

Royal Mail Holdings plc
Report and Accounts
Year Ended 27 March 2005

Royal Mail Holdings plc

Royal Mail Group is unique in reaching everyone in the UK through its mails, Post Office® and parcels businesses – which employ over 196,000 people. Every working day Royal Mail collects, processes and delivers around 84 million items to 27 million addresses for prices that are amongst the lowest in Europe; each week we serve 28 million customers through our network of 14,609 Post Office® branches and each year our domestic and European parcels businesses – General Logistics Systems and Parcelforce Worldwide – deliver some 285 million parcels.

This year sees the completion of the three-year Renewal Plan, which provides a platform to face up to competition in our mails business, continues to transform Post Office Limited and our domestic and European parcels businesses, provides an improved commercial return to our Shareholder and allows us to continue to invest in our people, our infrastructure and our service quality.

Contents

Highlights	3
Chairman's Statement	4
Chief Executives' Statement	6
Annual Review 2004-05	8
Operating and Financial Review	12
Royal Mail Holdings plc Board	21
Directors' Report	23
Corporate Governance	25
Internal Control	29
Directors' Remuneration Report	30
Statement of Directors' responsibilities in respect of the accounts	37
Independent Auditors' Report to the members of Royal Mail Holdings plc	38
Accounting policies	39
Group profit and loss account	42
Group statement of total recognised gains and losses	43
Reconciliation of movements in Group shareholders' funds	43
Balance sheets	44
Group cash flow statement	45
Notes to the cash flow statement	46
Notes to the accounts	47
Five year summary	68
Glossary of terms	69
Corporate Information	71

Royal Mail Holdings plc

Highlights

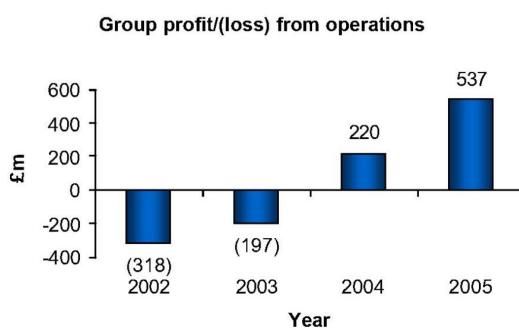
- Quarter 4 quality of service for 1st Class was 92.8%
Pre-Renewal Plan: In 2001-02 Quarter 4, 1st Class performance was 91.4%
- Profit from operations of £537m is £317m (144%) higher than last year
Pre-Renewal Plan: In 2001-02 the Group lost £318m
- Share in Success reward to our people of £218m - £1,074 per eligible person
Pre-Renewal Plan = No Share in Success
- 62% of our people believe Royal Mail is a great place to work
Pre-Renewal Plan: We had no measurement
- Cash inflow of £140m before Post Office Limited working capital funding
Pre-Renewal Plan: In 2001-02 the Group consumed £96m of cash and was facing going concern issues
- Gross cost savings of £1.5bn (15% efficiency) reinvested in our people, customers and infrastructure (target £1.4bn)
- Renewal Plan completed and progress delivered on all its objectives:
 - improving customer service
 - making Royal Mail a 'Great Place to Work'
 - return to profitability
 - cash generative

Summary of results

Year ended March	Renewal Plan			Pre-Renewal Plan
	2005	2004	2003	2002
External sales (£m)	8,956	8,633	8,299	8,408
Profit/(loss) from operations (£m)¹	537	220	(197)	(318)
Profit/(loss) before tax (£m)	207	105	(611)	(1,124)
Cash flow (£m)²	140	65	(553)	(96)
People (UK wholly owned subsidiaries) (000's)	196	202	213	229
Great Place to Work (%)	62%	57%	n/a	n/a
Quarter 4 quality of service – 1st Class (%)	92.8	89.4	91.8	91.4

1. Total profit/(loss) before exceptional items and pension deficit costs/pension surplus credits. A full reconciliation of total profit/(loss) is shown on page 68.

2. Net cash flow before use of liquid resources and financing and before Post Office Limited client balance movement.



Royal Mail Holdings plc

Chairman's Statement

"Royal Mail's postmen and postwomen have achieved a fantastic turnaround."

Royal Mail has had a remarkable year. By the end of 2004-05:

- quality of service was at its highest levels on record;
- postmen and postwomen had earned their biggest bonus – nearly £1,100;
- the £537m profit from operations in 2004-05 was a record with more than £200m going to the Company's people in one of the biggest profit shares with employees in UK corporate history;
- the implementation of operational changes have been completed to give Royal Mail the platform it needs to take on full competition in the mail market from January 2006;
- mail volumes reached a record 84 million letters a day, a million more a day compared to the previous year, and the Group's sales income was also a record at £8.9bn; and
- 15% efficiency has been achieved over the Renewal Plan, saving gross costs of £1.5bn, which have been reinvested in our people, our customers – including specific improvement in quality of service – and our infrastructure, beating the £1.4bn target set.

Three years ago, the idea that Royal Mail could achieve any of the successes above seemed far-fetched to many. In 2002, the Company was losing well over £1m a day on its operations, failing its customers, had one of the worst industrial relations records in the UK, and had an inefficient operation that was incapable of being profitable under the heaviest regulation in the postal world. It was in no position to embrace competition. Royal Mail could not have survived without modernisation. We had to change. But what's really impressive about the 2004-05 results is the sheer scale of the progress the Company has made. Royal Mail's postmen and postwomen have achieved a fantastic turnaround. It's not just that we've made a decent profit but, above all, postmen and postwomen have significantly improved service to customers. Everyone in Royal Mail is more focused on customers and more committed to achieving even better quality of service than ever before.

The growth in letters volume was the biggest factor that fuelled record sales of £8.9bn - a 3.7% growth in revenue on the previous year. Domestic mail price increases at below the rate of inflation also contributed to improved turnover, along with increased sales income from Parcelforce Worldwide and General Logistics Systems.

Crucially, the overhaul of Royal Mail's frontline operations was implemented and the jobs of some 164,000 of our people have now been changed. This year saw the move to a single daily delivery to replace the two deliveries, which every other modern postal company had abandoned years ago. The Company had first considered making this necessary change nearly two decades ago. For our customers, the change was the most visible one we made as it meant a dip in quality of service during the spring and early summer of 2004. However, the service has since recovered strongly and we are now giving our customers unprecedented, high levels of service. We also completed this year the streamlining of our transport network and introduced more efficient working in our mail centres.

The productivity gains we've made have triggered pay increases for postmen and postwomen with basic, pensionable pay now at least £311.50 a week – more than £60 or almost 25% better than basic pay just before we launched the modernisation programme. It's our people who have successfully accomplished the operational changes that have delivered the profit from operations, and they are being rewarded, not just with better pay, but with a Share in Success gross payment of £1,074. If we had hit a £400m profit from operations, the pay-out would have been £800, but exceeding the target has led to an enhanced payment. Our people fully deserve their Share in Success payment because it's our people who have turned the Company around.

A further success this year has been the turnaround of Parcelforce Worldwide. It emerged from 2004-05 making a profit from operations in the second half on its day-to-day operations. The business's radical restructuring, with a focus on express, time-guaranteed services for business customers, is paying off. Its overall performance in 2004-05 was a loss from operations of £13m but this was an improvement of nearly 80% on the £54m loss the previous year.

General Logistics Systems, our European parcels business which delivers to customers in 34 countries, continued to perform strongly with a profit from operations of £61m – a £36m increase on the previous year, up 144%. The company increased its sales with growth in its core markets in Germany, France and Italy. This was also helped by tight cost controls, improved operational productivity and expansion of the GLS network in Italy. GLS has made excellent progress over the past three years and it now represents a significant contributor to overall Group profitability. Over this period GLS has also continued to strengthen its network providing Royal Mail with a strong presence in Europe.

Post Office Limited continues to face some of the biggest challenges in the entire Group – indeed this year we again had some uncertainty as to whether it can be considered a going concern. It made a £110m loss from its operations, £7m worse than the previous year, although the result includes £18m of start up losses from Post Office Financial Services. Despite the loss from operations, the year saw the Post Office® network continuing to provide more than 28 million customers a week with its unique and valued mix of public service, combined with an expanding range of new financial services. Its biggest traditional source of income – handling the payment of pensions and child benefit by order books – was coming to an end in 2004-05 as the traditional benefits income continued to switch to direct payments into bank accounts.

The full impact of the change to direct payment of benefits into bank accounts, which has been worth some 40% of revenue every year and has now gone, will be felt in 2005-06. This is being partly offset by additional revenue from new services such as banking, car, and home and contents insurance, Post Office® savings products, mobile phone top-ups and the HomePhone service, which has won well over 60,000 new customers in the ten weeks since its launch. Post Office Limited is already a market leader with its commission-free foreign exchange service along with travel insurance, which this current year, is expected to see sales in excess of one million policies. There remains an income shortfall between the loss of the benefits business and the revenue from new products. The challenge facing the network, therefore, is substantial. Post Office Limited's goal of creating a sustainable and viable network remains stretching.

