	(25)
At 26 March 2006	723	150	246	471	113	782	2 485
Net book value							
At 26 March 2006	767	110	248	323	117	29	1 594
At 28 March 2005	794	107	256	320	88	26	1 591

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11. Goodwill

	2007 £m	2006 £m
Cost		
At 27 March 2006 and 28 March 2005	476	475
Exchange movement	(1)	-
Additions (see note 13)	12	1
At 25 March 2007 and 26 March 2006	487	476
Impairment		
At 27 March 2006 and 28 March 2005	344	344
Exchange movement	-	-
At 25 March 2007 and 26 March 2006	344	344
Net book value		
At 25 March 2007 and 26 March 2006	143	132
At 27 March 2006 and 28 March 2005	132	131

The carrying value of goodwill arising on business combinations of £143m (2006 £132m) at the balance sheet date includes £142m (2006 £131m) relating to the General Logistics Systems (GLS) business segment. In line with the accounting policy (see note 2) this goodwill has been reviewed for impairment. An impairment loss is recognised for the amount by which the carrying value of an asset or cash generating unit exceeds the recoverable amount. The recoverable amount is the higher of net realisable value and value in use. The carrying value of GLS, excluding interest bearing and tax related assets and liabilities, is £322m (2006 £282m) at year end (see note 3) and the operating profit before exceptional items is £115m (2006 £100m) for the year (see note 3). The carrying value represents a multiple of 2.8 (2006 2.8) on operating profit before exceptional items. The net realisable value of GLS for the purposes of the impairment review (i.e. the 'fair value less costs to sell') has been assessed with reference to earnings multiples for quoted entities in a similar sector. On this basis the net realisable value of GLS has been assessed to be in excess of the carrying value. No reasonable possible change in the earnings multiples referenced would reduce the net realisable value to below the carrying value.

12 Intangible assets

	2007				2006			
	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m
Cost								
At 27 March 2006 and 28 March 2005	19	7	42	68	19	6	-	25
Additions	-	-	65	65	-	-	42	42
Acquisition of businesses	-	8	-	8	-	1	-	1
At 25 March 2007 and 26 March 2006	19	15	107	141	19	7	42	68
Amortisation and impairment								
At 27 March 2006 and 28 March 2005	8	3	15	26	4	-	-	4
Impairment	-	-	39	39	-	-	15	15
Amortisation	4	3	5	12	4	3	-	7
At 25 March 2007 and 26 March 2006	12	6	59	77	8	3	15	26
Net book value								
At 25 March 2007 and 26 March 2006	7	9	48	64	11	4	27	42
At 27 March 2006 and 28 March 2005	11	4	27	42	15	6	-	21

The intangible assets recognised in the Group's balance sheet have finite lives and are being written down on a straight-line basis over their remaining economic lives as follows:

Intangible asset	Remaining economic life in years
Master franchise licences	1 to 4
Customer listings	1 to 4
Software licences	1 to 6

The amortisation charge of £12m (2006 £7m) relating to intangible assets is aggregated within other operating costs within the income statement and disclosed in note 5 to the accounts. Details of impairments are disclosed in note 7 to the accounts.

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13 Business combinations

The acquisitions during the current or prior years are not material and therefore the following disclosures are made on an aggregated basis. The table below sets out the identifiable assets and liabilities that were acquired at their provisional fair values to the Group as at the date of acquisition which where relevant, are consistent with their book values immediately before the acquisition

	Book value/ fair value Total 2007 £m	Book value/ fair value Total 2006 £m
Trade and other receivables	9	-
Trade and other payables	(11)	-
Net working capital acquired	(2)	-
Property plant and equipment	1	-
Cash and cash equivalents	2	-
Net assets acquired	1	-
Intangible assets recognised on acquisition	8	1
Goodwill recognised on acquisition	12	1
Total cost recognised	21	2
Gross consideration	20	2
Acquisition costs	1	-
Total costs	21	2
Less deferred consideration	(2)	(1)
cash and cash equivalents acquired	(2)	-
Net cash outflow	17	1

The current year acquisitions relate to the purchase by General Logistics Systems (GLS) of 100% of the voting shares of ABX Belgium Distribution a parcels and general cargo business based in Belgium on 31 December 2006 and certain assets of three franchisee businesses in Italy (not material in aggregate). If these combinations had taken place at the beginning of the financial year Group revenue from continuing operations would have been £9 251m. The profit or loss of the combined entities for the period if these combinations had taken place at the beginning of the year is not material in the context of the Group's profit after tax

The goodwill arising on the above acquisitions principally relates to ABX Belgium Distribution. GLS management believe that this goodwill represents the benefits expected to be achieved in providing further scale in the important Benelux market

The prior year acquisitions represent £1m in respect of the remaining 9% shareholding of GLS Stafetten A/S (giving the Group 100% ownership) and £1m relating to the acquisition by GLS of a franchisee business in Italy

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14 Investments in joint ventures and associates**Joint ventures**

During 2006-07 and 2005-06, the Group's only joint venture investment was a 50% interest in First Rate Exchange Services Holdings Limited whose principal activity is the provision of Bureau de Change

Associates

Details of the Group's 2006-07 and 2005-06 associate investments are provided in note 29. The reporting dates for these investments is 31 March 2007 except for Quadrant Catering Limited (30 September 2006) and G3 Worldwide Mail N V (Spring) (31 December 2006). Estimates of the profits of Quadrant Catering Limited and G3 Worldwide Mail N V (Spring) from their reporting date to 25 March 2007 (and 26 March 2006 for the prior year) have been included to ensure that the reported share of profits of associates aligns with the Group's financial year. There are no significant restrictions on the ability of associates to transfer funds to the Group in the form of cash dividends, repayment of loans or advances.

	At 27 March 2006 £m	Impairment (see note 7) £m	Share of post tax pre dividend profit £m	Dividend £m	At 25 March 2007 £m
Joint ventures					
Share of net assets	51	-	30	(23)	58
Goodwill	1	-	-	-	1
Net investments	52	-	30	(23)	59

Associates

	At 27 March 2006 £m	Impairment (see note 7) £m	Share of post tax pre dividend profit £m	Dividend £m	At 25 March 2007 £m
Associates					
Share of net assets	56	(3)	9	(16)	46
Goodwill	16	(7)	-	-	9
Net investments	72	(10)	9	(16)	55
Total net investments in joint ventures/associates	124	(10)	39	(39)	114

	At 28 March 2005 £m	Impairment (see note 7) £m	Share of post tax pre dividend profit £m	Dividend £m	At 26 March 2006 £m
Joint ventures					
Share of net assets	40	-	28	(17)	51
Goodwill	1	-	-	-	1
Net investments	41	-	28	(17)	52
Associates					
Share of net assets	65	-	4	(13)	56
Goodwill	25	(9)	-	-	16
Net investments	90	(9)	4	(13)	72
Total net investments in joint ventures/associates	131	(9)	32	(30)	124

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14 Investments in joint ventures and associates (continued)

	2007			2006		
	Joint ventures £m	Associates £m	Total £m	Joint ventures £m	Associates £m	Total £m
<u>Share of assets and liabilities</u>						
Current assets	128	102	230	162	116	278
Non-current assets	2	39	41	2	33	35
<u>Share of gross assets</u>	<u>130</u>	<u>141</u>	<u>271</u>	<u>164</u>	<u>149</u>	<u>313</u>
Current liabilities	(72)	(91)	(163)	(113)	(92)	(205)
Non-current liabilities	-	(4)	(4)	-	(1)	(1)
<u>Share of gross liabilities</u>	<u>(72)</u>	<u>(95)</u>	<u>(167)</u>	<u>(113)</u>	<u>(93)</u>	<u>(206)</u>
Share of net assets	58	46	104	51	56	107
<u>Share of revenue and profit</u>						
Revenue	60	1,084	1,144	55	1,084	1,139
Profit after tax	30	9	39	28	4	32

15 Non-current assets held for sale

<u>Net book amount</u>	Assets		Disposal group		
	Freehold £m	Long leasehold £m	Freehold £m	Long leasehold £m	Total £m
At 27 March 2006	11	-	-	-	11
Reclassification from property, plant and equipment	8	-	19	2	29
Impairment	-	-	-	-	-
<u>Disposals</u>	<u>(12)</u>	<u>-</u>	<u>(19)</u>	<u>(2)</u>	<u>(33)</u>
At 25 March 2007	7	-	-	-	7

<u>Net book amount</u>	Assets		Disposal group		
	Freehold £m	Long leasehold £m	Freehold £m	Long leasehold £m	Total £m
At 28 March 2005	-	-	-	-	-
Reclassification from property, plant and equipment	26	-	-	-	26
Impairment	(3)	-	-	-	(3)
<u>Disposals</u>	<u>(12)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(12)</u>
At 26 March 2006	11	-	-	-	11

The expected disposal of these properties is as a result of the rationalisation of the portfolio

Non-current assets held for sale are reported in the relevant business segment. Further details are provided in note 3

During the year, certain properties were sold as part of a disposal group, which also included liabilities, creating a profit on disposal of £74m recognised in the income statement. In addition a gain of £13m (2006 £20m) was recognised in the income statement in relation to the disposal of other assets held for sale

During the year £nil (2006 £3m) was recognised as an impairment in operating exceptional items (note 7)

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16 Inventories

	2007 £m	2006 £m
Supplies and materials (uniforms fuel, printing and stationery mailbags engineering spares)	16	17
Merchandise (Post Office Limited retail and lottery products)	10	10
Total	26	27

During the year £3m (2006 £nil) of inventory items were written off. The cost of inventories recognised as an expense in the income statement was £41m (2006 £44m).

