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EXTRACTS OF THE PROSPECTUS FOR POL

1. Risk Factor 1.17 (The Group's relationship with POL exposes it to a number of material risks)

Post Office branches serve as the Group's principal retail distribution network in the UK and the Group's agreements with POL limit its ability to use other retail channels

The UK's network of around 11,500 Post Office branches is a key sales channel for the Group's products and services in the UK and serves as the Group's principal retail distribution network in the UK. The Group's relationship with the Post Office is of material significance to the business and revenue of the Group. In FYE 2013, approximately £1.7 billion of the Group's revenue was generated through the sale of the Group's products and services by POL on the Group's behalf.

Under the Mails Distribution Agreement (further detail on which can be found in section 16.2 of Part XI (*Additional Information*)) between RMG and POL, POL sells the Group's letter and parcel services, under both the "Royal Mail" and the "Parcelforce Worldwide" brands, to customers on behalf of RMG. Part of the UK's Post Office network is used to satisfy part of RMG's obligation to provide access points for universal postal services under the designated universal service provider condition issued by Ofcom in March 2012. Post Office branches also serve as points for the collection of letters and parcels by customers (including pursuant to the "click and collect" service announced by the Group in May 2013).

The Mails Distribution Agreement imposes a number of limitations on the ability of the Company to use third party retail outlets for the sale or distribution of its products and services. The Group may be required to use POL's branch network as the retail outlet for any new products or services it wishes to introduce even if in the future there are circumstances in which POL may not be the Group's preferred retail partner, with the potential result that the Group is not able to realise all or part of the benefits that it expects from that new product or service. [This gives the impression that the 10 year MDA is a shackle for RM – needs to be balanced with the positive point that it gives RM exclusive access to the UK's largest retail network – can they add language to make that point upfront?]. The Group is also reliant to an extent on POL to ensure that Post Office branches provide a physical estate and environment in which customers want to purchase the Group's products and services or ask for advice on sending items through the post. [This would be true of any retail partner – risks giving the impression that RM have specific doubts about our commitment to customer service – perhaps insert "As would be the case with any retail partner," at the start of this sentence to soften the impact.] Furthermore, the Group's ability to introduce new products and services may be adversely affected by operational and logistical problems and limitations that may be encountered by POL. As an example, the Group is reliant on POL in connection with the successful implementation of its new "click and collect" service. [Would prefer they didn't pick out click and collect as an example – this is an important initiative, and it gives the impression that there are specific concerns around implementation. Suggest this sentence is deleted.] Any limitations in POL's IT systems, and their ability to interface with the Group's own IT systems, may affect the ability of the Group to introduce new products or services through POL's branch network, including the success of Royal Mail's new "click and collect" service. [as above – delete reference to C&C]

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Although the Group sells stamps through other sales channels, revenue generated for the Group under the Mails Distribution Agreement represents a significant proportion of the Group's total revenue and this, combined with the limitations accepted by RMG on its ability to use other retail outlets in addition to Post Office branches, means that the Group has a significant reliance on POL and POL's ability to meet its service obligations under the Mails Distribution Agreement.

Risk of material operational failure by POL

Any material failure by POL to meet its obligations under the Mails Distribution Agreement (including as a result of any further industrial action by POL's employees) could result in retail customers not being able to purchase the Group's products and services at Post Offices, which could have a material adverse effect on the Group's reputation, business, results of operations, financial position and prospects. POL is in the process of implementing its own modernisation programme in relation to its network of Post Office branches which may lead to service and quality disruptions, including as a result of industrial action, or lack of cooperation, by POL's employees, agents or others acting on its behalf. [This needs to be balanced with the positive side of modernisation i.e. improved customer experience and longer opening hours. By itself the current language creates a very misleading impression – customer satisfaction in the first 1000 new branches is at 98%!!]

The Group is also dependent on the effective operation of POL's IT systems for the successful functioning of the retail distribution services which POL provides for the Group's products and services. In July 2013, an interim report was published into alleged problems with POL's "Horizon" computer system, which is used to record transactions in its branch network. The report confirmed that no system wide problems had been found in relation to the "Horizon" software, but suggests that POL should examine its support and training processes for sub-postmasters. [Would strongly prefer this sentence on the SS review is deleted – not needed to make the point that there are inherent risks related to IT. By including here it directly undermines the conclusion that there are no system wide problems.] Any material failures in POL's IT, or other, systems, including their interface with the Group's own IT systems, could cause material disruption to the operations of the Group and could affect the ability of POL to provide the retail distribution services it provides for the Group's products and services. Any of the foregoing events could have a material adverse effect on the Group's reputation, results of operations, financial condition and prospects.

