



UK Government  
Investments

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# **Post Office Ltd**

## **Portfolio Summary**

*29 June 2018*

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## Asset Summary

<b>Asset's strategic objectives</b>	Post Office Ltd (POL) operates and maintains the network of post office branches across the UK. It is obliged (through legal funding agreements) to maintain a minimum network of branches that meet HMG's access (proximity) criteria. It receives subsidy of £50m per annum and it has also been awarded up to £210m of investment funding (between 18/19 and 19/20). POL aims to achieve full financial sustainability without need for further HMG subsidy from the early 2020s.
<b>Key risks / contextual factors which may impact strategic objectives</b>	<ul style="list-style-type: none"> <li>• Long run decline in some core products (mails and government services) means that improved performance relies on continued cost reductions and expansion of financial services</li> <li>• POL is implementing large scale upgrades to core infrastructure, particularly IT</li> <li>• Renegotiating core third party contracts (in particular with Royal Mail and Bank of Ireland)</li> <li>• POL is unable to access external finance, which could limit its room for manoeuvre</li> <li>• Successfully defending against class action from some subpostmasters</li> </ul>
<b>What levers does UKGI have?</b>	POL is a public corporation, with an independent fiduciary Board. BEIS is the sole shareholder and UKGI is responsible for the day to day management of BEIS's shareholding. UKGI has a NED seat on the POL Board (now held by Tom Cooper). UKGI monitors the financial and network performance of POL and approves the release of investment funding on a quarterly basis. It also approves Board appointments and remuneration for the CEO and CFOO.
<b>What are UKGI's overarching objectives?</b>	<ul style="list-style-type: none"> <li>• Assist POL in delivering its strategic objectives by providing constructive/ challenging input at Board level as a shareholder representative</li> <li>• Ensure POL accords with network commitments</li> <li>• Monitor POL's financial performance and investment pipeline and approve release of allocated investment funding by BEIS over the period 2018/19 to 2019/20.</li> <li>• Ensure HMG best-practice corporate finance/ governance principles are applied and adhered to</li> <li>• To facilitate the transfer of certain activities to BEIS</li> </ul>
<b>Timeframe</b>	• Ongoing
<b>UKGI resource and skills required</b>	• 1 Director (30% time allocation), 1 Exec Director (50%), 1 AD (50%), 1 Manager (50%) and 1 HEO (80%).

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## UKGI Quarterly Priorities (1)

	Q1 (April – June)	Q1 Progress Report	Q2 (July – Sept)	Q2 Progress Report
<b>UKGI's quarterly priorities</b>	<ul style="list-style-type: none"> <li>• Agree information sharing protocol with POL, UKGI and BEIS legal ahead of hearings on the Horizon IT litigation case</li> <li>• Agree Framework Agreement between UKGI and POL</li> <li>• Agree transfer of responsibilities from UKGI to BEIS</li> <li>• Advise POL on acquisition of Payzone and negotiations with BOI</li> <li>• Secure £50m intra-day loan facility from BEIS</li> <li>• Ensure network commitments are met</li> <li>• Finalise arrangements for financial reporting linked to quarterly release of funding</li> </ul>	<ul style="list-style-type: none"> <li>• Legal protocol agreed with POL</li> <li>• Framework agreement mostly agreed with BEIS</li> <li>• Loan facility agreed with BEIS and HMT</li> <li>• In principle agreement for transfer to BEIS</li> <li>• Acquisition of Payzone finalised</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor and challenge on prep for litigation case</li> <li>• Monitor / challenge preparations for negotiations with BOI including potential buyout of JV</li> <li>• Finalise handover of policy role to BEIS</li> <li>• Agree framework document with HMT and POL</li> <li>• CST sign off for CEO and CFO remuneration</li> </ul>	
<b>How will these be achieved/monitored?</b>	<ul style="list-style-type: none"> <li>• Generally the above rely on the team working with POL, BEIS, and HMT, facilitated by our seat on the Board.</li> </ul> <p>Specifically:</p> <ul style="list-style-type: none"> <li>• Work closely with UKGI and BEIS legal teams on developing legal protocol</li> <li>• Meeting with Perm Sec and BEIS officials to agree transfer of policy role</li> <li>• Work with POL and advisers Fenchurch on BOI and use Board sub-cite to finalise Payzone</li> <li>• Quarterly network meetings</li> </ul>		<ul style="list-style-type: none"> <li>• Above all rely on strong relationships with POL that allow good communication and constructive challenge</li> <li>• Brief Perm Sec and minister on litigation</li> <li>• Invest time in developing relationship with BEIS policy team and achieving clarity of roles</li> <li>• Reviewing Board papers to prepare NED for meetings</li> </ul>	

