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# Post Office update for the Permanent Secretary

***BEIS*** *POL Policy Sponsorship Team*

***UKGI*** *POL Team*

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# Outline

- Live issues:
  1. Litigation
  2. CEO appointment
  3. Postmaster remuneration
  4. DMB franchising
  5. Telco business
- Longer term issues:
  1. Ambition and strategy for POL
  2. Dividend policy
  3. Investment facility
- Responsibilities across BEIS
- 2019 milestones

Annex: Financial performance and investment

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# Live issues: (1) Litigation

## POL has changed its legal adviser and is considering appeal options

**Common Issues trial**

- 15 March: Judgement handed down on Common Issues Trial, finding that the contract with Postmasters is relational and terms must be implied into it
- POL is considering the operational impacts of the decision, which has led to a delay in approving the Budget for FY 19/20

**Recusal application**

- 21 March: POL applied for the trial judge to recuse himself from the rest of the litigation on the grounds of'apparent bias'
- 9 April: Justice Fraser dismissed the recusal application and refused permission to appeal
- 11 April: POL filed an application directly with the Court of Appeal, seeking its permission to appeal the recusal decision. No date has yet been set for a hearing at the Court of Appeal

**POL's legal strategy and appeal**

- 16 April: Board appoints Herbert Smith Freehills to take oversight of the litigation and revisit the approach including Common Issues Appeal, Horizon Issues Trial, resolution strategy. The Board is looking for a material change in substance and tone
- 24 April: POL litigation sub-committee to review appeal options (Tom C to give verbal update)

**Horizon trial**

- 4 June: the Horizon Issues Trial will resume, hearing the IT Expert Witnesses for both parties. This is subject to the Court of Appeals decision on POL's request to stay the Horizon Trial while the Recusal Appeal is heard
- 1-2 July: closing oral submissions on the Horizon Issues trial (subject to the Court of Appeals decision)

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# Live issues: (2) CEO appointment

CEO recruitment is underway but we expect CST to reject POL's pay proposal

- Al Cameron has been appointed as interim CEO
- Afua Kyei has accepted the role of interim CFO and will sit on the Board
- POL have proposed that remuneration for the new CEO increases by 27% to bring it closer in line with the lower quartile of comparable organisations
- This package has been approved by BEIS ministers and is now with CST
- Discussions with HMT suggest they are content for the base to be increased, but resistant to an increase in the overall package. We have asked the Minister to write to the CST on this issue
- In parallel, headhunters have worked up a longlist, contingent on CST decision (UKGI to give verbal update)
- The selection panel (including an independent member) will meet on 30 April. Subject to CST approval, POL may be able to move to interviews, allowing us to get ahead of timetable
- We have asked POL to do more on Succession Planning – a paper is coming to Board on 30 April

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# Live issues: (3) Postmaster remuneration

- Although some have expressed concern about remuneration affecting the sustainability of the network, branch numbers have been stable and are rising. POL is continuing efforts to simplify post office transactions and improve the balance with the retail offer
- However, a recent survey by the National Federation of SubPostmasters found:
  - 76% take home less than the National Minimum Wage and 61% have seen their earnings decline over time
  - In 2018, postmasters took an average of 10 days leave, with 1/3 taking none at all
  - 22% said they planned to close or downsize in the next year
- On 15 April, POL announced that under the new Banking Framework remuneration for all cash deposit services will double and in some cases triple (from Oct 2019)
- POL are undertaking a deep dive on remuneration, which will report to the Board in October 2019
- Minister Tolhurst will convene a working group with POL and the NFSP on 13 June [date TBC], to discuss these and other issues
- We recommend that it remain a HMG priority to ensure that running a post office is an attractive proposition and are working closely with POL and NFSP to explore what more could be done

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# Live issues: (4) DMB franchising

- ‘Crown’ branches make up <3% of the network. Since January 2016, POL has been seeking to franchise around 135 directly managed ‘Crown’ post offices, following the 48 that were franchised 2012-15
- Franchising has helped reduce losses in this part of the network from £46 million per year in 2012 to break-even today. POL plan to complete their current programme of franchising
- Local opposition, including from constituency MPs, is common when branches are franchised and misconceptions persist about the implications for local services
- We are working closely with POL to explore how their communications around franchising could be improved (for example developing a ‘mythbuster’)
- Minister Tolhurst will meet with POL to discuss franchising comms on 7 May [likely to be rescheduled]

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# Live issues: (5) Telco business

