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Royal Mail Holdings plc
Report and Accounts
Year Ended 28 March 2004



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Royal Mail Holdings plc

Chairman's Statement

'We've come a long way – but there's still much work to be done.'

2003-04 was a tough year for Royal Mail but it was also a year of solid achievement. For the first time in four years, the Group made a profit from its operations – £220m – which was an improvement of more than 200% on the £197m loss from operations a year earlier. That's real progress, driven mainly by a mix of market growth, cost efficiencies, the impact of the increases in postage prices in May 2003 and the increases in banking revenues. Overall, the Group made a pre-tax profit of £105m, compared to a loss of £611m a year earlier, when there were heavy exceptional costs.

Our top priority now is to improve the quality of service to our customers. That means urgently tackling those areas where we know mail is being delayed and completing as quickly as possible much-needed operational changes in our letter business. These changes are crucial to deliver and sustain a high quality of service in the longer-term and the efficiency savings to achieve our financial target for 2004-05 of a £400m profit on our day-to-day operations.

This level of profit will not be an easy target to hit, as Royal Mail letters will have an additional cost of £340m in this current year to fund the 14.5% pay increase for postmen and women and other businesses need to fund their own pay awards. We are very determined, however, to achieve our financial goal, as it will trigger a Share in Success payment of at least £800 to our people. We very much want to make this payment. It's achievable – but it rests on completing the essential operational changes that will deliver productivity savings through more efficient working.

Making a £220m profit from operations, when Royal Mail was losing well over £1m every working day two years earlier, was not our only success in 2003-04, far from it. There was real progress in the way we operate. We are well on the way towards introducing a single daily mail delivery, a huge change. Significant progress has been made towards completing a new distribution network for the letters business – the biggest change Royal Mail has ever undertaken to its transport operation. Efficiency improvements are also being introduced in mail centres.

The strike in our letters business in the autumn of 2003, in the London area, was a setback. It cost Royal Mail £25m and, much worse, it hit quality of service and irreparably undermined the effort to hit the quality targets set by Postcomm. We had shown in the summer of 2003 that we are capable of world-class quality of service when we hit some of the highest levels of customer service since the current measuring system was introduced 15 years ago.

We are working hard to improve quality of service as rapidly as possible. As competition intensifies and business customers find more choice, Royal Mail must ensure its customers choose us, not because there is no alternative but because we offer them unbeatable service at value-for-money prices, and they trust us consistently to deliver win-win solutions to meet their needs.

However, the unprecedented level of major change across our entire letters business – in deliveries, transport and mail centres – is inevitably hitting customer quality of service. We apologise to our customers for any adverse impact on our service, but these are key operational changes that we must make to improve Royal Mail's competitive edge. We have to go through this period of vital change to improve quality of service, not just now, but in the long-term.

The overall changes we are making span the entire range of our business – letters, the Post Office network, parcels and logistics. For most businesses, successfully implementing one of our programmes would be a hard task. Making real headway in all of them underlines the scale and scope of the work Royal Mail is doing to achieve the biggest turnaround in UK industry.

The Post Office network is expanding its range of financial services, following the joint venture agreement it signed with the Bank of Ireland. Parcellforce Worldwide reduced its operating losses, and has now embarked on the final phase of its restructuring with the aim of delivering a break-even profit from operations in the third year of the Renewal Plan.

The year saw the first agreement reached with another mail company for access to Royal Mail's sorting and delivery network. There are now three such agreements. They allow Royal Mail to earn a commercial return on the service it provides for other operators, while preventing the sort of cream-skimming which would damage our ability to continue providing the one-price-goes-anywhere universal service to the UK's 27 million addresses. It's right that customers have more choice, and access deals also offer the potential for market growth. One thing is certain – Royal Mail will fight vigorously for every letter in the market.

Companies with highly motivated people deliver high quality service. That's why I believe the agreement on the pay package, which is giving postmen and women basic pensionable pay of £300 a week, will deliver benefits to our customers – as better pay will play a significant role in our efforts to make Royal Mail a great place in which to work. We've made modest progress here, with 57% of our people saying they enjoy working for the Company. This is still far short of the 75% minimum level we want to achieve but it's a further sign that things are getting better in Royal Mail, not worse, as was the case for too many years.

Last year, we set up a confidential helpline staffed round the clock by professional, independent counsellors, who can give help and support to any of our people who make contact because they are concerned about bullying and harassment. There were just under 4,000 calls in the year to the telephone helpline, a totally unacceptable number, but we are determined to confront this issue and eliminate all forms of bullying and harassment.

We remain committed to ensuring the pension plan meets all its funding obligations. This has resulted in an additional payment of £132m into the plan to fund the deficit, on top of an increase in regular contributions of some £140m.

Royal Mail Holdings plc

Chairman's Statement (continued)

Royal Mail is already a very different company to the one that embarked on the Renewal Plan two years ago. We've come a long way and we're within sight of our goals. But we can't afford any let-up and it will be essential in this current year that we finish laying the foundations, not just to be profitable in a year's time, but to be able to earn and sustain profits in the years that follow. Our people are the crucial point of difference between Royal Mail and the competition. Recognising this strength and using it is the way in which we will realise our full potential. We can be the best postal business in the world and Royal Mail's people will give us our distinctive edge.



Allan Leighton

Chairman

26 May 2004

Royal Mail Holdings plc

Joint Deputy Chairman's and Chief Executives' Statement

We've been successful in the past year in terms of growing our revenue and improving efficiency and our financial results reflect this progress. But we have to keep the momentum going – there's still much tough work to complete across our business if we're to provide our customers with a consistently high quality of service in the face of competition entering our markets, and deliver the Renewal Plan. Improving quality of service to our customers is Royal Mail's number one priority.

A key efficiency improvement in the last few months of 2003-04 has been the introduction, finally, of Single Daily Delivery. The change has been introduced successfully into 900 of the 1,400 main delivery offices and we are working hard to successfully complete the implementation in a further 200 offices with completion of the change in all our offices being a vital goal in 2004-05. Efficiency improvements are also being introduced in the offices which sort and handle the mail with changes already made in 31 out of 72 mail centres, and in 45 of the 100 distribution hubs.

Also vital to our business is the transformation of our transport network. We are establishing a simple system for an efficient mails business, involving a reduction in the number of daily vehicle journeys from 9,000 to some 2,900 through the more efficient use of road transport and a hub-and-spoke operation. A new road and air network was launched in January this year and the changes we are making include: closing seven of the 16 regional distribution centres, opening a new National Distribution Centre at Daventry and reducing nightly air services, with the intention of running 24 services from 20 airports by the end of this year, based on large aircraft with mail transported in containers. The last Travelling Post Offices ran in January and the one remaining rail mail freight service is expected to end in May.

In February 2004, we signed a deal covering pay, London weighting and changes to the business (including the introduction of single daily deliveries). This 14.5% pay package is giving every postman and woman basic pensionable pay of £300 a week – a key milestone for our frontline people. Royal Mail is a people business and we know that pay has been an important issue, so we are pleased we've reached this landmark agreement.

However, the pay agreement was reached following the worst period of industrial action since 1996 – despite the majority of our people voting against strike action in a nationwide ballot. During the year, there were just over 85,000 days lost to strikes – the bulk in October and early November, when more than 80,000 days were lost in the dispute over London weighting, even though many of our people in London continued to work. This cost us some £25m and had a major impact on our quality of service, so almost everybody lost – our people, our business and, most importantly, our customers.

The cumulative effect of the essential operational changes we are making – in deliveries, in the transport network and in our mail centres – has, unavoidably, led to a reduction in quality of service in the latter half of the year. We apologise to customers who will continue to see adverse effects while we complete these key operational changes in our letters business. The magnitude of the changes we are making over a period of just some six months amounts to the biggest restructuring of any company in the UK. It's notable that until September 2003, we were exceeding some of our targets and the First Class level of service was the best for 15 years.

However, in the latter half of the year, as the impact of the autumn industrial action took its toll, we failed every single operational target set by Postcomm in our licence. Not only does this undermine customer confidence, it exposes us to the risk of being fined by Postcomm and paying compensation to bulk mailers and retail customers. Last year the Regulator fined us £7.5m for failing to meet the targets for two First Class business mail services. In the light of our recent poor quality of service performance, the prospect of fines, that will not benefit our customers or the Company, only underlines how vital it is for us to complete the operational changes that will bring efficiency savings and better services to customers.

After many months of discussion, Royal Mail agreed with Postcomm a three-year price control, allowing a modest 1p rise in basic First and Second Class postage in May 2003, the first rises in basic postage for three years. Over the past year, letter mail volumes have increased by 1.6%, whilst mail prices have increased by approximately 3% in the first year of the price control. This tariff increase generated some £200m, but the RPI –1% formula applying in the coming year will see Royal Mail's basket of prices falling in real terms, underlying the need to make further efficiencies and cost savings in the year ahead, particularly because we need to find £340m more to fund the 14.5% pay increase for frontline people within the letters business.

Our estimate has been that some 30,000 jobs in the Group would be made redundant over the course of the three-year Renewal Plan, with some further jobs going through outsourcing and natural turnover. By the end of March 2004, some 27,100 people had left the Group – through a combination of voluntary redundancy (10,900), natural turnover (8,000) and outsourcing (8,200). A further 5,000, who have accepted voluntary redundancy, are working their notice period, many of whom will leave the business by September 2004. By this date, therefore, 32,100 people will have left Royal Mail through voluntary redundancy, natural turnover or outsourcing.

Our outsourcing contracts cover a range of non-core services including IT support, employee health services, buildings maintenance and cleaning services, and the management of the company car fleet. Of course, the jobs of people working in these roles continue with the suppliers of these services.

Royal Mail Holdings plc

Joint Deputy Chairman's and Chief Executives' Statement (continued)

Parcelforce Worldwide continues to strengthen its position in the express-only, guaranteed delivery market for its 17,000 business customers. It has halved its number of depots to around 50, and its high 98% quality of service on its core product is among the best compared to its 4,000 rivals. It has cut its losses by almost £100m compared to the previous year – thanks to the efforts everyone in the business have made to make efficiency savings but it is still losing money - £102m over this financial year. It is vital it completes its restructuring plans to hit its goal of breaking even in this current financial year.

Our European parcels business, GLS, had a very good year, increasing its revenue by £32m (4%) to £818m, and more than doubling its profit from operations of £11m in the previous year to £25m in 2003-04. GLS is now delivering one million parcels a day on average in 30 countries, and it is a formidable player in its markets.

Post Office Limited also cut its operating losses over the year – to £102m. The result, however, does not include the financing of the rural Post Office branches through the Rural Network Reserve. A total of 1,278 branches closed in the same period, but Post Office Limited still faces a considerable challenge to replace its traditional benefit payment business, which is being lost because of the Department for Work and Pensions' programme to switch to the direct payment of benefits into customers' bank accounts.

A combination of new services, coupled with a plan to manage a significant reduction in the number of urban Post Office branches, is helping the network to drive forward financially and to create a vibrant business for the future. Over 21 million customers can now withdraw cash from their current accounts at Post Office branches with just their bank card and personal identification number, as can the basic bank account customers of 17 banks and building societies. More than two million customers have opened a Post Office Card Account since its launch in April last year.

During the year, the Post Office finalised an agreement with the Government to utilise £450m of Royal Mail Group plc's reserves to finance the rural network over the three years to March 2006. The joint venture signed in March 2004 with the Bank of Ireland provides a £100m investment for the development of a broader range of financial services. Personal loans are now available, by phone or through the web, to the 29 million customers who visit the 16,000-strong branch network every week. More new financial services will be launched in the coming financial year, including motor insurance, a range of savings accounts and a credit card.

The financial problem of having too many urban branches chasing too little business is being addressed through the managed closure of up to 3,000 Post Office branches in towns and cities. The Government has sanctioned £210m of funding from existing financial resources - £180m to compensate outgoing subpostmasters for their investment in the business and £30m for investing in the branches that remain. More than 1,000 urban Post Office branches have already closed and consultations on the proposed closure of most of the remainder are underway with Postwatch, local communities, local authorities and MPs. Meanwhile, the Post Office has become one of the leading players in travel financial services – number one in providing foreign currency and the largest independent provider of travel insurance.

As we enter the final year of the Renewal Plan, we still face a significant number of challenges. Only by further reductions in costs, improving efficiency, consistently delivering a first class service to customers and making Royal Mail a truly great place to work for our people, will we be on a sound footing for the future.

**GRO**

Elmar Toime
Executive Deputy Chairman
Royal Mail Holdings plc
26 May 2004

**GRO**

Adam Crozier
Chief Executive
Royal Mail Group plc
26 May 2004

**GRO**

David Mills
Chief Executive
Post Office Limited
26 May 2004

Royal Mail Holdings plc

Annual Review 2003-04

Reaching more people than anyone else

Foundation for the future

Royal Mail is unique in reaching everyone in the UK every working day for prices that are amongst the cheapest in Europe. Every working day we collect, process and deliver around 82 million items to 27 million addresses; each week we serve 29 million customers through our network of 16,000 Post Office branches and deliver some 40 million express parcels every year. But we need to change and modernise operations to improve service to customers and keep ahead of the competition in the letters business.

During the second year of our three-year Renewal Plan, there has been a huge effort to complete the implementation of operational changes within the mails business. There's still a lot of hard work to be done, but progress is being made. Out of 1,400 main delivery offices, more than 900 have successfully implemented a single daily delivery of mail, or have reached an agreement at local level on doing so, and now millions of customers receive letters through a single daily delivery. Our people are now benefiting from an increase in basic pay and a five-day working week. We are also committed to improving working practices in our 72 mail centres and 100 distribution hubs across the UK, so that all of them adopt a best practice standard for productivity and efficiency.

Over the past year, we have continued to improve our UK-wide transport network. We are aiming to create a new network that will be more robust, flexible and reliable than before, capable of delivering a better quality of service to customers and cost savings to Royal Mail. A key component of the new network has been the opening of the £40m National Distribution Centre in Daventry, and the use of larger jet aircraft to transport more mail from 20 airports. By using fewer, larger vehicles and aircraft, the new integrated road and air network reduces the impact on the environment of Royal Mail's distribution operation by 30%.

As part of the Transport Review, we have revised our use of rail for transporting mail – a decision driven by economic considerations. Whilst the use of rail has not been ruled out for the future, it needs to be commercially beneficial in terms of quality of service and price – our customers cannot subsidise rail operators. This resulted in us reducing train services from 68 to just one, including ceasing the use of Travelling Post Offices (TPOs). In service since 1838, TPO use was at its peak in the early 1900s when rail was the most reliable way of sending mail long distances. Although the TPOs were great in their time and did an excellent job, they were a Victorian answer to a Victorian problem of moving mail around the country in the pre-motorway and pre-air era. However, the world has moved on and, like mail coaches before them, TPOs are now a proud part of Royal Mail's history, not its future.

Service to customers

In the first half of the year, our First and Second Class services showed their strongest ever performance, with both ahead of targets. However, whilst our people have been doing an outstanding job in implementing changes across the business that will provide the foundation for consistently good service, the scale and pace of those changes had an impact on quality of service in the second half of the year. Inevitably, making these changes is causing turbulence. We regret any reduction in customer service caused by these necessary changes but we are putting in place a long-term sustainable network to provide a better service than ever before. We also felt the impact of strike action in the autumn, which disrupted mail across the country even though the majority of postmen and women continued to work normally. With Postwatch's endorsement we agreed that it was a good idea to donate £1m to London's bid for the Olympic Games in 2012, to say sorry to our customers for the disruption this strike action caused.

Whilst our aim is to ensure customers get the service they expect from Royal Mail, in handling around 82 million items a day, sometimes things go wrong. If they do, we want to compensate customers quickly and fairly. Royal Mail has introduced new compensation arrangements for customers whose mail is delayed. We offer better protection for customers in the UK than almost anywhere else, and are one of the very few postal services to pay compensation for delay.

New compensation schemes were introduced where individual customers can claim a book of 12 First Class stamps, for First Class letters that arrive more than four working days after posting, and also for Second Class letters that arrive more than six working days after posting. Business customers can get a percentage refund on their postage bills if Royal Mail does not meet regulatory performance targets.

We have set up a comprehensive range of processes to monitor the Group's performance on health and safety issues, as well as care of the environment. In September, we published our first external Health, Safety and Environmental Report as part of our commitment to transparent reporting in these areas. This report was recognised as the Best First Time Environmental Report at the Association of Chartered Certified Accountants' (ACCA) UK Awards for Sustainability Reporting in 2003. A copy of the report can be found on our website. It highlights how we have invested in improved health service support for employees, revised approaches to safety management that have yielded significant improvements in many parts of the business and cut carbon dioxide emissions by 6% since 2001-02. We have also reduced our use of energy by 8% and have begun using renewable energy for the first time. We will be producing our first full Corporate Social Responsibility (CSR) Report in September 2004.

'With us it's personal'

In the second year of our three-year Renewal Plan, the focus has been on our core businesses and improving our service to customers. This has seen us underlining the unique benefits of using Royal Mail services through our 'get personal' advertising campaign. This features a number of Royal Mail people demonstrating how our people go the extra mile every day to deliver around 82 million items of mail to 27 million addresses across the UK.

Royal Mail Holdings plc

Annual Review 2003-04 (continued)

In September, Royal Mail launched its Special Delivery 9am service - a direct challenge to the courier market. This guarantees next working day delivery to most UK destinations by 9am, or customers get their money back. It costs as little as £6.95 to anywhere in the UK. It is challenging the market and offering customers a better deal.

Doing business online is not stamping out stamps. In January, Royal Mail launched the UK's first digital stamp with a new online postage purchasing system called 'SmartStamp'. Aimed at businesses, customers can create SmartStamps on their desktop computer, buy them over the Internet and print them directly onto envelopes from a normal printer at any time of the day or night. SmartStamps can be printed for most UK and international mail, and can be posted directly into post boxes or taken to a Post Office branch in the usual way.

Small businesses can add their own logo designs and print them directly on to an envelope or label in the office. The ability to personalise the logo gives small businesses the opportunity to differentiate themselves from competitors and achieve a professional brand appearance more commonly associated with larger companies.