Royal Mail Holdings plc

Chairman's Statement (continued)

In fact, the Group faces challenges and pressures across its entire operation. It would be very foolish to think that having successfully transformed Royal Mail over the last three years, it's a job done and the Company can sit back while benefits pile up. The reality is that Royal Mail is going to have to focus even more intensely on further improvements to customer service, more efficiency gains and ensuring the continued commitment of all its people.

Competition is already biting but the opening of the postal market to full competition from January 2006 will make real the biggest challenge Royal Mail has ever faced. The Company is going to have to master – and fast – the ability to win and keep customers when they are being offered an increasing range of rival services. Competition is real – we all have to face up to that. This will mean a culture change across the whole organisation. With the Regulator continuing to subject Royal Mail to tight controls, including our prices – on which we lose over £200m on nearly 90% of price controlled volumes that we are obliged to provide - Royal Mail needs to be even better at operating the virtuous circle of earning profits to pay its people and fund the investment in more technology to improve further the service to customers, and deliver the efficiency savings and sales that generate more profit. Royal Mail remains committed to ensuring its pension fund continues to meet its obligations in full but the £2.5bn deficit demands increases in the employer's contribution – and the best way to achieve that is by being more profitable. We need to remember that Royal Mail's return on turnover for its domestic letters business of 8.6% is much lower than the double-digit returns of two of our biggest competitors, Deutsche Post and TNT Post Group, 16.4% and 22.2% respectively.

Royal Mail's mission remains to become demonstrably the best and most trusted mail company in the world. The last three years have demonstrated that huge effort by all in the Company has resulted in major achievements in quality of service to customers, Company performance and reward for our people. The challenge now is to show how well and successfully a modernised and re-invigorated Royal Mail can compete in a market that will change forever from 2006.

Allan Leighton

Chairman

16 May 2005

Royal Mail Holdings plc

Chief Executives' Statement

"Delivering even better quality of service remains our number one priority."

This has been a milestone year for Royal Mail. It marked the successful completion of the programme to modernise its operations with one of the largest transformations of any UK industry over the last 25 years. For our customers, Royal Mail ended the year by delivering the best quality of service on record – including 1st and 2nd Class services hitting or exceeding their targets since July last year. The Company that was losing more than £1m a day and failing its targets has become a business making more than £2m a day - even after the significant investment in improving quality of service – and now hitting key quality of service target levels. Postmen and postwomen can be justifiably proud of what we have all achieved. They've done a fantastic job.

But 2004-05 was a milestone year in another critical sense. It was the last financial year in which Royal Mail had any protection from competition. From January 2006, the mail market will be fully open to rival companies, large and small. Everything Royal Mail has been doing over the last three years has been about getting the Company ready to compete. The modernisation plan was the greatest test Royal Mail faced in decades, for our very future depended on it. The challenge we will face as full competition becomes a reality will be even greater. There are tough but exciting times ahead.

In truth, competition has already arrived as last year saw several rival companies launch services to collect business customers' mail and then pass it to Royal Mail for our postmen and postwomen to deliver over the final mile. As competition intensifies, Royal Mail must work even harder to put the customer at the heart of everything we do. That will represent a huge change in our culture and will affect everyone who works for the Company, but it is essential if Royal Mail is to compete successfully. We've got to ensure that our customers choose us because Royal Mail is delivering the consistently high quality service they need at great, value-for-money prices. The challenge is to keep our customers and win new ones. If we don't, we risk losing volume and revenue to competitors. This in turn means declining profitability and not enough investment for our people and our infrastructure.

The key to winning and keeping customers is to provide a consistently high quality of service for our customers. That has been a top priority for everyone during 2004-05 and it's at the heart of our strategy moving forward. In service terms, last year had two very different and distinct parts. The spring and early summer saw the most intensive period of operational change in decades and as a result, service to customers dipped. We established a single daily delivery of mail in our 1,400 delivery offices, introduced more efficient working into our 71 mail centres and eight regional distribution centres, and streamlined our nationwide transport network through a new national distribution centre. But a huge effort and commitment across the whole Company saw service recover strongly by early summer. By the end of the year we had hit or exceeded target levels for 1st and 2nd Class mail, Mailsort and Presstream bulk mail services, and Standard Parcels, which in total represented around 80% of the daily mailbag. Crucially, 1st Class, the benchmark service, hit the highest level on record for quarter 4 by a significant margin of nearly 1%. This was despite atrocious weather in January which closed down the air network, that carries 1st Class mail in Scotland and Northern England, and heavy snow in the South East in February and March which prevented some deliveries. 2nd Class exceeded its 98.5% target for the whole of the year. These are world-class performances, delivered at a time when mail volume is at a new record high of an average 84 million letters a day, and with the added bonus for customers of almost the lowest postage prices in Europe.

The scale of change we have undergone, and the speed in which we have been able to bed those changes in, whilst maintaining our one-price-goes-anywhere service to the UK's 27 million addresses, is a testament to the hard work and commitment of our people. They are crucial to our success in the future. To recognise their achievements and dedication, we are making a gross Share in Success payment of £1,074 to the majority of our people who have been with the business during the final year of our Renewal Plan. The £218m of profit from operations that we are returning to our people is one of the largest profitshare payments to employees in UK corporate history. Royal Mail also continues to offer a final salary pension scheme to most of our people, which is a key benefit. With a current funding deficit of £2.5bn, Royal Mail has already contributed £271m in two years over and above the regular contributions to ensure the fund can meet its obligations to our people. Clearly, the best way to safeguard Royal Mail's continuing contributions is for the Company to continue to make a profit.

Basic pay for our postmen and postwomen is increasing again – up by £11.50 from 1 April, which is 3.8% on top of the basic, pensionable pay of at least £300 a week our people are already getting. We want them to keep sharing in the success of the Company and under a new bonus scheme, postmen and postwomen have the opportunity to earn up to 50% of any savings above budget made by their unit and a further 10% if we hit the new 1st Class target of 93.0%. It is also significant that industrial relations have improved. At the onset of our Renewal Plan, barely a day passed without some form of disruption. Last year was one of the calmest in almost a decade, and the improved, constructive relationship with our union produced a pay deal for 2005-06 more quickly and smoothly than in any year that anybody could remember – a win-win for all.

All that sounds terrific – and it is. But the challenges we face are formidable. Not only will Royal Mail have to generate sufficient profit to pay off the £2.5bn pension fund deficit, it currently makes losses of over £200m on nearly 90% of its price controlled volumes which it has to provide under its universal service obligation. Also, the 14,609 strong network of Post Office® branches made a loss on its operations last year of £110m. The rural network of 8,000 branches is uneconomic and needs an injection of £3m a week to survive. The current annual Government funding of £150m is due to end in 2008 and Post Office Limited cannot be expected to absorb extra costs at this level. Meanwhile, Royal Mail also lags behind its major rivals on automated sorting technology and we need to make a several billion pound investment if we are to compete successfully – that means being profitable in order to invest.

We will fundamentally change what we do and how we do it. That means as well as investing in automation we also need to develop a set of products and services that really match the needs of our customers. We are working on that and we expect to be able to tell you about them this summer. At the same time, we are shaping a whole new sales and marketing strategy with the kind of customer focus which a modern postal business needs but which we have never had in the past.

This customer focus is also at the heart of Post Office Limited, which has 28 million customers visiting more than 43 million times a week. One of the largest retail networks in Europe, Post Office Limited is at the heart of communities and is committed to providing products and services that are important to our customers simply and at a profit.

Replacing lost revenue remains our biggest and most important challenge as we face a future without the traditional benefits payments, which has historically represented some 40% of our revenue. Turning around the £71m loss making directly managed branches and determining the future of the uneconomic parts of the rural network, which are costing us some £3m per week on an annual basis, will also be key.

Royal Mail Holdings plc

Chief Executives' Statement (continued)

This year has been a time of radical change for Post Office Limited with the introduction of a competitive portfolio of financial services and products which will help to replace the income previously provided by benefits payments and develop the commercial profitability of the business in the future. Post Office Limited provides more than 170 different products and services, but those which are key both to our customers and our future are banking, mails, telephony, travel and financial services.

Our banking services are particularly important to our customers because we have opened up access to banking in communities where the big banks no longer have a presence.

We have formed partnerships with Alliance & Leicester, Bank of Ireland, Barclays, Cahoot, Clydesdale, Co-op, First Direct (Scotland only), Lloyds TSB and Smile, and discussions continue with others.

Crucially, Post Office Limited plays a key part in increasing financial inclusion as customers with basic bank accounts can access their money in a friendly environment in which they feel comfortable and secure and can talk to people they trust.

We have also reorganised to make sure we've got the right people in the right places doing the right things and we've recruited some first class managers who have proven track records from the financial services and retailing world to help guide, coach and support our people.

Ensuring customers know all about Post Office® products and services is a key part of our recovery strategy. Our advertising aims to increase our sales by introducing customers to our new products and services and encouraging them to reappraise our existing ones.