Possible termination or expiry of the Mails Distribution Agreement

The provision of services under the Mails Distribution Agreement commenced on 26 March 2012, and the agreement will continue in force until at least the tenth anniversary of the date the agreement was signed (19 January 2012), subject to termination or review in certain limited circumstances before the end of such period. Although the Group would have notice of POL's intention not to renew the agreement and would have the opportunity to develop alternative distribution arrangements, the termination or expiry of the agreement would result in the Group ceasing to have access to its principal retail distribution network in the UK which could have a material adverse effect on the business, results of operations, financial position and prospects of the Group. If the agreement were renewed or extended so that it did not expire in accordance with its terms, the new terms of any agreement with POL may be less favourable to the Group than the terms on which the current arrangements were concluded. Any

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deterioration in the terms on which the Group and POL contract could have a material adverse effect on the Group's results of operations, financial condition and prospects.

Further, the Mails Distribution Agreement provides for a number of renegotiation events whereby RMG and POL are to meet in good faith to enter into discussions with a view to agreeing amendments to the agreement. Under one such renegotiation event, the Mails Distribution Agreement and its operation will be reviewed by the parties within six weeks following the fifth anniversary of the commencement date to ensure that it continues to meet both parties' expectations and takes into account changing market dynamics over the first five years of the term. [I think this is the first time that the 5 year review point in the MDA has been publicly disclosed – can understand RM may need to disclose this, but carries very significant political and stakeholder risks – will need to be ready with Q&A and wider comms to reinforce 10 year commitment.] There is a risk that, following the occurrence of a renegotiation event under the Mails Distribution Agreement, the terms of any new agreement with POL may be less favourable to the Group than terms of the current agreement. Any deterioration in the terms on which the Group and POL contract could have a material adverse effect on the Group's results of operations, financial condition and prospects.

Public perceptions that Royal Mail and POL are the same entity

There remains a perception on the part of some customers of the Group and some members of the general public in the UK that the "Post Office" and "Royal Mail" are the same entity. Any operational failure, disruption or industrial action in the Post Office branch network, and/or any other business or commercial decisions taken by POL, could therefore be perceived as decisions taken by, or events relating directly to, the Group and adversely affect the reputation and brand of the Group. In particular given this perception on the part of some customers and members of the general public, any failure in POL's IT or other systems (including any failure which affects POL's ability to sell the Group's products and services) may lead to adverse publicity and adversely affect the reputation and brand of the Group.

The Group faces risks associated with the separation of POL's IT systems and infrastructure from those of the Group

POL is currently heavily dependent on the Group for the provision of IT services under the Master Services Agreement, including certain services provided through the Group's external IT suppliers. The IT services provided by the Group to POL are complex and cover a range of areas. They include services supporting the customer-facing sales operations of POL, as part of which POL retails the Group's products and services in post office branches across the UK. [Suggest this last sentence is deleted as not wholly accurate – the main customer-facing IT system (i.e. Horizon) is provided by POL not RM.] As a consequence, any failure of the Group's IT systems and infrastructure (or the failure of any external supplier through whom the Group provides services to POL) may impact the ability of POL to retail the Group's products and services. Moreover, any failure in the Group's own IT systems, infrastructure or estate which affects the level of service which it is able to provide to POL may lead to adverse publicity and reputational damage for the Group. The Group and POL are undertaking a joint project to deliver the required standalone IT capability for POL in order to facilitate the cessation of the provision of IT services by the Group to POL. The project is currently scheduled to be completed by September 2014, when the provision of IT services to POL under the Master Services Agreement is due to terminate, however it is likely that POL will

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require ongoing IT services from the Group (and its external IT suppliers) after September 2014. Further details regarding the separation of POL's IT systems and infrastructure from those of the Group can be found in section 9.4 of Part II (*The Business*).

The ITST Programme (which is described further in section 1.14 of these Risk Factors) faces certain risks if the separation of POL's IT systems and infrastructure from those of the Group has not been completed by the time the Group transitions to its new IT arrangements as part of the ITST Programme. If this occurs, the Group may be required to delay the implementation of the ITST Programme. Alternatively, the scope of the ITST Programme, which does not currently include the provision of ongoing services to POL, may need to be changed to include the provision of services to POL. This could expose the Group to a challenge that the ITST Programme it is not compliant with public procurement law, which, if successful, could have a number of material adverse consequences for the Group including the suspension of the ITST Programme or the award of a contract under the ITST Programme being deemed void and unenforceable. The ongoing provision of IT services to POL during the ITST Programme transition period would add considerable complexity to the transition, which would require the transition of additional services (or volumes of services) to the external suppliers selected as part of the ITST Programme. Such complexity may affect the level of service assurance which the Group could provide to POL during the ITST Programme transition period and would be likely to result in the need for the devotion of significant additional management time and other Group resources. In addition, the completion of the separation of POL's IT from that of the Group following the transition to the ITST Programme may adversely impact the Group's ability to execute its ongoing IT transformation activities. Any of the foregoing events could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group faces a number of risks associated with the separation of POL's IT systems and infrastructure from those of the Group. The separation of POL's IT from that of the Group is a complex project which requires significant management time and other Group resources. Moreover, any failure or delay in completing the separation of POL's IT from that of the Group may lead to adverse publicity and reputational damage for the Group. Although the Group does not currently anticipate any material impediments in this regard, it may not, for technical reasons, be possible to achieve the entire separation of POL's IT systems and infrastructure from those of the Group as currently planned. As a result, POL may continue to be dependent on the Group for the provision of all or part of its IT systems and infrastructure in the future. The ongoing provision of IT services by the Group to POL would be likely to require significant management time and other Group resources. Any of the foregoing events could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