Celebrations through stamps

For customers who want to continue using traditional stamps, our 2003 stamp programme was packed with anniversaries and celebrations, including two Royal occasions, both in June. Fifty years on, Royal Mail issued ten stamps to mark the Coronation of Her Majesty The Queen. On 17 June 2003, the Queen's grandson, Prince William, celebrated his 21st birthday, the first time Royal Mail has marked a 'coming of age' with a stamp issue.

In November 2003, as England celebrated winning the Rugby World Cup with a 20-17 victory over Australia, Royal Mail set to work designing four commemorative stamps, which went on sale in December. Hugely popular with the public and collectors alike, the Rugby World Cup set comprised two First Class and two 68p stamps - the latter being the 20g air-letter rate to Australia.

Christmas greetings by mail

Last Christmas saw another bumper postbag for Royal Mail, with average daily postings up from 82 million to over 135 million on peak days. Total festive mail volumes reached 2.1 billion, including a huge growth in Internet shopping with Royal Mail delivering more than 40 million items bought online, double the quantity we handled last year.

Royal Mail delivered its biggest ever e-Christmas, as online shoppers broke all records by spending £3.34bn on gifts and presents ordered over the Internet. The popularity of text messaging and e-mail has done nothing to halt the sending of Christmas cards - in the UK we sent and received some 700 million Christmas cards posted at home and abroad.

And sending a Christmas wish-list to Santa Claus was as popular as ever. Royal Mail helped Santa by delivering replies to more than 750,000 children who wrote to him last Christmas.

Young Letter-Writers

Royal Mail's Young Letter-Writers Competition has attracted over four million entries since it began 26 years ago, making it the biggest letter-writing competition of its kind in the UK. This year the competition challenged the nation's young letter-writers to 'Write to Their First Class Hero'.

Primary school children throughout the UK are invited to enter the competition, in three categories: ages 7-8, 9-11, and Special Achievement - for children who overcome exceptional difficulties in order to write their letter.

Postal Heritage Trust

The Postal Heritage Trust was set up in 2003, to protect over 300 years of Royal Mail history, with Tony Conder appointed as the first Chief Executive. Building on the history and reputation established through the centuries is a key part of Royal Mail's Renewal Plan to return the business to profitability. The vast historic collection dates back to the 17th century, and by establishing a charitable trust, and appointing an independent management board, its future is secure for new generations. The Postal Heritage Trust will be established as an entity separate from Royal Mail during 2004.

Strengthening our reputation in express

Investing in the customer experience

Parcelforce Worldwide continues to work to establish itself as one of the UK's leading providers of global express, time-guaranteed delivery services. The past year has seen the business consistently deliver a quality of service of 98%, a standard that is one of the best, if not the best, in the industry. This has been recognised by our customers, from small businesses to major retailers, with contract wins to provide services for well-known brands such as the famous London department store, Harrods, and DVD retailer, Play.com. We have also invested in new technology to improve the all-round collection and delivery experience. New web-trading services enable our customers to order collections and print labels online, access information on the delivery of their item more quickly, as well as arrange redeliveries. We have also added 24-hour voice recognition to our portfolio of customer service options, meaning customers can access our services any time of the day or night, seven days a week.

Royal Mail Holdings plc

Annual Review 2003-04 (continued)

The transformation of the business into an express, time-guaranteed delivery service provider only, has enabled Parcelforce Worldwide to reduce its losses by 48% in the financial year. However, the profit challenge remains, and further restructuring will take place in the coming year to bring down costs, while maintaining a high quality of service to customers.

For the 11th year, we recognised small business excellence through the Parcelforce Worldwide Small Business Awards. Endorsed by the Federation of Small Businesses, the winner was Croft Engineering Services, which beat off competition from 4,500 entrants. The company, based in Warrington, was also recognised for its export achievements.

New solutions for UK businesses

Adding logistics expertise

Royal Mail has continued to provide tailored logistics solutions, utilising its warehousing and fulfilment services, to meet the specific needs of major UK businesses. We have developed a strong track record in handling returned goods for major retailers, and reinforced our position by winning a major contract with television channel, Auctionworld.tv. And we have moved a step ahead of the competition, with an innovative solution to give retailers a better return on unwanted goods. Using Internet-based auctions, we handle the whole process of selling the items – from assessing the condition of the goods through to delivery to the buyer and follow-up customer service. Through this channel, which has proved popular in the past year, items fetch up to five times the value they would get through other disposal channels.

Investing in our retail network

Changes and challenges

Over the past year, the Post Office has continued to invest in its branch network, introducing new products and forming partnerships with other organisations to improve services to customers. From April 2003, Post Office customers have been able to access current accounts (of selected banks), basic bank accounts and the Post Office Card Account at branches, in many cases just using their bank card and personal identification number. This has seen the Post Office establish itself as a key provider of banking services through its extensive branch network, especially in rural areas, as 60% of villages have a Post Office branch but only 9% have a bank branch. The Post Office Carry on Collecting Roadshow visited some 160 shopping centres, high streets and seaside locations throughout the spring and summer to raise awareness of Post Office banking services, and let customers know how they can continue to collect their benefits in cash at Post Office branches as the Government moves closer towards paying all benefits directly into customer accounts by 2005.

Customers are also now able to pay for many Post Office products and services using a debit card, as well as cash or cheques.

Building a sustainable urban network

The restructure of the urban Post Office branch network has gathered pace with the planned closure of up to 3,000 urban branches expected to be complete by the end of the year. Consultations are now being carried out on an area-by-area basis, so that customers and subpostmasters get a realistic picture of future Post Office services in every town and city. This also helps reduce the uncertainty facing subpostmasters so they can concentrate on building sustainable businesses. The consultation process, agreed by Postwatch, was extended to give everyone affected by a potential closure a better chance to make their views known. MPs are now given earlier notification of closure proposals, and local authorities are able to contribute further planning and regeneration information to the programme's planning process, in addition to the information we already obtain. As a sustainable urban network takes shape, we are determined that over 95% of our urban customers nationally will remain within a mile of a Post Office branch.

Safeguarding rural Post Office branches

In May 2003, the Government received approval from the European Commission for a £450m, three-year funding package to support Post Office branches in rural areas. This money, which is drawn from Royal Mail's existing financial resources, enables the Post Office to continue to provide customers with face-to-face access to its services, and recognises the important social role that Post Office branches play in everyday life, particularly in rural communities.

The Post Office remains committed to preventing avoidable closures of rural Post Office branches and the rate of closures has slowed in recent years. This reflects the work of our dedicated team of rural transfer advisors, who actively seek solutions to potential rural branch closures. This has seen branches in pubs, churches, village halls, butchers, pharmacists, a police station and even a fish and chip shop. These increasingly offer a wider range of Post Office products – in February, the vehicle licensing service was extended to almost 600 additional Post Office branches, many in rural areas. The Post Office now offers electronic mobile phone top-ups, supplementing the top-up vouchers that continue to be offered at branches, giving customers in rural and urban locations the convenience of crediting their phones at their local Post Office branch.

For the little things that make the big things happen

The Post Office has consolidated its position as a key provider of travel services, capturing a 20% share of the foreign currency exchange market with sales of £2bn from nearly 9 million transactions per year. The Post Office is also now the fifth largest provider of travel insurance, with an 8% share of the market. We also plan to build on the trust and convenience that customers associate with the Post Office, to move into the financial services products market with the launch of a personal loan – the first of a portfolio of products from the Bank of Ireland and Post Office Limited joint venture. Other products in the pipeline will be motor insurance, savings accounts, a credit card and mortgages, and these are expected to be launched over the next two years. With a range of new products, investment in branches and building on agreements with existing partners, as its new advertising campaign maintains, the Post Office really is for the little things that make the big things happen.

Royal Mail Holdings plc

Operating and Financial Review

Introduction

This year is the second year of the Group's three-year Renewal Plan, which sets out to fundamentally restructure our operations and create a profitable and sustainable business that can confidently face the imminent challenge of new competition within our core market.

Year two has delivered a significant improvement to profitability and cashflow, which have been restored. Efficiencies have continued to be introduced and costs are under tight control. However, returns are still uncommercial and Parcelforce Worldwide and Post Office Limited are both loss making and consuming large amounts of cash. Unless the cost base is further reduced, future results will quickly slip back into losses. It is our imperative to continue to deliver operational efficiency programmes and to reduce expenditure in all areas of the business. This will allow us to face up to new competitors and afford to pay the recent pay agreement, whereby wages within the letters business will increase by 14.5%, which will cost an additional £340m on an annual basis. These programmes, including Single Daily Delivery, Mail Centre Efficiency and Automation programmes and initiatives, Parcelforce Worldwide overhead and infrastructure cost reduction, and managerial overhead reductions, are estimated to cost some £550m of cash to finalise. We expect most of this spend to take place in the next financial year.

A major focus is placed on external turnover and profits from operations, which best reflect underlying performance at both Group and business unit level. This year, the Group recorded £220m of profit from operations, a very significant improvement on the losses reported for the last three years. This is still lower than the £259m achieved in 1998-99, and considerably less than the £387m recorded in 1997-98, when profits from operations reached their peak. The major contributor to this result is the Royal Mail letters business, which contributed 76% of external turnover and £253m of profit from operations. General Logistics Systems, our European parcels business, also contributed to profitability by more than doubling its profits from operations from £11m to £25m. Parcelforce Worldwide and Post Office Limited both recorded losses from operations of £102m, although these are almost half of the losses recorded last year by each of these businesses.

Royal Mail Holdings plc and the Royal Mail group of companies

The Royal Mail group of companies comprises Royal Mail Holdings plc (the Company) - which is wholly owned by HM Government - and its subsidiaries. The Company is incorporated under the Companies Act 1985 (the Act) and the accounts are produced in accordance with the Act and applicable UK accounting standards.

The accounts are drawn up for the 52-week period ended 28 March 2004 (2003 52 weeks ended 30 March 2003) and have been prepared on a going concern basis.

Financial highlights

Summary of results	2004 £m	2003 £m
External turnover	8,633	8,299
Profit/(loss) from operations	220	(197)
Exceptional items	Nil	(695)
Net interest receivable	17	35
Profit/(loss) before taxation	105	(611)
Taxation (charges)/credit	(98)	52
Profit/(loss) after taxation	7	(559)
Net cash outflow	(222)	(486)

External turnover

External turnover has increased by £334m (4%) to £8,633m, driven mainly by tariff increases of some £200m and 1.6% volume growth in the Royal Mail UK letters business, partially offset by customers trading down to lower priced products. Post Office Limited reported an increase of £78m (9%) as a result of increases in banking revenue, whilst retaining much of the Department for Work and Pensions related income. Parcel revenue within General Logistics Systems in Europe grew by £32m (4%) - largely as a result of volume increases in Germany and higher parcel yields in France. These increases are partly offset by a decline in Parcelforce Worldwide income of £51m (17%), driven by its downsizing and strategy of focusing on 'next day' services, and £12m (2%) relating to the Royal Mail's international letters operation, as a result of lower cross-border volumes.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Profit/(loss) from operations Summary	2004 £m	2003 £m
Group operating profit before exceptional items	51	19
Add charge/(benefit) in respect of pensions deficit/(surplus)	132	(246)
Add share of profits in associates and joint ventures	37	30
Profit/(loss) from operations	220	(197)

Profit from operations of £220m represents a £417m turnaround against the comparable loss in 2003 of £197m. This is mainly a result of market growth, price increases, cost efficiencies and increases in banking revenues. The reconciliation to Group operating profit in the profit and loss account is shown in the adjacent table.

Margin from operations

Margin from operations (profit from operations expressed as a percentage of external turnover) of 2.5% improved considerably over the negative return of 2.4% from the corresponding period last year but is still way below a commercial return, and much lower than in the 1990s when margins of nearly 6% were generated (5.7% in both 1996-97 and 1997-98).

Exceptional items

Net exceptional items were zero and comprise £64m of operating exceptional costs (2003 £697m) offset by £64m of non-operating exceptional profit (2003 £2m). The £64m of operating exceptional costs comprises impairment of fixed assets of £41m (2003 £97m) and a further £23m restructuring costs (2003 £600m), including an increase in the provision for surplus properties of £17m (2003 £18m) associated with the core programmes underpinning the Renewal Plan.

The £64m of non-operating exceptional profit comprises £67m of profit associated with the sale of properties (2003 £24m), £nil for the impairment of goodwill in associates (2003 £24m) and £3m (2003 £2m) of losses relating to business disposals for this year (2003 £2m profits), primarily the outsourcing of IT operations and the associated disposal of CSC Business Systems Limited (formerly RM Business Systems Limited).

Net interest receivable

Net interest received during the year reduced from £35m in the prior year to £17m. This was due to lower interest rates received on the Group's cash and current asset investments, compounded by a reduction in average net investment balances, which were used to fund Post Office Limited's working capital and the cost of the rural network.

Taxation

The accounts include a current tax charge of £12m (2003 a credit of £4m) and a deferred tax charge of £86m (2003 a credit of £48m) for the year.

The tax charge for 2004 represents an effective tax rate of 93% on the Group's profit before tax, compared to a 9% credit on its loss before tax for 2003. The high effective tax rate is mainly due to the tax on disposal of assets and the unrelieved losses in Post Office Limited.

Cash flow and capital expenditure

Summary of cash flows	2004 £m	2003 £m
Net cash outflow from operating activities	(241)	(383)
Dividends received from joint ventures and associates	21	7
Capital expenditure and disposals	(56)	(159)
Tax and interest	29	51
Business acquisitions and disposals	25	(2)
Net cash outflow	(222)	(486)

Net cash outflow of £222m was significantly better than last year's outflow of £486m. This is mainly due to the increase in profit from operations and the flow through benefit of the pension prepayment for regular and deficit contributions of £400m made in March 2003, offset by outflows relating to Post Office Limited's working capital cash, and payments relating to one-off expenditure to support delivery of the Group-wide Renewal Plan. Increases in dividends received from joint ventures and associates to £21m (2003 £7m) are the result of dividends received mainly from Quadrant £7m (2003 £3m), Camelot £7m (2003 £4m) and the Bureau de Change business £5m (2003 £nil).

Capital expenditure, net of disposals of £56m (2003 £159m) comprises £158m (2003 £221m) of expenditure for projects, including the international mail centre near Heathrow and further spend on mails automation, offset by inflows of £102m (2003 £62m), mainly relating to surplus property disposals. Tax and interest inflows in the year of £29m (2003 £51m) are the result of less interest income and the recovery of £12m of tax (2003 £17m). Business acquisitions and disposals resulting in a £25m inflow (2003 £2m outflow) arise primarily from the disposal of CSC Business Systems Limited (£29m), offset by minor acquisition spend to buy the Italian subsidiary of our European parcels business, GLS.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Business acquisitions and disposals

In June 2003, the Group disposed of its IT operation for £29m of cash, resulting in an exceptional charge of £3m.

In March 2004, the Group signed a joint venture agreement with the Bank of Ireland to sell Post Office branded financial service products, such as personal loans, motor insurance, a credit card and savings accounts. This arrangement will initially run for ten years. As part of the transaction, the Bank of Ireland invested £100m to enable the establishment of the joint venture and to provide the core infrastructure and start-up costs.

Other minor acquisitions were made for £4m to support the development of our European parcels business in Italy.

Pensions

Pension scheme overview

Royal Mail operates the 5th largest UK occupational pension scheme, with asset values of some £12bn at March 2003, the date of the most recent triennial actuarial valuation, a fall of some £5bn since the previous valuation in March 2000. A recovery in the scheme's asset values to £15.1bn at March 2004 is offset by an equivalent increase in the scheme's liabilities, as assessed by the actuaries. The scheme has 180,000 members and 250,000 pensioners. Due to its size, even minor changes to assumptions used to calculate pension costs and liabilities, and the mere fact that asset values are dependent on the UK equity markets, mean that there can be large volatility in the pension costs recorded in the profit and loss account.

Pension charges in the profit and loss account

Summary of pension charges	2004 £m	2003 £m
Regular pension costs	243	311
Pension deficit/(surplus) adjustment	132	(246)
Exceptional redundancy costs	54	200
Total charge included in profit/(loss) before taxation	429	265

The Group continues to account for pension costs under SSAP 24 Accounting for pension costs. The 2004 charges/deficits are based on the recent full triennial valuation as at March 2003, whilst the 2003 comparatives are based on the March 2000 triennial valuation.

The latest valuation highlights a movement from a surplus to a substantial deficit due principally to increased life expectancy of employees, compounded by lower discount rates which increase the liabilities of the Plan.

Regular pension costs, which are included within profit from operations, of £243m (2003 £311m) have decreased due to lower pensionable payroll costs and changes in underlying assumptions. The pension deficit net cost of £132m consists of £188m in respect of recognising the accounting deficit over 12 years – the average remaining service lives of employees – offset by notional interest on the pension asset of £56m. This compares to a surplus in 2003 of £246m (including £45m notional interest credit) based upon the March 2000 triennial valuation. Charges relating to redundancy provisions of £54m (2003 £200m) relate to pension costs associated with implementing the Group-wide Renewal Plan.

Pension cash funding

Summary of pension cash flows	2004 £m	2003 £m
Regular pension contributions	16	184
Funding of pension deficit	45	54
Payments relating to redundancy	194	38
Prepayments for next year	125	400
Net cash payments	380	676

The calculations to determine the funding of the pension schemes do not rely on the same assumptions that are used to generate the SSAP 24 charge to the profit and loss account. More prudent actuarial assumptions are used by the Trustees and independent Plan actuary, and using the latest valuation this has confirmed a cash funding shortfall of £2.5bn, which requires an initial cash contribution of £132m, substantially higher than the £100m anticipated at the time of publishing last year's accounts. Cash flows relating to pensions are highlighted in the adjacent table. This year's cash flows are positively impacted by £275m due to the timing of pension prepayments.