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## UKGI Quarterly Priorities (2)













	Q1 (April – June)	Q1 Progress Report	Q2	Q2 Progress Report
<b>Threshold reqs.</b> (What MUST be in place)	<ul style="list-style-type: none"> <li>Sufficient UKGI Resource (new ED joining at end of May and will need to "bed in")</li> <li>BEIS sponsorship - sufficient BEIS resource and engagement, which we are struggling to achieve at the moment</li> <li>Good working relationships with Ministers offices, HMT, BEIS (which are currently in a good state)</li> <li>Open engagement by POL</li> </ul>	<ul style="list-style-type: none"> <li>New ED in place</li> <li>BEIS have identified resource for policy sponsorship</li> </ul>	<ul style="list-style-type: none"> <li>ED develops knowledge of POL</li> <li>Clear UKGI sense of desired relationship with BEIS policy team</li> <li>Continued relationship building with POL and Board</li> <li>HMT &amp; BEIS agreement on framework doc</li> </ul>	Weekly teach ins planned on key issues + branch visits planned Joint POL-UKGI session planned to improve relationships
<b>Company culture/people considerations</b>	<p>POL can be protective about sharing information eg :</p> <ul style="list-style-type: none"> <li>Project monitoring and financial performance</li> <li>Litigation case</li> </ul> <p>New Board member Tom Cooper and new ED Tom Aldred, will need to build relationships with the company</p>	Legal protocol agreed TC and TA have met all Board members	<ul style="list-style-type: none"> <li>POL protective of operational independence - may see framework agreement as invasive and overly legalistic</li> <li>Board may be over-ambitious for the capacity of the business (leading to lack of focus)</li> <li>Need to integrate new acquisition into POL</li> </ul>	



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## Traffic Light Analysis

	10/16	01/18	Current	Comments
Company Relationship ("C")				<ul style="list-style-type: none"> <li>The relationship with POL is generally open and fairly collaborative but with room for improvement. POL can perceive UKGI team as asking for 'too much' information</li> </ul>
Governance ("G")				<ul style="list-style-type: none"> <li>Although there is no formal governance or shareholder relationship letter with POL, there is a clearly defined governance relationship set out in POL's articles and a contractual funding agreement that sets out key elements of the shareholder relationship (e.g. access to information). There is also an entrustment letter in place. Currently developing a framework agreement.</li> <li>There are formal financial meetings held every month (and quarterly shareholder meetings) tailored to UKGI's needs, and quarterly reports on investment performance. Access to senior management and others relevant members is also good</li> <li>UKGI administers a complex working capital facility which we would like to transfer</li> </ul>
Quality of Management Team & Board ("T")				<ul style="list-style-type: none"> <li>Board and exec team are generally of good quality. Extension of Chair's term to December 2022 has been approved. CEO despite some identified weaknesses works well with the Chair.</li> <li>There has been some churn at the executive level - recently the Chief Executive of the Financial Service and Telecoms business segment has left and a new Retail Chief Executive has joined. Whilst both are still bedding in, we consider that there is a continuing trend of strengthening the team under the CEO and CFO.</li> <li>There has been no recent Board Effectiveness Review; chair known to be sceptical</li> </ul>
Departmental Relationship ("D")				<ul style="list-style-type: none"> <li>UKGI currently undertakes both policy and shareholder functions, and POL has suffered from a lack of policy sponsorship in BEIS.</li> <li>BEIS have agreed in principle to take over policy function. This should include taking over some time-consuming aspects including correspondence and daily management of a short term loan facility.</li> <li>Meeting with BEIS team in July to flesh out detail and timing.</li> </ul>