The year has also seen the completion of the urban Network Reinvention programme ahead of schedule and under budget. The programme has been a major step towards making the network viable and the Post Office® more attractive for subpostmasters by reducing overprovision, and providing more modern branches for customers which will safeguard access to services for all, particularly the vulnerable. Having consulted extensively with the public and subpostmasters, the programme has seen the closure of 2,500 branches in total.

Rural Post Offices play a pivotal role within the economic and social fabric of their communities. However the majority cost more to run than the income they generate and as a result there is a question about their long-term viability. The Government has already released funds of £450m from the Group's reserves of historic profits to support parts of the network, which are not commercially viable, and in 2004 it announced that a further £300m would be released to extend that support to April 2008, subject to EU State Aid clearance. This money will allow us to continue to pay rural subpostmasters' wages, provide support services to the network and crucially continue to pilot activity on different ways to provide services to the rural network. We have already started to develop and test different approaches including Post Offices carrying out work on behalf of the Police service. These pilots will inform the Government's decision about the future of the network post 2008.

In the UK parcels market, Parcelforce Worldwide has been successful in turning around its business and is now a key player in the competitive express parcels industry, continuing to improve the quality of service provided to customers, particularly in terms of its time-critical products. It has dramatically cut its losses from operations by 76% over the past 12 months, from £54m in 2003-04 to £13m this year, and it has generated profits from operations in the second half of 2004-05. The challenge it now faces is to build on these improvements and to deliver profit from operations for the next full year.

In Europe, our parcels business, General Logistics Systems, has significantly increased its revenue over 2004-05 – with a remarkable 144% growth in its profit from operations to £61m. This has been driven by growth in its markets in Germany, France and Italy, together with tight cost control, two new acquisitions in Italy and consolidation of its operations in Poland. GLS has made excellent progress over the past three years and it now represents an important contributor to overall Group profitability. Over this period GLS has also continued to strengthen its network. It has strong positions in its core markets and provides Royal Mail with a significant presence in Europe. It will continue to focus on strengthening its European network and securing operational efficiencies.

We have now completed our three-year Renewal Plan and Royal Mail is back in profit, delivering an improved quality of service to customers and investing in our people. All our stakeholders have benefited from the transformation. Customers are receiving unprecedented, high levels of quality of service while our prices have fallen in real terms. Postmen and postwomen are better paid. The Company is profitable again and our willingness to embrace competition in January 2006, ahead of the original liberalisation date of April 2007, also means customers are getting more choice in the market 15 months earlier. It is vital that we now make the cultural change needed for us to be successful as a commercial business and be the postal operator of choice for customers in an open competitive market. Our vision remains to be demonstrably the best and most trusted mail company in the world. With the dedication and commitment of our people, we are confident we can achieve that goal.

Adam Crozier

Chief Executive

Royal Mail Group plc

16 May 2005

David Mills

Chief Executive

Post Office Limited

16 May 2005

Royal Mail Holdings plc

Annual Review 2004-05

This year saw more operational changes implemented in Royal Mail than in any other year for many decades. It was also the year when significant competition became a reality with several competitors establishing mail services based on access to Royal Mail's sorting and delivery network. However, despite these changes, the challenges the business faced and the sheer scale of the operational change, Royal Mail had a remarkable year, and ended it with the best quality of service performance for the majority of mail products in a decade.

Improving customer service

To enable us to compete successfully in the UK postal market in the future we have undertaken a huge transformation of our operations to provide our customers with a consistent high quality of service and to make Royal Mail a great place in which to work for our people. This has transformed the jobs of some 164,000 of our frontline people – probably one of the largest changes in UK industry over the last 25 years. Throughout 2004-05, improving customer service has been our top priority and we have made real progress. By the end of the year, 1st Class, our benchmark service, was above its target of 92.5% - the best final quarter performance in a decade - and 2nd Class exceeded its 98.5% target for the whole of the year. The majority of our bulk business mail products also performed well with Maisorts 2, 3 and Pressstream 2 achieving the best annual performances in the last ten years. Delivering consistent, high quality service is essential for Royal Mail to compete successfully in a market open to full competition from January 2006.

The transformation of our distribution network was put to its real test over Christmas, always the busiest time for Royal Mail as we deliver Christmas cards, parcels and presents across the UK and around the world - a time when we handle up to 60 million extra items per day, taking the average daily mailbag to 140 million items. We proved we were more than capable of meeting that challenge, delivering everything that was posted by the recommended last posting dates in time for Christmas. Overall, the business recorded its strongest trading performance, with a 10.6% increase in revenue and an £80m increase in sales in the four weeks to 25 December – one of the best performances announced by a large UK company over that period.

Protecting the integrity of the mail

Every letter is important to Royal Mail and we are determined to do everything we can to protect the integrity of the mail and to ensure the security of the letters and parcels entrusted to us for delivery. The vast majority of our people are scrupulously honest and the huge bulk of mail (99.92%) arrives at its correct destination safe and sound. Whilst our aim is to ensure customers get the service they expect from Royal Mail, in handling around 84 million items a day, sometimes things go wrong. If they do, we want to compensate customers quickly and fairly. This has seen us pay some £60m back to customers whose mail was delayed last year. We offer better service protection for our customers than almost any other company, and are one of the very few postal operators to compensate for delay. We sent a leaflet to the 27 million addresses across the UK in January 2005 to provide answers to some of the frequently asked questions about mail deliveries, the service customers should expect from Royal Mail, and who to contact if things go wrong.

As we expect the highest standards of integrity from our people, employees joining Royal Mail are now vetted to ensure they are not attempting to conceal any past criminal convictions. This adds an important new layer of security to our operations and means that customers can post their mail with even more confidence than before.

The number of casual employees taken on by the business has dropped significantly over the past year, from over 20,000 to around 2,500. Where we do need additional support to cover busy periods, we have been working to create a pool of high-calibre temporary employees. This involves issuing new recruits with a passport-style ID card, carrying details of the training and work experience they have had in Royal Mail, even if they have worked in different offices and have moved in and out of employment with the Company.

Our people, our greatest asset

The scale of change we have undergone, and the speed with which we have been able to bed those changes in whilst keeping the service going, is a testament to the hard work and commitment of our people. To recognise this, we are making a Share in Success payment of £1,074 to the majority of our people who have been with the business during the final year of our Renewal Plan. At £218m, that is probably the largest profitshare payment to employees of any UK company. We have also improved basic pay for postmen and postwomen, taking full-time basic pensionable pay to over £300 a week, and moved from a six-day to a five-day working week whilst deliveries continue six days a week.

Over the past 12 months we have continued to root out bullying and harassment because any such incidences will not be tolerated at any level. We undertook a Company-wide diversity training programme that ran throughout the year to show how everyone must be valued and respected for their contribution to the organisation, what types of behaviour are unacceptable and where to go for help if there is a problem. In recognition of the efforts the business has made in tackling these issues, the Race for Opportunity, in its report on race and ethnicity across a number of different business areas named Royal Mail Group the most improved organisation in its sector.

We have also made huge strides in tackling absenteeism. New initiatives to provide better support to people off sick and reward those people with a good attendance record were introduced last summer. In a prize draw that was open to our people who did not take any time off sick between the beginning of August 2004 and the end of January 2005, 37 people won a brand new car, 75 people won £2,000 in holiday vouchers and over 90,000 people won £150 in holiday vouchers as a thank-you for their contribution to customers and the business. In that six-month period, postmen and postwomen's daily attendance levels increased by almost 11% compared to the same period in the previous year – equivalent to an extra 1,000 postmen and postwomen at work collecting, sorting and delivering mail on any particular day.

Royal Mail Holdings plc

Annual Review (continued)

Other initiatives included maintaining closer contact with people who need to take time off because they are ill to ensure they are getting the right level of support to help them return to work as soon as they are able, and cover gaps without any loss of service to customers. We also improved the support available to anyone who is off sick. It is now easier and quicker for our people to get treatment that is more closely matched to their needs, a new medical helpdesk will assist referrals and there will be better access to physiotherapy and occupational therapy services for those who need them.

There are other ways in which we have been helping support our people by negotiating special deals on their behalf. Through the Learning for All initiative, around 26,000 people now have a computer at home with internet access, costing around 40 per cent less than comparable systems on the high street. Over 30,000 people have taken advantage of two 20% discount weekends at Homebase, and around 300 people have so far taken the chance to save up to £5,000 on a new Vauxhall car, under a deal reached between GM Motors and Royal Mail.

Internet shopping

Internet shopping is proving to be tough competition for high street retailers, with online retailing currently representing around 6% of retail sales and set to reach 15% by 2010, a market worth over £40bn. Over Christmas 2004, Royal Mail delivered 55 million items ordered online – 15 million more than the same period in the previous year. Books, videos and DVDs remain the favourite low-ticket items, but clothing and bigger-ticket items are becoming more popular, with clothing now accounting for 10% of total online sales. This growth has also driven up sales of postal orders at Post Office® branches by 6% - with a high proportion of customers in the 16 – 24 year age group - as they provide a secure and trusted form of payment for customers without a bank account. We estimate some 445,000 eBay sellers are also mailing 650,000 items via our Post Office® branches each week, with 23% of these items going overseas.