Accounting standards

The accounting standard, FRS 17 Retirement benefits, introduces radical changes to accounting for pensions and similar benefits in the UK. Royal Mail is complying with the transitional arrangements as modified by the Accounting Standards Board in November 2002. The balance sheet and profit and loss impacts are disclosed in note 19 to the accounts. This is further complicated because the Group plans to adopt International Financial Reporting Standards (for pensions accounting these are expected to be similar to FRS 17), which means that the FRS 17 disclosures will continue to be made next year, with March 2006 being the first year in which all pension costs and related information will be reported in accordance with the international standards.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Treasury management

The Group operates a central Treasury function that manages some £1bn of current asset investments, £600m of borrowings and £1bn of cash, 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 retained profits and borrowings.

Group Treasury derives its authority from the Royal Mail Holdings plc Board, and provides monthly 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, gilts and long and short-term borrowings.

During the year the Group entered into the following financing arrangements for the future funding of Post Office Limited:

- in October 2003, the Group signed a committed borrowing facility between the DTI and Post Office Limited for £1,150m. This financing is intended to replace the pre-funding provided by the Department for Work and Pensions for benefit payments prior to the introduction of Automatic Credit Transfer for claimant payments. The facility is in the form of short and long-term bonds; and
- the Framework Agreement entered into last year between Post Office Limited, Royal Mail and the DTI, granted Post Office Limited a further borrowing facility of £250m for a maximum of 28 days from Royal Mail surpluses.

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

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 Royal Mail International's obligation to pay overseas postal operators for carrying UK mail abroad, and the balances held to operate the Bureau de Change services within Post Office Limited. These risks are mitigated by a hedging programme 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. All other significant liabilities are hedged when they become contractual;
- the Group's obligation to pay overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising of USD, JPY, Sterling and euro. The Group has a policy of matching receipts and payments for individual currencies. The policy is that 80% of the forecast exposure is hedged. Group Treasury operate a rolling 18-month programme, which is subsequently reviewed on a quarterly basis. Major currency holdings for the Bureau de Change business are hedged along with minor currencies showing a correlated movement. The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries;
- the Group is exposed to fuel risk since it operates one of the largest vehicle fleets in Europe and consumes over 150 million litres of fuel per year;
- the Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil market. The strategy operates within the parameters set by the Board. The fuel procurement programme allows for the use of over-the-counter derivative products to manage both the commodity and foreign exchange elements of the exposure;
- counterparty risk is managed by limiting aggregate exposure to any individual counterparty. These exposures are reviewed regularly and adjusted as appropriate; and
- the committed borrowing facilities relating to Post Office Limited and Royal Mail Group plc, along with net cash investments held on the balance sheet, ensure that the Group can finance its operations into the foreseeable future.

Regulation

The Postal Services Commission (Postcomm) was created as the independent Regulator for the UK postal industry in 2000. Subsequently, Royal Mail was granted its first licence, which required it to provide a universal postal service at affordable prices. Currently, several other companies have also been granted licences.

In March 2003, Royal Mail accepted Postcomm's proposals for a second price control over a three-year period starting 1 April 2003. This allowed Royal Mail to increase its prices by approximately 3% on 8 May 2003, followed by a conventional RPI-1% approach in the second and third years.

In May 2003 Postcomm published its proposal for downstream access prices and on 20 August 2003 Royal Mail submitted its response to the access consultation. In February 2004, Royal Mail agreed terms with Business Post Group plc to provide access to its delivery network and consequently Business Post withdrew its application to Postcomm for a determination on access. In April 2004, Royal Mail also agreed access terms with TPG N.V. and Deutsche Post A.G.

In April 2004, Postcomm commenced a consultation process for size based pricing. Royal Mail believes size based pricing is much more cost reflective than the current weight based pricing structure and will be responding accordingly.

Royal Mail has recently started planning for its next price control, which is due to commence in April 2006, and Postcomm has already issued its business planning questionnaire. The outcome of the next price control will determine the ultimate success or failure of liberalising the postal sector and Royal Mail believes Postcomm must build enough pricing flexibility within the next control, particularly around size, channel and zonal pricing, to facilitate the introduction of fair and efficient competition rather than allowing entrants to capitalise on areas where Royal Mail's prices are currently misaligned.

Royal Mail Holdings plc

Operating and Financial Review (continued)

People

Management of our people and their costs remains a key cornerstone of the three-year Renewal Plan, and success or failure in this area will determine whether the Group can remain a profitable and sustainable business into the foreseeable future. The chart below highlights the reduction in headcount since April 2002 by the UK businesses.

During the year, headcount reduced by 10,500 due to, the outsourcing of 1,700 people, net leavers of 3,400 and 5,400 from the voluntary redundancy schemes relating mainly to the following programmes:

- Single Daily Delivery within Royal Mail Letters;
- Mail Centre Review within Royal Mail Letters;
- Transport Review within Royal Mail Logistics and Royal Mail Letters;
- Continuation of the Apollo project within Parcelforce Worldwide; and
- Managerial voluntary headcount reduction programme within the Group Centre and other overhead areas of our businesses.

At the end of the year, 5,000 people remained in the business who have accepted voluntary redundancy, 2,203 of whom had left by the end of April 2004, and most of the remainder will leave by September 2004.

Special reserves

During the period, £1,121m of the Mails Reserve has been utilised for the provision of financial assistance to Post Office Limited, including £450m to set up the Rural Network Reserve and £671m to cover the write-off of Post Office Limited's intercompany debt to Royal Mail Group plc. £146m of the Rural Network Reserve has been used by Post Office Limited, representing the financing required during the year to maintain the rural network of post offices.

International Financial Reporting Standards (IFRS)

The Group plans to adopt and implement IFRS for the year ending March 2006, in line with requirements announced in June 2002 by the Council of the European Union, which are mandatory for all listed companies. The Company has established a project team to manage the convergence to IFRS and this team is working closely with our auditors.

At the date of this report, the Group has made good progress on converting to IFRS. Whilst the Group has commenced an exercise to understand the differences between International Accounting Standards (IAS)/IFRS and the Group's current policies, the conversion project is and will continue to be ongoing. A number of revised standards were issued by the International Accounting Standards Board (IASB) in December 2003 and March 2004. The IASB has confirmed that only standards issued and in place by March 2004 will apply for adoption for the year ending in March 2006. However, the IASB will continue to issue further new standards during 2004, 2005 and beyond, for which the Group will consider early adoption on a case-by-case basis. In addition, the International Financial Reporting Interpretations Committee is expected to continue to issue interpretations, which will apply to the standards that are mandatory for listed companies for March 2006.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Segmental analysis – turnover and profitability

The segmental analysis in note 1 to the accounts analyses the operating profit/(loss) in accordance with SSAP 25 - Segmental reporting. The analysis below sets out trading results, which focus on:

- operational business units rather than the statutory segments; and
- external turnover and profit from operations (the latter excluding the charge/benefit in respect of pensions deficit/surplus but including share of profits from joint ventures/associates and the charging of internal interest for centrally managed funding resources).

Furthermore, comparatives have been restated to reflect the changes in organisational structures that took place during the year. The segmental analysis in note 1 to the accounts has two principal segments: (i) Mails and Parcels covering Royal Mail, Parcelforce Worldwide, and General Logistics Systems and (ii) Post Office Limited.

Group external turnover of £8,633m (2003 £8,299m) and profit from operations of £220m (2003 £197m loss) is made up as follows:

Business unit performance	External turnover		Profit/(loss) from operations	
	2004 £m	2003 £m	2004 £m	2003 £m
Royal Mail	6,589	6,290	253	20
Post Office Limited	977	899	(102)	(198)
General Logistics Systems	818	786	25	11
Parcelforce Worldwide	245	296	(102)	(198)
Other Businesses	4	28	146	168
Group	8,633	8,299	220	(197)

A further analysis of results, on a unit-by-unit basis, is shown below:

Royal Mail	2004 £m	2003 £m
External turnover	6,589	6,290
Profit from operations	253	20

External turnover rose by £299m (5%) to £6,589m, £311m of which relates to an increase in the UK letters business as a result of price increases on 8 May 2003, and an increase in volumes of 1.6%, offset by an adverse shift towards lower priced products. The price increases of approximately £200m (3%) across most products are the result of Royal Mail accepting a new price control regime which was agreed by Postcomm. The growth in volume from 23.1 billion to over 23.5 billion items is driven by the Mailsort, Door-to-Door,

Presstream and Cleanmail product range. Turnover of the international letters operation declined by £12m (2%), due to lower volumes as a result of both higher prices and further impacts due to electronic substitution, particularly on cross-border social mail.

The increase in profit from operations of £233m is mainly driven by the turnover growth highlighted above and cost savings resulting from tight cost control, rather than from the productivity savings required to fund the cost of increasing basic weekly pay to £300 per week. Costs would have been lower if savings relating to key productivity programmes were delivered as planned but these were delayed to the last quarter of the year because of difficulties in gaining union agreement, which culminated in a series of official and unofficial strikes. A direct result of the strike action was a reduction of revenue and increases in costs, which had the combined impact of reducing profitability by some £25m.

In December 2003, union agreement on the key productivity programmes was reached, which allowed the essential changes in working practices at both delivery office and mail centres to be implemented. It is anticipated that these programmes will now be completed by September 2004. These productivity savings will help fund the increase in annual salary costs of some £340m and provide a platform to allow Royal Mail to effectively compete with competitors in the future.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Post Office Limited	2004	2003
	£m	£m
External turnover	977	899
Loss from operations	(102)	(198)

Post Office Limited is responsible for 15,961 retail outlets, of which 560 are directly owned. Since March 2003, 1,101 urban Post Offices have been closed as part of the Urban Reinvention Programme.

External turnover increased by £78m (9%) to £977m, primarily due to an increase in banking revenue. In addition, new products, such as e-top-ups, allowing customers to top-up their mobile phone credit over the counter, have

been successfully introduced and further growth has been registered for existing products, such as the Bureau de Change business, which is now the largest provider in the UK.

Loss from operations improved by £96m (48%) to £102m, primarily driven through cost control and headcount reductions, better product profitability and network restructuring. Savings have been made in staff and agents' costs through the efficiency programme and Network Reinvention strategy. During the second half-year, a new marketing strategy spearheaded by the 'Ants' commercials on both radio and television, contributed to the increase in revenue.

In March 2004, a joint venture agreement with the Bank of Ireland was signed, which further demonstrates Post Office Limited's commitment to growing revenues and margins by utilising its network and brand to sell financial services.

General Logistics Systems	2004	2003
	£m	£m
External turnover	818	786
Profit from operations	25	11

External turnover increased by £32m (4%) compared with the prior year but included a £13m reduction as a result of the weakening of the euro. The underlying growth of £45m (6%) resulted from strong growth in core parcel volumes particularly in Central Europe. Profit from operations more than doubled from £11m to £25m reflecting tight cost control and improvements in underlying profitability.

Parcelforce Worldwide	2004	2003
	£m	£m
External turnover	245	296
Loss from operations	(102)	(198)

External turnover decreased by £51m (17%) to £245m as the full year impact of last year's decision to exit standard products and terminate contracts with inadequate yields has flowed through. However the progress planned for reducing costs, particularly in the South East, and increasing the number of owner drivers has not been achieved and the cost base is still too high by some £100m when compared against competitive benchmarks. However, underlying income performance and average yields have improved against a relatively weak parcels market.

The operational restructuring continued with focus upon improving efficiency and reducing costs within the restructured network. The decrease in turnover was more than offset by reductions in costs, mainly due to the impact of last year's restructuring and downsizing flowing through into this year's results. As a result, the loss from operations was reduced by £96m (48%) to £102m. The major focus of the business next year is to reduce further its cost base and to increase the level of owner drivers to deliver the required cost flexibility to compete profitably and effectively.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Other businesses	2004 £m	2003 £m
External turnover	4	28
Profit from operations	146	168

Other Group businesses principally comprise internal interest income of £131m (2003 £162m) and £15m (2003 £10m) share of profits of centrally held associates and its joint venture Romec. The increase of £5m in share of profits mainly relates to Romec.

Way forward

This year's results represent a key stage in our Renewal Plan in that they show a turnaround in the financial fortunes of the Group as a whole, from a loss making and cash consuming business to one that is now profitable for the first time in four years. Particularly successful has been the performance of our European ground-based parcel business, which delivered profits of £55m at the EBITDA level and a margin of 7%. Our challenge next year is to address our two major loss making businesses – Parcelforce Worldwide and Post Office Limited, although both have halved their losses over the year to some £100m. Parcelforce Worldwide needs to reduce its cost base significantly if it is to break even at an operating level and Post Office Limited needs to drive up income, particularly from its new products and financial services joint venture with the Bank of Ireland, if it is to achieve its ambition of becoming cash generative over the next two years. The letters operation has two major challenges to deliver - to complete its strategic efficiency programmes in order to deliver sufficient savings to help fund the cost of £340m for the £300 per week wage package and the growing pensions burden, and to recover its quality of service to acceptable levels to meet its licence commitment to deliver the quality of service our customers expect and to avoid the substantial financial costs and penalties of failure. The Group has made good progress but there is still a way to go before we are generating sustainable profits, at acceptable levels of margin, and healthy cash flows.

GRO

Marisa Cassoni

Group Finance Director

26 May 2004

Royal Mail Holdings plc

Royal Mail Holdings plc Board

Non Executive Directors

ALLAN LEIGHTON (CHAIRMAN)

Allan (51) joined the Board in April 2001 as a Non Executive Director, becoming Chairman in March 2002. He 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 left in 2000 and is currently Chairman of BHS Limited, and Lastminute.com plc, Non Executive Chairman of Cannons Health Club Investments Limited, Non Executive Director of Dyson Limited, BskyB, Selfridges Holdings Limited, and Business in the Community. He is also a Director of Post Office Limited, and a member of the Nomination Committee.

DAVID FISH

David (55) joined the Board on 1 January 2003. He 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 Chairman of United Biscuits Group (Investments) Limited, Chairman of Christian Salvesen and Tate & Lyle PLC. David is Chairman of the Remuneration Committee, and a member of the Nomination Committee.

RICHARD HANDOVER

Richard (58) is Chairman of WH Smith plc. He is also Chairman of the Adult Learning Inspectorate and Business in the Community Education Leadership, and is a Non Executive Director of the Nationwide Building Society. Richard was appointed to the Board on 1 January 2003. He is Chairman of the Nomination Committee, and a member of the Remuneration Committee.

SIR MICHAEL HODGKINSON

Mike (60) was Chief Executive of BAA plc until retiring in June 2003. He is Board Member and Chairman of the Finance Committee of Transport for London, a Non Executive Director of FKI plc and the Non Executive Chairman of First Choice Holidays plc. Mike was appointed to the Board on 1 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 he is also Chair of the Corporate and Social Responsibility Governance Committee.

JOHN NEILL CBE

John (56) 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 a 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, Business in the Community, and Vestcave Limited. John was appointed to the Board on 1 January 2003, and is a member of the Audit and Risk Committee.

ROSEMARY THORNE

Rosemary (52) is Group Finance Director of Bradford & Bingley plc. She joined the Board in October 1998 and left on 25 March 2004 at the end of her appointed term as Non Executive Director. She was Chair of the Audit and Risk Committee, and a member of the Remuneration Committee. Rosemary is also a member of the Financial Reporting Council, Financial Reporting Review Panel and The Hundred Group's main and technical committees.

BOB WIGLEY

Bob (43) is Chairman of Merrill Lynch's European Corporate Banking Business, and a Trustee of the children's mobility charity, Whizz-Kidz. Bob joined the Board on 1 April 2003, and is a member of the Audit and Risk Committee and became its Chairman following the departure of Rosemary Thorne in March 2004.

Executive Directors

ELMAR TOIME (EXECUTIVE DEPUTY CHAIRMAN)

Elmar (56) joined the Company on 1 March 2003, having been Chief Executive of New Zealand Post since 1993. Prior to that he held senior appointments in New Zealand Post in Business Planning, Marketing and Retail Operations. In 2002 he established Kiwibank, a new, full-service retail bank, as a wholly owned subsidiary of New Zealand Post. Elmar remains a Non Executive Director of Sky City Entertainment Group in New Zealand. He is a Director of Post Office Limited, a member of the Corporate and Social Responsibility Governance Committee, Chair of the GLS Supervisory Board and Chair of the Management Board.

MARISA CASSONI (GROUP FINANCE DIRECTOR)

Marisa (52) joined the organisation in February 2001 from Britannic Assurance plc, where she had been Group Finance Director from 1998. Prior to that she had been Finance Director of the Prudential's UK Division since 1994. She became a Non Executive Director of Severn Trent plc in September 2001. She is also a member of the Management Board, and Chair of the Pensions Committee, Chair of the Risk Management Committee, a Trustee of the Royal Mail Pension Plan, and a member of the GLS Supervisory Board.

Royal Mail Holdings plc

Royal Mail Holdings plc Board (continued)

JERRY COPE (MANAGING DIRECTOR UK, ROYAL MAIL)

Jerry (52) joined the organisation in 1973 and held senior positions in Personnel and Industrial Relations, line management and Strategic and Commercial Planning. He was appointed to the Board in 1996 as Group Managing Director Strategy and Business Development. He became Group Managing Director of Mail Services in September 2001. He also held positions as a shareholder-nominated Director of Camelot, and Chairman of the Governors of Kingston University. Jerry left the Company on 14 November 2003.

ADAM CROZIER (CHIEF EXECUTIVE, ROYAL MAIL GROUP PLC)

Adam (40) joined the Company on 1 February 2003, having previously been Chief Executive of the Football Association since 2000. Before then he had held a number of senior roles at Saatchi and Saatchi Advertising, including that of Joint Chief Executive from 1995. He is also a member of the Management Board.

TONY MCCARTHY (GROUP DIRECTOR, PEOPLE & ORGANISATIONAL DEVELOPMENT)

Tony (48) joined the Company on 6 January 2003, having 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 Management Board, the Pensions Committee and the Corporate and Social Responsibility Governance Committee.

DAVID MILLS (CHIEF EXECUTIVE, POST OFFICE LIMITED)

David (60) joined the organisation as an Executive Director and Chief Executive of Post Office Limited on 15 April 2002. He began his career with Midland Bank (now HSBC Bank plc) in 1962, where he conceived and established First Direct. In December 1999, he was appointed General Manager, Personal Banking. He is currently Chairman of Post Office Financial Services, and the Employers' Forum on Disability, a Director of Camelot, and a Trustee of the Royal Association for Disability and Rehabilitation (RADAR). He is also a member of the Management Board.