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## Traffic Light Analysis

	10/16	01/18	Current	Comments
Financial Performance ("F")				<ul style="list-style-type: none"> <li>POL's financial performance is much improved over the last five years. It achieved its first profit in 16 years of £13m in FY 16/17 and is on track to achieve an operating profit of approximately £36m before subsidies in FY 17/18 (ahead of £28m target). The three year strategy targets £85m by 20/21, so that it will not require ongoing HMG subsidy and investment funding.</li> <li>Better performance has partly been driven by significant cost reductions, although there is scope to do more. New technology provides capability for POL to considerably improve its Management Information.</li> <li>UKGI will be providing close scrutiny and monitoring of POL's performance in delivering against this objective.</li> <li>UKGI also monitors the performance of POL's investments and approves the release of investment funding tranches on a quarterly basis, with a maximum of £210m available in investment funding over the period 18/19 and 19/20.</li> </ul>
Balance Sheet & Risk ("B")				<ul style="list-style-type: none"> <li>The Company has an adequate capital structure - £370m funding agreed to be provided by BEIS over the 3 year period to 2021, State Aid Approval obtained, £950m loan facility extended to March 2021. Treasury approval obtained for a £50m facility for emergency intra-day cash needs for the POL network. UKGI currently working through how this will be operated by BEIS.</li> <li>There is an ongoing litigation being undertaken against Post Office Limited in relation to historic claims about the Horizon IT system. If successful, the quantum of the claims could be substantial. It is worth noting that POL's auditors EY have agreed POL's accounting treatment of this, which is not to create a provision given the lack of claim details to date.</li> <li>POL is considering the buy out of a JV with Bank of Ireland. At over £250m, this would require additional capital funding</li> </ul>

Current Entry in UKGI Dashboard

Asset	Governance - Top Priorities	Assessment	Lead																		
<div>  BEIS</div>	<p><b>UKGI's overarching objective:</b></p> <ul style="list-style-type: none"><li>Shareholder oversight to ensure it delivers on its strategic objectives of (i) maintaining a network of post offices above the 11,500 branches (ii) compliance with the minimum network access requirements and delivery of Services of General Economic Interest, while (iii) operating as an increasingly profitable commercial business aspiring to zero subsidy post 2021.</li></ul> <p><b>Outlook – key issues/upcoming risks, including reputational</b></p> <ul style="list-style-type: none"><li>Network size drops below the 11,500 branches required by funding package and manifesto commitment</li><li>Re- negotiation of critical third party contracts (Royal Mail and Bank of Ireland), both which are fundamental to POL's mails and financial services revenues.</li><li>Civil litigation judges that POL has acted inappropriately or illegally on the "horizon case".</li><li>POL's IT transformation programme results in systems not fit for purpose or service outages.</li><li>BEIS governance relationship with UKGI on POL, discussions are ongoing.</li><li>Establishing a more formal Framework Agreement with POL to govern its relationship with HMG.</li><li>Facilitating the implementation of HMG Financial Inclusion agenda.</li></ul>	<table><tr><td>C</td><td>G</td><td>T</td><td>D</td><td>F</td><td>B</td></tr><tr><td>●</td><td>●</td><td>●</td><td>●</td><td>●</td><td>●</td></tr><tr><td>●</td><td>●</td><td>●</td><td>●</td><td>●</td><td>●</td></tr></table>	C	G	T	D	F	B	●	●	●	●	●	●	●	●	●	●	●	●	Tom
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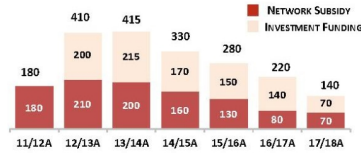
## **Appendices**

## SECTION A: POL'S CURRENT SITUATION

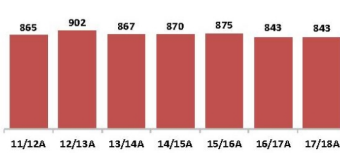
### BENEFITS DELIVERED BY HMG FUNDING SINCE 2011/12

Since separating from Royal Mail POL has delivered progress in many areas of its business. With HMG support the network has been stabilised, pre-subsidy losses have been eradicated, and customers and operators have benefitted through network transformation

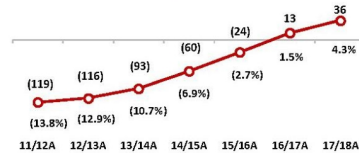
**DOWNWARD TREND IN GOVERNMENT FUNDING**  
(£M TOTAL FUNDING PER YEAR)