We work closely with retailers to ensure they are well placed to capitalise on this new retailing channel and can deliver the items to their customers. Following an agreement with US e-commerce solutions provider Marketworks, Royal Mail can now help companies who want to start trading on eBay.co.uk by managing all aspects of the operation – from store-front design, order management and online marketing activities to product warehousing and goods fulfilment. The partnership enables retailers to use eBay as a channel to complement other core sales activities, especially for trading overstock, refurbished items or goods that have been returned because they were unwanted, rather than damaged. We are also working to encourage retailers to take up our Local Collect service, whereby the retailer can offer to deliver a customer's items to their local Post Office® branch for collection if that is more convenient for the customer.

Helping small businesses

Royal Mail's online postage system SmartStamp™, launched last year, allows small businesses to add a professional look to their mail by printing a customised message or company logo alongside the postage impression directly from their own computers. This has proved a popular alternative to traditional stamps amongst small businesses across a range of sectors.

Some 13 million SmartStamp™ items have been sent to date, helping the 15,000 registered users to really make their mail stand out from their competitors, as well as saving them time. And the innovative postage system was also recognised at the National Business Awards last year, at which Royal Mail picked up the Best Use of Technology Award.

Additional advice on how small businesses can save time and money on their mailings can be found on Royal Mail's dedicated online information centre on our website - www.royalmail.com/smallbusiness. The Small Business Centre helps small companies to quickly and easily access information on everything from how to better manage mail costs to finding new customers and building lasting business relationships. It is also a forum for sharing experiences and successful tactics with other similar-sized companies.

1st Class People Awards

Our people are our greatest asset and to recognise the extraordinary efforts they go to as they deliver everyday to the UK's 27 million addresses, four postmen and postwomen were chosen from 30 regional finalists to receive this year's 1st Class People Awards. Tracey Smith and Karen Cowling were named "postman and woman of the year" for their heroic support to flood-stricken Boscastle, in Cornwall. The pair's unique local knowledge proved invaluable after devastating flash floods hit the historic village in August 2004. Both Karen and Tracey worked 20-hour days in the immediate aftermath of the disaster to help the emergency services and to ensure the mail continued to be delivered to villagers.

Steve Lyon, a Chippenham postman, was recognised for his brave rescue of an 18 month-old boy who fell into a fast flowing river whilst feeding ducks and was being swept towards a dangerous weir, and Watford postman Mohammed Younis was named Royal Mail's "fundraiser of the year" for raising £250,000 over the past 20 years to build a hospital for the residents of Pindi Bhattian, a remote area in Pakistan where medical help is currently over five hours away.

Being a responsible company

Royal Mail's business is large and we inevitably have a significant impact on the world around us. We take our corporate social responsibility seriously and in September 2004, we published our first full Corporate Social Responsibility (CSR) Report. This sets out our commitment to deliver our business in the right way for our people, our customers and our communities, the programmes we have developed to drive improvement and the targets we have set ourselves.

The report confirmed some very positive progress – our safety performance has improved and we are on track with the majority of our environmental improvement targets. Our approach has won recognition from many sources, including being recognised as European Best CSR Programme in the European Risk Management Awards 2004. During 2004-05, the number of reportable accidents in the business has continued to reduce, down over 23% to 5,598. Over the course of the Renewal Plan, we have seen reportable accident rates reduce by some 40%. This downward trend is the result of our investigations into all major accidents and many less serious incidents to help us identify areas where improvements can be made.

Royal Mail Holdings plc

Annual Review (continued)

Young letter-writers

Royal Mail's young letter-writers competition has attracted over 5 million entries since it began 28 years ago, making it the biggest letter-writing competition of its kind in the UK. Primary school children throughout the UK are invited to enter the competition and this year, the competition challenged the nation's young letter-writers to "Write to their 1st Class Hero".

Celebrations through stamps

Royal Mail's stamps celebrated a wide range of anniversaries and occasions over the past year. The courage of the soldiers who fought in the Crimean War 150 years ago was marked by a set of stamps issued last October.

In the first ever national television stamp poll, viewers of ITV1's This Morning voted to decide which ITV programmes from the past 50 years should appear in a specially commissioned set of Royal Mail stamps. The winner, Emmerdale, beat stiff competition from Coronation Street and The Bill, and will be seen on letters and parcels from September.

The most famous stamp in the world, the Penny Black, made a comeback this year, 163 years after its original issue, to mark the 250th anniversary of the Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA). It was shown on the 1st Class stamp, one of six issued to mark the RSA's unrivalled contribution to innovation and creativity over two and a half centuries.

Post Office Limited - changing focus for the future

The change to the way benefits such as pensions, child benefit and job seeker's allowance are paid has been a catalyst for change at Post Office Limited. Faced with the prospect of losing some 40% of its historic income from benefit payments as the direct transfer of money has replaced the previous paper-based system, the Post Office® is undergoing a huge culture change as it strives to become a more sales and customer-focused organisation to compete with other high street retailers and retain the 28 million customers who visit a Post Office® branch every week.

In its efforts to stem this loss of revenue, Post Office Limited has launched a number of new products and services over the past 12 months. The launch of car insurance, Growth Bonds and Guaranteed Equity Bonds has extended the portfolio of Post Office Financial Services and two new banking partners – Clydesdale Bank and the Bank of Ireland – now mean that more than 26 million people can withdraw cash free of charge over the counter at any Post Office® branch.

The challenge now facing Post Office Limited is to become better at selling its wide range of products and services if it is to stem its financial losses in the coming year. Its future will ultimately depend on its ability to sell its products and services.

Post Office Limited also entered the fixed telephone line market in January with the launch of Post Office® HomePhone. Over 60,000 customers signed up in the first 10 weeks, and the challenge that faces the Post Office® is to maintain this level of take-up if it is to reach its target of signing up 1million customers by 2008.

In the travel sector, the Post Office® established itself as a leading provider of foreign currency exchange services – where it is now number one in the market – and travel insurance policies. Around 2,000 on-demand Post Office® branches are now selling commission-free foreign currency – with the remainder of the branch network, offering a next-day delivery pre-order service.

Towards a viable and sustainable network of Post Office® branches

The past year has been a time of great change and some new thinking for our network of Post Office® branches. The restructuring of our urban network of Post Office® branches is now complete and, as we predicted, we remain at the heart of the community with more than 99% of the population in urban areas remaining within one mile of a Post Office® branch. Work is underway with our subpostmasters to improve the facilities and smarten up urban branches.

We remain committed to preventing avoidable closures of rural Post Office® branches. They play an important social role in everyday rural life and in recognition of this, we welcomed the Government's announcement that it will continue its funding of £150m per year until 2008. In addition to keeping rural branches running, the funding includes investment for new and innovative ways to provide Post Office® services to customers in more remote areas. As a result of the work of our dedicated team of rural transfer advisors, Post Office® branches can now be found in village halls, pubs and churches amongst other locations. We have teamed up with Norfolk Constabulary in a pilot to offer information and advice on Police matters as well as Post Office® products and services from a number of Norfolk branches. In Cumbria, a mobile Post Office® branch comes to customers, saving them a journey to a nearby town, and provides the same online banking transactions and wide range of other products and services as a permanent branch.

Going from strength to strength in the parcels business

In the parcels market, Parcelforce Worldwide has improved its financial position at the same time as continuing to improve the quality of service provided to customers, particularly in terms of its time-critical products. Over the past year it has grown its volumes and revenue, and continues to win significant business. It has also been named as European Express Parcel Carrier 2005 by the Institute of Transport Management in recognition of its high performance levels in delivering to customers, its use of sophisticated track-and-trace technology and its customer-focused employees.

Royal Mail Holdings plc

Annual Review (continued)

Now in its 12th year, the Parcelforce Worldwide Small Business Awards again recognised excellence amongst small businesses and their contribution to the economy. Sheffield-based Blue Chip Feed Ltd was named Small Business of the Year 2004. Judges praised the company, which supplies top quality horse feed, for its passion and success in creating a market for scientifically advanced horse feed products – Blue Chip Feed enjoys a 55% share of this specialist market.

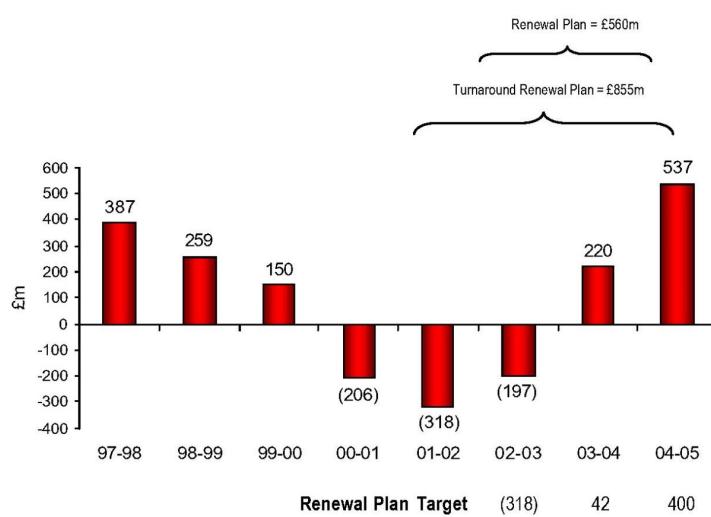
Parcelforce Worldwide delivers to over 240 countries and territories worldwide and is the UK partner of General Logistics Systems (GLS), our European parcels business. This comprises a network of companies in 15 countries that deliver on average one million parcels per day across 34 countries for some 180,000 customers.