JONATHAN EVANS (COMPANY SECRETARY)

Jonathan (52) joined the organisation directly from university in 1974. Before his appointment as Company Secretary in 1999, he held a wide range of management positions throughout the Group, latterly as Network Director in Post Office Limited. He is also a member of the Management Board and Pensions Committee, Secretary to the Audit and Risk, Remuneration and Nomination Committees.

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 28 March 2004 (2003 52 weeks ended 30 March 2003).

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 (UK).

Review of the business and future developments

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

Results and dividends

The profit on ordinary activities before taxation amounted to £105m (2003 £611m loss). After taxation, the profit was £7m (2003 £559m loss). The Directors do not recommend a dividend (2003 nil dividend).

Political and charitable contributions

During the year the Group made charitable contributions of £0.6m. No political contributions were made.

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 included on the purchase order apply. It is Company policy to make payments within 45 days of receiving a valid invoice. The Company and its principal operating subsidiaries in the UK have sought to comply with the DTI's 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 can be found in their accounts.

Land and buildings

In the opinion of the Directors, the aggregate market value of the Group's land and buildings exceeds the net book value, based upon a historic cost accounting policy, of £1,162m by significant margin.

Directors and their interests

The Directors of the Company and details of changes during the year are given on page 26. 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. The Directors' biographical details are included on pages 17 and 18.

People

Royal Mail Group employs around 200,000 people. Our people are our strategic strength and competitive advantage.

The Group's policy is to encourage effective communication and consultation between employees and management, 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. Employees have various bonus schemes, significant elements of which are based on business-related targets.

We actively encourage continuous training and skill development for all employees to ensure achievement of corporate and individual objectives. Management development and training programmes have been designed to attract and retain the best people. 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.

In 2002, our Chairman created a programme to make Royal Mail Group a 'Great Place to Work' and made it a priority for everyone across the business. This was emphasised by the appointment of a Director People & Organisational Development to the Holdings and Management Boards and has been followed by the transformation of the People & Organisational Development function to ensure people considerations will be at the heart of all major business decisions.

Royal Mail Holdings plc

Directors' Report (continued)

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:

- defining, recruiting and developing the core capabilities we need to thrive in a competitive, deregulated market;
- developing a high-performance culture in which everyone understands their contribution and is motivated to achieve their full potential;
- creating interesting, meaningful jobs with more flexible working patterns;
- building a fluid, innovative and adaptive organisation to improve our response to environmental and market changes;
- identifying and developing in all our people a set of core behaviours that determine how we treat each other, our customers and our shareholders;
- 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, our key mechanism for monitoring our progress towards becoming a 'Great Place to Work' is the Employee Opinion Survey, launched in January 2003. This is administered annually, on a rolling basis, across all employees. Comments from this survey have resulted in significant improvements at a local level across our business.

Corporate Social Responsibility

Royal Mail 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 has been established which reports to the Board. It publishes an annual report of its activities and last year's report won the Association of Certified Chartered Accountants' Best First Time Environmental Report Award, a significant recognition of progress in this area. Further details of our CSR governance structure and activities will be available in our 2004 CSR Report, due to be published in September 2004.

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.

Auditors

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

By Order of the Board

A large, bold, black signature of Jonathan Evans is enclosed within a dashed rectangular box.

Jonathan Evans

Secretary

26 May 2004

Royal Mail Holdings plc

Corporate Governance

Statement by the Directors on compliance with the Combined Code

The Company recognises the importance and is committed to high standards of Corporate Governance. The Directors confirm that for the year ended 28 March 2004 and up to the date of approval of these accounts, the Company has fully complied with the provisions of the Combined Code (the Code), as issued by the UK Listing Authority in June 1998, in so far as they are appropriate to a public company with a single shareholder with the exception of the membership of the Audit and Risk Committee. This arose following the resignation of Rosemary Thorne on the 25 March 2004, which resulted in the composition of this Committee falling below the recommended level of three Non Executive members. The Company is currently seeking to fill the vacancy created by recruiting a candidate with relevant experience.

The new Combined Code, arising out of the Higgs Review of the Role and Effectiveness of Non Executive Directors, and a review of Audit Committees led by Sir Robert Smith, came into effect during 2003 for reporting periods beginning on or after 1 November 2003. The Directors will be reporting on compliance with the new Code in the Annual Report and Accounts published in 2005. However, as evidenced below, the Company is already largely compliant with these requirements.

The Secretary of State also approves the remuneration of both Executive and Non Executive Directors, including all incentive plans.

The Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance. The Board currently comprises a part-time 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 17 and 18. The Board usually meets monthly, and has defined those matters that are reserved exclusively for its consideration. During the financial year, the Board met 11 times. Individual Director attendance was: Allan Leighton (11), Elmar Toime (11), Adam Crozier (11), Tony McCarthy (11), Marisa Cassoni (11), David Mills (10), Richard Handover (8), David Fish (10), Mike Hodgkinson (11), Rosemary Thorne (6), John Neill (11) and Bob Wigley (9 out of 10). 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. There is currently a Non Executive Director vacancy, which the Company is seeking to fill. 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. Performance evaluation of the Board, its committees and individual Directors takes place on an annual basis.

There is a clear division of responsibilities between the Chairman, the Executive Deputy Chairman and Chief Executives.

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.

On appointment, the Directors take part in an induction programme where they receive information about the Royal Mail Group, the role of the Board and matters reserved for its decision, the terms of reference and membership of the principal Board committees, the Company's Corporate Governance arrangements and the latest financial information about the Group. This is supplemented by visits to key business locations. The Company 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 the meeting.

Outside appointments

The Remuneration Committee believes that there are significant benefits to both the Company 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.

The following committees deal with specific aspects of the Group's Governance:

Audit and Risk Committee

The Audit and Risk Committee consists of Non Executive Directors. The Committee met four times during the year. Its membership and individual attendance was: Rosemary Thorne (Chair) (4), John Neill (3) and Bob Wigley (4), who replaced Allan Leighton on 1 April 2003 and assumed Chairmanship of the Committee in succession to Rosemary Thorne. The Committee, which is assisted by the Risk Management Committee, provides a forum for reporting by both internal and external auditors and is responsible for a wide range of matters including:

- monitoring the effectiveness of internal controls;
- reviewing the half year and annual accounts before their submission to the Board;
- advising the Board on the appointment of external auditors and on their remuneration both for audit and non-audit work;
- discussing the nature, scope and outcomes of the audit with external auditors;
- keeping under review the independence and objectivity of the external and internal auditors; and
- agreement of the Internal Audit Plan.

Royal Mail Holdings plc

Corporate Governance (continued)

Management Board

The Executive Deputy Chairman, Elmar Toime, chairs the Management Board, which comprises all Executive Directors of Royal Mail Holdings plc and Royal Mail Group plc and certain other Senior Executives of the Group. The Management Board develops and monitors deployment of the Group's strategy, annual operating plans and budgets for Board approval. It reviews operational activities, and sets policies where these are not reserved to the Board. The Holdings Board has delegated authority to the Investment Committees of the Management Board and Post Office Limited to make investment decisions of up to £10m.

The members of the Management Board are:

Elmar Toime, Executive Deputy Chairman	Adam Crozier, Chief Executive Royal Mail Group plc
Paul Bateson, Managing Director Logistics	David Burden, Chief Information Officer
Marisa Cassoni, Group Finance Director	Mary Fagan, Group Corporate and Government Affairs Director
Vanessa Leeson, Managing Director Parcelforce Worldwide	Tony McCarthy, Group Director People & Organisational Development
David Mills, Chief Executive Post Office Limited	Paul Rich, Deputy Managing Director and Marketing Director UK, Royal Mail
Jonathan Evans, Company Secretary	

Pensions Committee

The Pensions Committee is chaired by Marisa Cassoni. The other members are Tony McCarthy and Jonathan Evans. The Committee is responsible for reviewing funding, benefits, scheme structure and strategic developments impacting on the Group's occupational pension schemes. The Committee represents the Group in discussions with the Trustees of the Group's occupational pension schemes.

Remuneration Committee

The Remuneration Committee reviews the Company's policy on Executive Directors' remuneration for approval by the Board and the Secretary of State. The Committee consists of Non Executive Directors and it met five times during the year. The membership and individual attendance was; David Fish (Chairman) (5), Rosemary Thorne (1), Mike Hodgkinson (4) and Richard Handover (4).

Nomination Committee

The Nomination Committee has the overall role of leading the process both for appointments to the Board of the Company, and for appointments to subsidiary boards. The Committee advises the Board on succession planning for the positions of Chairman, Deputy Chairman, Chief Executive and all other Board appointments and other senior appointments. Some appointments will be subject to the consent of the Special Shareholder, as provided in the Articles. The Committee consists of Non Executive Directors and it met four times during the year. Its membership and individual attendance was Richard Handover (Chairman) (4), Allan Leighton (3) and David Fish (4).

Corporate and Social Responsibility Governance Committee

The Corporate and Social Responsibility Governance Committee has been established reporting to the Board. Chaired by Sir Michael Hodgkinson, the Committee acts on behalf of the Management Board to identify Corporate and Social Responsibility issues with Group-wide impact and makes recommendations on minimum Corporate and Social Responsibilities standards and policies. The other members of the Committee include Elmar Toime, Tony McCarthy, the Head of CSR, Heads of Environment, Health and Safety and other Senior Executives from across the Group.

Internal Control

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, operational and reputational risks. 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 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.

The key processes of internal control and risk management include the following:

Management structure

The business units have authority to manage within the limits set by the Board and within the scope of reserved powers. The Code of Business Standards sets the principles of professionalism and integrity for our people.

Royal Mail Holdings plc

Internal Control (continued)

Identification and evaluation of business risks

The Directors have overall responsibility for overseeing the process for identifying and managing risks. A process of internal control self-assessment encompasses all areas of the Group. The process defines significant risks and the controls in place to manage them, and requires each business unit Managing Director to undertake a formal assessment of the effectiveness of the control processes on a quarterly basis. The Management Board reviews the Company's key risks and ensures that mitigating actions are taken.

The Internal Audit and Risk Management function regularly reviews the management of the Group's risks. The function also undertakes regular reviews of the most significant areas of risk and ensures that key controls remain in place, and reports its findings to the Audit and Risk Committee.

Information and financial reporting system

The Group's planning, financial and reporting procedures include the review and approval of annual budgets by the Board. Performance is monitored monthly by reference to key performance indicators, updated forecasts and information on the key risk areas. The Group operates a business-wide risk management framework to support operational management in the assessment and mitigation of risk.

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 control environment. The Committee reviews the scope of work, authority and resources of the Internal Audit and Risk Management function.

Risk Management Committee

This is a sub-committee of the Audit and Risk Committee. It sets the framework for risk management within the Group and ensures integration with strategic planning. It also facilitates regular reporting of key risks and the actions to manage the risks to a desired level. The members of this committee include Marisa Cassoni, the Head of Treasury, the Head of Internal Audit, the Head of CSR and other Senior Executives from across the Group.

Royal Mail Holdings plc

Directors' Remuneration Report

Information not subject to audit

This report provides the information required by the Directors' Remuneration Report Regulations 2002 (the Regulations). The Company confirms that throughout the year it has complied with the principles in Section 1 of the Combined Code on Corporate Governance (the Code).

The Royal Mail Group is committed to achieving demanding improvements in its performance and is undergoing extensive changes to ensure that the public are offered high quality and cost-effective services. The Board believes that an effective remuneration strategy is essential to support these objectives by ensuring that the Group has people of the right calibre and skills. Incentives, which create an identity of interest between employees and the Shareholder, form a vital part of this.

The Remuneration Committee

The Board retains overall accountability for the framework and costs of executive remuneration and the material terms of the service contracts offered to all Executive Directors, which require the consent of the Secretary of State. 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, pensions and other terms and conditions of employment. The Committee also recommends appropriate compensation on the cessation of employment.

The Remuneration Committee is made up wholly of independent Non Executive Directors. Its membership is described on page 22. The Executive Deputy Chairman, Elmar Toime, the Chief Executive of Royal Mail Group plc, 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.

The Committee met on five occasions in 2003-04 and details of members' attendance is set out on page 22.

Advice to the Remuneration Committee

The Committee may call 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 2003-04, advice on the performance of key executives was given by the Chairman, Executive Deputy Chairman and the Chief Executive. External professional advice was given by Mercer, the Hay Group and Watson Wyatt. Internal support is primarily provided by the Director People & Organisational Development, Tony McCarthy, advised by Ernst & Young LLP, and from the Company Secretary, Jonathan Evans. Other advice has been provided by specialists from People & Organisational Development and Finance.

During the year Watson Wyatt also advised the Company on pension and actuarial matters and Ernst & Young LLP, the Group external auditors, on taxation and regulation 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, and 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 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. During 2003-04, as part of its regular review, the Committee has reviewed the current base pay and annual and long-term incentive arrangements.

The main components of remuneration

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

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 performance, increased individual responsibilities and market levels. No awards are made unless performance warrants it.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Performance-related, personal annual bonus

The Chairman and Executive Directors may earn a performance-related bonus for achievement of financial and customer targets. These bonuses are based on targets set each year in line with the Renewal Plan and agreed with the Shareholder.

The maximum annual bonus for all Executive Directors, except the Executive Deputy Chairman and Chief Executive of Royal Mail Group plc, is 40% of basic pay. The Executive Deputy Chairman and Chief Executive of Royal Mail Group plc can achieve a maximum of 75%; the Non Executive Chairman may earn an annual performance-related bonus of £180,000. 80% of potential bonus earnings relate to financial performance and 20% to the achievement of customer service targets. The Chief Executive of Post Office Limited can achieve a maximum of 40% of basic pay based upon achievement of targets of Post Office Limited (80%) and Group (20%). As a result of these bonus opportunities, all Executive Directors have a substantial proportion of their annual remuneration at risk. For those with a 40% opportunity, 28% of their combined base salary and bonus is at risk. In the case of the Executive Deputy Chairman and the Chief Executive of Royal Mail Group plc, the percentage at risk exceeds 40%.

Long-Term Incentive Plan

The Company operates a Long-Term Incentive Plan (LTIP) for the Executive Directors and certain other senior employees, which has been approved by the Secretary of State for Trade and Industry. The objectives of the LTIP are to incentivise the delivery of the long-term business goals of the Group and to reward success in achieving or exceeding these goals over a three-year period.

The LTIP consists of Annual Company Performance Awards and Bonus Awards, both of which are made at the discretion of the Remuneration Committee. Annual Performance Awards will accrue on a sliding scale above a threshold level of financial performance of the Group, in line with the Renewal Plan targets for profit from operations, and subject to satisfactory personal performance. The Renewal Plan operating targets have been agreed with the Shareholder and are based on moving the Group from a level of loss from operations in 2001-02 to a targeted profit in 2004-05.

Individual senior managers are eligible for annual awards of up to 37.5% of their basic salary if the Group achieves 120% of the agreed target. For performance levels between 87.5% and 120% of the agreed targets, awards are made on a sliding scale in 5% steps. The award for on-target performance is 25% of basic salary and no award is made for performance below 87.5% of the agreed target. The Bonus Award element of the scheme allows the Remuneration Committee to award into the LTIP up to 50% of their performance-related personal annual bonus, taking into account individual preferences.

At the end of the three-year period, the value of these annual accrued awards, together with any deferred bonus element will be paid out in cash and enhanced by up to 33% if the cumulative target over the three-year period is met. The maximum enhancement is 100% if the cumulative target over the three years is exceeded by 178%. The Remuneration Committee may, if it is appropriate for the retention of key senior managers, permit a further period of deferral with enhancement beyond the proposed three-year period. All awards under the LTIP are subject to payments being made under the Share in Success scheme to all our people. If no payments are made to our people under this scheme, no Annual Performance Awards will be paid and there will be no enhancement to Bonus Awards. The Share in Success scheme is designed to pay £800 to all our qualifying people for achieving on-target profits for the financial year ending March 2005 and up to £1,200 if stretch targets are achieved.

Benefits

Benefits include the provision of company cars, health insurance, relocation expenses, plus 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.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

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 UK 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:

	Date of contract	Expiry date of current service contract	Unexpired term (months)
Chairman (Non Executive)			
Allan Leighton (appointed Chairman on 25 March 2002. Initially appointed as Non Executive Director on 2 April 2001.)	25 March 2002	25 March 2005	12
Executive Directors			
Elmar Toime	1 March 2003	(i)	12
Adam Crozier	1 February 2003	(i)	12
Marisa Cassoni	1 February 2001	(i)	12
Tony McCarthy	6 January 2003	(i)	12
David Mills	15 April 2002	(i)	12

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 Mike Hodgkinson	1 January 2003	31 December 2005	21
David Fish	1 January 2003	31 December 2005	21
Richard Handover	1 January 2003	31 December 2005	21
John Neill	1 January 2003	31 December 2005	21
Rosemary Thorne	26 March 2002 (initial appointment 6 October 1998 for 3 years plus one year extensions)	25 March 2004	-
Bob Wigley	1 April 2003	31 March 2006	24

(i) All Executive Directors have a contracted 12-month notice period from the Company; the Director may give six-months notice. The standard term for compensation for loss of office is a maximum payment of 12-months basic salary. The Company is committed for the full three-year term for Non Executive Directors, including the Chairman.