From Admission, the Group and POL will cease to be under common ownership

Prior to Admission, the Group and POL will be wholly-owned subsidiaries of the Selling Shareholder (and thereby, HM Government) but this will cease from Admission. Following Admission, POL will remain under the ownership of the Selling Shareholder (and thereby, HM Government). There is therefore a risk that the Group's relationship with POL may change when they cease to be wholly-owned by, and under the control of, a common shareholder. Furthermore, it is possible that changes to the policy of HM Government in the future in relation to the size, scope and purpose of the Post Office network (including as a result of, or in

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connection with, any mutualisation of POL pursuant to the PSA), as well as any decision by POL itself to rationalise the number of branches in the Post Office network, could lead to a reduction in the number of Post Office branches in the UK at which customers are able to purchase “Royal Mail” and “Parcelforce Worldwide” products and services. [Need very clear statement here that both current Government policy and commercial strategy are focussed on maintaining the branch network – otherwise leaves misleading impression that a closures programme is on the cards…] While, in the Mails Distribution Agreement, POL has agreed to use its reasonable endeavours to maintain a network of at least 11,500 Post Office branches until at least the end of March 2015 and, subject to additional HM Government funding (and State Aid clearance), beyond 31 March 2015, any reduction in the size of the Post Office branch network could have a material adverse effect on the Group’s results of operations, financial condition and prospects. Further information in relation to HM Government policy with respect to the Post Office can be found in Part V (*Relationship with HM Government*).

Draft European Directive relating to transactions in “vouchers”

In May 2012, the European Commission published a proposal for a Directive to change the VAT treatment of transactions in, or concerning, “vouchers” under the provisions of the Directive of 28 November 2006 on the Common System of Value Added Tax (Directive 2006/112/EC). The definition of a “voucher” in the draft Directive does not refer specifically to postage stamps but is expressed in terms which would be likely to encompass postage stamps.

It is uncertain whether this draft Directive will be adopted by the EU member states, either in its current form or in some amended form. Nor is it certain when the draft Directive, if so adopted, would be implemented in UK law. However, if the draft Directive were to be adopted in its current form, the resultant changes to the UK VAT treatment of transactions in postage stamps would potentially give rise to an increased cost for the Group. This is because the Mails Distribution Agreement between RMG and POL described in section 16.2 of Part XI (*Additional Information*) provides, as more fully explained in that section, for a substantial part of the remuneration earned by POL under that Agreement to accrue to POL, once RMG and POL have ceased to be members of the same VAT group (which, as there explained, they will do if, upon implementation of the Offer, HM Government no longer holds a majority interest in RMG and may do in other circumstances), as profit margin on the purchase and sale by POL of Royal Mail postage stamps (the "**POL Margin**"). It has been proposed to HMRC that the POL Margin should not, under current law, be liable to VAT and HMRC have accepted this in respect of part of the POL Margin. The implementation in UK law of the draft Directive in its current form would potentially change that treatment and require POL instead to account for VAT on the whole of the POL Margin. The resultant additional irrecoverable VAT cost to be borne by RMG in that event could have a material adverse effect on the Group’s results of operations, financial condition and prospects.

2. Paragraph 1 (Overview of the Business) of Part II

The Group is the leading provider of postal and delivery services in the UK, with significant operations in continental Europe.

The Group’s origins date back nearly 500 years to the time of King Henry VIII. Today, the Group’s core business is the collection, sorting, transportation and delivery of parcels and

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letters in the UK, leveraging its unique networks and powerful brands, which underpin leading positions in the UK's parcels and letters delivery markets. It is the UK's designated universal postal service provider and delivers a "one price goes anywhere" service on a range of parcels and letters products in the UK. The Group's UK business is complemented by its ownership of GLS, which operates one of the largest ground-based deferred parcels delivery networks in Europe. In FYE 2013, the Group handled more than 17 billion letters and more than 1.4 billion parcels across all of its networks.

The Group operates through two core divisions, UKPIL and GLS.

UKPIL collects and delivers parcels and letters predominantly through two networks: the Royal Mail Core Network and Parcelforce Worldwide. It provides collection and delivery services under the "Royal Mail" and "Parcelforce Worldwide" brands. The functions of RMG as the UK's designated universal postal service provider are discharged through UKPIL. Through the Royal Mail Core Network, Royal Mail delivers parcels and letters, and has the capability to deliver to more than 29 million business and residential addresses in the UK six days a week (excluding UK public holidays). Parcelforce Worldwide is a separate UK network, which collects and delivers express parcels. At the end of Q1 FYE 2014, UKPIL employed 149,437 employees.