We have come a long way since the start of our three-year Renewal Plan but as Royal Mail now faces full competition from January 2006, in the UK mail market, our challenge is to further improve service to customers and invest in our people so we are the company that customers choose.

Royal Mail Holdings plc

Operating and Financial Review

Introduction and financial highlights



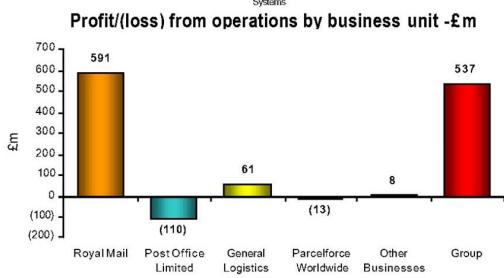
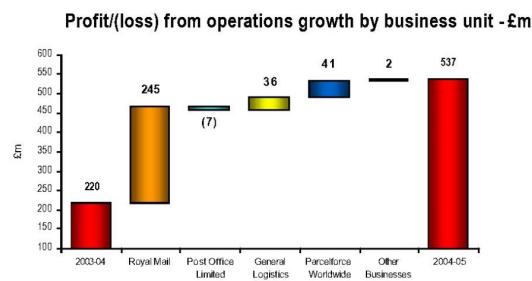
This year is the final year of the Group's three-year Renewal Plan, which set out to restructure our operations and create a profitable and sustainable business that can confidently face the imminent challenge of competition within each of our core markets – letters, parcels and the Post Office® retail network.

Summary of results	2005 £m	2004 £m
External turnover	8,956	8,633
Profit from operations	537	220
Exceptional items:		
Share in Success costs	(218)	nil
Other	8	nil
Profit before interest and taxation	189	88
Net interest receivable	18	17
Profit before taxation	207	105
Taxation credit/(charge)	28	(98)
Profit after taxation	235	7

This year we report record profit from operations of £537m compared to £220m for 2003-04, an increase of £317m or 144.1%. All operational business units apart from Post Office Limited contributed to this increase, with Royal Mail improving profitability by £245m (70.8%), General Logistics Systems by £36m (144.0%), Parcelforce Worldwide by £41m (75.9%), whilst Post Office Limited increased its losses by £7m (6.8%). Royal Mail's £245m improvement is mainly due to an increase of £211m (3.2%) in mail revenues - which have benefited from underlying volume growth, excluding international products and Door-to-Door, of 1.4% and additional price increases of 1.3% as permitted under the current price control. Royal Mail's net costs were reduced by £35m (0.7%) adding to the turnaround, the higher people costs with respect to the 14.5% pay deal being more than offset by reductions in non people costs.

Despite the loss of the traditional benefits income which had represented 40% of its historic revenue and a share of start-up losses amounting to some £18m for the new financial services products, Post Office Limited contained its losses to £110m, which is £7m (6.8%) worse than last year. This was achieved by attracting new revenue, primarily from higher banking and Bureau de Change activity, together with continued improvements in overall cost efficiency. The £110m loss includes the cost of maintaining the uneconomic part of the rural network – had this activity been funded by an arm's length commercial contract with Government rather than funded from our balance sheet reserves, Post Office Limited would have made modest profits.

GLS's external turnover rose by £95m (11.6%) including an £8m favourable impact as a result of the strengthening of the euro. The underlying growth of £87m (10.6%) results from strong growth in core parcel volumes, particularly in central Europe and the contribution from acquisitions of £23m. Profit from operations increased by £36m (144.0%), from £25m last year to £61m this year, driven by a combination of increased turnover, tight cost controls and improved operational productivity, which resulted in a profit margin of 6.7%.



Royal Mail Holdings plc

Operating and Financial Review (continued)

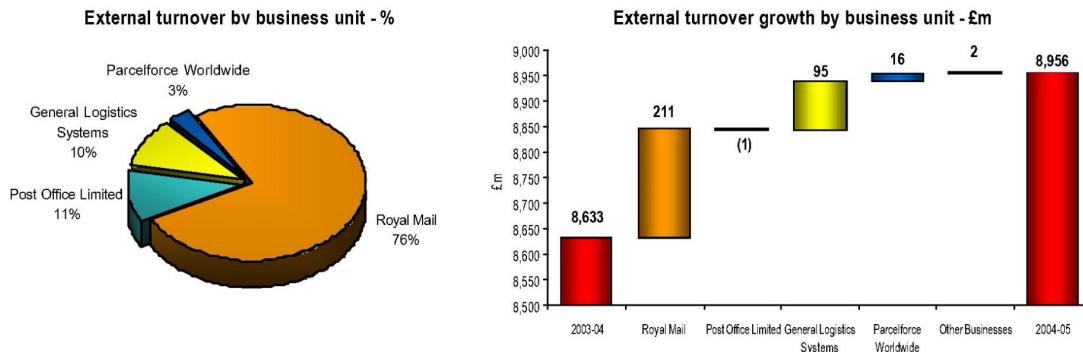
Parcelforce Worldwide contributed £41m to the overall Group profit from operations improvement because of a reduction in losses from operations from £54m to £13m, an improved performance of 75.9%. Importantly, this business generated profits from operations in the second half of the year. This performance results from revenue growth (5.7%) and improved margins, due to its cost reduction programmes.

Other businesses include the Group's share of results from our joint ventures (JVs) and associates, notably Romec (facilities management), Quadrant (catering), National Design Consultancy (NDC) (building engineering services) and Camelot (lottery). In aggregate, the other Group businesses reported profits up at £8m compared to £6m last year.

These results show that the Share in Success target of £400m has been more than achieved and represents a £1,074 before tax payment to all our people who were with us throughout 2004-05. This equates to an investment in our people of £218m – or nearly a month's wages for most of our qualifying people – to reward their contribution over the last three years and their dedication to our business. This cost has been classified as an operating exceptional item due to the payment being the first of its kind by the business and its size.

These results also include significant compensation costs, which will be paid to our customers next year for missing quality of service targets throughout the year. This is on top of the £58m related to last year's poor performance. However, throughout this year, quality of service trends have improved and the main driver of compensation costs this year was underperformance in quarter 1 – mainly as a result of the bedding-in of the Transport Review and Single Daily Delivery.

External turnover



External turnover has increased by 3.7% (£323m) from £8,633m to £8,956m, of which £211m was driven by domestic mail volume growth (1.4%) and domestic mail price increases (1.3%) in Royal Mail. Mails revenue contributes 75.5% of the Group's external turnover. Post Office Limited reported a decrease of 0.1% (£1m) from £977m to £976m (10.9% of Group external turnover), primarily as a result of erosion of traditional benefits volumes offset by new financial service revenues. General Logistics Systems increased its turnover by 11.6% (£95m) – 10.6% before exchange rate impact - from £818m to £913m (10.2% of Group external turnover) due to volume growth, primarily in Germany, France and Italy, and some country specific price increases, whilst Parcelforce Worldwide increased its turnover by 5.7% (£16m) from £282m to £298m (3.3% of Group external turnover), reflecting higher volumes relating to increases in national account products and favourable mix.

Costs (excluding exceptional items)

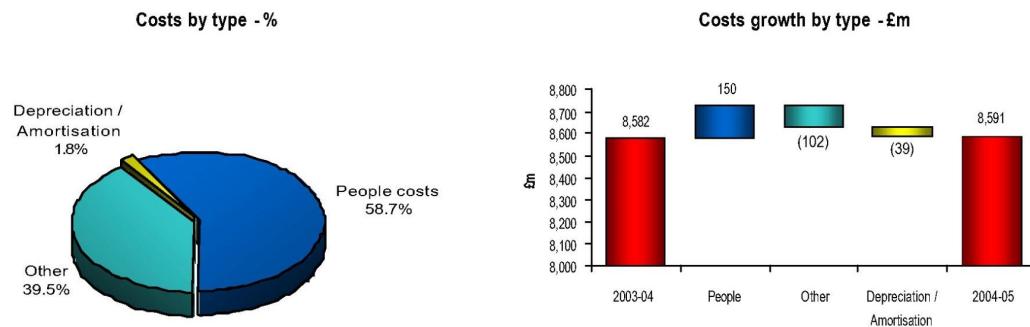
In total, costs of £8,591m have increased by £9m (0.1%), which confirms that the pay deal, inflation and volume growths have been absorbed by efficiency gains arising from the core change programmes and reduction in other operating costs such as administration and facilities.

People costs of £5,038m represent 58.7% of the Group's cost base and have increased by £150m (3.1%) during the year, primarily due to the pay deal to our postmen and postwomen, which gave a further increase of 10% - taking basic weekly pay to £300 per person for the majority of our frontline people, upon successful completion of core efficiency programmes – offset by reductions in people due to voluntary redundancy.