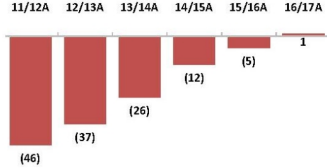
**FLAT REVENUE IN COMPETITIVE OR DECLINING MARKETS**  
(£M GROUP NET REVENUE, POST DIRECT COST OF SALES)



**REDUCED COSTS DRIVING INCREASED PROFITABILITY**  
(EBITDA PRE-SUBSIDY % MARGIN, AND £M)



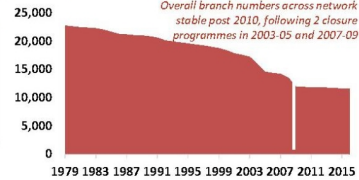
**LOSSES IN THE CROWN NETWORK ELIMINATED**  
(£M EBITDAS)



**STRONG PROGRESS IN NETWORK TRANSFORMATION**  
(NUMBER OF BRANCH MODERNISATIONS)



**BRANCH NUMBERS ACROSS NETWORK**  
STATIC FOR FIRST TIME IN DECADES (# BRANCHES)



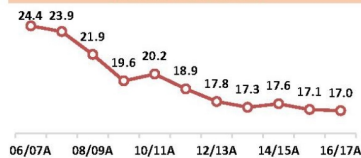
## SECTION A: POL'S CURRENT SITUATION

### CHALLENGES FACING THE POST OFFICE NETWORK

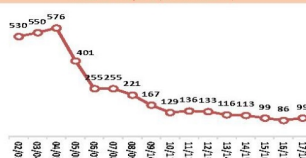
*In recent years POL has had to confront declining customers, falling revenue in traditional markets and increasing competition. Recently a number of new internal challenges have also emerged, particularly around commercial contracts and POL's relationships with its subpostmasters*

#### 30% DECLINE IN NETWORK FOOTFALL SINCE 2006/7

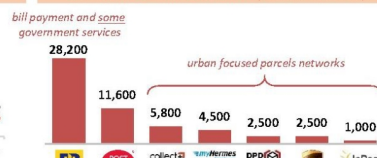
(MILLIONS OF CUSTOMER SESSIONS)



#### 80% DECLINE IN GOVT. SERVICES REVENUE SINCE 2002/03 (£M NET INCOME)



#### SIGNIFICANT EXPANSION OF COMPETITOR NETWORKS ERODING POL'S MARKET POSITION (# COMPETITOR OUTLETS)



#### POL NEEDS TO RENEGOTIATE AND REALIGN ITS LARGEST TWO COMMERCIAL RELATIONSHIPS

**Royal Mail**  
2016/17A Value  
£337m revenue

POL's 2012 contract with RM did not envisage how mail or parcel markets would develop (or RM's responses). An opportunity now exists to reset key aspects of the relationship

**Bank of Ireland**  
2017A Value: c.£70-90m revenue plus c.£35m FX profit share

POL plans to renegotiate its relationship with BoI to agree a shared strategy for savings and lending, to get freedom to work with other providers for certain products and to get a better share of profit in foreign exchange products

#### POL RELIES ON HIGH COST, POORLY SUPPORTED AND INFLEXIBLE IT WHICH OPERATES OUTSIDE OF THE BOARD'S RISK PARAMETERS



Point-of-sale system is >15 years old and POL's enterprise software is no longer supported. Front and back office outages are increasing, impacting the ability of branches to serve customers



Replacement printers are no longer available, meaning the existing estate must be cannibalised for spares to keep branches functioning



POL relies on dedicated datacentres which are more costly, less flexible and less secure than the cloud solutions used by competitors