17 Current trade and other receivables

	2007 £m	2006 £m
Trade receivables	803	783
Prepayments and accrued income	167	227
Sub total	970	1 010
Client debtors	61	78
Interest	-	5
Total	1,031	1 093

Trade receivables are net of a bad debt provision of £28m (2006 £24m). In the year bad debts written off amounted to £6m (2006 £4m). Details of related party transactions can be found in note 29.

18 Cash and cash equivalents

	2007 £m	2006 £m
Cash in the Post Office Limited network	768	782
Other cash in hand	17	18
Cash at bank	45	29
Total cash at bank in hand or in Post Office Limited network	830	829
Cash equivalent investments Short-term deposits	366	332
Total	1,196	1,161

Other than cash in the Post Office Limited network and in hand of £785m (2006 £800m), the cash and cash equivalent balances of £411m (2006 £361m) are interest bearing. Cash at bank of £45m (2006 £29m) earns interest at either floating or short-term fixed rates based upon daily bank deposit rates. Short-term deposits of £366m (2006 £332m) are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group and earn interest at the respective short-term deposit rates. The fair value of cash and cash equivalent investments is not materially different from the carrying value of £1 196m (2006 £1 161m).

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19 Financial liabilities

	2007			
	Loans £m	Finance lease/hire purchase contracts £m	Derivative liabilities £m	Total £m
Amounts falling due in				
One year or less or on demand (current)	301	-	7	308
More than one year (non-current)	502	1	-	503
More than one year but not more than two years	-	1	-	1
More than two years but not more than five years	1	-	-	1
More than five years	501	-	-	501
Total	803	1	7	811
2006				
	Loans £m	Finance lease/hire purchase contracts £m	Derivative liabilities £m	Total £m
Amounts falling due in				
One year or less or on demand (current)	361	1	3	365
More than one year (non-current)	505	1	-	506
More than one year but not more than two years	1	1	-	2
More than two years but not more than five years	2	-	-	2
More than five years	502	-	-	502
Total	866	2	3	871

Analysis of loans and committed facilities

	Loans £m	Further committed facility £m	Total facility £m	Average interest/interest range of loan drawn down %	Average maturity date of loan drawn down Year
DTI loans to Royal Mail Group Ltd	500	1,200	1,700	5.8	2023
DTI loans to Post Office Limited	300	850	1,150	5.7	2007
Committed facilities	800	2,050	2,850		
Miscellaneous bank loans in overseas subsidiaries	3	-	3	4.6 - 5.4	2010
Total	803	2,050	2,853		

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19 Financial liabilities (continued)

	Loans £m	Further committed facility £m	Total facility £m	Average interest/interest range of loan drawn down %	Average maturity date of loan drawn down Year
DTI loans to Royal Mail Group Ltd	500	844	1 344	5.8	2023
DTI loans to Post Office Limited	360	790	1 150	4.8	2006
Committed facilities	860	1 634	2 494		
Miscellaneous bank loans in overseas subsidiaries	6	-	6	3.1-6.9	2010
Total	866	1,634	2 500		

The miscellaneous bank loans in overseas subsidiaries are either unsecured or secured on various assets (mainly property) of the overseas subsidiaries. The loans are repayable in variable and fixed amounts over their maturity periods.

The obligations under finance leases and hire purchase contracts are either unsecured or secured on various assets of the overseas subsidiaries. These are repayable in variable and fixed amounts over their maturity periods. The average interest rate is 5% (2006 6%). The average maturity date is within one to two years (2006 - within one to two years).

The undrawn committed facilities, in respect of which all conditions precedent had been met at the balance sheet date, expire as follows

	2007 £m	2006 £m
Expiring in one year or less	-	200
Expiring in more than one year but not more than two years	-	150
Expiring in more than two years	2,050	1 284
Total	2,050	1 634

The following securities apply to the Group's committed facilities

	2007 £m	2006 £m	Security
Royal Mail Group Ltd drawn down loans	500	500	Fixed charges over Royal Mail Group Ltd's loans to General Logistics Systems B V Royal Mail Group Ltd's loans to subsidiaries of General Logistics Systems B V and Royal Mail Investments Limited's shares in General Logistics Systems B V Floating charge over non regulated assets of Royal Mail Group Ltd
Royal Mail Group Ltd senior debt facility	900	844	Fixed charges over Royal Mail Holdings plc's shares in Royal Mail Group Ltd and Royal Mail Group Ltd's shares in Royal Mail Estates Limited. Floating charges over all assets of Royal Mail Holdings plc Royal Mail Group Ltd and Royal Mail Estates Limited
Royal Mail Group Ltd Shareholder loan facility	300	- None	
	1,700	1 344	
Post Office Limited facility	1,150	1 150	Floating charge over all assets of Post Office Limited and a negative pledge over cash and near cash items*
Total	2,850	2 494	

* The negative pledge is an agreement not to grant security over these assets or to set up a vehicle that has the same effect.

The Post Office Limited facility of £1 150m is restricted to funding the cash and near cash items held within the Post Office Limited network. As at 25 March 2007 the balance of this cash was £768m (2006 £782m) as shown in note 18.

The DTI loans to Post Office Limited under the facility are short dated on a programme of liquidity management and mature on average 16 days after the year end (2006 four days). On maturity it is expected that further loans will be drawn down under this facility which expires in 2010.

The security in place in the previous year was as disclosed above apart from the Royal Mail Group Ltd senior debt facility. The previous facility which was replaced by the senior debt facility was secured via a floating charge over all assets and cash deposits with the National Loans Fund. The Royal Mail Group Ltd Shareholder loan facility was not in place in the previous year.

The DTI loans to Royal Mail Group Ltd and Post Office Limited become repayable immediately on the occurrence of an event of default under the loan agreements. These events of default include non-payment, insolvency and breach of covenant relating to interest and total indebtedness. It is not anticipated that the Company is at risk of breaching any of these obligations.

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20. Provisions for liabilities and charges

	Current provisions £m	Non-current provisions £m	Held for sale provisions £m	Total £m	Mails and Parcels £m	Counter Services £m	Total £m
At 27 March 2006	58	53	-	111	109	2	111
Reclassification to Mails and Parcels	-	-	-	-	1	(1)	-
Charged in operating exceptional items	179	-	-	179	141	38	179
Charged in other operating costs	4	10	-	14	11	3	14
Reclassification to non-current provisions	(4)	4	-	-	-	-	-
Reclassification to held for sale provisions	-	(25)	25	-	-	-	-
Utilised non-cash	(41)	-	-	(41)	(29)	(12)	(41)
Utilised cash	(127)	-	(1)	(128)	(103)	(25)	(128)
Disposal of property group	-	-	(24)	(24)	(24)	-	(24)
At 25 March 2007	69	42	-	111	106	5	111

	Current provisions £m	Non-current provisions £m	Total £m	Mails and Parcels £m	Counter Services £m	Total £m
At 28 March 2005	124	48	172	160	12	172
Charged in operating exceptional items	75	-	75	60	15	75
Charged in other operating costs	7	4	11	11	-	11
Reclassifications to non-current provisions	(3)	3	-	-	-	-
Utilised non-cash	(48)	-	(48)	(39)	(9)	(48)
Utilised cash	(97)	(2)	(99)	(83)	(16)	(99)
At 26 March 2006	58	53	111	109	2	111

The Mails and Parcels provision includes amounts relating to onerous property contracts £27m (2006 £51m) and decommissioning costs £9m (2006 £13m), with the balance of £70m (2006 £45m) principally relating to redundancy. The Mails and Parcels provision is in the main expected to be utilised in 2007-08 with the remaining amount expected to be utilised over the next two to three years except for £19m relating to onerous property contracts and £8m relating to decommissioning costs which are expected to be utilised over a longer period. The timing of cash flows for such provisions are by their nature uncertain and dependent upon the outcome of related events.

Counter Services provisions include amounts in respect of the organisational design review and onerous property contracts. These provisions are expected to be utilised in 2007-08 with the exception of certain property provisions which are expected to be utilised over a longer period.

Details of amounts charged as operating exceptional items are contained in note 7. The amounts charged in other operating costs relate to onerous property contracts and decommissioning costs. The change in the carrying value of the discounted element of the provision balance due to the passage of time is not material. Non-cash utilised amounts principally relate to transfers from provisions to current payables for amounts due to the pension scheme for redundancies with early retirement. Of the current payables recognised in this way during the year £27m (2006 £1m) had been cash settled by the balance sheet date.

The cash utilised of £128m (2006 £99m) includes £118m (2006 £96m) of spend relating to exceptional rationalisation and £10m (2006 £3m) relating to other operating costs. Total cash spend in the year relating to exceptional rationalisation is shown in the cash flow statement.

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21. Current trade and other payables

	2007 £m	2006 £m
Trade payables and accruals	1,178	1 226
Advance customer payments	264	255
Social security	89	92
Sub total	1,531	1 573
Deferred consideration	3	3
Client creditors	303	248
Amounts due to pension schemes relating to redundancies	14	47
Interest	2	1
Capital	71	51
Share in Success	-	90
Total	1,924	2 013

The Group through Post Office Limited, receives and disburses cash on behalf of Government agencies and other clients to customers through its Post Office® branch network. Amounts owed to these parties are separately shown as client creditors (above). The level of cash held and the related creditors can vary significantly at each balance sheet date.

The change in the carrying value of the discounted element of the payable balance due to the passage of time is not material.