Other operating charges of £3,397m represent 39.5% of the Group's cost base and have decreased by £102m (2.9%) due to continuing efficiency improvements in a number of areas, including central support functions, whilst depreciation/amortisation represents £156m (1.8%) of the cost base and has reduced by 20.0%.

Royal Mail Holdings plc

Operating and Financial Review (continued)



Profit from operations

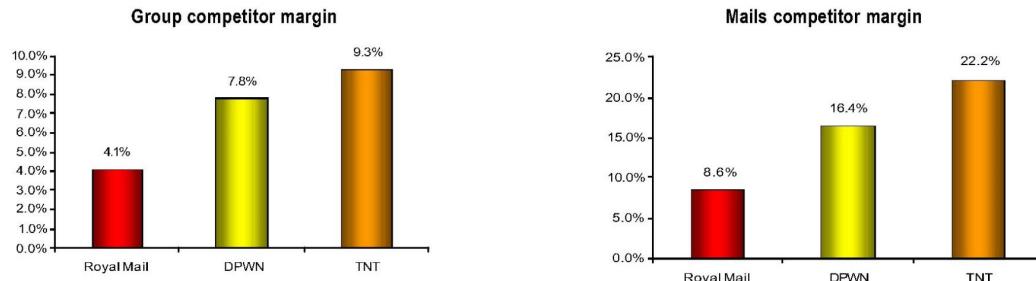
Summary	2005 £m	2004 £m
Group operating profit before exceptional items	365	51
Add share of profits in JVs and associates	34	37
Total operating profit before exceptional items	399	88
Add pension deficit charge under SSAP 24	138	132
Group profit from operations	537	220

The Group continues to report profits from operations during the Renewal Plan to measure its underlying profitability performance. This measure excludes charges relating to pension funding deficits but includes its share of results from joint ventures and associates. The reconciliation to Group operating profit before exceptional items in the profit and loss account is shown in the adjacent table, which highlights that the Group reported £399m (2004 £88m) profit after pension deficit costs, an improvement of 353.4% over the prior year.

Margins

Margins (Group operating profit before exceptional items expressed as a percentage of external turnover) of 4.1% improved compared to the 0.6% return last year. This is entirely due to the increase in turnover of £323m flowing through to profit from operations, which highlights the fact that the Group is absorbing additional volume and pay deal costs and thus delivering real efficiencies within its cost base.

Although our returns continue to improve, they compare unfavourably to other European postal operators as shown below. This is mainly due to Royal Mail's domestic letter prices being lower than the rest of Europe.



However, the above analysis does not highlight that our mails business makes losses of over £200m on nearly 90% of its price controlled volumes. These are offset by profits from the remaining 10% of price controlled products and non regulated mails products such as contract services.

Pension costs

Summary of pension charges	2005 £m	2004 £m	
Regular pension costs	253	243	
Pension deficit charge	138	132	
Exceptional redundancy costs	21	54	
Total charge included in profit before taxation	412	429	

This is the last year that the Group will account for pension costs under SSAP 24 Accounting for pension costs, as next year it will report under International Financial Reporting Standards. The current pension deficit charges are based on the last full triennial valuation as at March 2003. This valuation confirmed a substantial deficit due principally to changes in asset valuations, lower discount rates, a fall in the expected long-term investment returns that effectively increased the liabilities of the Plan, and increased life expectancy of employees and pensioners.

Regular pension costs, which are included within profit from operations are £253m (2003 £243m). The pension deficit net cost of £138m consists of £198m in respect of recognising the accounting deficit over 12 years – the average remaining service life of employees – offset by notional interest on the pension prepayment of £60m. Full disclosure of pensions, including the estimated significant impact of FRS 17 Retirement benefits, is made in note 19 to the accounts.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Pension cash funding

Summary of pension cash flows	2005 £m	2004 £m
Regular pension contributions	187	16
Funding of pension deficit	138	45
Payments relating to redundancy	5	194
Prepayments for next year	-	125
Net cash payments	330	380

The calculations to determine the funding of the pension schemes do not rely on the same assumptions that are used to generate the SSAP 24 charge to the profit and loss account. More prudent actuarial assumptions are used by the Trustees and independent Plan actuary, and using the latest valuation this has confirmed a cash funding shortfall of £2.5bn, against which we have now paid £271m, including £138m in 2004-05. Cash flows relating to pensions are highlighted in the adjacent table. In addition, a further payment of £200m relating to redundancy costs was made in the first week of 2005-06. The year's cash flows are positively impacted by £128m, due to the timing of pension prepayments. Over the course of the Renewal Plan we have paid £255m into our pension plan to fund the pension element cost of the redundancy payments.

Share of profits in associates and joint ventures

The Group's share of profits in associates and joint ventures of £34m (2004 £37m) comprises £1m (2004 £4m) from Romec, £8m (2004 £4m) from Camelot, £1m (2004 £1m) from NDC, £38m (2004 £21m) from the Bureau de Change joint venture (First Rate Travel Services Limited), £5m (2004 £7m) from Quadrant, a loss of £18m (2004 £2m) from Post Office Financial Services and a £1m loss (2004 £2m profit) from other minor ventures. The losses from Post Office Financial Services were expected and are a result of start-up costs, mainly associated with sales and marketing expenditure. During the year, changes were made to the ownership and control of NDC and Romec, resulting in these being accounted for as subsidiaries with effect from 7 October 2004 and 22 December 2004 respectively.

Exceptional items - Share in Success

A charge of £218m has been made this year (2004 £nil), which represents the costs of paying to each eligible UK employee, namely those who have been with the Group throughout the last year of the Renewal Plan and up until the date we announced our results, some £1,074 before tax. This means that of the £560m net profit since the start of the Renewal Plan, 39% has been paid back to our people in recognition of the considerable effort during the turbulence necessitated by the Renewal Plan and the many different turnaround programmes, including the restructuring of Parcelforce Worldwide, Network Reinvention in Post Office Limited, and Transport Review, Single Daily Delivery and Mail Centre Review in the letters operations.

Exceptional items - other

Net other exceptional items of £8m (2004 £nil) comprise £59m of operating exceptional costs (2004 £64m), offset by £67m of non-operating profit. The latter relates to the sale of properties £70m (2004 £67m), offset by a loss on the disposal of Citipost, £3m (2004 £3m loss relating to business disposals – primarily the outsourcing of IT operations and the associated disposal of CSC Business Systems Limited). The £59m of operating exceptional costs relates to further redundancy costs of £34m for Royal Mail, £23m for impairment of fixed assets and £2m for other operating costs (2004 £23m restructuring and £41m for impairment of fixed assets).

Net interest receivable

Net interest received increased from £17m in the prior year to £18m. This was due to higher interest rates received on the Group's cash and current asset investments, offset by a reduction in average net investment balances arising mainly from redundancy payments made to our people and other exceptional costs in the year of £255m.

Taxation

The accounts include a tax credit of £28m (2004 £98m charge) for the period. This is due to utilisation of tax losses in Post Office Limited, the rollover of profits on the sale of property into the tax carrying value of new property, the settlement of prior year issues with the Inland Revenue and the recognition of a deferred tax asset with respect to our European parcels business, in light of its continued improvement in performance. The charge for 2003-04 was mainly due to the tax on disposal of CSC Business Systems Limited and unrelieved losses in Post Office Limited.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Cash flow and capital expenditure

Summary of cash flows	2005 £m	2004 £m
Net cash outflow from operating activities	(220)	(241)
Dividends received from JVs and associates	19	21
Capital expenditure and disposals	(124)	(56)
Tax and interest	23	29
Business acquisitions and disposals	(2)	25
Net cash outflow	(304)	(222)
Post Office Limited working capital funding	(444)	(287)
Cash inflow before Post Office Limited working capital funding	140	65

Net cash outflow from operating activities reduced from £241m to £220m. This is mainly due to operating profit before exceptional items of £365m (2004 £51m) and depreciation/amortisation of £156m (2004 £195m) being more than offset by rationalisation spend of £255m (2004 £412m) and working capital outflows of £486m (2004 £75m). The working capital movement is principally driven by the expected withdrawal of interest free benefits pre-funding, which acted as quasi equity funding in Post Office Limited £444m (2004 £287m), and which is replaced by an interest bearing loan from Government. Dividends received from joint ventures and associates of £19m (2004 £21m) are mainly from Quadrant, £2m (2004 £7m), Camelot, £5m (2004 £7m) and the Bureau de Change business, £10m (2004 £5m).