Non Executive Directors

The fees paid to the Non Executive Directors are determined by the Board and approved by the Shareholder. 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 on page 27.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Audited information

Directors' remuneration, excluding pensions, was as follows:

	Basic salary and fees	Performance-related bonus	Awards deferred	Benefits	Compensation for loss of office	Total excluding pensions	
						2004	2003
	£	£	£	£	£	£	£
Chairman (Non Executive)							
Allan Leighton ¹	20,000	-	-	-	-	20,000	186,795
Executive							
Elmar Toime ²	500,000	150,000	(150,000)	36,250	-	536,250	59,076
Adam Crozier	500,000	300,000	(150,000)	14,224	-	664,224	114,152
Marisa Cassoni	321,250	105,600	(52,800)	21,491	-	395,541	362,839
Jerry Cope ³	150,000	55,000	-	35,707	277,343	518,050	240,116
Tony McCarthy	300,000	96,000	(48,000)	36,258	-	384,258	211,949
David Mills	268,750	105,600	(52,800)	21,339	-	342,889	299,498
John Roberts ⁴	-	-	-	-	-	-	503,744
Non Executive							
Sir Michael Hodgkinson	65,987	-	-	-	-	65,987	7,615
David Fish	34,000	-	-	-	-	34,000	8,056
Richard Handover	34,000	-	-	-	-	34,000	7,807
John Lloyd ⁴	-	-	-	-	-	-	21,069
John Neill	31,500	-	-	-	-	31,500	7,615
Miles Templeman ⁴	-	-	-	-	-	-	25,255
Rosemary Thorne	33,935	-	-	-	-	33,935	26,500
Bob Wigley	31,560	-	-	-	-	31,560	-
Total 2004	2,290,982	812,200	(453,600)	165,269	277,343	3,092,194	-
Total 2003	1,318,724	619,848	(157,631)	182,037	119,108	-	2,082,086

¹ Allan Leighton has voluntarily decided to defer his entire performance-related bonus entitlement of £144,000 into 2004-05. This will only be paid if the four key quality of service targets (1st Class, 2nd Class, Mailsort 2 and Mailsort 3) are achieved in the final quarter of 2004-05. This effectively converts any bonus entitlement in 2003-04 which related to profit achievement, into a quality of service bonus for next year.

² Elmar Toime has voluntarily decided to defer half his £300,000 performance-related bonus entitlement amounting to £150,000. This will only be paid if the four key quality of service targets (1st Class, 2nd Class, Mailsort 2 and Mailsort 3) are achieved in the final quarter of 2004-05. This effectively converts any bonus entitlement in 2003-04 which related to profit achievement, into a quality of service bonus for next year.

³ Jerry Cope left the Company on 14 November 2003 and he retained his benefits (car and private medical insurance) until March 2004. He also received the benefit of outplacement and legal services amounting to £29,500.

⁴ John Roberts retired on 31 December 2002, and the contracts of John Lloyd and Miles Templeman expired on 25 March 2003.

No fees (2003 £nil) were paid to third parties in respect of services provided by Directors.

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, (with the exception of the performance-related bonus for Jerry Cope, which was paid during 2003-04). Prior year amounts have been restated to remove the element of the performance-related bonus deferred into the Long-Term Incentive Plan.

On 7 April 2004, the Secretary of State for Trade and Industry, as Special Shareholder, approved the following basic salary/fee increases:

- Marisa Cassoni's salary increased to £330,000 per annum with effect from 1 July 2003; and
- David Mills' salary increased to £275,000 per annum with effect from 1 July 2003.

Annual performance-related bonuses for 2003-04

As agreed with the Secretary of State for Trade and Industry, the Remuneration Committee has the role of authorising the annual performance-related bonuses for the Chairman and the Executive Directors.

The details of the scheme are outlined on page 25. For 2003-04, the Remuneration Committee concluded that the financial targets set for the Group had been met, triggering payment of 80% of maximum bonus potential. Whilst some customers service measures within parts of the Group had been met, for which an element of bonus would have been warranted under the terms of the scheme, the Directors have recommended and the Remuneration Committee have agreed to waive any award for customer service for the year. For David Mills, the portion of his potential bonus relating to the customer service performance of Post Office Limited has been awarded as the target was fully achieved.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Annual Performance and Bonus Awards held under the Long-Term Incentive Plan at 28 March 2004

	Awards held at 30 March 2003 £	LTIP awards during 2003-04 £	Awards held at 28 March 2004 £
Elmar Toime	Nil	201,860	201,860
Adam Crozier	Nil	216,219	216,219
Marisa Cassoni	Nil	164,846	164,846
Jerry Cope	Nil	Nil	Nil
Tony McCarthy	Nil	125,544	125,544
David Mills	Nil	141,037	141,037

The amounts awarded into the Long-Term Incentive Plan in 2003-04 include the Annual Company Performance Award and the Bonus Award. Neither the Annual Company Performance Award nor the enhancements will be paid if the target in 2004-05 is not achieved.

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. Additional fees are paid to the Chairs (£2,500) and members (£1,500) of committees. Sir Michael Hodgkinson receives additional fees of £37,500 for his position as Chairman of Post Office Limited.

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 19 to the accounts. The Plan is a funded, Inland Revenue-approved final salary occupational pension scheme. The scheme provides for a two-thirds final pensionable salary at normal retirement age, subject to the necessary pensionable service and 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 an appropriate Funded Unapproved Retirement Benefits Scheme (FURBS) or equivalent. Gross employer contribution rates range between 25% and 55% of base pay above the earnings cap. The Company has made provision for retirement pension arrangements for Elmar Toime and Adam Crozier at a rate of 40% and at a rate of 55% for Marisa Cassoni. The increase in this provision made during the year was £446,382 for the current year and a further £120,069 adjustment following finalisation of prior year pension arrangements. The total provision at the year end is £734,191 (2003 £167,740). The Company is also due to establish a reserve for the additional pension for Tony McCarthy to provide the total retirement pension, including the pension from previous employer's pension scheme, of two-thirds of base pay at normal retirement age. In addition, David Mills receives cash supplements of 24.2% of earnings below the pensions cap, and 40% of earnings above, giving a total of £84,358 (2003 £80,754).

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

- Stock Exchange Listings Rules: the requirements are the same as that disclosed in last year's accounts and are designed to place a value on the increase in 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.

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.

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	Accumulated accrued benefit at 28 March 2004 £	Increase in accrued benefits during the period* £	Increase in accrued benefits during the period (net of inflation)* £	Transfer value* of increase before inflation less Directors' contributions £
Elmar Toime	56	3,553	3,278	3,270	41,346
Adam Crozier	40	48,596	3,282	3,267	13,279
Marisa Cassoni	52	111,165	3,628	617	6,797
Jerry Cope	52	119,186	33,241	33,241	344,342
Tony McCarthy	48	8,976	7,220	7,171	48,989
David Mills	60	3,223	1,665	1,621	23,274

* Excluding any increase arising from the transfer-in of pension entitlements accrued with previous employers.

	Age	Transfer value at 31 March 2003 £	Plus transfers-in received £	Sub total £	Transfer value at 28 March 2004 £	Movement in the period less Directors' contributions £
Elmar Toime	56	3,365	-	3,365	51,379	42,074
Adam Crozier	40	2,454	235,421	237,875	285,882	42,067
Marisa Cassoni	52	933,777	-	933,777	1,224,538	290,761
Jerry Cope	52	767,026	-	767,026	1,302,261	535,235
Tony McCarthy	48	11,885	-	11,885	76,343	52,458
David Mills	60	26,005	-	26,005	58,085	26,140

Marisa Cassoni, Tony McCarthy and David Mills are also on a 1/60th basis due to the effect of retained benefits from previous employers. All other Executive Directors are members of RMSEPP on a 1/30th basis.

By Order of the Board

GRO

Jonathan Evans
Secretary
26 May 2004

Royal Mail Holdings plc

Statement of Directors' responsibilities in respect of the accounts

Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss of the Group for that period.

In preparing those accounts Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy, at any time, the financial position of the Company and of the Group, and which enable them to ensure that the accounts comply with the Companies Act 1985. Directors are also responsible for ensuring that the assets of the Group are safeguarded 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 Royal Mail Holdings plc

We have audited the Group's financial statements for the year ended 28 March 2004, which comprise the Group profit and loss account, the Group and Company balance sheets, the Group cash flow statement and associated notes, the Group statement of total recognised gains and losses, the reconciliation of movements in Group shareholders' funds, accounting policies and the related notes 1 to 23. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as being 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 are responsible for preparing the accounts, including the financial statements, which are required to be prepared in accordance with applicable United Kingdom law and accounting standards as set out in the statement of Directors' responsibilities in respect of the accounts.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the Group is not disclosed.

We read other information contained in the accounts and consider whether it is consistent with the audited financial statements. This other information comprises the Directors' Report, Operating and Financial Review, Directors' Remuneration Report and Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the 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 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 financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 28 March 2004 and of the profit of the Group for the year then ended, and the financial statements and the part of the remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.



Ernst & Young LLP

Registered Auditor

London

26 May 2004

Royal Mail Holdings plc

Accounting policies

The following accounting policies apply throughout the Group:

Financial year

The financial year ends on the last Sunday in March and accordingly, these accounts are made up to the 52 weeks ended 28 March 2004 (52 weeks ended 30 March 2003).

Basis of preparation

The accounts on pages 32 to 60 have been prepared in accordance with applicable accounting standards under the historic cost accounting convention and the requirements of the Companies Act 1985, except for investments in Government gilt-edged securities as described in the Current Asset Investments accounting policy.

Royal Mail Holdings plc (the Company) has not presented its own profit and loss account, as permitted by the Companies Act 1985 s230(3). However, the results of the Company for the year are disclosed in note 16 to the accounts.

No new Financial Reporting Standards, which affect the presentation of these accounts, have been issued by the Accounting Standards Board.

These accounts have been prepared in accordance with the current accounting standard SSAP 24 Accounting for pension costs. The Group has also adopted the transitional arrangements of the latest pensions accounting standard, FRS 17 Retirement benefits.

Royal Mail Group plc 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 the Company's licence. The amount of such fines and compensation will be determined by the regulator after further representations from the Company and no further information is being disclosed on the grounds that it can be expected to prejudice the outcome of that process.

Basis of consolidation

The accounts consolidate the accounts of Royal Mail Holdings plc and its subsidiary undertakings.

Entities, other than subsidiary undertakings, in which the Group has a participating interest and over whose operating and financial policies the Group exercises a significant influence, are treated as associates or where the Group exercises joint control, joint ventures.

The Group operates through business units that make use of each other's services in order to take advantage of Group synergies, having regard to the mutual dependencies that exist. The interbusiness charges recognise these dependencies. The Board's policy is to maintain controls to ensure adherence to appropriate pricing principles.

Turnover

Turnover comprises revenue receivable directly from customers as adjusted for an assessment of prepaid stamps and meter sales still in the hands of the public. Turnover excludes VAT.

It is not considered that there is a material difference between turnover by origin and destination.

Goodwill

Goodwill arising on acquisition, being the excess of the fair value of consideration over the fair value of the separately identifiable net assets acquired, is capitalised and amortised on a straight-line basis over its estimated useful economic life of 20 years. It is reviewed for impairment at the end of the first full financial year following acquisition and thereafter, as appropriate. Further details on goodwill can be found in note 7 to the accounts.

Tangible fixed assets

Tangible fixed assets are recognised at cost, including directly attributable costs in bringing the asset into working condition for its intended use.

Depreciation of tangible fixed assets is provided on a straight-line basis by reference to original cost and to the remaining useful economic lives of assets and their estimated residual values. The lives assigned to major categories of tangible fixed assets and remaining lives are:

	Average remaining lives	Range of asset lives
Land and buildings:		
freehold land	not depreciated	not depreciated
freehold buildings	14 years	up to 50 years
leasehold land and buildings	9 years	the shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	5 years	3 – 15 years
Motor vehicles and trailers	3 years	1 – 12 years
Fixtures and equipment	2 years	2 – 15 years

Impairment reviews of fixed assets are performed where there is an indication of impairment as defined by FRS 11 Impairment of fixed assets and goodwill. Further details on tangible fixed assets can be found in note 8 to the accounts.

Leasing and hire purchase

Assets acquired under finance leases or hire purchase agreements are capitalised and treated as tangible fixed assets. Depreciation is provided accordingly and the capital element of future rentals is included within creditors. Interest on such contracts is charged to the profit and loss account over the period of the contract and represents a charge that relates to the proportion of the capital repayments outstanding. All other leases are regarded as operating leases and rentals are charged to the profit and loss account over the lease term.

Royal Mail Holdings plc

Accounting policies (continued)

Fixed asset investments

Investments in subsidiaries, joint ventures and associates within the Company's accounts are stated at cost less provision for impairment and at net asset value for internally formed companies.

Investments in joint ventures and associates are incorporated within the Group accounts using the gross equity method and the equity method of accounting respectively, such that the Group's share of their profit and loss is included within the Group profit and loss account and the Group's share of the net assets of each associate and joint venture is recorded in the Group balance sheet. Other fixed asset investments are stated at cost less provision for impairment. Further details on fixed asset investments can be found in note 9 to the accounts.

Stocks

Stocks include uniforms, bicycles and stationery, and in the case of Counter Services also include retail stocks. All stocks are carried at the lower of cost and net realisable value.

Current asset investments

Government gilt-edged securities, held as current assets, are stated at market value at the balance sheet date and the difference between cost and market value is taken to the profit and loss account. The treatment is a departure from UK accounting rules, which stipulate that unrealised profits be credited to a revaluation reserve. In the opinion of the Directors, the treatment adopted is necessary to present a true and fair view. The accounting treatment adopted represents a fairer reflection of the investment return. All other current asset investments are treated according to standard UK accounting rules. Other current asset investments mainly comprise short-term deposits with the National Loans Fund or Local Authorities all of which are held at historic cost.

Further details on current asset investments can be found in note 11 to the accounts.

Deferred tax

Deferred tax is generally provided in full on timing differences at the balance sheet date, at rates expected to apply when the tax liability (or asset) crystallises based on substantially enacted tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the accounts.

Deferred tax is not recognised in the following instances:

- on gains on disposal of fixed assets where, on the basis of available evidence, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only when there is a commitment to dispose of those replacement assets;
- on unremitted earnings of subsidiaries and associates where there is no commitment to remit those earnings; and
- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax assets and liabilities are not discounted. Further details of deferred tax can be found in notes 6 and 15 to the accounts.

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 defined benefit schemes are financed on the basis that the combined current service contributions payable by the employees and employer are sufficient to cover the cost of the benefits which are expected to accrue in the future to members. The charge to the profit and loss account is calculated so as to spread variations from regular cost and to amortise the surplus or deficit over the expected remaining service lives of the employees. The assets of the schemes are held in separate trustee administered funds.

Valuations of the defined benefit schemes are carried out by independent professionally qualified actuaries at intervals not normally exceeding three years, as determined by the Trustees. The accounting charge for pensions reflects best estimate assumptions as required by SSAP 24, whereas the funding arrangements use a more cautious assumption for investment returns to assess the cash position of the Royal Mail Pension Plan (RMPP). This results in the cash payments being higher than the accounts charge for the RMPP. The difference is dealt with through the long-term pensions prepayment in the balance sheet. Further details on pensions and other retirement benefits can be found in note 19 to the accounts.

Research and development

Expenditure on research and development is written off in the year it is incurred. Further details can be found in note 3 to the accounts.

Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction (or at the contracted rate if the transaction is covered by a forward foreign currency contract). Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date (or the appropriate forward contract rate). All differences are taken to the profit and loss account with the exception of differences on foreign currency borrowings, which are used to finance or provide a hedge against foreign equity investments. These are taken directly to reserves together with the exchange difference on the carrying amount of the related investments. Tax charges and credits attributable to exchange differences on those borrowings are also dealt with in reserves. The accounts of overseas subsidiary undertakings are translated at the rate of exchange ruling at the balance sheet date and the differences arising from the translation of opening net investments are taken to reserves.

Royal Mail Holdings plc

Accounting policies (continued)

Financial instruments

The Group uses forward foreign currency contracts to reduce exposure to foreign exchange rates. The Group's policy is that its derivative instruments qualify for hedge accounting when the following criteria are met:

- the instrument must be related to a foreign currency asset or liability that is probable and whose characteristics have been identified;
- it must involve the same currency as the hedged item; and
- it must reduce the risk of foreign currency movements on the Group's operations.

The contracted rates are used to record the hedged item. As a result, gains and losses are offset against the foreign exchange gains or losses on the related financial assets and liabilities. Where the instrument is used to hedge a committed or probable future transaction, gains or losses are not recognised until the transaction occurs.

In addition, over-the-counter derivative products are used to manage both the commodity and foreign exchange risks associated with the fuel procurement policy. Further details on financial instruments can be found in note 18 to the accounts.

Royal Mail Holdings plc

Group profit and loss account

for the years ended 28 March 2004 and 30 March 2003

	Notes	2004			2003		
		Before exceptional items £m	Exceptional items (note 4) £m	Total £m	Before exceptional items £m	Exceptional items (note 4) £m	Total £m
Turnover: Group and share of joint ventures' turnover		8,768	-	8,768	8,378	-	8,378
Less: share of joint ventures' turnover		(135)	-	(135)	(79)	-	(79)
Turnover	1	8,633	-	8,633	8,299	-	8,299
Costs:		(8,582)	(64)	(8,646)	(8,280)	(697)	(8,977)
Staff costs	2/4	(4,888)	(68)	(4,956)	(4,632)	(564)	(5,196)
Depreciation and amortisation	3	(195)	-	(195)	(233)	-	(233)
Impairment	3/4	-	(41)	(41)	-	(97)	(97)
Other operating charges	3/4	(3,499)	45	(3,454)	(3,415)	(36)	(3,451)
Group operating profit/(loss)	1/3	51	(64)	(13)	19	(697)	(678)
Share of operating profit in joint ventures		23	-	23	18	-	18
Share of operating profit in associates		14	-	14	12	-	12
Impairment of goodwill in associates	4	-	-	-	-	(24)	(24)
Total operating profit/(loss): Group and share of joint ventures and associates		88	(64)	24	49	(721)	(672)
Net profit on disposal of tangible fixed assets	4	-	67	67	-	24	24
(Loss)/profit on disposal of subsidiary undertaking	4	-	(3)	(3)	-	2	2
Profit/(loss) on ordinary activities before interest		88	-	88	49	(695)	(646)
Net interest receivable	5	17	-	17	35	-	35
Profit/(loss) on ordinary activities before taxation		105	-	105	84	(695)	(611)
Taxation	6			(98)			52
Profit/(loss) retained for the financial year	16			7			(559)

Royal Mail Holdings plc

Group statement of total recognised gains and losses

for the years ended 28 March 2004 and 30 March 2003

	Note	2004 £m	2003 £m
Loss for the financial year excluding share of profit in joint ventures and associates		(30)	(588)
Share of joint ventures' profit for the year		23	18
Share of associates' profit for the year		14	11
Profit/(loss) for the financial year		7	(559)
Exchange differences on retranslation of net assets		(3)	40
Unrealised gain on joint venture transaction	9	46	2
Total recognised gains/(losses) for the financial year		50	(517)

There is no statement of historical cost profits and losses as the accounts are produced under the historic cost accounting convention.