GLS comprises the Group's European parcels business and is focused on the deferred parcels segment. GLS operates in 23 countries and nation states through wholly-owned members of the GLS Group and franchisees, and covers an additional 14 countries and nation states through network and service partners of the GLS Group, which include Parcelforce Worldwide in the UK. The GLS Network is one of the largest ground-based deferred parcel delivery networks in Europe. GLS's main markets are Germany, Italy and France, and in FYE 2013 revenues generated in these markets contributed approximately 70 per cent. of GLS's total revenue. The Group's ownership of GLS delivers a number of strategic benefits for the Group, including geographic earnings diversification, its ability to generate cash which can be used to fund investment in other parts of the Group's business, a means to capture growth in cross-border parcels and opportunities for sharing operational excellence within the Group. At the end of Q1 FYE 2014, the GLS Group employed 13,523 employees.

"Royal Mail" is a household name in the UK with a reputation for delivering operational excellence. The Group is a trusted partner for consumers and businesses across the UK and Europe.

In FYE 2013, the Group generated revenue of £9,146 million and operating profit after transformation costs of £598 million. In FYE 2013, UKPIL accounted for approximately 83 per cent. (£7,633 million) of the Group's revenue and 73 per cent. (£294 million) of its operating profit after transformation costs. In the same period, GLS accounted for 16 per cent. (£1,498 million) of the Group's revenue and approximately 25 per cent. (£101 million) of its operating profit after transformation costs. In FYE 2013, approximately 48 per cent. of the Group's revenue (£4,477 million) was generated from parcels.

In Q1 FYE 2014, the Group generated revenue of £2,304 million and operating profit after transformation costs of £164 million. In Q1 FYE 2014, UKPIL accounted for approximately 82 per cent. (£1,898 million) of the Group's revenue and approximately 80 per cent. (£132 million) of its operating profit after transformation costs. In the same period, GLS accounted for

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approximately 17 per cent. (£402 million) of the Group's revenue and approximately 19 per cent. (£31 million) of its operating profit after transformation costs.

Since FYE 2008, Royal Mail has been undergoing a radical transformation programme which has covered every aspect of its operations, namely: collection, processing, logistics, sorting and delivery. The Group has improved the productivity and effectiveness of the Royal Mail Core Network, which has traditionally been focused on the delivery of letters, and is now well-positioned to benefit further from predicted levels of growth in the overall UK parcels market, while continuing to deliver high levels of service as the UK's universal postal service provider.

In recent years, the operating environment for the Group has changed following the transition to a new and more supportive regulatory framework in the UK, the development of improved relationships with trade unions representing the Group's employees in the UK and the transfer to HM Government of the Group's pre-1 April 2012 pension liabilities (based on service and pay up to that date) and certain pension assets relating to the Royal Mail Pension Plan.

In April 2012 RMG transferred Post Office Limited to the Selling Shareholder. POL operates the UK's network of around 11,500 post office branches. The Group and POL have entered into a long-term distribution agreement under which POL (as agent of RMG) sells the Group's retail products and services (under the "Royal Mail" and "Parcelforce Worldwide" brands) to customers on behalf of RMG across the UK's Post Office branch network. Customers contract with RMG for the provision of the retail product or service which they have purchased through the agency of POL. Under the agreement POL currently receives commission payments from RMG for each product or service sold plus a fixed annual fee. In FYE 2013, approximately £1.7 billion of the Group's revenue was generated through the sale of the Group's products and services by POL on the Group's behalf. In FYE 2013, the Group made payments of approximately £371 million to POL, including the annual fee and commission payable under the Mails Distribution Agreement as well as payments in respect of other operational items. Following Admission, POL will remain in the ownership of HM Government.

3. Paragraph 9 (Group's relationship with the Post Office) of Part II

Post Office Limited

Post Office Limited operates the UK's network of around 11,500 Post Office branches. It is one of the UK's largest retail networks. Post Office branches can be found across the UK and around 99 per cent. of the UK population live within three miles of a branch. In recent years, the Post Office branch network has begun to change and in many cases branches now offer longer opening hours with some branches opening seven days a week. The Post Office is currently implementing its own "Network Transformation Programme" which aims to further modernise Post Office branches and offer extended opening hours to customers.

Royal Mail and Parcelforce Worldwide retail products and services can be purchased by customers through the Post Office branch network under the terms of the Mails Distribution Agreement described further below in this Part and in section 16.2 of Part XI (*Additional Information*). POL sells the Group's products and services as agent of RMG and, accordingly, customers contract with RMG for the provision of the retail product or service which they have purchased through the agency of POL. Customers purchasing the Group's retail products and services at Post Office branches fall mainly within the consumer and SME segments.

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In addition to the sale of Royal Mail and Parcelforce Worldwide products and services, Post Office Limited provides a range of its own products and services, including savings, mortgages, government services, foreign currency and travel insurance.

Following Admission, Post Office Limited will remain under the ownership of HM Government.

Further information on the Group's relationship with POL can be found below in this Part and in section 3 of Part V (*Relationship with HM Government*).

Historical relationship and separation in 2012

Prior to separation in April 2012, POL was a subsidiary of RMG.