## POL is considering strategic options for its Telco business

- POL sells TalkTalk broadband and home phone services, receiving commission on sales
- This is a profitable business unit, with c.£150m revenue and £30m EBITDAS p.a.
- POL has undertaken strategic work which shows their offering is at its peak – POL can't compete with providers who also sell fibre and TV as part of the deal
- This results in 3 feasible options:
    - Invest significantly in capability to maintain the profitable revenue stream
    - Do nothing and enjoy the profits while they last
    - Sell the customer base and arrange a distribution agreement with the buyer

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# Longer term issues: (1) Ambition and strategy for POL

- Minister Tolhurst has clearly indicated a desire to do more with on POL. The BEIS Policy Sponsorship team was established in August 2018 and will take this work forward
- The team are initiating strategy work to develop **a Government vision for the future of the Post Office**
- Priority areas include delivering on POL's social purpose, ensuring sustainability of the network and alignment with Government objectives
- We intend to prepare materials for Ministers to review before Summer recess
- POL are also undertaking internal work on business strategy (including taking advice from McKinsey). The timing of this is partly dependent on the arrival of the new CEO; BEIS will need to ensure that work on the HMG ambition feeds into POL strategy

**Questions for discussion:**

- What are the Permanent Secretary's key priorities for the future of the Post Office?
- What should the scale and scope of our ambition be (timeline, approach, stakeholders)?

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# Longer term issues: (2) Dividend policy

## We should consider a dividend policy now that POL is becoming more profitable

- Historically POL have not been able to pay dividends because they were not profitable and has no distributable reserves
- The medium term prospects for POL are good and it should generate more profit than it needs to invest in the business (on a BAU basis)
- Under the current Funding Agreement, POL receives £50m p.a. subsidy for uncommercial branches. BEIS would like to eliminate this subsidy, with POL effectively cross-subsidising loss-making branches
- Alternatively, we could continue to pay POL for the service provided, and take out excess profits via a dividend. This is the approach set out in HMG budgeting guidance
- We are seeking ministerial approval to develop a formal dividend policy, exploring how to share the proceeds of any excess profits between investment, taxpayers and the workforce
- Including a capital reduction as part of POL's planned corporate restructure would enable it to pay dividends
- POL's management has been resistant to a dividend as it thinks this could be difficult to manage with postmasters
- History: Pre-privatisation, Royal Mail (including Post Office) paid dividends from 1969-99 of a total of £2.4bn. The 1990s averaged a 75% payout ratio, peaking at 93% of post-tax profits in 1993/94. This lead to severe cashflow problems and even excess staff as they couldn't afford redundancy payments

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# Longer term issues: (3) Investment facility

## POL can fund BAU investment but will need finance options for major projects

- POL do not require a CDEL budget in the next Spending Review
- POL operates in commercial markets so may need to finance large investments that it cannot fund from its own resources
- This could includes an acquisition (FRES or an insurance firm) or investment in the supply chain or ATMs
- An investment facility of up to £500m would allow this, likely in the form of an amortising loan
- The availability of an investment facility should make POL more willing to accept a dividend policy that reduces their ability to build up reserves
- HMT have proposed that this could sit with the Nuclear Liabilities Fund who are looking for investment opportunities, but only have 2 funding windows a year – the loan could sit with HMT in the interim
- Tom Taylor has approved UKGI to work with BEIS to develop the facility

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# Roles and responsibilities across BEIS

- POL have two primary points of contact with government:
  1. UKGI, as the shareholder representative
  2. The BEIS policy sponsorship team on all policy matters
- In brief, UKGI leads on managing POL as a Government asset, in the interests of UK citizens. BEIS leads on Government's long-term approach to POL and ensuring that POL's activity is consistent with wider government policy
- BEIS finance and partnerships teams primarily provide support to these teams, rather than dealing directly with POL

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# POL: 2019 milestones

*Apr 2019*

Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec

**Parliament/ external**

- **26 Apr:** Westminster Hall Debate
- **21 May:** BEIS Select Committee inquiry
- Summer recess → House returns

**POL**

- Banking Framework II agreed
- **30 Apr:** Board meeting to agree annual budget
- **28 May:** Corporate restructure due for Board approval
- **1 Jun:** interim CFO start date
- **30-31 Jul:** POL strategy off-site
- Board discussion on remuneration
- Banking Framework II remuneration starts to postmasters

*Litigation*

- Recusal hearings
- **24 Apr:** POL to lodge appeal TBC
- **16 May:** Deadline to appeal common issues judgement
- **4 Jun:** Horizon trial resumes
- **1-2 Jul:** closing submissions