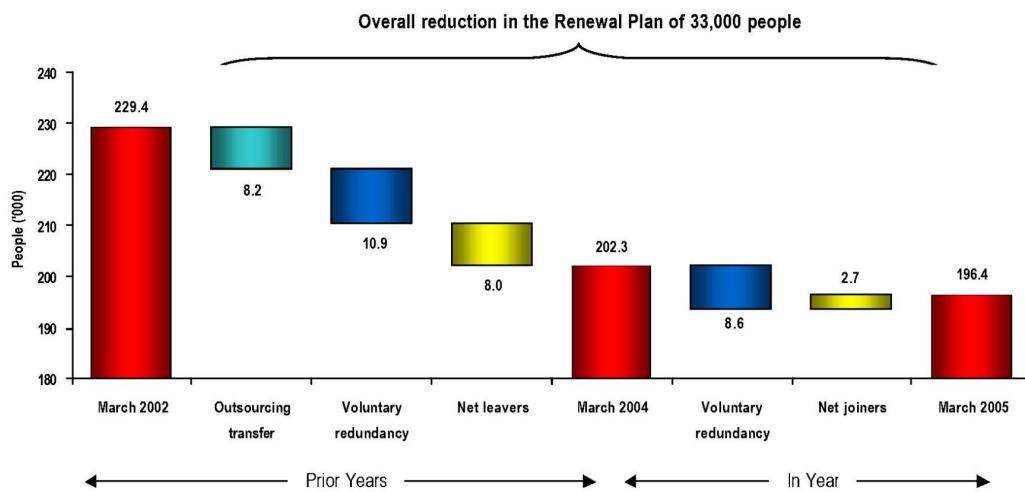
Capital expenditure net of disposals of £124m (2004 £56m) comprises £219m (2004 £158m) of expenditure for our strategic efficiency projects, including the international mail centre near Heathrow of £26m, further spend on mails automation of £21m, £14m for sorting frames for Single Daily Delivery, £22m for new GLS depots and the balance for motor vehicles and property improvements, offset by inflows of £95m (2004 £100m), mainly from surplus property disposals. Tax and interest inflows in the year of £23m (2004 £29m) are broadly in line with last year. Business acquisitions and disposals of £2m outflow (2004 £25m inflow) relates to the purchase by the GLS Group of two Italian businesses (DGE Firenze and DGE Vincenza). Last year, the Group received £25m, primarily relating to the disposal and outsourcing of IT operations to the Prism alliance.

Provisions

Provisions at the end of March 2005 were £266m comprising £171m (2004 £479m) relating to rationalisation and £95m (2004 £96m) relating to deferred tax. Rationalisation provisions of £355m have been utilised during the year (of which £224m was cash spend) mainly to fund voluntary redundancies offset by new exceptional rationalisation charges of £36m, principally relating to further redundancy costs within the letters operations, and new non-exceptional property related provisions of £11m.

People

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



During the period 8,617 of our people took up the opportunity for voluntary redundancy as we completed our implementation of the following programmes:

- Royal Mail Letters - Single Daily Delivery and Mail Centre Review;
- Royal Mail Logistics and Royal Mail Letters - Transport Review;
- Continuation of the restructuring project of Parcelforce Worldwide; and
- The Group Centre and other overhead areas of our businesses - managerial voluntary redundancy programme.

Royal Mail Holdings plc

Operating and Financial Review (continued)

This was offset by 2,725 net joiners, which was the result of reducing the mix of agency staff within the frontline letters operation and increasing the amount of full-time employees.

A reconciliation to the Group headcount is shown in note 2 to the accounts.

Treasury management

The Group operates a central Treasury function that manages some £1.1bn of current asset investments, £860m of borrowings and £890m of cash primarily in the Post Office® network, in accordance with investment restrictions set by the Government. It also acts as internal banker for the Group's business units. The Group finances its operations largely through retained profits and borrowings.

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

The Group is financed from the following facilities provided by the DTI and HM Treasury:

Borrower	Purpose	Facility end date	Facility £m	Utilised £m	Average loan maturity date
Royal Mail Group plc	Acquisition funding	2021-2025	500	500	2023
Royal Mail Group plc	Restructuring and working capital	2007-2009	844	Nil	-
Post Office Limited	Netw ork cash repayable on demand	2010	1,150	360	2005

The terms of the Government borrowing facility and the associated Framework Agreement impose strict constraints on the separation of cash funds within the Royal Mail Group and the purposes for which they can be used. The committed borrowing facilities relating to Royal Mail Group plc and Post Office Limited, along with net cash investments held on the balance sheet, ensure that the Group can finance its operations into the foreseeable future.

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

- The Group is exposed to foreign currency risk due to Royal Mail International's obligation to pay overseas postal operators for carrying UK mail abroad, and the balances held to operate the Bureau de Change services within Post Office Limited. These risks are mitigated by a hedging programme managed by Group Treasury. Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts. All other significant liabilities are hedged when they become contractual.
- The Group's obligation to pay overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising of USD, JPY, Sterling and euro. The Group has a policy of matching receipts and payments for individual currencies where possible and then hedging any material net exposure. The policy is that up to 80% of the forecast net exposure is hedged with agreement of the internal business unit. Group Treasury operates a rolling 18-month programme, which is subsequently reviewed on a quarterly basis.
- Balances of major currency holdings along with minor currencies showing a closely correlated movement for the Bureau de Change business are hedged.
- The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries.
- The Group is exposed to fuel risk arising from operating one of the largest vehicle fleets in Europe, which consumes over 150 million litres of fuel per year and a jet fuel risk from the purchasing of air freight services. The Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy operates within the parameters set by the Board, which allow the use of over-the-counter derivative products to manage these exposures.
- Counterparty risk is managed by limiting aggregate exposure to any individual counterparty based on their financial strength.

These exposures are reviewed regularly and adjusted as appropriate.

Regulation

Since April 2004, Royal Mail has continued to discuss its proposed move from weight to size-based pricing with Postcomm. Postcomm announced in April 2005 that it was minded to accept Royal Mail's proposals subject to final consultation. If approved, the new prices will be introduced from April 2006.

In June 2004, Postcomm published its Decision Document on the services that are to be classified as universal postal services. Postcomm proposes that 1st and 2nd Class services up to 2 kgs should be universal. This decision requires an increase in the weight range of 2nd Class services offered from 750 grams up to 2 kgs. The question of which bulk mail services should be classified as universal remains open and a decision is expected on this during 2005-06.

Royal Mail Holdings plc

Operating and Financial Review (continued)

In September 2004, Postcomm published three further consultation documents:

- Proposals for a revised timetable for opening the market: Postcomm proposed to bring forward the date of full liberalisation from April 2007 to January 2006 with no further intermediate steps. This decision was confirmed in February 2005 and the UK postal market will be fully competitive from January 2006.
- A Competitive Market Review: Since competition has not evolved as much as had been expected, Postcomm proposed measures to encourage further competition including bringing access arrangements within the next price control, lobbying for Royal Mail to be liable for VAT, increasing Postcomm's resources for dealing with possible anti-competitive behaviour by Royal Mail, and raising the awareness of liberalisation amongst customers. In March 2005, Postcomm issued a Decision Document that included a recommendation that a solution was needed to the VAT issue and considered that VAT at 5% applied to postal services is one solution. It is also recommended that a number of privileges afforded Royal Mail as a universal service provider should be removed and that privileges should no longer be extended to Parcelforce Worldwide.
- The 2006 Price and Service Quality Review: Postcomm is now consulting on the next price control to operate from April 2006, with 'Initial Proposals' being due in May 2005 and 'Final Proposals' in autumn 2005.

Downstream access

The Group has experienced significant growth in downstream access volumes, with the first contracts being signed in February and April 2004 and over 100 million items handled by our Access Unit in 2004-05. In addition to access via other postal operators such as UK Mail Ltd, TPG Post UK Ltd and Deutsche Post Global Mail (UK) Limited, the Group is also receiving access mail from Regional Mail Services Ltd and direct from one of its major customers. Other major customers are expected to access Royal Mail's postal facilities directly next year.

Special reserves

During the period, £151m of the Rural Network Reserve has been used by Post Office Limited, representing the financing required during the period to maintain the rural network of Post Office® branches.

International Financial Reporting Standards (IFRS)

Royal Mail prepares its financial statements under UK Generally Accepted Accounting Principles (UK GAAP). From the period commencing 28th March 2005 the Royal Mail Group will prepare its consolidated financial statements in line with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). Royal Mail's first IFRS results will be the interim figures for the half year to September 2005.

The Company's established project team continues to manage the conversion to IFRS and this team is working closely with our external auditors. The Group continues to make good progress towards IFRS conversion and will be restating the March 2005 financial statements under IFRS, on the basis of IFRS's anticipated to be in place for the year ending March 2006. The profit and loss account, balance sheet and cash flow statements from these restated financial statements will then be subject to external audit review and it is anticipated that this will be completed by September 2005.

IFRS's are subject to ongoing review, endorsement by the EU and interpretations by the International Financial Reporting Interpretations Committee (IFRIC). Since the standards at March 2004 were finalised there have been a number of changes:

- The IASB has issued an amendment to IAS 19 on Employee Benefits allowing actuarial gains and losses to be accounted for through a Statement of Recognised Income and Expenditure (SORIE). This closely follows the approach in the UK standard FRS 17 on Retirement benefits.
- The EU has endorsed a revised version of IAS 39 on Financial Instruments referred to as the 'carve out' version.
- Several other interpretations and amendments of less relevance to Royal Mail.