Reconciliation of movements in Group shareholders' funds

	Note	2004 £m	2003 £m
Opening shareholders' funds	16	2,088	2,605
Total recognised gains/(losses) for the financial year (see above)		50	(517)
Closing shareholders' funds	16	2,138	2,088

Royal Mail Holdings plc

Balance sheets

at 28 March 2004 and 30 March 2003

		Group		Company	
	Notes	2004 £m	2003 £m	2004 £m	2003 £m
Fixed assets					
Intangible assets	7	123	156	-	-
Tangible assets	8	1,550	1,648	-	-
Investments:	9	138	83	2,146	2,180
Share of gross assets of joint ventures		139	64	-	-
Share of gross liabilities of joint ventures		(64)	(54)	-	-
Share of net assets of joint ventures		75	10	-	-
Investments in associates		56	62	-	-
Other investments		7	11	2,146	2,180
Total fixed assets		1,811	1,887	2,146	2,180
Current assets					
Stocks		32	33	-	-
Debtors - receivable within one year	10	1,171	1,296	-	-
Debtors - receivable beyond one year	10	784	712	-	-
Investments	11	999	1,250	-	-
Cash at bank and in hand		1,049	1,060	-	-
		4,035	4,351	-	-
Creditors – amounts falling due within one year	12	(2,590)	(2,566)	-	-
Net current assets		1,445	1,785	-	-
Total assets less current liabilities		3,256	3,672	2,146	2,180
Creditors – amounts falling due after more than one year	13	(543)	(618)	-	-
Provisions for liabilities and charges	15	(575)	(966)	-	-
Net assets		2,138	2,088	2,146	2,180
Capital and reserves					
Called up share capital	17	-	-	-	-
Profit and loss account	16	999	218	2,146	2,180
Mails Reserve	16	765	1,853	-	-
Rural Network Reserve	16	311	-	-	-
Other reserves	16	63	17	-	-
Shareholders' funds		2,138	2,088	2,146	2,180

The accounts on pages 32 to 60 were approved by the Board of Directors on 26 May 2004 and signed on its behalf by:

GRO

Allan Leighton

GRO

Marisa Cassoni

Royal Mail Holdings plc

Group cash flow statement

for the years ended 28 March 2004 and 30 March 2003

	Notes	2004 £m	2003 £m
Reconciliation of operating profit to net cash outflow from operating activities			
Group operating profit before exceptional items	(c)	51	19
Depreciation and amortisation		195	233
Changes in working capital and other non-cash items:		(75)	(396)
Decrease in stock		1	9
Decrease/(increase) in debtors		42	(573)
Increase in creditors		340	198
(Decrease)/increase in client balances		(287)	67
Decrease in provisions		(171)	(97)
Cash payments in respect of operating exceptional items	(b)	(412)	(239)
Net cash outflow from operating activities		(241)	(383)
Group cash flow statement			
Net cash outflow from operating activities		(241)	(383)
Dividends received from joint ventures and associates		21	7
Dividends received from joint ventures		6	-
Dividends received from associates		15	7
Returns on investments and servicing of finance		17	34
Interest received		52	69
Interest paid		(35)	(35)
Taxation			
Corporation tax recovered		12	17
Capital expenditure and financial investment		(56)	(159)
Purchase of intangible fixed assets		(2)	-
Purchase of tangible fixed assets		(158)	(221)
Purchase of fixed asset investments		(5)	-
Sale of tangible fixed assets		100	58
Sale of fixed asset investments		9	4
Acquisitions and disposals		25	(2)
Purchase of interest in joint ventures and associates		(4)	-
Payment of deferred consideration in respect of prior years' acquisitions		-	(9)
Disposal of subsidiary undertaking		29	7
Cash outflow before use of liquid resources and financing		(222)	(486)
Management of liquid resources			
Net movement in current asset investments	(a)	251	550
Net cash inflow before financing		29	64
Financing		(40)	(61)
Repayment of finance leases and hire purchase agreements	(a)	(32)	(37)
New long-term loans	(a)	-	53
Repayment of loans	(a)	(8)	(77)
(Decrease)/increase in cash in the period		(11)	3

Royal Mail Holdings plc

Group cash flow statement (continued)

for the years ended 28 March 2004 and 30 March 2003

Reconciliation of net cash flow to movement in net funds (see note (a))

	2004 £m	2003 £m
(Decrease)/increase in cash in the period	(11)	3
Repayment of finance leases and hire purchase agreements	32	37
New long-term loans	-	(53)
Repayment of loans	8	77
Cash flow from management of liquid resources (net movement in current asset investments)	(251)	(550)
Change in net funds resulting from cash flows	(222)	(486)
Exchange differences	-	1
Movement in net funds in the period	(222)	(485)
Opening net funds	1,673	2,158
Closing net funds	1,451	1,673

Notes to the cash flow statement

(a) Analysis of net funds

	At 31 March 2003 £m	Cash flows £m	Other non-cash movements £m	At 28 March 2004 £m
Cash at bank and in hand	1,060	(11)	-	1,049
Loans due beyond one year	(515)	8	-	(507)
Loans due within one year	(53)	-	-	(53)
Finance leases and hire purchase agreements due beyond one year	(35)	32	1	(2)
Finance leases and hire purchase agreements due within one year	(34)	-	(1)	(35)
Current asset investments	1,250	(251)	-	999
Total	1,673	(222)	-	1,451

(b) Cash flows relating to operating exceptional items charged in both current and prior years

The net cash outflows relating to the above were as follows:

	2004 £m	2003 £m
Net cash outflow relating to:		
Current year exceptional items	3	29
Prior year exceptional items	409	210
Total	412	239

The net cash outflow of £412m comprises the £329m in respect of exceptional provisions (as shown in note 15) and a further £83m relating to the settlement of the prior year pensions redundancy liability, which was recorded within creditors.

(c) Group operating loss of £13m (2003 £678m loss) includes £64m of operating exceptional charges (2003 £697m charge) which have been added back to derive a Group operating profit before exceptional items of £51m (2003 £19m).

Royal Mail Holdings plc

Notes to the accounts

1 Segmental information

The Group discloses its segmented results as required by SSAP 25 into the two classes of business: Mails and Parcels, and Counter Services. In the following analyses, the costs of the Group's corporate activities have been allocated, which means that the results disclosed below may be different from the reported results of each segment within their own statutory accounts.

Analysis of turnover by class of business					2004		2003 as restated		
					£m				
	Total turnover	Turnover between segments	External turnover		Total turnover	Turnover between segments	External turnover		
Mails and Parcels	7,678	(22)	7,656		7,418	(18)	7,400		
Counter Services	1,278	(301)	977		1,186	(287)	899		
Total	8,956	(323)	8,633		8,604	(305)	8,299		

Analysis of operating profit/(loss) by class of business					2004		2003 as restated		
					£m				
Operational activity	Pensions deficit	Before exceptional items	Exceptional items	Total	Operational activity	Pensions surplus	Before exceptional items	Exceptional items	Total
Mails and Parcels	305	(121)	184	(40)	144	(10)	224	214	(296)
Counter Services	(122)	(11)	(133)	(24)	(157)	(217)	22	(195)	(382)
Pensions adjustment	(132)	132	-	-	-	246	(246)	-	-
Group operating profit/(loss)	51	-	51	(64)	(13)	19	-	19	(678)

Analysis of turnover and operating profit/(loss) by geographic area of origin					2004		2003			
					Operating profit/(loss)			Operating profit/(loss)		
	External turnover £m	Before exceptional items £m	After exceptional items £m		External turnover £m	Before exceptional items £m	After exceptional items £m			
United Kingdom	7,795	20	(18)		7,481	12	(678)			
Rest of the World (principally Europe)	838	31	5		818	7	-			
Total	8,633	51	(13)		8,299	19	(678)			

Analysis of net assets/(liabilities) by class of business			2004		2003 as restated	
			£m		£m	
Mails and Parcels			1,847		2,233	
Counter Services			160		(217)	
			2,007		2,016	
Share of net assets of joint ventures			75		10	
Share of net assets of associates			56		62	
Total			2,138		2,088	

All net assets other than £381m (2003 £404m) were located in the United Kingdom with the balance principally in Europe.

Comparatives have been restated to reflect the changes in organisational structures and the impact of fully allocating the 'Other' segment (2003: £26m operating loss) to underlying operational segments. The overall net impact of these two changes is to increase the 2003 operating loss before and after exceptional items for Mails and Parcels by £17m and Counter Services by £9m.

Royal Mail Holdings plc

2 Staff costs and numbers

	2004 £m	2003 £m
Wages and salaries	4,226	4,628
Social security costs	301	303
Pension costs (note 19)	429	265
Total	4,956	5,196

A loan to one officer totalling £2,113 (2003 – one officer £3,818) was outstanding at the end of the year.

Staff costs include £68m (£14m wages and salaries and £54m pension costs), which is included in operating exceptional items (2003 £564m, £364m and £200m respectively).

Staff numbers, calculated on a headcount basis, were:

	Period end employees		Average employees	
	2004	2003	2004	2003
UK Mails and Parcels	189,221	198,552	194,606	202,134
UK Counter Services	13,115	14,260	13,590	14,568
UK total	202,336	212,812	208,196	216,702
Overseas	9,974	10,497	10,442	10,541
Group total	212,310	223,309	218,638	227,243

There were 13,575 subpostmasters at the end of the year (2003 14,567).

Details of Directors' remuneration and pension entitlements are included in the Directors' Remuneration Report.

3 Operating profit/(loss)

	2004 £m	2003 £m
Group operating profit/(loss) is stated after charging:		
Depreciation and amortisation:	195	233
Depreciation of owned tangible fixed assets	161	196
Depreciation of tangible fixed assets held under finance leases and hire purchase agreements	24	27
Amortisation of intangible fixed assets	10	10
Exceptional impairment write-down:	41	97
Tangible fixed assets	17	90
Intangible fixed assets	24	7
Subpostmasters' costs	557	575
Research and development expenditure	3	5
Operating lease charges:	207	202
Land and buildings	119	113
Vehicles and equipment	88	89
Regulatory body costs:	17	16
Postcomm	7	6
Postwatch	10	10

Royal Mail Holdings plc

3 Operating profit/(loss) (continued)

Auditors' remuneration	2004 £000	2003 £000
Audit of statutory accounts	1,488	1,548
Audit of regulatory accounts	502	323
Further assurance services	375	1,037
Tax services:	715	658
Compliance services	493	235
Advisory services	222	423
Other services:	63	335
Financial information technology	-	37
Other services	63	298
Total auditors' remuneration	3,143	3,901

Royal Mail Holdings plc

4 Exceptional items

Exceptional items comprise operating exceptional items, which are recorded within the Group operating profit/(loss), and non-operating exceptional items, which are recorded below Group operating profit/(loss) in the profit and loss account. Both are further highlighted below:

	2004 £m	2003 £m
Operating exceptional items:		
Impairment of tangible fixed assets	(17)	(7)
Impairment of goodwill relating to subsidiaries	(24)	(90)
Provision for onerous contracts relating to surplus properties	(17)	(18)
Provision for Renewal Plan restructuring	(6)	(582)
	(64)	(697)
Non-operating exceptional items:		
Impairment of goodwill relating to associates	-	(24)
Net profit on disposal of tangible fixed assets	67	24
(Loss)/profit on disposal of subsidiary undertaking	(3)	2
Total	-	(695)

The £64m of operating exceptional costs comprises impairments of tangible and intangible fixed assets of £41m (2003 £97m), £17m of costs relating to onerous contracts for surplus leasehold properties (2003 £18m) and £6m charges relating to the Group-wide Renewal Plan (2003 £582m). The £6m charges comprise a £68m charge in respect of employee-related costs and a £62m release in provision in respect of other operating costs. Furthermore, this £62m release and the £17m onerous property contracts costs above comprise the £45m shown separately as other operating charges in the profit and loss account.

The £64m of non-operating exceptional profit (2003 £2m) comprises £67m profit arising from the sale of a number of properties (2003 £24m), £nil for the impairment of goodwill in associates (2003 £24m) and a £3m loss relating to business disposals (2003 £2m profit), in this instance the outsourcing of IT operations and the associated disposal of CSC Business Systems Limited (formerly RM Business Systems Limited).

The tax charge/(credit) on non-operating exceptional items were:

	2004 £m	2003 £m
Disposal of CSC Business Systems Limited	39	-
Disposal of tangible fixed assets	(6)	-
Total tax charge on non-operating exceptional items	33	-

5 Net interest receivable

	2004 £m	2003 £m
Interest payable on bank loans and overdrafts	-	(5)
Interest payable on other loans	(35)	(29)
Total interest payable	(35)	(34)
Interest receivable on investments	52	69
Total net interest receivable	17	35

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6 Taxation

(a) Tax on profit/(loss) on ordinary activities

The tax charge/(credit) is made up as follows:

	2004 £m	2003 £m
Current tax		
Amount receivable for surrender of losses to associates and joint ventures in respect of consortium relief	(10)	(10)
Tax under/(over)-provided in previous years	4	(7)
UK current tax	(6)	(17)
Foreign current tax	6	2
Group current tax	-	(15)
Amount payable by joint ventures in respect of consortium relief	6	5
Amount payable by associates in respect of consortium relief	4	5
Share of joint ventures' current tax payable	1	-
Share of associates' current tax payable	1	1
Total current tax (see table below)	12	(4)
Total deferred tax (note 15)	86	(48)
Total taxation	98	(52)

(b) Factors affecting the current tax charge/(credit)

The tax assessed for the year differs from the standard rate of corporation tax in the UK of 30% (2003 30%). The differences are explained below:

	2004 £m	2003 £m
Profit/(loss) on ordinary activities before tax	105	(611)
Profit/(loss) on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2003 30%)	32	(183)
Deferred relief for asset depreciation and impairment	32	52
Deferred/(accelerated) relief for pension contributions	59	(180)
Provisions not deductible until incurred	(98)	88
Impairment and amortisation of goodwill	7	5
Losses and other reliefs not utilised	9	196
Utilisation of prior year losses	(41)	-
Other	12	18
Total current tax (see table above)	12	(4)

Pensions contributions qualify for tax relief in the year in which they are paid. Charges to the profit and loss account in respect of pensions exceeded contributions paid in the year.

(c) Factors that may affect future tax charges

The Group has unrecognised deferred tax assets of £144m (2003 £146m) relating to tax losses in subsidiaries that are available to offset against future taxable profits of those companies. The Group has unrecognised deferred tax assets of £178m (2003 £158m) relating mainly to fixed asset timing differences.

Deferred tax assets have not been recognised in respect of these items, as they have arisen in companies that are loss-making and the losses, in particular, may not be used to offset future taxable profits elsewhere in the Group. The unrecognised deferred tax assets will be recognised in future to the extent that suitable taxable profits are expected to become available.

The Group has capital losses carried forward, the tax effect of which is approximately £12m (2003 £12m). These may be set-off in future years against capital gains. The Group has rolled over capital gains, the effect of which totals £88m (2003 £75m). It is expected that gains on tangible fixed assets sold in the year will be fully rolled over in due course.

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7 Intangible fixed assets

Group			
	Goodwill £m	Other £m	Total £m
COST			
At 31 March 2003	482	19	501
Exchange movement	(7)	-	(7)
Acquisition of business	4	-	4
At 28 March 2004	479	19	498
AMORTISATION			
At 31 March 2003	343	2	345
Exchange movement	(4)	-	(4)
Charge for the year	9	1	10
Impairment	24	-	24
At 28 March 2004	372	3	375
NET BOOK AMOUNT			
At 28 March 2004	107	16	123
At 31 March 2003	139	17	156

Other intangible fixed assets include the value of master franchise licences relating to parcel delivery in Italy.

8 Tangible fixed assets

Group	Land and buildings			Plant and machinery	Motor vehicles	Fixtures and equipment	Total
	Freehold £m	Long leasehold £m	Short leasehold £m	£m	£m	£m	£m
COST							
At 31 March 2003	1,557	232	422	666	246	856	3,979
Exchange movements	-	-	-	(1)	-	(1)	(2)
Reclassification	(6)	13	(20)	18	-	(5)	-
Additions	12	1	76	50	13	13	165
Disposals	(58)	(2)	(21)	(40)	(69)	(7)	(197)
Disposal of business	(17)	-	-	-	-	(77)	(94)
At 28 March 2004	1,488	244	457	693	190	779	3,851
ACCUMULATED DEPRECIATION							
At 31 March 2003	687	128	195	336	176	809	2,331
Exchange movements	-	-	-	(1)	-	(1)	(2)
Reclassification	(11)	2	(9)	12	-	6	-
Charge for the year	48	10	32	67	18	10	185
Impairment	4	-	7	-	4	2	17
Disposals	(35)	(1)	(22)	(39)	(62)	(6)	(165)
Disposal of business	(8)	-	-	-	-	(57)	(65)
At 28 March 2004	685	139	203	375	136	763	2,301
NET BOOK AMOUNT							
At 28 March 2004	803	105	254	318	54	16	1,550
At 31 March 2003	870	104	227	330	70	47	1,648

Depreciation rates are disclosed within the accounting policies. No depreciation is provided on freehold land, which represents £156m (2003 £151m) of the total cost of freehold properties. The net book value of the Group's tangible fixed assets held under hire purchase contracts and finance leases amounts to £86m (2003 £110m).