The PSA provided for the introduction of private capital into Royal Mail and its transfer out of public ownership. By contrast, the PSA provided that POL would remain in public ownership, with the possibility that a mutual structure may be introduced in the future. In addition, the PSA made provision to address the historic pension deficit of the Royal Mail Pension Plan by transferring the pre-1 April 2012 pension liabilities (based on service and pay up to that date) to HM Government. On 1 April 2012, following the transfer of such liabilities to HM Government, the ownership of POL was transferred from RMG to RMH.

Prior to separation in April 2012, all staff of the post office business who were employed by RMG were seconded to POL under an undocumented secondment arrangement. Therefore, as part of the separation process, such secondment arrangement was terminated pursuant to a deed dated 23 March 2012 and the employment of Post Office staff transferred to POL under the Transfer of Undertakings (Protection of Employment) Regulations 2006 on 1 April 2012. Part of the separation project also involved POL being admitted to participate in the Group's various UK pension arrangements.

As part of the separation process, RMG and RME transferred or granted leasehold interests to POL in respect of certain properties which POL required to operate its business. This was effected pursuant to: (i) a transfer scheme made on 28 March 2012, which transferred certain properties owned by RMG or RME but which were wholly occupied by POL with effect from 1 April 2012; and (ii) a second transfer scheme made on 27 March 2013, which provided for the transfer, or the grant of leases in respect of, certain properties which were partly occupied by RME or RMG and partly occupied by POL with effect from 31 March 2013. Both transfer schemes were made by RMH, and approved by the Secretary of State, pursuant to the PSA.

Current relationship

To prepare for separation, two key agreements governing the Group's ongoing relationship with POL were signed in January 2012.

Mails Distribution Agreement

Under the Mails Distribution Agreement, POL (as agent of RMG) sells the Group's retail products and services (under the "Royal Mail" and "Parcelforce Worldwide" brands) to customers on behalf of RMG across the UK's Post Office branch network. Accordingly, customers contract with RMG for the provision of the retail product or service which they have

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purchased through the agency of POL. POL currently receives commission payments from RMG for each product or service sold plus a fixed annual fee. In FYE 2013, approximately £1.7 billion of the Group's revenue was generated through the sale of the Group's products and services by POL on the Group's behalf.

Post Office branches also act as a drop off point for Royal Mail prepaid items and can be designated as a customer collection point for items sent using Royal Mail services. Royal Mail is the only postal operator which uses POL either as a retailer of services or as an acceptance or collection point for postal items. The provision of services under the Mails Distribution Agreement commenced on 26 March 2012 and the agreement will continue in force until at least the tenth anniversary of the date it was signed (19 January 2012), subject to termination or review in certain circumstances before the end of such period. No changes are proposed to be made to the Mails Distribution Agreement in connection with Admission.

Post Office branches are a key sales channel for the Group's products and services in the UK and serve as the Group's principal retail distribution network in the UK. The Group's relationship with the Post Office is of material significance to the business and revenue of the Group.

Master Services Agreement

The Master Services Agreement is an agreement under which the Group provides certain services, including IT and finance services, to POL on a transitional basis. The separation process is ongoing as the parties work together to facilitate the migration of POL away from transitional services provided by the Group. Further information regarding the provision of IT services by the Group to POL under the Master Services Agreement is set out below.

Further details on the Mails Distribution Agreement and the Master Services Agreement can be found in section 16.2 of Part XI (*Additional Information*). In FYE 2013, the Group made payments of approximately £371 million to POL, including the annual fee and commission payable under the Mails Distribution Agreement as well as payments in respect of other operational items.

"Click and collect"

In May 2013, Royal Mail announced that, working with the Post Office, it will be launching the UK's largest "click and collect" network. The new service will allow online shoppers to opt to collect the products they have purchased from one of approximately 10,500 nominated Post Office branches (to which items are then delivered using the Royal Mail Core Network).

Provision of IT services to POL and POL IT separation

The IT services provided by the Group (including through its external IT suppliers) to POL under the Master Services Agreement are complex and cover a range of areas. They include network and telecommunications services, e-business services, infrastructure services and IT systems supporting a number of POL's "back office" and central functions. The IT services provided by the Group also support the customer-facing sales operations of POL, as part of which POL retails the Group's products and services under the terms of the Mails Distribution

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Agreement. POL is heavily reliant on the IT services provided by the Group under the Master Services Agreement.

The Group and POL are currently undertaking a joint project to deliver the required standalone IT capability for POL in order to facilitate the cessation of the provision of IT services by the Group to POL. The completion of the separation of POL's IT from that of the Group is a key strategic project for the Group, given the dependency that POL has on the IT services currently provided by the Group and the ongoing implementation of the ITST Programme, which is further described in section 12.3 below. The separation project is complex as a result of the large volume and complexity of the IT services currently provided by the Group to POL under the Master Services Agreement. The separation project involves more than 200 separation items which have been grouped into 17 workstreams.