**HMG**

- 1 Jul: Sub to Ministers on CEO appointment
- Spending Review?
- DWP tender for Post Office Card Account replacement

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# Annex: Financial performance and investment

## POL will beat its profits target for FY 18/19

| Unaudited 18/19 Figures (£m) | | | | |
|---|---|---|---|---|
| | Actual | Budget | Variance | YoY |
| Retail | | | | |
| FS&T | | | | |
| Identity | | | | |
| Other | | | | |
| **Total Revenue** | | | | |
| Cost of Sales | ( | | | |
| **Net Income** | IRRELEVANT | | | |
| Agents Pay | ( | | | |
| Staff Costs | ( | | | |
| Admin Expenses | ( | | | |
| FRES | | | | |
| Other Income | | | | |
| **Trading Profit** | **61.5** | **50.0** | **11.5** | **119%** |

- Unaudited figures for FY 18/19 show a **£61.5m trading profit**, ahead of its £50m target, up from £35m in FY 17/18
- Cost savings are the main driver
- Transformation spend has not been as good as hoped, with IT overruns and cost benefits below forecast
- Mails is the biggest source of revenue and is on budget, but in a declining market, while banking services are benefitting from bank closures that increase reliance on POL
- The 2018 travel market struggled due to warm weather and a weak pound, so Travel Money (FX) and Insurance are behind budget
- Telecoms revenues are behind budget as POL struggles to compete
- Verify has seen growth during the year, but HMG's fee cut in Q3 harms revenue
- A reduction in agents pay has been driven by smaller Mails volumes
- Admin expenses are beating the budget due to lower IT and property costs and underspend on marketing budgets

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# Annex: Financial performance and investment

## Higher banking fees should drive further growth in FY 19/20

- Trading profit is forecast to rise to IRRELEVANT in 2019/20, primarily driven by the new Banking Framework in January 2020. This which will increase the group's revenues by c. IRRELEVANT p.a.
- UKGI believes POL's target could be more ambitious
- Budget and transformation spend plans will change due to the litigation judgment. The potential implications on the operations of the business are being worked through with the aim to return to the May Board for approval
- McKinsey are advising on cost efficiency improvements
- Benefits from the transformation programme should also drive cost efficiencies
- Identity revenues are forecast to fall due to reduced fees plus losing the UKVI (Home Office) contract
- Litigation costs are classed as exceptional items outside of trading profit

| Bridge from 2018/19 to 2019/20 | £m |
|---|---|
| **Previous Forecast for 2018/19** | |
| Benefits from transformation spend | |
| Banking Framework 2 (Q4 only) | |
| Lost Identity contracts | ( |
| Moving staff from change spend to opex | |
| Loss of Week 53 | |
| 2.6% staff pay increase | IRRELEVANT |
| Marketing spend increase | |
| New BOI arrangement (incl. Credit Card deal) | |
| Other | |
| **Sub-total for 2019/20** | |
| IFRS16 impact on leases | |
| **Target for 2019/20** | |



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# Annex: Financial performance and investment

## Transformation spending to continue to deliver benefits in FY 19/20

- POL's 3YP to March 2021 included investment spend of c. IRRELEVANT of which BEIS provides IRRELEVANT and the remainder to come from POL's own commercial income streams
- POL spent IRRELEVANT in 2018/19, of which IRRELEVANT has been contributed by BEIS
- UKGI has reviewed the planned investments for 2019/20 which are projected to cost IRRELEVANT and are consistent with the three-year strategy:
  - Mandatory spend IRRELEVANT on projects that are vital, such as the DMB franchising programme (IRRELEVANT and migration of Horizon to the cloud IRRELEVANT
  - Strategic spend IRRELEVANT on business units, such as Insurance (including a system migration) IRRELEVANT Telecoms (£8m) and Identity services IRRELEVANT
  - Discretionary spend IRRELEVANT to develop new revenues and create longer-term cost savings, such as investments in mails and converting small mains branches
- This is forecast to provide an incremental IRRELEVANT of benefits to POL's trading profit for 2019/20
- UKGI expects POL to draw the maximum IRRELEVANT per the Funding Agreement during the first quarter of 2019/20
- POL's investments will be subject to its business case approval process and POL shall provide UKGI with quarterly reports to monitor portfolio performance
- Overall, POL proposes to increase the c. IRRELEVANT to c IRRELEVANT mainly on non-cash items (e.g. DMB onerous lease provisions), funded by its additional profits