22 Non-current other payables

	2007 £m	2006 £m
Deferred consideration	1	-
Other payables	24	31
Total	25	31

23. Financial risk management objectives and policies

The Group's principal financial instruments other than derivatives comprise short-term deposits, money market liquidity investments, Government gilt edged securities, loans, finance leases and hire purchase contracts and cash. The main purposes of these financial instruments are to raise finance and manage the liquidity needs of the business operations. The Group has various other financial instruments such as trade debtors and trade creditors which arise directly from operations.

The Group enters into derivative transactions, principally commodity swaps and forward currency contracts. The purpose is to manage the commodity and currency risks arising from the Group's operations.

It is, and has been throughout the year under review, the Group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk, commodity price and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The Group's exposure to market risk for changes in interest rates relates to the Group's debt obligations and interest bearing financial assets. The DTI loans to Royal Mail Group Ltd of £500m (2006 £500m) are at a fixed interest rate to maturity with an average maturity date of 2023 (2006 average date of 2023). The DTI loans to Post Office Limited of £300m (2006 £360m) are at short-dated fixed interest rates - average maturity 16 days (2006 average 4 days). The total interest bearing financial assets of the group of £1 428m (2006 £1 060m) are at short-dated fixed or variable interest rates with average maturity 8 days (2006 average 50 days). These short-dated financial instruments are maturity managed to obtain the best value out of the interest yield curve.

The Group's policy is to manage its net interest expense using an appropriate mix of fixed and variable rate financial instruments. No external hedging of interest rate risk is undertaken.

Royal Mail Holdings plc

23 Financial risk management objectives and policies (continued)

Foreign currency risk

The Group is exposed to foreign currency risk due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, the balances held to operate the Bureau de Change services within Post Office Limited and various sales and purchase contracts denominated in foreign currency. These risks are mitigated by hedging programmes managed by Group Treasury. Where possible exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts. Hedging will not normally be considered for exposures of less than £1m, hedging is normally confined to 80% of the forecast exposure where forecast cash flows are highly probable.

The Group's obligation to settle with overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprising of US Dollar (US\$), Japanese Yen, Sterling and euro. Group Treasury operates a rolling 18-month hedge programme which is subsequently reviewed on a quarterly basis. There has been no external SDR hedge in place throughout the financial year 2006-07 due to there being no material net exposure.

For the Bureau de Change business, balances of major currency holdings are hedged along with minor currencies showing a closely correlated movement.

The Group's obligations to settle conveyance charges in US\$ and euro has been hedged (to April 2007).

The Group's obligations to settle euro invoices on a specific capital project were hedged. This programme matured during the year.

Two further hedge programmes have been initiated during the year. The Group's obligations to settle euro invoices on two separate capital projects (IMPS and FLATS) have been hedged (as far forward as February 2009).

The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries.

Commodity price risk

The Group is exposed to fuel price risk arising from operating one of the largest vehicle fleets in Europe which consumes over 150 million litres of fuel per year and a jet fuel price risk arising from the purchasing of air freight services. The Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy uses over-the-counter derivative products (in both US\$ commodity price and US\$/Sterling exchange rate) to manage these exposures.

In addition, the Group is exposed to the commodity price risk of purchasing electricity and gas. The Group's risk management strategy aims to reduce uncertainty created by the movements in the electricity and gas markets. These exposures are managed by locking into fixed rate price contracts with suppliers.

Credit risk

Royal Mail operates a Credit Policy which provides a fair and equitable arrangement for all its account customers. The level of credit granted is based on a customer's risk profile assessed by an independent credit referencing agent. The Credit Policy is applied rigidly within the regulated products area so as to ensure that Royal Mail is not in breach of compliance legislation. Assessment of credit for the non-regulated products is based on commercial factors which are commensurate with the Group's appetite for risk.

Royal Mail has a dedicated credit management team which sets and monitors credit limits and takes corrective action as and when appropriate. Despite all the controls in place Royal Mail does suffer from bad debts but the level of bad debts incurred is below 0.2% of turnover.

With respect to credit risk arising from other financial assets of the Group which comprise cash, cash equivalent investments available for sale, financial assets held to maturity, financial assets held for trading, financial assets, loans and receivables, financial assets and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty with a maximum exposure equal to the carrying amount of these instruments.

There are no significant concentrations of credit risk within the Group apart from a £1bn exposure to the Royal Bank of Scotland as a result of the establishment of the two pension escrow accounts. This exposure is expected to be short-term pending the implementation of a longer term investment strategy for the accounts.

Liquidity risk

The Group's primary objective is to ensure that the Group has sufficient funds available to meet its financial obligations as they fall due. This is achieved by aligning short-term investments and borrowing facilities with forecast cash flows. Typical short-term investments include money market funds, time deposits with approved counterparties, UK Government gilts and treasury bills. Borrowing facilities are regularly reviewed to ensure continuity of funding.

The unused facilities for Royal Mail Group Ltd were renegotiated during the year with the effect that £1,200m expires between 2014 and 2016 (2006 £844m expiring by 2009). The unused facility for Post Office Limited of £850m (2006 £790m) expires in 2010. Additionally the Group has £300m (2006 £300m) of uncommitted lines of credit which are reviewed annually.

Royal Mail Holdings plc

24 Financial instruments**Financial assets - pension escrow investments**

On 23 March 2007 Royal Mail Holdings plc and Royal Mail Group Ltd established £1bn of investments in escrow. These investments are held as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006. At 25 March 2007 Royal Mail Holdings plc had £850m of investments in the pensions escrow and Royal Mail Group Ltd had £150m. Charges over these assets have been registered. Further details on the Royal Mail Pension Plan, including the latest full actuarial valuation are contained in note 25.

Carrying amounts and fair values

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial instruments. Trade debtors, creditors, prepayments, accruals and client creditors have been omitted from this analysis on the basis that carrying value is a reasonable approximation for fair value. Pension scheme assets and liabilities are also excluded. Fair values have been calculated using current market prices (forward exchange rates/commodity prices) and discounted using appropriate discount rates.

The tables below also set out the carrying amount of the currency of the Group's financial instruments.

	Sterling £m	US\$ £m	euro £m	Other £m	2007 ⁽¹⁾ Total £m
Financial assets					
Cash at bank in hand or in Post Office Limited network	680	17	109	24	830
Cash equivalent investments	366	-	-	-	366
Cash and cash equivalents	1,046	17	109	24	1,196
Loans and receivables financial assets	14	-	-	-	14
Available for sale financial assets	3	-	-	-	3
Financial assets - investments (current)	17	-	-	-	17
Financial assets - pension escrow investments (non-current)	1,000	-	-	-	1,000
Total	2,063	17	109	24	2,213
Financial liabilities					
DTI loans to Post Office Limited	(300)	-	-	-	(300)
Miscellaneous bank loans in overseas subsidiaries (current)	-	-	(1)	-	(1)
Financial liabilities - loans (current)	(300)	-	(1)	-	(301)
DTI loans to Royal Mail Group Ltd ⁽¹⁾	(500)	-	-	-	(500)
Miscellaneous bank loans in overseas subsidiaries (non-current)	-	-	(2)	-	(2)
Financial liabilities - loans (non-current)	(500)	-	(2)	-	(502)
Obligations under finance leases and hire purchase contracts (non-current)	-	-	(1)	-	(1)
Derivative liabilities	-	(7)	-	-	(7)
Total	(800)	(7)	(4)	-	(811)
Net total financial assets	1,263	10	105	24	1,402

Royal Mail Holdings plc

24. Financial instruments (continued)

	Sterling £m	US\$ £m	euro £m	Other £m	2006 ⁽¹⁾ Total £m
Financial assets					
Cash at bank, in hand or in Post Office Limited network	715	13	79	22	829
<u>Cash equivalent investments</u>	<u>332</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>332</u>
Cash and cash equivalents	1 047	13	79	22	1 161
Financial assets at fair value through the income statement	133	-	-	-	133
Held to maturity financial assets	549	-	-	-	549
<u>Loans and receivables financial assets</u>	<u>12</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12</u>
Financial assets – investments (current)	694	-	-	-	694
Financial assets – investments (non-current)	5	-	-	-	5
<u>Derivative assets</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>-</u>	<u>3</u>
Total	1 746	16	79	22	1 863
 Financial liabilities					
DTI loans to Post Office Limited	(360)	-	-	-	(360)
Miscellaneous bank loans in overseas subsidiaries (current)	-	-	(1)	-	(1)
<u>Financial liabilities – loans (current)</u>	<u>(360)</u>	<u>-</u>	<u>(1)</u>	<u>-</u>	<u>(361)</u>
DTI loans to Royal Mail Group Ltd ⁽¹⁾	(500)	-	-	-	(500)
Miscellaneous bank loans in overseas subsidiaries (non-current)	-	-	(5)	-	(5)
<u>Financial liabilities – loans (non-current)</u>	<u>(500)</u>	<u>-</u>	<u>(5)</u>	<u>-</u>	<u>(505)</u>
Obligations under finance leases and hire purchase contracts (current)	-	-	(1)	-	(1)
Obligations under finance leases and hire purchase contracts (non-current)	-	-	(1)	-	(1)
<u>Derivative liabilities</u>	<u>-</u>	<u>(3)</u>	<u>-</u>	<u>-</u>	<u>(3)</u>
Total	(860)	(3)	(8)	-	(871)
Net total financial assets	886	13	71	22	992

⁽¹⁾ The only financial instrument where the carrying amount is different to the fair value is the DTI loans to Royal Mail Group Ltd. At the year end the respective fair value is £494m (2006 £520m)

All the above financial assets and liabilities are recorded in the accounts at amortised cost with the exception of the following

- Financial assets – investments (non-current) £nil (2006 £5m) and available for sale financial assets £3m (2006 £nil) are classified as available for sale and valued at fair value with the movement taken to reserves
- Financial assets at fair value through the income statement £nil (2006 £133m) all of which are classified as held for trading are valued at fair value with the movement taken straight to the income statement, and
- Derivative assets £nil (2006 £3m) and liabilities £7m (2006 £3m) are valued at fair value. Effective changes in the fair value of derivatives which are part of designated cash flow hedge under IAS 39 are deferred into equity. All other changes in derivative fair value are taken straight to the income statement.