The project is currently scheduled to be completed by September 2014, when the provision of IT services to POL under the Master Services Agreement is due to terminate. However, in order to meet that deadline, POL will need to complete a number of critical projects, including the creation of new POL network solutions; the creation of a POL supply chain solution; the implementation of a new POL web presence; the building of a POL contact centre telephony capability with POL specific systems; and the implementation of standalone POL finance systems and reporting capability.

The Group believes that POL will need to undertake significant additional work in order to complete these projects by September 2014. Therefore, it is likely that POL will require some ongoing IT services from the Group (and its external suppliers) after September 2014. POL may request an extension to the provision of IT services under the Master Services Agreement in order to continue to receive those services. Further details regarding the Master Services Agreement can be found in section 16.2 of Part XI (Additional Information). As a result, if POL is not able to complete its separation projects in time and there are delays to completion of the projects beyond September 2014, the Group would plan to include the services provided to POL in the ITST Programme. These services would then be transitioned to the Group's new suppliers as part of the ITST Programme and the separation of POL's IT from the Group would be completed after completion of this transition to new suppliers.

RMG and POL are continuing to develop plans for the separation. The Group faces a number of risks associated with the ongoing provision of services to POL under the Master Services Agreement and the project for the separation of POL's IT, which are described further in section 1.17 of the Risk Factors.

4. Paragraph 3 (The Group's relationship with POL) of Part V

The Group has a significant trading relationship with POL pursuant to which POL provides retail letters and parcels services to customers on behalf of the Group through its Post Office branch network in the UK. Post Office branches serve as the Group's principal retail distribution network in the UK and are of material significance to the business and revenue of the Group. The UK's Post Office branch network is used to satisfy part of the Group's obligation to provide access points for universal postal services. In FYE 2013, approximately £1.7 billion of the Group's revenue was generated through the sale of the Group's products and services by POL

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on the Group's behalf. Further details of the relationship between the Group and POL are summarised in section 9 of Part II (*The Business*) and section 16.2 of Part XI (*Additional Information*).

In responding to the Third Report of the House of Commons Business, Innovation and Skills Committee entitled "Post Office Network Transformation" published on 16 July 2012, the Department for Business, Innovation and Skills, on behalf of HM Government, stated on 16 October 2012 that it has committed £1.34 billion over the duration of the current Parliament to both maintain the size of the network at its current size of at least 11,500 branches, and to modernise around 6,000 post offices, including in-branch improvements for both customers and sub-postmasters. In that response, HM Government also stated that public funding ensures that there will be no programme of post office closures in the current Parliament. POL is wholly-owned by the Selling Shareholder. The PSA provides that no disposals of HM Government's interest in POL may be made except by way of mutualisation. In its response referred to above, the Department for Business, Innovation and Skills, on behalf of HM Government, stated that there should be progress made towards mutualisation of the Post Office prior to the end of the current Parliament.

5. Paragraph 16.2 (Agreements with POL) of Part XI.

(A) Mails Distribution Agreement

The Mails Distribution Agreement ("**MDA**") entered into between RMG and POL on 19 January 2012 governs the provision by POL (as agent for RMG) of retail letters and parcels services to RMG and its customers.

Under the terms of the MDA, POL provides certain services to the Group and customers of RMG, and (as agent for RMG) sells stamps and Royal Mail and Parcelforce Worldwide products and services to customers through Post Office branches from 26 March 2012 (the "**Commencement Date**") until at least the tenth anniversary of the date of the MDA (the "**Term**"), subject to termination or review in certain circumstances before the end of such period. In return for the sale of the Group's product and services, POL currently receives commission payments from RMG for each product or service sold plus a fixed annual fee. Customers contract with RMG for the provision of the retail product or service which they have purchased through the agency of POL. Pursuant to the MDA, Post Office branches also act as access points at which RMG customers can deposit or collect letters and parcels.

Subject to certain adjustments, under the MDA POL must pay RMG the aggregate of: (i) the amount of revenue collected by POL on behalf of RMG from RMG customers in respect of services and products provided under the MDA; and (ii) the aggregate face value of all stamps sold by POL as agent and as principal, to RMG in respect of a trading week (being from Monday to the following Sunday, inclusive) in immediately availably funds no later than close of business on the first Monday following the end of that trading week.

Under the MDA, POL maintains a network of post office branches to enable RMG to comply with its obligations as the UK's designated provider of universal postal services, agreeing to use its reasonable endeavours to maintain a network of at least 11,500 post office branches until at least the end of March 2015 and, subject to additional HM Government funding (and State Aid clearance), beyond 31 March 2015.

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RMG sells postage stamps through a large number of retail outlets other than Post Office branches. However, RMG has made a number of commitments regarding future business with POL pursuant to the terms of the MDA. Subject to certain conditions, in the event that RMG does not meet a lower total revenue test of deriving not less than 77 per cent. of its retail mails revenue through POL in a financial year, RMG must pay compensation to POL for the fees lost by POL as a result of this threshold not having been met. In effect, RMG pays POL as if it derived not less than 77 per cent. of its retail mails revenue through POL.