#### SUBPOSTMASTER INCOME IS FALLING, INCREASING STRAIN ON LESS VIABLE BRANCHES (£M SUBPOSTMASTER COSTS)



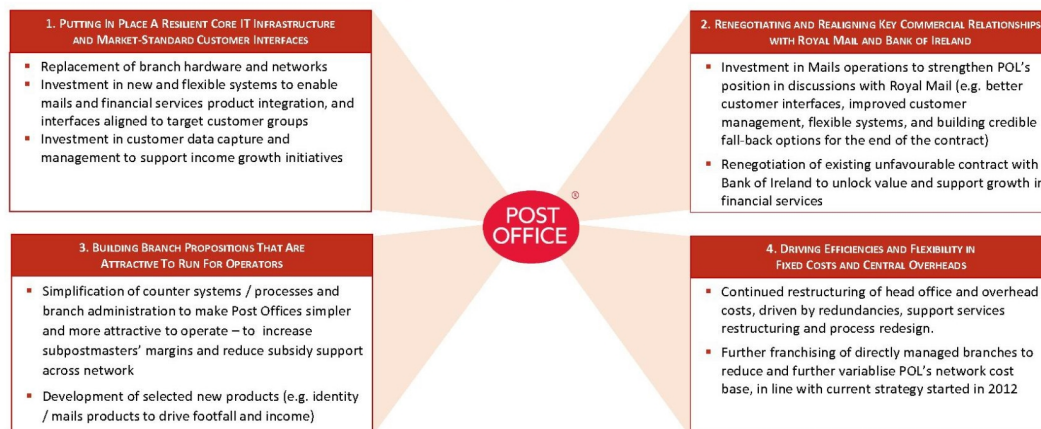
Declining post office income makes it more important for branches to be co-located with retail outlets, which has helped to keep the network stable

But Post Office is increasingly competing for retail space in convenience stores. Their current offering to agents is complicated. Alternatives (e.g. hot food counters) can drive greater margin and footfall relative to the effort and space involved.

## SECTION A: POL'S CURRENT SITUATION

### SUMMARY OF OPPORTUNITIES TO PROTECT, DIVERSIFY AND GROW POL'S BUSINESS

*POL has identified a number of opportunities to address challenges and build on recent progress to develop a sustainably profitable organisation. These centre around strengthening core infrastructure, rebalancing key commercial relationships, improving its offering to network operators and driving further efficiencies in central costs. All require financial investment.*

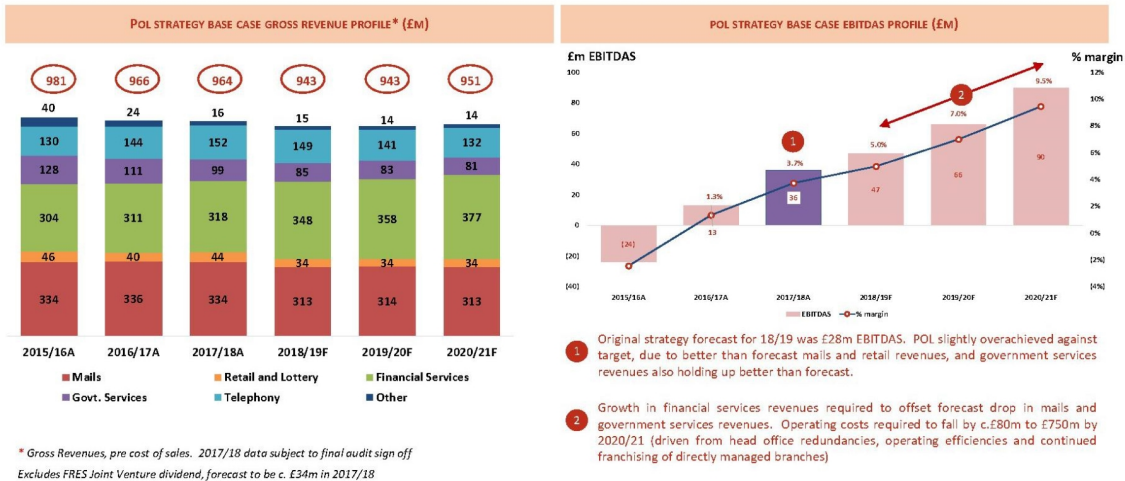


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## SECTION B: POL'S STRATEGY AND INVESTMENT PLANS

### FINANCIAL SUMMARY OF POL'S PROPOSED STRATEGY

POL's strategy sees income decrease by a CAGR\* of 0.6% between 2015/16 and 2020/21, driven by declines in selected mails products and in retail and government services revenues, countered by continued growth in financial services and moderate growth in telephony. Over the period POL expects EBITDAS to increase from a £13m profit in 16/17 to a profit of c£90m by end of 20/21