Royal Mail Holdings plc

24 Financial instruments (continued)

Interest rate risk

Interest on financial instruments classified as floating is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

A one-percentage point increase in interest rates throughout the period would have increased profit before tax by £8m (2006 £6m). Calculated as the increase in interest income less expense on floating rate financial instruments and fixed rate financial instruments that matured during the year plus the profit/loss impact on fixed rate financial instruments that are carried at fair value.

The table below sets out the carrying amount by maturity of the Group's financial instruments that are exposed to interest rate risk. The pension escrow investments mature within 1 year but have been disclosed as maturing in greater than 5 years as the investments have been provided as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006.

Financial year ended 25 March 2007

Fixed rate	Average effective interest rate %	Within 1 year						Total £m
		£m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	
Cash at bank	3.8	21	-	-	-	-	-	21
Cash equivalent investments	5.2	366	-	-	-	-	-	366
Loans and receivables financial assets	5.4	14	-	-	-	-	-	14
Available for sale financial assets	5.4	3	-	-	-	-	-	3
DTI loans to Post Office Limited	5.7	(300)	-	-	-	-	-	(300)
DTI loans to Royal Mail Group Ltd	5.8	-	-	-	-	-	(500)	(500)
Total		104	-	-	-	-	(500)	(396)
Floating rate								
Cash at bank	2.9	24	-	-	-	-	-	24
Financial assets – pension escrow investment (non-current)	5.2	-	-	-	-	-	1,000	1,000
Miscellaneous bank loans in overseas subsidiaries	4.8	(1)	-	(1)	-	-	(1)	(3)
Obligations under finance leases and hire purchase contracts	5.3	-	(1)	-	-	-	-	(1)
Total		23	(1)	(1)	-	-	999	1,020
Non-interest bearing								
Cash in hand or in Post Office Limited network	785	-	-	-	-	-	-	785
Derivative liabilities	(7)	-	-	-	-	-	-	(7)
Total		778	-	-	-	-	-	778
Net total financial assets/(liabilities)	905	(1)	(1)	-	-	-	499	1,402

Royal Mail Holdings plc

24 Financial instruments (continued)

Financial year ended 26 March 2006

	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
Fixed rate								
Cash at bank	2.7	12	-	-	-	-	-	12
Cash equivalent investments	4.4	332	-	-	-	-	-	332
Financial assets at fair value through income statement	4.4	133	-	-	-	-	-	133
Held to maturity financial assets	4.5	549	-	-	-	-	-	549
Loans and receivables financial assets	4.8	12	-	-	-	-	-	12
Financial assets – investments (non- current)	4.5	-	3	2	-	-	-	5
DTI loans to Post Office Limited	4.8	(360)	-	-	-	-	-	(360)
DTI loans to Royal Mail Group Ltd	5.8	-	-	-	-	-	(500)	(500)
Miscellaneous bank loans in overseas subsidiaries	6.1	(1)	(1)	-	(1)	-	(1)	(4)
Obligations under finance leases and hire purchase contracts	6.1	-	(1)	-	-	-	-	(1)
Total		677	1	2	(1)	-	(501)	178
Floating rate								
Cash at bank	2.0	17	-	-	-	-	-	17
Miscellaneous bank loans in overseas subsidiaries	3.1	-	-	(1)	-	-	(1)	(2)
Obligations under finance leases and hire purchase contracts	6.4	(1)	-	-	-	-	-	(1)
Total		16	-	(1)	-	-	(1)	14
Non-interest bearing								
Cash in hand or in Post Office Limited network		800	-	-	-	-	-	800
Derivative assets		3	-	-	-	-	-	3
Derivative liabilities		(3)	-	-	-	-	-	(3)
Total		800	-	-	-	-	-	800
Net total financial assets/(liabilities)		1 493	1	1	(1)	-	(502)	992

Royal Mail Holdings plc

24 Financial instruments (continued)**Hedging Activities**

The Group had six designated cash flow hedge programmes during the current and previous financial year

- i) The diesel fuel hedge programmes uses forward commodity price swaps and forward currency purchase contracts to hedge the exposure arising from commodity price and US\$/GBP exchange rates for forecast diesel fuel purchases
- ii) The air conveyance hedge programme uses US\$ and euro forward currency purchase contracts to hedge the exposure arising from US\$/GBP and GBP/euro exchange rates for forecast air conveyance purchases
- iii) The euro capital programme uses euro forward currency purchase contracts to hedge the exposure arising from GBP/euro exchange rates for contracted capital expenditure. This programme matured during the year
- iv) The US\$ capital programme used US\$ forward currency purchase contracts to hedge the exposure arising from US\$/GBP exchange rates for contracted capital expenditure. This programme matured during the previous financial year
- v) The FLATS capital programme uses euro forward currency purchase contracts to hedge the exposure arising from GBP/euro exchange rates for contracted capital expenditure. This programme commenced during the year
- vi) The IMPS capital programme uses euro forward currency purchase contracts to hedge the exposure arising from GBP/euro exchange rates for contracted capital expenditure. This programme commenced during the year

The following table shows the movements on the hedging reserve for each of these hedge programmes

	Gains/(losses) deferred into equity during year	(Gains)/losses released from equity to income during year	(Gains)/losses released from equity to the carrying value of non-financial assets during year
2007	£m	£m	£m
Diesel Fuel	(8)	3	-
Air Conveyance	(1)	1	-
Total	(9)	4	-
<hr/>			
2006			
Diesel Fuel	3	(10)	-
Capital Programme – US\$	-	-	(1)
Total	3	(10)	(1)

For all the above cash flow hedge programmes the underlying cash flows being hedged are expected to occur at the same dates as the hedge instruments (derivatives) mature. For the non-capital programmes (Diesel and Air Conveyance) the profit or loss will be taken on maturity. For capital programmes the impact on the income statement will be through the depreciation charge over the life of the asset being hedged.

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24 Financial instruments (continued)

The following table shows the derivatives outstanding at the year end

2007	Commodity/ currency	Nominal amount	Maturity date	Average contracted commodity price/ exchange rate	Derivative asset fair value £m	Derivative liability fair value £m
Diesel fuel	Diesel fuel	149k tonnes	Apr 07-Oct 08	US\$644/tonnes	-	(3)
Diesel fuel	US\$	\$96m	Apr 07-Oct 08	US\$1.88/£	-	(2)
Air conveyance	US\$	\$3m	Apr 07	US\$1.77/£	-	-
Air conveyance	euro	€1m	Apr 07	£0.70/€	-	-
FLATS capital programme	euro	€51m	May 07-Feb 09	£0.69/€	-	-
IMPS capital programme	euro	€51m	Jul 07-Nov 08	£0.69/€	-	-
Cash flow hedges					-	(5)
Other derivatives					-	(2)
Total					-	(7)
 2006						
Diesel fuel	Diesel fuel	131k tonnes	Apr 06-July 07	US\$618/tonnes	2	(2)
Diesel fuel	US\$	\$81m	Apr 06-Jul 07	US\$1.77/£	1	(1)
Air conveyance	US\$	\$24m	Apr 06-Apr 07	US\$1.74/£	-	-
Air conveyance	euro	€4m	Apr 06-Apr 07	£0.69/€	-	-
Capital programme	euro	€4m	Apr 06-Nov 06	£0.69/€	-	-
Cash flow hedges					3	(3)
Other derivatives					-	-
Total					3	(3)

Other derivatives represent hedges by the Group of other foreign exchange and commodity price exposures which are not designated as hedges under IAS 39 (including the hedge of jet fuel costs arising from the purchasing of air freight services and the hedge of the Bureau de Change currency holdings within Post Office Limited)

The Group had outstanding forward transactions to hedge foreign currency and fuel purchases as follows

	In currency (millions)		Sterling equivalents (millions)	
	2007	2006	2007	2006
Maturing within one year				
euro	110	103	74	71
US Dollars	133	140	71	80
Australian Dollars	4	7	2	3
Fuel (US Dollars)	94	94	51	53
Maturing after one year				
euro	84	-	58	-
US Dollars	25	15	13	9
Fuel (US Dollars)	25	12	13	7

The Group's fuel hedges which fix the GBP cost of purchasing fuel, consist of two elements

- a commodity forward transaction fixing the cost in US Dollars of purchasing fuel and
- a currency forward transaction fixing the GBP cost of these US Dollars

The table above contains both of these transactions. The commodity forward transactions are shown under the heading Fuel (US Dollars) - \$94m maturing within one year and \$25m maturing after one year. The related currency forward transactions are contained within the total of US Dollars - \$133m maturing within one year and \$25m maturing after one year

Royal Mail Holdings plc

25 Employee benefits – pensions

The Group operates pension schemes as detailed below

Scheme	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives	Defined benefit
Royal Mail Retirement Savings Plan (RMRSP)	UK employees	Defined contribution
Various other small-scale schemes operated by overseas subsidiaries	Overseas subsidiary employees	Defined contribution