POL must be given the opportunity to accept and process at least 99 per cent. of all pre-paid products (other than stamps) accepted and processed on RMG's behalf from customers through physical retail outlets. POL must also be given the opportunity to hold for RMG at least 99 per cent of all pre-paid products (other than stamps) held for subsequent collection by customers from physical retail outlets. These commitments do not, however, extend to products directly accepted, held or processed by the Group.

RMG has undertaken to POL that except in circumstances where RMG contracted with retailers as at the date of the MDA, it will not contract to provide retail mails products other than stamps to customers from physical retail outlets of third parties. In addition, RMG shall not facilitate the growth of, or pro-actively seek to grow sales of, retail mails products other than stamps to customers through physical retail outlets of retailers other than POL. Further, RMG shall not offer or make available any retail mails products (except for stamps and under arrangements existing at the date of the MDA) other than through POL.

POL may not, without the written consent of RMG, provide competing mails services or offer competing mails products in any of its branches. In addition, POL may not solicit the provision of competing mails products or services through any of its branches and must notify RMG of any formal written third party approaches in connection with the same. In the event that a third party does access the POL network, the MDA contains a number of protections for RMG to ensure that RMG shall not be placed at a disadvantage with regard to the terms offered to that third party.

Within six weeks following the fifth anniversary of the Commencement Date, a renegotiation event will occur whereby RMG and POL will meet in good faith to enter into discussions with a view to agreeing amendments to the MDA. The MDA and its operation will therefore be reviewed by the parties halfway through the Term to ensure that it continues to meet both parties' expectations and takes into account changing market dynamics over the first five years of the Term. If the parties are unable to reach agreement in connection with this review following the relevant dispute resolution process, either party may refer the matter to an expert for resolution.

As soon as reasonably practicable following the seventh anniversary of the date of the MDA, the parties will meet to discuss whether they wish to extend the Term of the MDA or replace it with another agreement either before or at the end of the Term. If RMG and POL have not agreed either such course of action by the eighth anniversary of the date of the MDA, then certain provisions of the MDA will cease to apply as the parties prepare to exit the MDA. RMG may require POL to continue to provide services and to make available any products and stamps for a period of up to 12 months following the termination or expiry of the MDA.

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Either party may terminate the MDA with immediate effect, if certain conditions are satisfied, in the event of material or persistent breach by the other party, or in the event of insolvency of the other party. If any provision of the MDA is or becomes illegal, invalid or unenforceable, the parties will negotiate in good faith to agree amendments to the MDA to take account of such circumstances. Should the parties be unable to agree the terms of such amendments within two months, either party may terminate the MDA by not less than 12 months' notice to the other party if the affected provision is material to the agreement.

In addition to the renegotiation event described above, the MDA includes further renegotiation events under the following circumstances having a material adverse effect on the relevant party: (i) material changes in connection with the business of either party and/or the overall services or products (and stamps), including significant regulatory changes, major changes in the competitive landscape and material changes to the tax position; (ii) change of control in limited circumstances (which excludes any change of control contemplated in connection with HM Government ceasing to have control of RMG); (iii) if the POL network is materially different from that envisaged in the MDA and the Network Transformation Programme (as described in section 9.1 of Part II (The Business)); or (iv) a material adverse change in the condition or reputation of either party such that footfall of customers to Post Office branches or volumes of products and stamps sold by POL falls significantly.

Subject to certain liabilities excluded under the MDA, POL's aggregate liability to RMG in connection with the MDA, whether in contract (including any indemnity), in tort (including negligence), under statute or otherwise, is limited to £20 million in any financial year. Subject to certain liabilities excluded under the MDA, RMG's aggregate liability to POL in connection with the MDA, whether in contract (including any indemnity), in tort (including negligence), under statute or otherwise, is limited to £2.5 million in any financial year.

POL and RMG are currently members of the same VAT group. If, following implementation of the Offer, HM Government no longer holds a majority interest in RMG, POL and RMG will cease to belong to the same VAT group; and if HM Government retains a majority interest in RMG, the ability of POL and RMG to remain members of the same VAT group will depend on various conditions prescribed by VAT legislation being satisfied at all times, the outcome of which cannot be known for certain in advance.

In the event that POL and RMG do cease to be members of the same VAT group, anything done by POL under the MDA which represents, for VAT purposes, the making of a taxable supply to RMG will give rise to a VAT liability. Under the provisions of the MDA, RMG will be obliged to pay to POL an amount equal to the VAT that is properly chargeable on any such taxable supply by POL.

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The proportion of such VAT that RMG will be able to recover will depend on the detailed operation, from time to time, of the partial exemption special method agreed between RMG and HMRC and on the extent to which direct attribution is possible. As a general matter, RMG will not be able to recover such part of that VAT as relates to the supply by RMG of VAT-exempt postal products and services or to other exempt activity by RMG, rather than relating to the supply by RMG of postal products and services which bear VAT or to other taxable activity by RMG.