## SECTION B: POL'S STRATEGY AND INVESTMENT PLANS

### OVERVIEW OF CORE AREAS OF INVESTMENT SPENDING

	ACTION	£m	COMMENT
Non-Discretionary Investments	Branch IT Investments	£120m - £140m	<ul style="list-style-type: none"> <li>Redesigning, building and hosting replacement point-of-sale terminals and replacing end-of-life hardware. All of these are needed to bring POL back in-line with the competition and to help make sure the network can function day-to-day</li> </ul>
	Essential IT Upgrades		<ul style="list-style-type: none"> <li>Urgent investment in measures to prevent system outages and failures, as well as back office operating systems upgrades and new security systems and command centre</li> </ul>
	Modernising IT Architecture		<ul style="list-style-type: none"> <li>New supporting service contract with ATOS and buy-out of contracts with Computacenter to regain operational flexibility and control needed to deliver wider IT plans</li> </ul>
	Network Development		<ul style="list-style-type: none"> <li>POL's current transactions and administrative processes are complex, making POL uncompetitive and branches unattractive to run. In response to pressure from clients and current and prospective operators' POL is investing to streamline transactions to reduce time and training burdens on operators. This will mitigate risks to network stability</li> </ul>
	Maintenance Capex		<ul style="list-style-type: none"> <li>Annual investment including in branches (basic IT checks, desks, fascia etc), head office, property/vehicle maintenance and regulatory requirements</li> </ul>
Cost Reduction Investments	Other Branch IT Upgrades	£160m - £200m	<ul style="list-style-type: none"> <li>Replacement of counter printers and enhanced "cloud" based hardware to integrate to new point of sale terminals</li> </ul>
	Other Modernising IT Architecture		<ul style="list-style-type: none"> <li>Renegotiating contract with Fujitsu to reduce future IT running costs, as well as cost of developing a new digital platform to support growth in FS, Identity and Mails</li> </ul>
	Other Network Development		<ul style="list-style-type: none"> <li>Investment to reduce subsidy paid to branches that do not need it to be sustainable, to increase the number of branches (i.e. network "headroom") giving POL flexibility to manage churn effectively for customers, to increase the availability of self-service kiosks in the network, integration of new point of service terminals across the network, on-site support for sub-postmasters and to actively manage format changes for unviable small branches.</li> </ul>
	Network Transformation		<ul style="list-style-type: none"> <li>Ongoing cost of existing NTP programme that is due to finish by 18/19</li> </ul>
	Central Cost Savings		<ul style="list-style-type: none"> <li>Despite significant restructuring and redundancies in recent years POL believes more headcount efficiencies are possible, via organisational redesign (e.g. changing the functions performed within the business), process redesign (e.g. changing where, how and by who functions are delivered) and spend prioritisation (e.g. squeezing discretionary spend).</li> </ul>
Growth / Income Investments	Branch Franchising	£90m - £110m	<ul style="list-style-type: none"> <li>Management have plans to franchise a further c.100 owned branches in the new funding period (c.100 have so far been franchised since 2012). These branches are lower cost, variable the cost base and they also deliver improved customer outcomes (e.g. better hours, environments and accessibility, etc.) improving POL's long-run sustainability.</li> </ul>
	Mails		<ul style="list-style-type: none"> <li>Investment in existing Mails business to give RM confidence that POL can deliver improvements to its service (e.g. online integration to prevent POL being bypassed by Royal Mail). Additional investment in customer-focused initiatives such as new timed and tracked products, a better offering to SMEs (e.g. a Small Business Club, and collections support for large SME mailers) and customer data capture and recognition systems.</li> </ul>
	Post Office Money		<ul style="list-style-type: none"> <li>Development of a better, more customer focused and integrated financial services business with the launch of new products, a more effective sales capability and new digital systems to retain and up-sell customers more easily.</li> </ul>
	Identity		<ul style="list-style-type: none"> <li>Build spend for a new common Identity Services platform and in-branch biometric capabilities (to provide digital passport photos and other information), to consolidate POL's already leading position in this market and to open up the identity services offer to a wider range of public and private sector customers.</li> </ul>
	Data and Analytics		<ul style="list-style-type: none"> <li>Investment in digital and brand initiatives to allow POL to collect and use customer data more effectively, across all areas of its business and to retain customers (e.g. through the creation of a "digital branch").</li> </ul>
TOTAL		£370m to £450m	To fund this investment programme POL has been allocated up to £210m of investment funding, with a maximum of £168m available (spread over quarterly drawdowns) in 2018/19, and the remaining balance available in 2019/20 (again over quarterly drawdown). POL will fund the remaining required spend from its own resources.