Defined Contribution

A charge for the defined contribution schemes of £2m (2006 £2m) was recognised in operating profit before exceptional items within the income statement. The Company contributions to these schemes was £2m (2006 £1m)

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. The latest full actuarial valuations of both schemes have been carried out as at 31 March 2006 using the projected unit method. For RMPP this valuation has been concluded at £3.4bn deficit. For RMSEPP, the valuation has been concluded at £43m deficit

Payment of £541m (2006 £342m) was made during the year in respect of regular future service contributions, with £538m (2006 £337m) relating to RMPP. The regular future service contributions for RMPP expressed as a percentage of pensionable pay has increased from 12.6% (the rate during the prior year) to 20.0% effective from the beginning of the year. This rate is not expected to change materially during 2007-08. For RMSEPP these contributions have been at 20.9% (2006 20.9%). The rate increased to 48.2% from 1 April 2007

Payment of £243m (2006 £113m) was made during the year to fund the deficit in the schemes with £241m (2006 £109m) relating to RMPP. Deficit recovery payments are planned for RMPP over the 17 years from the date of the latest full actuarial valuation. These payments will be made before each 31 March and may therefore span across the Group's year end (the last Sunday in March). Over the 16 years from 31 March 2007, planned deficit payments are £260m per annum increasing in line with RPI (base year is 2006-07). For RMSEPP, deficit recovery payments will be £5m per annum from 1 April 2007 to 31 December 2015

A current liability of £14m (2006 £47m) has been recognised for payments to the pension schemes relating to redundancy (see note 21). During the year, payments of £74m (2006 £209m) relating to redundancy were made

On 23 March 2007 the Group established £1bn of investments in escrow as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period

The following disclosures relate to the gains/losses and deficit in the schemes recognised for the RMPP and RMSEPP defined benefit plans in the financial statements of the Group

a) Major assumptions

The size of the pension deficit which is large in the context of the Group and its finances is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the deficit and overall income statement charge. The major assumptions were

	At 25 March 2007 % pa	At 26 March 2006 % pa
Rate of increase in salaries	4.1	3.8
Rate of increase in pensions and deferred pensions	3.1	2.8
Discount rate	5.3	4.9
Inflation assumption	3.1	2.8
Expected average rate of return on assets	7.0	7.1

The above assumptions relate to both defined benefit plans with the exception of the expected average rate of return on assets which is computed for the combined assets of the plans. The expected average rate of return on assets is a weighted average of the long-term expected rate of return of each principal asset class (see section b). The expected average rate of return is computed at each balance sheet date based on the market values and long-term rate of return of each principal asset class as at that date

Mortality

The mortality assumptions for the larger scheme are based on the 1992 series mortality tables allowing for 'medium cohort' projections of future improvements. These are detailed below

Average expected life expectancy from age 60	2007	2006
For a current 60 year old male RMPP member	26 years	26 years
For a current 60 year old female RMPP member	29 years	29 years
For a current 40 year old male RMPP member	28 years	28 years
For a current 40 year old female RMPP member	30 years	30 years

Royal Mail Holdings plc

25 Employee benefits – pensions (continued)

b) Plans' assets and expected rates of return

The assets in the plans and the expected rates of return were

At 25 March 2007

	Market value		Long-term expected rate of return	
	2007 £m	2006 £m	2007 % pa	2006 % pa
Equities	15,372	17,190	8.0	7.7
Bonds	5,693	2,682	4.6	4.2
Property	2,484	1,835	6.2	5.9
Other assets	29	140	4.1	3.8
Fair value of plans assets	23,578	21,847		
Present value of plans liabilities	(28,563)	(27,435)		
Deficit in schemes	(4,985)	(5,588)		

There is no element of the above present value of liabilities that arises from plans that are wholly unfunded

Certain of the above investments relate to properties occupied by the Group but the contribution of these properties to the fair value of plans assets is not material. The pension plans have not invested in any other assets used by the Group or in the Group's own financial instruments

c) Recognised charges

An analysis of the separate components of the amounts recognised in the income statement and statement of recognised income and expense (SORIE) is as follows

	2007 £m	2006 £m
Analysis of amounts recognised in the income statement		
Analysis of amounts charged to operating profit before exceptional items		
Current service cost	704	527
Past service cost	16	-
Total charge to operating profit before exceptional items	720	527
Analysis of amounts charged to operating exceptional items		
Loss due to curtailments (within provision for restructuring charge – note 7)	51	24
Total charge to operating profit	771	551
Analysis of amounts charged/(credited) to financing		
Interest on plans liabilities	1,342	1,162
Expected return on plans assets	(1,541)	(1,263)
Total net credit to financing	(199)	(101)
Net charge to income statement before deduction for tax	572	450
Analysis of amounts recognised in the statement of recognised income and expense (SORIE)		
Actual return on plans assets	1,713	4,684
Less expected return on plans assets	(1,541)	(1,263)
Actuarial gains on assets (all experience adjustments)	172	3,421
Experience adjustments on liabilities	(122)	(161)
Effects of changes in actuarial assumption on liabilities	290	(4,919)
Actuarial gains/(losses) on liabilities	168	(5,080)
Total actuarial gains/(losses) recognised in SORIE before deduction for tax	340	(1,659)

Royal Mail Holdings plc

25 Employee benefits – pensions (continued)

d) Movement in plans' assets and liabilities

Changes in the present value of the defined benefit pension obligations are analysed as follows

	2007 £m	2006 £m
Plans liabilities at beginning of period	(27,435)	(21 315)
Current service cost	(704)	(527)
Past service cost	(16)	-
Curtailment costs*	(41)	(48)
Finance cost	(1,342)	(1 162)
Employee contributions	(162)	(162)
Actuarial gain/(loss) (recognised in SORIE)	168	(5 080)
Benefits paid	969	859
Plans liabilities at end of period	(28,563)	(27 435)

*The curtailment costs in the income statement are recognised on a consistent basis with the associated compensation costs. Estimates of both are included for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy during the accounting period. Such payments may occur in an accounting period subsequent to the recognition of costs in the income statement.

Changes in the fair value of the plans' assets are analysed as follows

	2007 £m	2006 £m
Plans assets at beginning of period	21,847	17,357
Company contributions paid	858	664
Movement in company contributions accrued	(33)	(161)
Employee contributions	162	162
Finance income	1,541	1 263
Actuarial gain (recognised in SORIE)	172	3,421
Benefits paid	(969)	(859)
Plans' assets at end of period	23,578	21 847

e) History of experience gains and losses

The cumulative amount of actuarial gains and losses recognised since transition to IFRSs at 29 March 2004 in the statement of recognised income and expense is £908m loss (2006 a loss of £1 248m). The Directors are unable to determine how much of the pension scheme deficit recognised in transition to IFRSs is attributable to actuarial gains and losses since inception of the pension schemes. Consequently the Directors are unable to determine the cumulative amount of actuarial gains and losses that would have been recognised in the statement of recognised income and expense between inception of the pension schemes and transition to IFRSs.

	2007 £m	2006 £m	2005 £m	2004 £m
Fair value of assets	23,578	21,847	17 357	15 200
Present value of liabilities	(28,563)	(27,435)	(21 315)	(19 594)
Deficit in schemes	(4,985)	(5 588)	(3 958)	(4 394)
	2007 £m	2006 £m	2005 £m	
Experience adjustment on assets	172	3 421	1 043	
Experience adjustment on liabilities	(122)	(161)	(302)	

Royal Mail Holdings plc

26 Share capital

Authorised	2007	2006
	£	£
Ordinary shares of £1 each	100,000	100 000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	100,001	100 001
Issued and called up	2007	2006
	£	£
Ordinary shares of £1 each	50,005	50 000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	50,006	50 001

The Special Share can be redeemed at any time by its holder (the Secretary of State for Trade and Industry) subject to such redemption being compliant with the Companies Act 1985. The Company cannot redeem the Special Share without the prior consent of its holder. No premium is payable on redemption.

On distribution in a winding up of the Company, the holder of the Special Share is entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member. The Special Share does not carry any rights to vote.

Under section 63(7) of the Postal Services Act 2000 for the purposes of the Companies Act 1985, certain shares issued shall be treated as if their nominal value had been fully paid up.

Under sections 72 and 74 of the Postal Services Act 2000 the Secretary of State for Trade and Industry may issue directions to the Company which depending on the direction issued could result in the recognition of a distribution.

The increase in share capital in the period was due wholly to the issue of shares. Details of the share issues are contained in note 27.