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9 Fixed asset investments

Group

	At 31 March 2003 £m	Additions £m	Disposals £m	Reclassification £m	Amortisation £m	Share of (loss)/ profit retained by joint ventures/ associates £m	At 28 March 2004 £m
Net investments in associates	62	-	-	-	(3)	(3)	56
Share of net assets in associates	41	-	-	(7)	-	(3)	31
Goodwill relating to associates	21	-	-	7	(3)	-	25
Net investment in joint ventures	10	50	-	-	-	15	75
Share of net assets in joint ventures	10	50	-	(2)	-	15	73
Goodwill relating to joint ventures	-	-	-	2	-	-	2
Other investments (Local Authority deposits)	11	5	(9)	-	-	-	7
Total	83	55	(9)	-	(3)	12	138

In March 2004, the Group signed a joint venture agreement with the Bank of Ireland to sell Post Office branded financial service products such as personal loans, motor insurance, credit cards and savings accounts. This arrangement will initially run for ten years. As part of the transaction, the Bank of Ireland invested £100m to enable the establishment of the joint venture - Midasgrange Limited - and to provide the core infrastructure and start-up costs. The Group's share of the investment, recorded as additions to net assets in joint ventures amounts to £50m. Other additions comprise £5m relating to Local Authority deposits.

Details of principal joint ventures and associates are given in note 23.

Company	2004 £m	2003 £m
At 31 March 2003	2,180	2,725
Change in net asset value of subsidiary undertaking	(34)	(545)
At 28 March 2004	2,146	2,180

The fixed asset investment of the Company represents the net asset value of its investment in an internally formed subsidiary undertaking.

10 Debtors

	2004 £m	2003 £m
Receivable within one year:		
Trade debtors	673	695
Pension prepayment	128	400
Other prepayments and accrued income	370	201
Total	1,171	1,296
	2004 £m	2003 £m
Receivable beyond one year:		
Pension prepayment	770	707
Other debtors	14	5
Total	784	712

The pension prepayment beyond one year relates to the cumulative excess of the amounts funded in the Group's defined benefit schemes over the amounts charged to the consolidated profit and loss account. The amount within one year represents prepaid contributions.

Other long-term debtors mainly represent amounts payable from employees in respect of the home computing initiative launched in November 2003.

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11 Current asset investments

	2004 £m	2003 £m
Government gilt-edged securities	131	253
Government short-term deposits (National Loans Fund)	583	913
Other deposits	285	84
Total	999	1,250

In accordance with the relevant accounting policy, current asset investments are stated at market value. The difference between cost and market value taken to the profit and loss account for these investments was a loss of £4m (2003 £1m).

The above investments include deposits of £549m, which are subject to a charge as security against the loans from the Department of Trade and Industry (DTI). The balance of investments are restricted in their use to that permissible by the section 72 order, which created the Mails Reserve (note 16).

12 Creditors – amounts falling due within one year

	2004 £m	2003 £m
Loans (note 14)	53	53
Obligations under finance leases and hire purchase agreements (note 14)	35	34
Client services balances	767	1,054
Trade creditors and accruals	1,377	1,026
Advance customer payments	224	253
Corporation tax	10	12
Other taxation and social security	106	112
Other creditors	18	22
Total	2,590	2,566

The Group, via its Post Office Limited subsidiary, 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 service balances above. The level of cash held and the related creditors can vary significantly at each balance sheet date.

13 Creditors – amounts falling due after more than one year

	2004 £m	2003 £m
Loans (note 14)	507	515
Obligations under finance leases and hire purchase agreements (note 14)	2	35
Deferred consideration (note 14)	2	-
Pension creditor	-	68
Other	32	-
Total	543	618

Other long-term creditors represent £10m payable to the leasing company in respect of the home computing initiative launched in November 2003 and £22m in respect of deferred income.

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14 Borrowings including loans, finance leases, hire purchase agreements and deferred consideration

	2004				2003			
	Loans £m	Finance leases/hire purchase agreements £m	Deferred consideration £m	Total £m	Loans £m	Finance leases/hire purchase agreements £m	Deferred consideration £m	Total £m
Amounts falling due in:								
One year or less or on demand	53	35	-	88	53	34	-	87
More than one year	507	2	2	511	515	35	-	550
More than one year but not more than two years	1	-	2	3	1	32	-	33
More than two years but not more than five years	-	1	-	1	5	1	-	6
More than five years	506	1	-	507	509	2	-	511
Total	560	37	2	599	568	69	-	637

Analysis of loans and facilities

	Loan £m	Further facility £m	Total facility £m	Average interest/interest range %	Average maturity date Year
DTI loans to Royal Mail Group plc	500	1,044	1,544	5.8	2023
HM Treasury loans to Post Office Limited	50	1,100	1,150	4.4	2004
Committed facilities	550	2,144	2,694		
Miscellaneous long-term bank loans taken out by overseas subsidiaries	10	-	10	3.36-7.35	2009
Total	560	2,144	2,704		

At 28 March 2004, the Group borrowing limit under section 115(6)(b) of the Postal Services Act 2000 was £5bn (2003 £5bn) subject to Government agreement.

The Group has various borrowing facilities available to it. The undrawn committed facilities available at 28 March 2004, in respect of which all conditions precedent had been met at that date, are as follows:

	2004 £m	2003 £m
Expiring in one year or less	500	-
Expiring in more than one year but not more than two years	-	500
Expiring in more than two years	1,644	494
Total	2,144	994

The undrawn amounts comprise multiple loan facilities amounting to £2,144m, of which £550m had been utilised at 28 March 2004. The £500m loan is secured by way of a fixed and floating charge on various assets of the Group. The £50m loan is secured against cash and near cash items.

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15 Provisions for liabilities and charges

	At 31 March 2003 £m	Charged in the year £m	Utilised non-cash £m	Utilised cash £m	At 28 March 2004 £m
Mails and Parcels	865	24	(159)	(301)	429
Counter Services	91	9	(15)	(35)	50
Deferred tax	10	86	-	-	96
Total	966	119	(174)	(336)	575

The Mails and Parcels provision includes amounts relating to redundancy and other non-redundancy items for the following major change projects: Single Daily Delivery, Mail Centre Efficiency Review, Transport Review, Parcellforce Worldwide restructuring and managerial overhead reduction. During the year £14m was charged to exceptional items and £10m to other operating costs. A further £29m was utilised to write-down fixed assets and £130m transferred to creditors due within one year; the latter representing amounts payable to employees who had an agreed leaving date under voluntary redundancy but who remained in the business at the year end, together with a contractual liability now agreed to be settled in 2004-05. £360m of this provision is expected to be utilised in 2004-05 and the remainder over the following two to three years, except for £46m relating to onerous property contracts, which is expected to be utilised over a longer period.

Counter Services provisions include amounts relating to Network Reinvention and its share of the managerial overhead reduction. During the year £9m was charged to exceptional costs. A further £15m was transferred to creditors due within one year, representing amounts payable to employees who had accepted voluntary redundancy but who remained in the business at the year end. £48m is expected to be utilised in 2004-05 and the remainder in the following year.

The cash utilisation of £336m includes £329m of spend relating to exceptional rationalisation. Total cash spend in the year relating to exceptional rationalisation is shown in the cash flow statement.

Included within provisions is £53m (2003 £40m) relating to onerous property contracts, all of which relate to Mails and Parcels.

The deferred tax provision comprises:

	2004 £m	2003 £m
Deferred capital allowances	23	43
Pension contributions timing differences	(250)	(338)
Provisions	98	197
Losses	33	88
Total	(96)	(10)

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16 Reserves

Group

	Distributable reserves				2004 Total £m
	Profit and loss account £m	Mails £m	Rural Network £m	Other £m	
At 31 March 2003	218	1,853	-	17	2,088
Profit for the financial year	7	-	-	-	7
Transfer of Mails Reserve	671	(1,121)	450	-	-
Transfer of Rural Network Reserve	146	-	(146)	-	-
Transfer of interest income	(40)	33	7	-	-
Unrealised gain on joint venture transaction	-	-	-	46	46
Exchange differences	(3)	-	-	-	(3)
At 28 March 2004	999	765	311	63	2,138

The Mails Reserve was created in Royal Mail Group plc on 3 February 2003, following directions issued by the Secretary of State for Trade and Industry under section 72 of the Postal Services Act 2000. The amounts allocated to the reserve are to be applied as if they were profits available for distribution and they are to be principally used to provide financial assistance to Post Office Limited and security for loans to Royal Mail Group plc.

During the period, £1,121m of the Mails Reserve has been utilised for the provision of financial assistance to Post Office Limited, including £450m to set up the Rural Network Reserve to provide funding for the rural network of Post Offices for three years, and £671m to cover the write-off of Post Office Limited's intercompany debt to Royal Mail Group plc. The Rural Network Reserve has been reduced by £146m, representing the financing required during the period in maintaining the rural network of Post Offices.

The transfer of interest relates to income recorded in the profit and loss account, which has been earned on the assets that support the Mails and Rural Network Reserves.

The unrealised gain on the joint venture transaction relates to the joint venture agreement with the Bank of Ireland, which is fully explained in note 9.

Company

	Profit and loss account £m	2004 Total £m
At 31 March 2003	2,180	2,180
Loss for the year	(34)	(34)
At 28 March 2004	2,146	2,146

The loss dealt with in the accounts of the parent company was £34m (2003 £545m). The Company is a non-trading company and the loss for the financial year represents the net asset value adjustment arising as a result of the accounting policy on Fixed Asset Investments. This states that the investments in internally formed subsidiary undertakings are stated at net asset value. Accordingly, the Company's loss for the financial year is eliminated in the Group Accounts and does not therefore form part of the Group results. Further details can be found in note 9.

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17 Share capital

Authorised	2004 £	2003 £
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

Allotted and called up	2004 £	2003 £
Ordinary shares of £1 each	50,000	50,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	50,001	50,001

The Special Share can be redeemed at any time by its holder (the Special Shareholder). The Company cannot redeem the Special Share without the prior consent of the Special Shareholder. No premium is payable on redemption. Subject to, and in accordance with, the provisions of the Postal Services Act 2000, the Special Shareholder can at any time require the Directors to declare and pay a dividend to the Special Shareholder or its nominee.

On distribution in a winding up of the Company, the Special Shareholder 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.

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

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18 Derivatives and other financial instruments

An explanation of the Group's treasury policy and controls is included in the Operating and Financial Review. The role of financial instruments in creating or changing the risks the Group faces in its activities is also explained in that section.

Financial assets and liabilities are a subset of the overall assets and liabilities of the Group and include balances which generally have interest rate and/or foreign currency risks attached. FRS 13 Derivatives and other financial instruments, permits exclusion of items such as trade debtors, trade creditors, prepayments and accruals. The assets and liabilities which fall under the definition, along with their fair values, are highlighted in (i) below:

(i) Fair value of financial assets/(liabilities)

Fair value is defined as the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties and is calculated by reference to market rates discounted to current value. Where market rates are not available, fair values have been calculated by discounting cash flows at prevailing rates transacted at year end exchange rates.

	2004				2003			
	Gross asset £m	Gross liability £m	Net book value £m	Fair value £m	Gross asset £m	Gross liability £m	Net book value £m	Fair value £m
Cash	1,049	-	1,049	1,049	1,060	-	1,060	1,060
Current asset investments (note 11)	999	-	999	999	1,250	-	1,250	1,250
Local Authority deposits (note 9)	7	-	7	7	11	-	11	11
Borrowings (note 14)	-	(599)	(599)	(599)	-	(637)	(637)	(637)
Client services balances (note 12)	-	(767)	(767)	(767)	-	(1,054)	(1,054)	(1,054)
Total	2,055	(1,366)	689	689	2,321	(1,691)	630	630

Fair values for borrowings and deposits have been calculated by discounting at an appropriate rate.

The carrying value of gilts is £138m (2003 £263m), of which £131m (2003 £253m) is included in the current asset investment figures and £7m (2003 £10m) in the fixed asset investment figures. The Group portfolio of gilt holdings showed a loss of £4m (2003 £1m) during the financial year when revalued.

(ii) Maturity profile of the Group's financial liabilities

The maturity profile of the Group's financial liabilities at 28 March 2004 is set out below:

	2004			2003		
	Borrowings (note 14) £m	Client balances £m	Total £m	Borrowings (note 14) £m	Client balances £m	Total £m
One year or less or on demand	88	767	855	87	1,054	1,141
More than one year but not more than two years	3	-	3	33	-	33
More than two years but not more than five years	1	-	1	6	-	6
More than five years	507	-	507	511	-	511
Total	599	767	1,366	637	1,054	1,691

(iii) Maturity profile of the Group's undrawn committed borrowing facilities

Details of the Group's borrowings and undrawn committed borrowing facilities can be found in note 14.

Royal Mail Holdings plc

18 Derivatives and other financial instruments (continued)

(iv) Interest rate profile and foreign currency analysis

	2004 Financial liabilities				2004 Financial assets					
	Sterling £m	Euro £m	Other £m	Gross total £m	Sterling £m	USD £m	Euro £m	Other £m	Gross total £m	Net total £m
Fixed rate	(550)	(8)	-	(558)	1,006	-	-	-	1,006	448
Floating rate	-	(4)	-	(4)	-	2	51	-	53	49
Non-interest bearing	(804)	-	-	(804)	936	20	38	2	996	192
Total	(1,354)	(12)	-	(1,366)	1,942	22	89	2	2,055	689

	2003 Financial liabilities				2003 Financial assets					
	Sterling £m	Euro £m	Other £m	Gross total £m	Sterling £m	USD £m	Euro £m	Other £m	Gross total £m	Net total £m
Fixed rate	(550)	(12)	-	(562)	1,261	-	-	-	1,261	699
Floating rate	(40)	(6)	-	(46)	-	-	43	-	43	(3)
Non-interest bearing	(1,083)	-	-	(1,083)	986	7	22	2	1,017	(66)
Total	(1,673)	(18)	-	(1,691)	2,247	7	65	2	2,321	630

The fixed rate sterling financial liabilities of £550m have a weighted average interest rate of 5.7% and an average time to maturity of 17 years (2003 5.67% and 18 years). The fixed rate sterling financial assets of £1,006m have a weighted average interest rate of 3.95% and an average time to maturity of 20 days (2003 3.59% and 82 days).

The floating rate euro financial liabilities have a weighted average interest rate of euro LIBOR plus 2% and an average time to maturity of four years (2003 euro LIBOR plus 2% and 5 years). The floating rate euro financial assets have a weighted average interest rate of bank rate minus 1% and an average time to maturity of one day (2003 bank rate minus 1% and one day).

Of the £804m of non-interest-bearing financial liabilities, £767m is payable on demand and £37m has an average maturity date of 202 days. All the non-interest-bearing financial assets are receivable on demand.

A one percentage increase in interest rates throughout the period would have increased profit before tax by £11m.

(v) Derivative financial instruments held to manage currency and commodity price fluctuations

	2004 Fair value £m	2003 Fair value £m
Foreign currency transactions	153	185
Fuel derivatives	16	18

At the balance sheet date, the Group held contracts to purchase foreign currency for £153m (2003 £185m) and £16m (2003 £18m) fuel contracts. No carrying amounts are shown as all these items are held off balance sheet. The difference between the contracted forward rate and mark to market rate was a loss of £4m (2003 £1m) for currency contracts and a gain of £1.5m (2003 £1.4m) for fuel contracts.

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18 Derivatives and other financial instruments (continued)

(vi) Forward transactions

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

	In currency (millions)		Sterling equivalents (millions)	
	2004	2003	2004	2003
Maturing within one year				
Euro	38	80	26	55
JPY	745	1,781	4	9
USD	207	181	121	116
AUD	3	3	1	1
Maturing after one year				
USD	1	-	1	-
Euro	-	4	-	5

(vii) Gains and losses on transactional exposures

The table below shows the Group's currency transactional exposures that give rise to net currency gains and losses recognised in the profit and loss account. These liabilities arise from the net payments due to overseas postal administrations for delivery of mail, and are denominated in Special Drawing Rights (SDRs). This is a basket of currencies comprising US Dollar, euro, Japanese Yen and Sterling. Such exposures comprise the monetary liabilities of the Group that are not denominated in the functional currency of the operating unit involved.

This year 100% (2003 80%) of the exposure to pay overseas administrations was hedged; consequently there is no unhedged exposure (2003 21 million SDRs were unhedged).

	2004	2003
Net foreign currency liabilities (SDRm)	-	21
Sterling equivalent value (£m)	-	19

At 28 March 2004, the Group also held various open forward contracts that were taken out to hedge expected future foreign currency payments (as shown in note (vi) above).

(viii) Gains and losses on hedges

Foreign exchange exposures are hedged using currency deposits, currency borrowings, forward currency contracts and currency options.

Gains and losses on these instruments are not recognised until the hedged exposure itself is recognised. Unrecognised gains and losses on these instruments used for hedging are not material.

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19 Pensions

The Group operates pension schemes as detailed below:

Name	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

The terms of the merger of the two former schemes - the Post Office Staff Superannuation Scheme (POSSS) and the Post Office Pension Scheme (POPS) - with effect from 1 April 2000, required them to be considered as separate sections of the RMPP whilst one section remained in surplus and one remained in deficit. As both of these sections are now in deficit, this requirement falls away and the RMPP is now dealt with as a single plan with no separate sections for overall funding and accounting requirements.

Pension charges in the profit and loss account

The Group continues to account for pension costs under SSAP 24 Accounting for pension costs, and a summary of pension charges, including those relating to redundancy provisions, is shown below:

	2004 £m	2003 £m
Regular pension costs - defined benefit schemes	242	310
- defined contribution schemes	1	1
Regular pension costs	243	311
Accounting deficit/(surplus) and best estimate reduction	188	(201)
Notional interest on pension asset	(56)	(45)
Charges relating to redundancy provisions	54	200
Total net charge included in profit/(loss) before tax (note 2)	429	265

Pension valuations

Valuations of the defined benefit schemes are carried out at intervals not normally exceeding three years as determined by the trustees. The latest actuarial assessments of the RMPP and the RMSEPP were carried out as at 31 March 2003. These were performed using an assumed rate of inflation of 2.5% for both schemes. Investment returns real were assumed to be 4.9% and 4.3% respectively. Pay increases real were assumed to be 1.5% and 3.0% respectively and pensions, both in payment and deferred, were assumed to increase at 2.5% for both schemes. The market value of assets at the latest actuarial assessments was £11,954m for the RMPP and £86m for the RMSEPP. The asset cover of the benefits accrued to members after allowing for future increases in earnings was 91% for the RMPP and 82% for the RMSEPP, both as at 31 March 2003. The next full valuation of both the RMPP and the RMSEPP is due to be carried out as at 31 March 2006. Key factors generating the move from surplus to deficit were investment market experience over the three years ending 31 March 2003 of some £725m, demographic changes, including increased life expectancy of members, of some £420m, and the higher assessed liabilities of some £1,350m based upon a lower discount rate.