As noted above, under the MDA, all products and services are sold by POL as agent for RMG. In addition, under the MDA, all sales to customers of Royal Mail postage stamps are made by POL as agent for RMG. However, the MDA further provides that, upon POL and RMG ceasing to be members of the same VAT group, POL will sell Royal Mail postage stamps (but not Royal Mail and Parcelforce Worldwide products and services) to customers as principal, rather than as agent, except in certain circumstances, including where the customer purchases stamps to pay the postage due on an RMG postal product which attracts VAT. To enable POL to fulfil such sales by it of postage stamps as principal and to preserve the return to which POL is entitled under the MDA, RMG will sell the necessary stamps to POL as principal at a price below their face value.

The result of these provisions of the MDA is that upon POL and RMG ceasing to be members of the same VAT group, a substantial part of the remuneration to be earned by POL under the MDA will accrue to POL as profit margin on the purchase and sale of stamps, rather than as commission or fee. It has been proposed to HMRC that, under current law, that profit margin should not be liable to VAT.

HMRC have indicated to RMG that they consider that only part of that profit margin is outside the scope of VAT and that POL will accordingly be liable to account for VAT on the other part on the basis that it represents payment for a supply of services by POL to RMG. If this view is sustained, it will increase RMG's total irrecoverable VAT cost. However, the likely annual amount of that increased cost, as estimated by the Group, is not considered to be material.

(B) Master Services Agreement

The Master Services Agreement ("**MSA**") was entered into between RMG and POL on 20 January 2012. Under the terms of the MSA, RMG provides a number of transitional services to POL for a limited period. The services covered under this agreement at its commencement were: finance services, IT services, facilities management services, fuel services, fleet support services, company secretarial services, HR services, storage services, print management services, procurement services, property management services, physical security services, information security services and contact centre services. The annual charges to be paid by POL to RMG for the provision of services under the MSA are agreed between the parties during the customary budgetary record discussions in November each year.

The MSA is intended to be a temporary arrangement. The parties must work together in good faith to facilitate the smooth migration of POL away from reliance on RMG for the provision of each service. The separation process is ongoing. The majority of services are due to cease by 31 March 2014; and some have already done so as at the date of this document. The finance and IT services are due to terminate by 24 September 2014; save for treasury forex services which may be terminated at any time on three months' written notice by either party.

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A service extension may be requested by either POL or RMG by notice to the joint MSA management board. The MSA management board will determine the duration of any extension which it agrees to grant. In the event that the MSA management board is unable to resolve the issue, it will escalate it to the Chief Executive Officers of both parties. In addition, subject to certain conditions, including the payment of a 30 per cent. premium on the service charge, POL may extend non-finance or non-IT services for up to six months without recourse to the MSA management board. The MSA also contains an automatic extension mechanism should POL's ability to migrate away from the provision of a service be delayed due to the failure of the Group or its contractors to perform obligations under the MSA or separation plans.

POL may, with the prior written consent of RMG, terminate services other than finance and IT services on not less than 90 business days' notice to RMG, or such longer notice period as RMG may reasonably require. In the event that a service is terminated in this manner, POL must continue to pay the service charge until the original service end date, together with certain other costs. If certain conditions are satisfied, either party may terminate the MSA or an individual service under the MSA on 20 business days' notice in the event of persistent breach by the other party or with immediate effect in the event of insolvency of the other party.

Certain RMG employees may be wholly or mainly engaged in providing the services to POL under the MSA. On the expiry of the provision of services under the MSA such employees are to transfer to POL in accordance with the Transfer of Undertakings (Protection of Employment) Regulations 2006. In addition, RMG has agreed with POL that it will indemnify POL and any successor supplier for termination costs incurred in respect of certain other employees.

Each party bears its own separation costs under the MSA. Separation costs in respect of RMG include one-off or other costs incurred by the Group in connection with separation, including any termination fees payable to third party providers. Separation costs in respect of POL include one-off or other costs incurred by POL in connection with arranging the provision of goods or services from a third party provider as a replacement for a service under the MSA.

Under the MSA, recurring stranded costs are the costs incurred by the Group on a recurring basis as a direct consequence of the termination or expiry of a service, or in connection with shared sites, premises, land or property of which POL ceases to receive the benefit. This does not include one-off separation costs or costs in relation to any employees of the Group who transfer by way of the Transfer of Undertakings (Protection of Employment) Regulations 2006 or otherwise. RMG will bear the first £15 million per annum of the recurring stranded costs incurred by the Group under the MSA but any recurring stranded costs in respect of shared sites, premises, land and property which POL ceases to receive the benefit of in excess of £1.5 million shall not be included for the purpose of calculating this first £15 million. Any recurring stranded costs above that threshold will be shared equally between RMG and POL. However, if any recurring stranded costs are incurred by RMG after the 24th month from the first day of the quarter immediately after a service terminates or expires, all such recurring stranded costs will be borne by RMG.

Further detail regarding the provision of IT services by the Group to POL under the MSA and the project for the separation of POL's IT can be found in section 9.4 of Part II (*The Business*). The Group faces a number of risks relating to the provision of IT services to POL under the MSA and the project for the separation of POL's IT, which are described further in section 1.17 of the Risk Factors.

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