Royal Mail Holdings plc

27 Total equity

	Share premium £m	Retained earnings £m	Mails Contribution Reserve £m	POL Contribution Reserve £m	Holdings Escrow Reserve £m	Mails Reserve £m	Rural Network Reserve £m	POL Funding Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Minority parent interest £m	Total equity £m
At 27 March 2006	-	(4,270)	-	-	-	836	28	-	8	-	55	(3 343)	4	(3,339)
Profit for the period	-	286	-	-	-	-	-	-	-	-	-	286	-	286
Translation differences	-	-	-	-	-	-	-	-	(2)	-	-	(2)	-	(2)
Actuarial gains on defined benefit schemes	-	340	-	-	-	-	-	-	-	-	-	340	-	340
Loss on cash flow hedges deferred into equity	-	-	-	-	-	-	-	-	-	(9)	-	(9)	-	(9)
Loss on cash flow hedges released from equity to income	-	-	-	-	-	-	-	-	-	4	-	4	-	4
Taxation on items taken directly to equity	-	27	-	-	-	-	-	-	-	-	-	27	-	27
Recognised income/(expense) for the period	-	653	-	-	-	-	-	-	(2)	(5)	-	646	-	646
Transfer from Mails Reserve to Rural Network Reserve	-	-	-	-	-	(75)	75	-	-	-	-	-	-	-
Allocation to Rural Network Reserve	-	(75)	-	-	-	-	75	-	-	-	-	-	-	-
Transfer from Rural Network Reserve	-	150	-	-	-	-	(150)	-	-	-	-	-	-	-
Transfer of interest income to Rural Network Reserve	-	(2)	-	-	-	-	2	-	-	-	-	-	-	-
Issue of ordinary shares (1)	145	-	-	-	-	-	-	-	-	-	-	145	-	145
Allocation to Mails Contribution Reserve	-	(145)	145	-	-	-	-	-	-	-	-	-	-	-
Transfer from Mails Contribution Reserve	-	145	(145)	-	-	-	-	-	-	-	-	-	-	-
Issue of ordinary shares (2)	231	-	-	-	-	-	-	-	-	-	-	231	-	231
Allocation to POL Contribution Reserve	-	(231)	-	231	-	-	-	-	-	-	-	-	-	-
Transfer from POL Contribution Reserve to POL Funding Reserve	-	-	-	(231)	-	-	-	231	-	-	-	-	-	-
Transfer of interest income to POL Funding Reserve	-	(2)	-	-	-	-	2	-	-	-	-	-	-	-
Transfer from POL Funding Reserve	-	233	-	-	-	-	-	(233)	-	-	-	-	-	-
Transfer of interest income to Mails Reserve	-	(34)	-	-	-	34	-	-	-	-	-	-	-	-
Distribution of Mails Reserve	-	795	-	-	-	(795)	-	-	-	-	-	-	-	-
Allocation to Holdings Escrow Reserve	-	(795)	-	-	795	-	-	-	-	-	-	-	-	-
Issue of ordinary shares (3)	54	-	-	-	-	-	-	-	-	-	-	54	-	54
Allocation to Holdings Escrow Reserve	-	(54)	-	-	54	-	-	-	-	-	-	-	-	-
Transfer of interest income to Holdings Escrow Reserve	-	(1)	-	-	1	-	-	-	-	-	-	-	-	-
Transfer from Holdings Escrow Reserve	-	850	-	-	(850)	-	-	-	-	-	-	-	-	-
Transfer of unrealised gain	-	8	-	-	-	-	-	-	-	(8)	-	-	-	-
Dividend paid to minority interest	-	-	-	-	-	-	-	-	-	-	-	(1)	-	(1)
At 25 March 2007	430	(2,775)	-	-	-	30	-	6	(5)	47	(2,267)	3	(2,264)	

Royal Mail Holdings plc

27. Total equity (continued)

	Retained earnings £m	Mails Reserve £m	Rural Network Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Minority interest £m	Total equity £m
At 28 March 2005	(3 085)	801	171	8	-	63	(2 042)	4	(2,038)
Restatement for the effect of IAS 32 and IAS 39 at 28 March 2005	(11)	-	-	-	8	-	(3)	-	(3)
Restated balance at 28 March 2005	(3 096)	801	171	8	8	63	(2 045)	4	(2,041)
Profit for the period	395	-	-	-	-	-	395	-	395
Translation differences	-	-	-	-	-	-	-	-	-
Actuarial (losses) on defined benefit schemes	(1 659)	-	-	-	-	-	(1 659)	-	(1 659)
Gains on cash flow hedges deferred into equity	-	-	-	-	3	-	3	-	3
(Gains) on cash flow hedges released from equity to income	-	-	-	-	(10)	-	(10)	-	(10)
(Gains) on cash flow hedges released from equity to the carrying amount of non-financial assets	-	-	-	-	(1)	-	(1)	-	(1)
Taxation on items taken directly to equity	(26)	-	-	-	-	-	(26)	-	(26)
Recognised income/(expense) for the period	(1 290)	-	-	-	(8)	-	(1,298)	-	(1 298)
Transfer from Rural Network Reserve	147	-	(147)	-	-	-	-	-	-
Transfer of interest income	(39)	35	4	-	-	-	-	-	-
Transfer of unrealised gain	8	-	-	-	-	(8)	-	-	-
At 26 March 2006	(4,270)	836	28	8	-	55	(3,343)	4	(3,339)

Share issue (1) & Mails Contribution Reserve

During the period one ordinary share of £1 in Royal Mail Holdings plc (the Company) was allotted and issued to the Secretary of State for Trade and Industry (the Secretary of State) under section 63(1) of the Postal Services Act 2000 (the Act). Consideration in full of £145m was received on the same day. A share premium of £144 999 999 resulted from this subscription.

Following a direction issued by the Secretary of State under section 72 of the Act, the Company upon receipt of the £145m consideration created the Mails Contribution Reserve and allocated to it a sum of £145m. Under the direction issued the Company then immediately transferred funds of £145m from the Mails Contribution Reserve to Royal Mail Group Ltd, a wholly owned subsidiary of the Company.

Under the terms of an agreement the funds transferred have been applied by Royal Mail Group Ltd as reimbursement in full of £145m that had been advanced to Post Office Limited. Post Office Limited is a wholly owned subsidiary of Royal Mail Group Ltd.

Mails, Rural Network and POL Funding Reserves

The Mails Reserve was created by Royal Mail Group Ltd on 3 February 2003 following directions issued by the Secretary of State under section 72 of the Act. The amounts allocated to this Reserve are to be applied as if they were profits available for distribution. The purposes for which the Mails Reserve may be utilised are stated in the directions issued, and principally relate to providing financial assistance to Post Office Limited (but also relate under certain circumstances to making a distribution to the Company). Financial assistance of £1 121m has been provided from this Reserve to Post Office Limited up to the beginning of the 2006-07 financial year.

The Rural Network Reserve was created by Post Office Limited following directions issued by the Secretary of State under section 72 of the Act. The amounts allocated to this Reserve are to be applied as if they were profits available for distribution. The purposes for which the Rural Network Reserve may be utilised are stated in the directions issued, and principally relate to the maintenance of a rural network of post offices. A total of £444m has been used from this Reserve towards the maintenance of a rural network between March 2003 and the beginning of the 2006-07 financial year.

Following directions issued by the Secretary of State under section 72 of the Act, Royal Mail Group Ltd transferred funds of £75m from the Mails Reserve to Post Office Limited during the period (2006 £nil) and, upon receipt, Post Office Limited allocated these funds to the Rural Network Reserve. In addition Post Office Limited received £75m during the period (2006 £nil) from the Secretary of State following an order issued by the Secretary of State under section 103 of the Act. This subsidy has been accounted for as a Government grant and recorded within revenue as the Social Network Payment (see note 2). Under the terms of an agreement, Post Office Limited immediately allocated £75m to the Rural Network Reserve on receipt of the Social Network Payment. During the period £150m (2006 £147m) of the Rural Network Reserve was applied towards the maintenance of a rural network of Post Offices.

Following a further direction issued by the Secretary of State, Royal Mail Group Ltd made a distribution to the Company of a sum equal to the amount standing to the credit of the Mails Reserve (£795m) and applied the Mails Reserve to make the distribution. This reduced the balance on the Mails Reserve to £nil. Under the direction issued the Company allocated £795m to the Holdings Escrow Reserve (see below).

Royal Mail Holdings plc

27 Total equity (continued)

The POL Funding Reserve was created by Post Office Limited following directions issued by the Secretary of State under section 72 of the Act. The amounts allocated to this Reserve are to be applied as if they were profits available for distribution. The purposes for which the POL Funding Reserve may be utilised are stated in the directions issued and principally relate to meeting the ongoing requirements of Post Office Limited such as to ensure that it may meet its debts as they fall due. The Reserve has not been used prior to the beginning of the current financial year. Of the £233m allocated to the Reserve during the period, £231m arose from funds transferred from the POL Contribution Reserve (see below) and £2m relates to the transfer of interest (see below). Following a further direction issued by the Secretary of State under section 72 of the Act, the amounts standing to the credit of the POL Funding Reserve were released.

Interest

The transfer of interest relates to income recorded in the income statement which has been earned on the assets that support the Mails, Rural Network, POL Funding and Holdings Escrow Reserves.

Share issue (2) & POL Contribution Reserve

During the period three ordinary shares each with a nominal value of £1 in the Company were allotted and issued to the Secretary of State under section 63(1) of the Act. Consideration in full of £37.5m, £156m and £37.5m respectively was received on the same day as issue (a total consideration of £231m). A share premium of £230,999,997 resulted from these subscriptions.

Following a direction issued by the Secretary of State under section 72 of the Act, the Company upon receipt of the £37.5m consideration for the first share created the POL Contribution Reserve and allocated to it a sum of £37.5m. Under the direction issued the Company then immediately transferred funds of £37.5m from the POL Contribution Reserve to Post Office Limited, a wholly owned subsidiary of Royal Mail Group Ltd and upon receipt Post Office Limited allocated these funds to the POL Funding Reserve. Royal Mail Group Ltd is a wholly owned subsidiary of the Company. Similarly the Company upon receipt of the consideration for each of the second and third shares, allocated a sum of £156m and £37.5m respectively to the POL Contribution Reserve, immediately transferred funds equal to these amounts from the POL Contribution Reserve to Post Office Limited and upon receipt Post Office Limited allocated these funds to the POL Funding Reserve.