Accounting standards

These accounts have been produced in accordance with the current accounting standard SSAP 24. The latest pensions accounting standard, FRS 17 Retirement benefits, has been adopted by the Group in accordance with the transitional arrangements. This is further complicated because the Group plans to adopt international financial reporting standards (these are expected to be similar to FRS 17), which means FRS 17 disclosures will continue to be made next year, with the year to March 2006 being the first year in which all pension costs and related information are reported in accordance with the international standards.

FRS 17 disclosures

The following FRS 17 disclosures relate to the RMPP and RMSEPP plans:

a) Assumptions

The major assumptions used by the actuary were:

	At 28/03/2004 % pa	At 30/03/2003 % pa	At 31/03/02 %pa
Rate of increase in salaries	4.10	3.55	3.80
Rate of increase in pensions	2.60	2.25	2.50
Discount rate	5.50	5.50	6.00
Inflation assumption	2.60	2.25	2.50
Expected average rate of return on assets	7.50	7.90	7.70

Royal Mail Holdings plc

19 Pensions (continued)

b) Plan assets and expected rates of return

The assets in the Plans and the expected rates of return were:

At 28 March 2004

	Market value at 28 March 2004		Long-term rate of return expected at 28 March 2004 % pa
	RMPP £m	RMSEPP £m	
Equities	12,066	106	8.00
Bonds	1,754	12	4.80
Property	1,313	-	6.40
Other net assets	(43)	6	3.60
Total market value of assets	15,090	124	
Present value of Plan liabilities	(19,438)	(156)	
Deficit in scheme	(4,348)	(32)	
Related deferred tax (liability)/asset*	-	-	
Net pension liability	(4,348)	(32)	

At 30 March 2003

	Market value at 30 March 2003		Long-term rate of return expected at 30 March 2003 % pa
	RMPP £m	RMSEPP £m	
Equities	9,650	56	8.50
Bonds	1,562	6	4.50
Property	1,240	-	6.50
Other assets	(352)	25	4.25
Total market value of assets	12,100	87	
Present value of Plan liabilities	(16,752)	(119)	
Pension liability before deferred tax	(4,652)	(32)	
Related deferred tax (liability)/asset*	-	-	
Net pension liability	(4,652)	(32)	

At 31 March 2002

	Market value at 31 March 2002		Long-term rate of return expected at 31 March 2002 % pa
	RMPP £m	RMSEPP £m	
Equities	12,607	63	8.20
Bonds	1,706	7	5.30
Property	1,194	-	6.70
Other assets	106	7	4.50
Total market value of assets	15,613	77	
Present value of Plan liabilities	(15,331)	(87)	
Surplus/(deficit) in scheme	282	(10)	
Surplus restriction	-	-	
Pension asset/(liability) before deferred tax	282	(10)	
Related deferred tax (liability)/asset*	(85)	3	
Net pension asset/(liability)	197	(7)	

*No deferred tax is recognised in relation to the pension liabilities due to uncertainty regarding the existence of future tax liabilities against which tax relief on pension costs might be offset.

Royal Mail Holdings plc

19 Pensions (continued)

c) Components of defined benefit costs

An analysis of the separate components of the cost that would be reflected in the performance statements is as follows:

	RMPP £m	RMSEPP £m	2004 Total £m	RMPP £m	RMSEPP £m	2003 Total £m
Analysis of amounts charged to operating profit:						
Current service cost	394	3	397	382	4	386
Total charge to operating profit	394	3	397	382	4	386
Analysis of other amounts (credited)/charged to profit and loss account:						
Gain on settlements	-	-	-	(18)	-	(18)
Loss on curtailments*	87	6	93	105	14	119
Total net operating charge	481	9	490	469	18	487
*These costs have already been recognised in the Group primary statements on a SSAP 24 basis.						
Analysis of amount charged/(credited) to other finance income:						
Interest on Pension Plan liabilities	909	6	915	905	5	910
Expected return on Pension Plan assets	(950)	(6)	(956)	(1,185)	(6)	(1,191)
Net credit to other finance income	(41)	-	(41)	(280)	(1)	(281)
Total profit and loss charge before deduction for tax	440	9	449	189	17	206
Analysis of amounts recognised in statement of total recognised gains and losses (STRGL):						
Difference between actual and expected return on Plan assets	(2,063)	(16)	(2,079)	4,342	28	4,370
Experience loss/(gain) on Plan liabilities	73	2	75	(22)	5	(17)
Loss on change in assumptions (financial and demographic)	1,886	24	1,910	672	4	676
Actuarial (gain)/loss recognised in STRGL	(104)	10	(94)	4,992	37	5,029

d) Movement in (deficit)/surplus

Analysis of the movement in (deficit)/surplus in the Plans during the period:

	RMPP £m	RMSEPP £m	2004 Total £m	RMPP £m	RMSEPP £m	2003 Total £m
(Deficit)/surplus in Plan at beginning of period	(4,652)	(32)	(4,684)	282	(10)	272
Company contributions paid	640	19	659	247	32	279
Current service cost	(394)	(3)	(397)	(382)	(4)	(386)
Settlement gain	-	-	-	18	-	18
Curtailment loss	(87)	(6)	(93)	(105)	(14)	(119)
Other finance income	41	-	41	280	1	281
Actuarial gain/(loss)	104	(10)	94	(4,992)	(37)	(5,029)
Deficit in Plan at end of period	(4,348)	(32)	(4,380)	(4,652)	(32)	(4,684)

Royal Mail Holdings plc

19 Pensions (continued)

e) History of experience gains and losses

	RMPP	RMSEPP	2004 Total	RMPP	RMSEPP	2003 Total
(Gain)/loss between actual and expected return on Plan assets:						
Amount (£m)	(2,063)	(16)	(2,079)	4,342	28	4,370
Percentage of Plan assets at end of period	13.7%	12.9%	13.7%	35.9%	32.2%	35.9%
Experience loss/(gain) on Plan liabilities:						
Amount (£m)	73	2	75	(22)	5	(17)
Percentage of Plan liabilities at end of period	0.4%	1.3%	0.4%	0.1%	4.2%	0.1%
Total actuarial (gain)/loss recognised in STRGL:						
Amount (£m)	(104)	10	(94)	4,992	37	5,029
Percentage of Plan liabilities at end of period	0.5%	6.4%	0.4%	29.8%	31.1%	29.8%

f) Balance sheet presentation

Net assets	2004 £m	2003 £m
Net assets as stated in balance sheet	2,138	2,088
Pension prepayment recoverable beyond one year (SSAP 24)	(770)	(707)
Related deferred tax	-	-
Net assets excluding pension asset	1,368	1,381
FRS 17 pension liability	(4,380)	(4,684)
Net assets including FRS 17 pension liability	(3,012)	(3,303)
Reserves		
	2004 £m	2003 £m
Profit and loss reserve as stated in balance sheet	999	218
Pension prepayment recoverable beyond one year (SSAP 24)	(770)	(707)
Related deferred tax	-	-
Profit and loss reserve excluding amounts relating to pension asset	229	(489)
FRS 17 pension liability	(4,380)	(4,684)
Profit and loss reserve including amounts relating to FRS 17 pension liability	(4,151)	(5,173)

The long-term rates of future contributions expressed as a percentage of pay are 12.6% for the RMPP and 20.9% for the RMSEPP.

Royal Mail Holdings plc

20 Commitments

Capital commitments contracted for but not provided in the accounts amount to £84m (2003 £138m).

The Group is committed to the following payments on operating leases during the next 12 months:

	Land and buildings		Vehicles and equipment	
	2004 £m	2003 £m	2004 £m	2003 £m
For leases which expire:				
Within one year	10	9	16	14
Between one and five years	21	26	51	56
Beyond five years	89	86	1	-
Total	120	121	68	70

21 Contingent liabilities and guarantees

Royal Mail Group plc, a subsidiary of the Company, has guaranteed the performance of a third party in relation to lease payments payable over the 15-year term of a lease entered into on 21 December 2000, and has given certain tax indemnities to the US lessors. In the opinion of the Directors, no loss will result to the Group as a result of these guarantees.

As required by the Notes Sorting Facility rules, notes in transit to cash handling centres and those processed overnight, for which the Group has received credit, are secured by gilts deposited with the Bank of England. On default, the estimated maximum liability would be £131m.

Royal Mail Group plc, has given a guarantee to the Secretary of State for Works and Pensions, the Department for Social Development (Northern Ireland) and the Commissioners of Inland Revenue, to underwrite the performance of Post Office Limited of its obligations under the Universal Banking Contract (Post Office Card Account).

Royal Mail Group plc has also given a guarantee to Electronic Data Systems Limited to underwrite Post Office Limited's performance of its obligations under the Universal Banking Contract (Post Office Card Account).

22 Related party transactions

During the year the Group entered into transactions with other 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 28 March 2004 were as follows:

	Sales to related party		Purchases from related party		Amounts owed from related party		Amounts owed to related party	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
Royal Mail Pension Plan	29	42	-	-	10	19	-	-
Quadrant Catering Limited	1	-	40	41	-	-	1	1
Camelot Group plc	1	14	-	-	-	-	-	-
G3 Worldwide Mail N.V. (trade name "Spring")	5	5	30	29	11	9	3	5
First Rate Travel Services Holdings Limited Group	19	17	-	-	-	2	-	-
Romec Limited	13	4	224	97	1	-	29	29

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

David Mills, a Director, is a shareholder-nominated Director of Camelot Group plc, with whom the Group has a commercial relationship for the sale of £750m (2003 £770m) lottery products per annum.

Bob Wigley, a Non Executive Director, is Chairman of Merrill Lynch's European Corporate Banking Business, with whom the Royal Mail Pension Plan has a commercial relationship to manage short-term investments to the value of £99m during the year.

Royal Mail Holdings plc

23 Principal subsidiary undertakings, joint ventures and associates

	Country of incorporation	Percentage holding %	Principal activities
Subsidiary undertakings			
Royal Mail Group plc ¹	UK	100	Mails and parcels services
Post Office Limited	UK	100	Counter and financial services
General Logistics Systems International Holdings B.V. ²	Netherlands	100	Parcel services
Associates			
Camelot Group plc	UK	20	Lottery operations
Quadrant Catering Limited ³	UK	51	Catering services
G3 Worldwide Mail N.V. (trade name 'Spring')	Netherlands	25	Mail services
Joint ventures			
Romec Limited	UK	51	Facilities management
First Rate Travel Services Holdings Limited	UK	50	Bureau de Change
Midasgrange Limited	UK	50	Financial services

¹ This investment is held by the Company. All other investments are held by subsidiaries.

² This is a non-trading holding company, which has investments in other operational companies that are based in Europe.

³ The Group holds 51% of the share capital of Quadrant Catering Limited. However, the voting rights attached to the various classes of shares give the other investor operational control. Quadrant is therefore treated as an associate in the Group Accounts.

All these principal subsidiaries, joint venture and associates have a 31 March year end date with the exception of Quadrant Catering Limited which has a 30 September year end date and G3 Worldwide Mail N.V. and Romec Limited which both have a 31 December year end date.

A full list of subsidiary undertakings, joint ventures and associates is available from the Company's Registered Office. All shareholdings are equity shares.

Royal Mail Holdings plc

Five-year summary

Profit and loss account	2000	2001	2002	2003	2004
	£m	as restated £m	£m	£m	£m
External turnover	7,522	8,119	8,408	8,299	8,633
Profit/(loss) from operations	150	(206)	(318)	(197)	220
Less share of operating (profit)/loss of joint ventures and associates	(4)	-	1	(30)	(37)
Add pensions benefit/(charge) in respect of pensions surplus/(deficit)	235	228	250	246	(132)
Group operating profit/(loss) before exceptional items	381	22	(67)	19	51
Operating exceptional items	(656)	(67)	(1,119)	(697)	(64)
Group operating loss	(275)	(45)	(1,186)	(678)	(13)
Share of operating profit of joint ventures and associates	4	-	4	30	37
Impairment of goodwill in associates	-	-	(12)	(24)	-
Total operating (loss)/profit	(271)	(45)	(1,194)	(672)	24
Non-operating exceptional items	11	20	14	26	64
(Loss)/profit before interest	(260)	(25)	(1,180)	(646)	88
Net interest receivable	89	106	56	35	17
(Loss)/profit before tax	(171)	81	(1,124)	(611)	105
Taxation	(96)	(34)	179	52	(98)
(Loss)/profit after tax	(267)	47	(945)	(559)	7
Equity minority interests	3	2	5	-	-
(Loss)/profit for the financial year	(264)	49	(940)	(559)	7
Transfer to dividend reserve	(151)	(93)	-	-	-
(Loss)/profit retained	(415)	(44)	(940)	(559)	7
Balance sheet	2000	2001	2002	2003	2004
	£m	as restated £m	£m	£m	£m
Intangible assets	270	421	146	156	123
Tangible fixed assets	2,419	2,026	1,783	1,648	1,550
Fixed asset investments	26	60	94	83	138
Net current assets	1,723	2,008	1,987	1,785	1,445
Creditors beyond one year and provisions	(342)	(977)	(1,405)	(1,584)	(1,118)
Total assets less liabilities	4,096	3,538	2,605	2,088	2,138
Cash flow	2000	2001	2002	2003	2004
	£m	£m	£m	£m	£m
Net cash flow from operating activities	(68)	330	12	(383)	(241)
Net cash outflow before use of liquid resources and financing	(474)	(121)	(100)	(486)	(222)

Note

The restated figures for 2001 reflect the impact of the implementation of FRS 19 Deferred tax, and the change to the historic cost accounting convention.

Profit/(loss) from operations reflects the underlying performance of the Group as defined in the Operating and Financial Review.

Royal Mail Holdings plc

Glossary of terms

Accounting convention

The basis on which accounts are prepared.

Accounting Standards Board (ASB)

The Accounting Standards Board is responsible for producing accounting standards which are known as Financial Reporting Standards. The Group is required to comply with Financial Reporting Standards when preparing accounts.

Capital expenditure

Expenditure on new, or additions to existing, fixed assets.

Cash

Cash in hand and deposits repayable on demand (within 24 hours or one working day) with any financial institution.

Client services balances

Balances owed to or due from clients in respect of counter transactions carried out by Post Office Limited.

Counter Services

The services provided to customers by the network of Post Office branches.

Creditors

The amount owed to others for pay, goods and services.

Currency options

An option to buy or sell foreign currency.

Current assets

Cash or other assets readily convertible into cash.

Debtors

Mainly amounts owed by customers for services provided and pension prepayments.

Deferred taxation

The estimated future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

Department of Trade and Industry (DTI)

The Department of Trade and Industry.

Financial Reporting Standard (FRS)

A Financial Reporting Standard issued by the Accounting Standards Board.

Finance lease

A lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee.

Goodwill

The excess of consideration paid over net assets acquired.

Group

Comprises Royal Mail Holdings plc and its subsidiary undertakings.

Hedge

The use of financial assets and financial liabilities to manage risk.

Historic cost basis

The system of accounting where all current and capital expenditure is recorded at its cost at the time of purchase.

International Accounting Standards Board (IASB)

The international accounting regulatory body that produces International Financial Reporting Standards, which the Group will have to comply with from April 2005 onwards.

Liquid funds (cash flow)

Current asset investments that are readily convertible into known amounts of cash at, or close to, their carrying amount and can be disposed of without curtailing business operations.

Mails reserve

A distributable reserve created under the Postal Services Act 2000 to provide funding.

Royal Mail Holdings plc

Glossary of terms (continued)

National Loans Fund (NLF)

National Loans Fund provides a source of funds for Government lending.

Operating lease

A lease other than a finance lease.

Operating profit

Represents the profit (before interest and non-operating exceptional items) on ordinary activities with the exception of where interest falls to be treated within operating activities.

Postcomm

The postal industry regulator.

Postwatch

The body that represents the interest of the consumer.

Profit and loss account reserve

The profit and loss account reserve represents retained profits to the extent these have not been transferred to another designated reserve.

Provisions

Amounts set aside to meet known liabilities likely to be incurred or certain to be incurred but where the amount or timing are uncertain.

Rural Network Reserve

A reserve created to fund the rural network.

Statement of Standard Accounting Practice (SSAP)

Financial reporting standards developed originally by the Accounting Standards Committee (ASC) and adopted by the Accounting Standards Board (ASB) in 1990.

Shareholder

The Company's shareholder is HM Government.

Special Share

One Special Rights Redeemable Preference Share of £1 in the capital of the Company.

Special Shareholder

The holder of the Special Share (i.e. The Secretary of State for the Department of Trade and Industry).

Tangible fixed assets

Land and buildings, plant and vehicles purchased for use over a number of years.

Total recognised gains and losses

Total of all gains and losses – realised and unrealised – that are recognised in a period and are attributable to the shareholder.

Universal Service Obligation (USO)

The requirement to provide a universal postal service in the UK.

Value Added Tax (VAT)

An indirect tax on goods and services.

Royal Mail Holdings plc

Corporate information

Registered Office and Group Head Office

Royal Mail Holdings plc
148 Old Street
LONDON
EC1V 9HQ
020 7250 2888
Registered No: 4074919

Corporate website

Additional corporate and other information can be accessed on the following website (www.royalmail.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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Financial Calendar

Regulatory Accounts	July 2004
Interim Accounts 2004-05	November 2004
Preliminary results 2004-05	May 2005