Share issue (3) & Holdings Escrow Reserve

Following a direction issued by the Secretary of State under section 72 of the Act the Company received a distribution of £795m from Royal Mail Group Ltd. created the Holdings Escrow Reserve and allocated to it a sum of £795m. Subsequently one ordinary share of £1 in the Company was allotted and issued to the Secretary of State under section 63(1) of the Act. Consideration in full of £54,273m was received on the same day. A share premium of £54,272,999 resulted from this subscription. Under the direction issued the Company then allocated a further £54,273m to the Holdings Escrow Reserve. The amounts allocated to this Reserve are to be applied as if they were profits available for distribution. The purposes for which the Holdings Escrow Reserve may be utilised are stated in the directions issued and include the use of £850m for the provision of security in favour of the trustee of the Royal Mail Pension Plan. Following the transfer of interest (see above) of £1m the balance on this reserve was £850m. Immediately following the transfer of interest £850m of the reserve was applied to provide this security through an escrow. The £54m received from this subscription partly offset the transfer of £75m from the Mails Reserve in Royal Mail Group Ltd to Post Office Limited earlier in the year (see above). This transfer resulted in a lower amount standing to the credit of the Mails Reserve at the time of the distribution from Royal Mail Group Ltd (see above).

Note: An additional escrow of £150m was established by Royal Mail Group Ltd as security for the trustee of the Royal Mail Pension Plan. The £150m was not connected to any balances on reserves established following directions issued by the Secretary of State under section 72 of the Act and as such does not appear in the analysis of reserve movements.

Foreign Currency Translation Reserve

The Foreign Currency Translation Reserve is used to record the gains and losses arising from 29 March 2004 on translation of assets and liabilities of subsidiaries denominated in currencies other than the reporting currency.

Hedging Reserve

The Hedging Reserve is used to record gains and losses arising from cash flow hedges since 28 March 2005.

Other Reserves

Other Reserves of £47m (2006 £55m) comprise £2m (2006 £2m) unrealised gain on First Rate Exchange Services Holdings Limited, a joint venture transaction, and £45m (2006 £45m) and £nil (2006 £8m) relating to unrealised gains on Midasgrange Limited and G3 Worldwide Mail N.V. (Spring) respectively, both associate transactions. During the year £8m (2006 £8m) was transferred to retained earnings following impairment of the investment in G3 Worldwide Mail N.V. (Spring) (see note 7).

Royal Mail Holdings plc

28 Commitments**Operating lease commitments**

The Group is committed to the following future minimum lease payments under non-cancellable operating leases as at 25 March 2007

	Land and Buildings		Vehicles and equipment		IT equipment		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Within one year	120	124	36	49	15	46	171	219
Between one and five years	366	419	42	76	52	169	460	664
Beyond five years	679	755	-	2	12	77	691	834
Total	1,165	1 298	78	127	79	292	1,322	1 717

Existing property leases have an average term of 14 years and any new leases entered into generally have a 15-year term with a 10-year break clause. Vehicle leases generally have a term of between 3 and 7 years, depending on the class of vehicle, with the average term being 4 years. The existing leases will mature between 2007 and 2011. The IT contract has a term of 10 years with 6 years remaining at the balance sheet date.

Capital commitments

The Group has commitments of £110m (2006 £59m) at 25 March 2007 which are contracted for but not provided in the accounts.

Royal Mail Holdings plc

29. Related party transactions

The ultimate parent (the Company) and principal subsidiaries

Royal Mail Holdings plc is the ultimate parent company of the Group. The consolidated financial statements include the financial statements of Royal Mail Holdings plc and the principal subsidiaries listed in the following table.

Company	Country of incorporation	% equity interest	
		2007	2006
Royal Mail Group Ltd	United Kingdom	100%	100%
Post Office Limited	United Kingdom	100%	100%
Royal Mail Investments Limited	United Kingdom	100%	100%
General Logistics Systems B V	Netherlands	100%	100%
Royal Mail Estates Limited	United Kingdom	100%	-
Romec Limited	United Kingdom	51%	51%

Royal Mail Estates Limited, a wholly owned subsidiary, was formed during the financial year. The security on the Royal Mail Group Ltd senior debt facility includes a fixed charge over shares in Royal Mail Estates Limited and a floating charge over all the assets of Royal Mail Estates Limited (see note 19). On the last day of the financial year, Royal Mail Group Ltd transferred most of its directly held property assets to Royal Mail Estates Limited.

Joint venture

The Group has a 50% interest in First Rate Exchange Services Holdings Limited (previously known as First Rate Travel Services Limited until its name change on 23 February 2006), a company registered in the United Kingdom.

Associates

The following companies are the principal associates of the Group.

Company	Country of incorporation	2007		2006	
		2007	2006	2007	2006
Quadrant Catering Limited	United Kingdom	51%	51%	51%	51%
Camelot Group plc	United Kingdom	20%	20%	20%	20%
G3 Worldwide Mail N V (Spring)	Netherlands	24.5%	24.5%	24.5%	24.5%
Midasgrange Limited	United Kingdom	50%	50%	50%	50%

The majority of the Board and voting power in Quadrant Catering Limited is held by the Group's partner, hence it is not a subsidiary.

Related party transactions

During the year the Group entered into transactions with related parties. The transactions were in the ordinary course of business and included administration and investment services recharged to the Group's pension plan by Royal Mail Pensions Trustees Limited. The transactions entered into and the balances outstanding at the financial year end were as follows:

	Sales/recharges to related party		Purchases from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2007	2006	2007	2006	2007	2006	2007	2006
	£m	£m	£m	£m	£m	£m	£m	£m
Royal Mail Pension Plan	9	9	-	-	-	-	-	-
Quadrant Catering Limited	-	-	43	42	-	-	5	6
Camelot Group plc	48	49	-	-	1	1	-	-
G3 Worldwide Mail N V (Spring)	1	1	12	13	13	11	2	2
Midasgrange Limited	9	6	-	-	8	-	-	-
First Rate Exchange Services Holdings Limited Group	26	26	-	-	1	-	4	-

Companies listed above are joint ventures and associates of the Group with the exception of Royal Mail Pension Plan.

The sales to and purchases from related parties are made at normal market prices. Outstanding balances at the year end are unsecured, interest free and settlement is made by cash.

The Group trades with numerous Government bodies on an arm's length basis. Transactions with these entities are not disclosed owing to the significant volume of transactions that are conducted.

Separately

- the Group has certain loan facilities with Government (see note 19)
- the Group has received certain funding via the issue of shares to Government (see note 27) and
- the Group has received the Social Network Payment from Government (see notes 2 and 27)

Royal Mail Holdings plc

29 Related party transactions (continued)

Key management compensation

	2007 £000	2006 £000
Short-term employee benefits	4,164	2,987
Post-employment benefits	707	688
Termination benefits	-	865
Other long-term benefits	3,113	463
Total compensation paid to key management	7,984	5,003

Key management comprises Executive and Non Executive Directors of the Royal Mail Holdings plc Board

HM Government is the Company's sole Shareholder and, accordingly the Directors have no interest in the shares of the Company

Transactions with other related parties

Bob Wigley a Non Executive Director of the Company until his resignation on 31 October 2006, is Chairman of Merrill Lynch's Europe Middle East and Africa Business. The Royal Mail Pension Plan not the Group had a commercial relationship with Merrill Lynch Investment Management for two UK equity portfolio mandates to the value of £970m for the 7 months up to 31 October 2006 (full year to 26 March 2006 £950m). Bob Wigley is not a Trustee of the Royal Mail Pension Plan

John Neill a Non Executive Director is Group Chief Executive and Deputy Chairman of Unipart Group which had a contract for the supply of operational support services and expertise with Royal Mail for improvements to mail centres. The work programme was successfully completed during 2006-07 with a payment made of £1.4m (2006 £0.5m). John Neill took no part in the decision to appoint Unipart Group

30 Events after the balance sheet date

A funding agreement for Post Office Limited was announced by Government on 17 May 2007. Details of the announcement are set out in the funding section of note 2

Since the year end there has been a period of industrial action. In October agreement was reached with the Communication Workers Union on pay modernisation and pension reform. The Group has recently outlined a series of proposals for pensions on which consultation is to commence shortly. The priority is to protect our existing people's pensions in a way that is affordable and does not expose our people or the business to unacceptable risk going forward.

Royal Mail Holdings plc

Group five-year summary (unaudited)

	Prepared or restated under				
	UK GAAP		IFRS		
	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m
Income statement					
Revenue	8 299	8 633	8 956	9 056	9,179
(Loss)/profit from operations	(197)	220	-	-	-
Pensions benefit/(charge) in respect of pensions surplus/(deficit) under SSAP 24	246	(132)	-	-	-
Operating profit before exceptional items	49	88	302	355	233
Operating exceptional items	(721)	(64)	(277)	(210)	(243)
Operating (loss)/profit	(672)	24	25	145	(10)
Non-operating exceptional items	26	64	67	67	118
(Loss)/profit before interest	(646)	88	92	212	108
Finance income and costs including net pensions interest	35	17	75	100	205
(Loss)/profit before tax	(611)	105	167	312	313
Taxation	52	(98)	(16)	83	(27)
(Loss)/profit after tax	(559)	7	151	395	286
Cash flow					
	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m
Net increase/(decrease) in cash	6	(11)	(159)	(61)	1
Net increase/(decrease) in cash equivalents	n/a	n/a	134	(118)	34
Net (decrease)/increase in cash and cash equivalents	n/a	n/a	(25)	(179)	35

	Prepared or restated under				
	UK GAAP		IFRS		
	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m
Balance sheet					
Goodwill and intangible assets	156	123	152	174	207
Property plant and equipment	1 648	1 550	1 591	1,594	1,619
Other non-current assets including those classified as held for sale	83	152	486	539	1,528
Net current assets	1 785	212	298	535	(60)
Non-current liabilities	(1 584)	(5 016)	(4 565)	(6 181)	(5,558)
Net assets/(liabilities)	2 088	(2 979)	(2 038)	(3 339)	(2,264)

Paragraph 37 of International Financial Reporting Standard 1 – First time adoption of IFRSs requires that information prepared under a previous GAAP is clearly labeled. Disclosure is also required of the nature of the main adjustments that would be necessary to comply with IFRSs. Quantification of those adjustments is not required. The main adjustments to the Group accounts on the adoption of IFRSs are

- the inclusion of a retirement benefit obligation on the face of the balance sheet,
- trade and other receivables no longer include an element of pension prepayment,
- deferred tax charges to reflect the introduction of the retirement benefit obligation
- an annual leave accrual is included in trade and other payables
- the income statement reflects a number of minor changes which are mainly presentational but changes to the pension charge and related taxation are the major amendments and
- the cash flow statement is now produced in IFRS format showing operating financing and investing activities

Royal Mail Holdings plc

Parent Company accounts

Statement of Directors' responsibilities in relation to the parent Company financial statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the Directors are required to

- select suitable accounting policies and apply them consistently
- make judgements and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time, the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Royal Mail Holdings plc

Independent Auditors' report to the members of the Company, Royal Mail Holdings plc

We have audited the parent Company financial statements of Royal Mail Holdings plc for the year ended 25 March 2007 which comprise the balance sheet and the related notes 1 to 6. These parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of Royal Mail Holdings plc for the year ended 25 March 2007.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work for this report or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent Company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view and whether the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company financial statements. The other information comprises only the Chairman and Chief Executive's Statement, the Annual Review, the Operating and Financial Review, the Directors' Report, the Corporate Governance statement, the Internal Control statement, the unaudited part of the Directors' Remuneration Report and the Statement of Directors' Responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the parent Company financial statements and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion

- the parent Company financial statements give a true and fair view in accordance with United Kingdom Generally Accepted Accounting Practice of the state of the Company's affairs as at 25 March 2007;
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the parent Company financial statements.

GRO

Ernst & Young LLP
Registered auditor
London
26 October 2007

Royal Mail Holdings plc

Parent Company balance sheet
at 25 March 2007 and 26 March 2006

	Notes	2007 £m	2006 £m
Fixed assets			
Investments in subsidiaries	4	3,784	3,784
Investments in pension escrow		850	-
Total net assets		4,634	3,784
Capital and reserves			
Share capital	5	-	-
Share premium	6	430	-
Profit and loss account	6	4,204	3,784
Shareholder's funds		4,634	3,784

The accounts on pages 96 to 98 were approved by the Board of Directors on 26 October 2007 and signed on its behalf by

GRO

Adam Crozier

GRO

Ian Duncan

Royal Mail Holdings plc

Notes to the parent Company accounts

1 Parent Company accounting policies

The following accounting policies apply

Financial year

The financial year ends on the last Sunday in March and, accordingly, these accounts are made up to the 52 weeks ended 25 March 2007 (52 weeks ended 26 March 2006)

Basis of preparation

The accounts on pages 96 to 98 have been prepared in accordance with applicable UK Accounting Standards and law including the requirements of the Companies Act 1985. Unless otherwise stated in the accounting policies below the accounts have been prepared under the historic cost accounting convention

Royal Mail Holdings plc (the Company) has not presented its own profit and loss account, as permitted by the Companies Act s230 (3). However the results of the Company for the year are disclosed in note 6 to the accounts

No new UK Accounting Standards which affect the presentation of these accounts have been issued

Impairment reviews

Unless otherwise disclosed in these accounting policies fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Company assesses at each reporting date whether such indications exist. Where appropriate an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount which is the higher of an asset's net realisable value and its value in use

Investments in subsidiaries

Investments in subsidiaries within the Company's accounts are stated at cost less any accumulated impairment losses. The opening and closing carrying value relates solely to the Company's investment in Royal Mail Group Ltd, a 100% subsidiary of the Company. Royal Mail Group Ltd is the only direct shareholding held by the Company

Investments in pension escrow

Investments in pension escrow are financial assets within the scope of FRS 26 Financial Instruments Recognition and Measurement

The investments are short-term deposits which mature within 1 year but have been included within fixed assets as the investments have been provided as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006

The investments are non-derivative assets that are neither held for trading nor quoted in an active market and are therefore classified as loans and receivables for measurement purposes under FRS 26. The investments are initially recognised at fair value, being the amount deposited. The investments accrue interest, thereby increasing the carrying value of the investments. This interest is included in the reported profit/(loss) for the year. The investments are derecognised when they mature

Contingent liabilities

Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote

2 Directors' emoluments

The Directors of the Company are not paid fees by the Company for their services as Directors of the Company. The Directors of the Company are paid fees by other companies of the Group. These emoluments are disclosed in the Group accounts

3 Auditors' remuneration

The Auditors of the Company are not paid fees by the Company. The Auditors of the Company are paid fees by the other companies of the Group. This remuneration is disclosed in the Group accounts

4 Investments in subsidiaries

	Cost £m	Impairment £m	2007 £m	2006 £m
At 27 March 2006 and 28 March 2005	3,784	-	3,784	3,784
Additions (see note 6)	376	-	376	-
Impairment (see note 6)	-	(376)	(376)	-
At 25 March 2007 and 26 March 2006	4,160	(376)	3,784	3,784

5 Share capital

Details of the share capital are disclosed in the Group accounts in note 26. Details of the share issues during the period are contained in the Group accounts in note 27

Royal Mail Holdings plc

Notes to the parent Company accounts (continued)

6 Shareholder's funds

	Share premium £m	Profit and loss account £m	Mails Contribution Reserve £m	POL Contribution Reserve £m	Holdings Escrow Reserve £m	Total £m
At 28 March 2005		3 784	-	-	-	3,784
Profit for the year	-	-	-	-	-	-
At 27 March 2006	-	3,784	-	-	-	3,784
Profit for the year	-	420	-	-	-	420
Issue of ordinary shares (1)	145	-	-	-	-	145
Allocation to Mails Contribution Reserve	-	(145)	145	-	-	-
Transfer from Mails Contribution Reserve	-	145	(145)	-	-	-
Issue of ordinary shares (2)	231	-	-	-	-	231
Allocation to POL Contribution Reserve	-	(231)	-	231	-	-
Transfer from POL Contribution Reserve	-	231	-	(231)	-	-
Allocation to Holdings Escrow Reserve	-	(795)	-	-	795	-
Issue of ordinary shares (3)	54	-	-	-	-	54
Allocation to Holdings Escrow Reserve	-	(54)	-	-	54	-
Transfer of interest to Holdings Escrow Reserve	-	(1)	-	-	1	-
Transfer from Holdings Escrow Reserve	-	850	-	-	(850)	-
At 25 March 2007	430	4,204	-	-	-	4,634

The profit dealt with in the accounts of the parent Company was £420m (2006 £nil) The profit of £420m comprises of the distribution relating to the Mails Reserve received from Royal Mail Group Ltd (£795m) and interest earned on assets that support the Holdings Escrow Reserve (£1m) less impairments on investments (£376m) The impairments arose on transfer of funds from the Mails Contribution (£145m) and POL Contribution Reserves (£231m) for the benefit of Post Office Limited a wholly owned subsidiary of Royal Mail Group Ltd Due to the ongoing losses of Post Office Limited these investments were immediately impaired Accordingly the Company's profit for the financial year, with the exception of the interest earned (£1m) is eliminated in the Group accounts and does not therefore form part of the Group results

Details are contained in the Group accounts in note 27 on (i) the distribution of the Mails Reserve (ii) the Holdings Escrow Mails Contribution and POL Contribution Reserves and (iii) the share issues

7. Charges

Details of charges registered over the assets of the Company are contained in the Group accounts in notes 19 and 24

Royal Mail Holdings plc

Forward Looking Statements

This document contains statements concerning the Group's business, financial condition, results of operations and certain of the Group's plans, objectives, assumptions, projections, expectations or beliefs with respect to these items.

The Company cautions that any forward looking statements in this document may and often do vary from actual results and the differences between these statements and actual results can be material. Accordingly, readers are cautioned not to place undue reliance on forward looking statements. The Company undertakes no obligation to release publicly the result of any revisions to these forward looking statements that may be made to reflect events or circumstances after the date of this document, including without limitation changes in the Group's strategy or to reflect the occurrence of unanticipated events.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Such forward looking statements should therefore be considered in light of various important factors that could cause actual results and developments to differ materially by those expressed or implied by these forward looking statements. These factors include among other things, the impact of competitive products and pricing, the occurrence of major operational problems, the loss of major customers, limitations imposed by the Group's indebtedness, undertakings and guarantees relating to pension funds, contingent liabilities, risks of litigation and risks associated with the Group's overseas operations.

Corporate Information

Registered Office and Group Head Office

Royal Mail Holdings plc
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020 7250 2888
Registered No 4074919

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Corporate website

Additional corporate and other information can be accessed on the following website (www.royalmailgroup.com). Information made available on the website is not intended to be, and should not be regarded as being, part of the accounts.

The maintenance and integrity of the Group's websites is the responsibility of the Directors, the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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