There may be further changes to IFRS before Royal Mail first publishes its March 2006 financial statements and the Company will address these as they arise and implement where appropriate.

First time adoption of IFRS is in line with IFRS 1. IFRS is to be adopted fully retrospectively, however, there are a number of exemptions under IFRS 1 which Royal Mail is likely to adopt. These will be discussed in the first published IFRS financial statements.

The international standards which are likely to have most impact on Royal Mail are:

IAS 1 Presentation of Financial Statements. This standard gives guidance on what must be presented in the first IFRS financial statements although there are no prescribed formats for the income statement and balance sheet under IFRS. Royal Mail will follow the guidance of the standard whilst retaining the format it has developed over the past years to the extent that it is appropriate. The cash flow statement will be in line with the international standard IAS 7.

IAS 19 Employee Benefits. Under this standard the Royal Mail pension deficit will be recognised in the balance sheet and the existing pension prepayment de-recognised. Recognition and measurement under IAS 19 is similar to the UK standard (FRS 17), which was due to be introduced at the latest, for accounting years beginning after 1 January 2005. Actuarial gains and losses in future years will be recognised in the SORIE.

IAS 12 Income Taxes. The major impact of this standard is expected to relate to the measurement and recognition of deferred tax in respect of the pension deficit recognised under IAS 19.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Segmental analysis – turnover and profitability

The segmental analysis in note 1 to the accounts has two principal segments: (i) Mails and Parcels covering Royal Mail, Parcelforce Worldwide and General Logistics Systems and (ii) Post Office Limited. The analysis below sets out trading results, which focus on:

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

Furthermore, comparatives below have been restated to reflect the changes in the charging of interest for centrally managed resources and minor changes in organisational structures that took place during the year.

Group external turnover of £8,956m (2004 £8,633m) and profit from operations of £537m (2004 £220m) are made up as follows:

Business unit performance	External turnover		Profit/(loss) from operations	
	2005 £m	2004 £m	2005 £m	2004 £m
Royal Mail	6,763	6,552	591	346
Post Office Limited	976	977	(110)	(103)
General Logistics Systems	913	818	61	25
Parcelforce Worldwide	298	282	(13)	(54)
Other businesses	6	4	8	6
Group	8,956	8,633	537	220

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

Royal Mail	2005 £m	2004 £m
External turnover	6,763	6,552
Profit from operations	591	346

External turnover grew by £211m (3.2%) to £6,763m, which is a result of price increases of 1.3% in April 2004, an underlying increase in volumes of some 1.4%, with the remainder of the growth due to favourable mix impacts. The price increases are across most products as permitted by the current price control, which allows Royal Mail to increase its prices by RPI minus 1%. The growth in volumes, excluding International products and Door-to-Door of 1.4%, from 19.9 billion to over 20.2 billion items is mainly driven by the Mailsort, Special Delivery and Walksort product range.

The increase in profit from operations of £245m (70.8%) is mainly driven by the turnover growth highlighted above and reduction of overheads because the increase in costs relating to the pay deal has been more than offset by efficiencies relating to the core change programmes and reductions of administration and facility costs.

Post Office Limited	2005 £m	2004 £m
External turnover	976	977
Loss from operations	(110)	(103)

Post Office Limited operates a network of 14,609 retail outlets.

Turnover decreased by £1m (0.1%) due to reduced benefit payments revenue as a result of migration to direct payment of benefits but offset by further growth in banking revenue, and other products such as mobile phone E top-ups. New products such as the Post Office® savings stamp have been introduced and during the year personal loans, car insurance, home insurance and HomePhone have also been successfully launched.

Losses from operations increased by £7m (6.8%) primarily due to reduced benefit payments and a share of losses from the launch of the new financial services products of £18m. This was offset by the gains in new revenue together with continued management focus on cost reduction. The Network Reinvention programme has generated efficiency savings of £39m, whilst underlying staff salaries have reduced by £6m due to the continuing drive to reduce central costs. These cost reductions have been offset by the increased back office costs of the Card Account product.

Royal Mail Holdings plc

Operating and Financial Review (continued)

General Logistics Systems	2005 £m	2004 £m
External turnover	913	818
Profit from operations	61	25

External turnover rose by £95m (11.6%) including an £8m positive impact as a result of the strengthening of the euro. The underlying growth of £87m (10.6%) results from strong growth in core parcel volumes, particularly in central Europe, new Italian franchisee acquisitions and the consolidation of GLS Poland. Profit from operations increased by £36m (144.0%), from £25m last year to £61m this year driven by a combination of increased turnover, tight cost controls and improved operational productivity, all of which is reflected in higher margins.

Parcelforce Worldwide	2005 £m	2004 £m
External turnover	298	282
Loss from operations	(13)	(54)

External turnover rose by £16m (5.7%) as Parcelforce Worldwide begins to see the benefits of its refocused commercial direction.

Operational restructuring continues to focus upon improving efficiency and reducing costs within the network. Whilst operational costs have improved, progress against planned revisions was slower than anticipated, reflecting lengthy but ultimately successful negotiations with the CWU over the final

phase of depot restructuring. Strong improvements in people, vehicle and logistics costs have in part been offset by increased export conveyance charges. Loss from operations of £13m has improved by £41m (75.9%) from last year. Importantly, Parcelforce Worldwide exited the year generating profit from operations in the second half year of £3m.

Other businesses	2005 £m	2004 £m
External turnover	6	4
Profit from operations	8	6

Other Group businesses principally comprise internal interest and the Group's share of profits of centrally held associates. During the year, two of these – Romec and NDC – became subsidiaries which is the main reason for the increase in profitability. The results of other associates and joint ventures not held centrally (Bureau de Change and financial services) are included within Post Office Limited's results.

Way forward

The Renewal Plan has been completed and our financial objective of turning the business from losing £318m in 2001-02 to making profits in 2004-05 of £537m, a £855m turnaround has been delivered – well in excess of our target profit expectations of £400m. Furthermore, the Group has generated £140m of cash – excluding Post Office Limited's interest bearing working capital requirements, which are replacing the interest free benefits pre-funding, but including £255m (2003-04 £412m) in respect of rationalisation costs, primarily due to the Renewal Plan voluntary redundancy programmes.

Our core strategic programmes and other cost reduction programmes have delivered over £1.5bn (15%) of gross savings, which is 7% more than the original efficiency target set at the start of the Renewal Plan of £1.4bn, which has been reinvested in our customers, including improving quality of service, and in our people. This provides a solid financial profitability platform to improve returns to our Shareholder and to compete successfully following the introduction of further competition in our domestic letters market.

During the Renewal Plan, the Group has incurred rationalisation cash costs of over £900m, pension deficit cash costs of £271m, some £660m to fulfil Post Office Limited's requirement for cash in its network and some £450m for Rural Network support. These have been financed primarily by internally generated cash, with only £360m of Post Office Limited's committed facility of £1,150m from Government being utilised to replace the pre-funding of cash for the network – the Royal Mail Group plc Renewal Plan loan facility has not been used at all. However, going forward Post Office Limited cannot be expected to absorb the costs relating to the support of the uneconomic part of its rural network and the Group cannot be expected to carry the pension funding deficit of some £2.5bn and the related accounting impact of £3.95bn on its balance sheet, following the introduction of the new accounting standards, without the support of all our stakeholders.

The completion of the Renewal Plan is only the first step in transforming ourselves into a Group where each of our businesses is truly commercial and market focused, generating both profits and cash to permit further investments in our people and their pension fund, in technology and service offerings to satisfy the needs of our customers and which deliver the returns required by our Shareholder. Key to achieving this is the continuation of efficiency improvements, and achieving a satisfactory price control which permits Royal Mail to change its prices to better reflect its costs and which also provides a medium-term solution to the pension funding deficit.

Marisa Cassoni

Group Finance Director

16 May 2005

Royal Mail Holdings plc

Royal Mail Holdings plc Board

Non Executive Directors

ALLAN LEIGHTON (CHAIRMAN)

Allan (52) joined the Board in April 2001 as a Non Executive Director, becoming Chairman in March 2002. He is also a Director of PostOffice Limited, and a member of the Nomination Committee and the GLS Supervisory Board. He began his career with Mars Confectionery and moved to Pedigree Petfoods as Sales Director. In 1992 he became Group Marketing Director of Asda Stores Limited, and Chief Executive in 1996, becoming President and CEO of Wal-Mart Europe when Wal-Mart bought Asda in 1999. He left in 2000 and is currently Chairman of BHS Limited, Non Executive Director of BSkyB, Selfridges Holdings Limited and Business in the Community. He held the position of Non Executive Chairman of Cannons Health Club until 30 September 2004. He was Chairman of Lastminute.com until 1 January 2005, and was a Non Executive Director of Dyson Ltd until 20 December 2004.

DAVID FISH

David (56) joined the Board on 1 January 2003. He is Chairman of the Remuneration Committee, and a member of the Nomination Committee. He was a member of the Mars Inc Operating Board from 1994 to 2001, and Joint President of Masterfoods Europe. He has also been President of Snackfoods Europe, and held European Vice-President positions in marketing and personnel. He is Chairman of United Biscuits Group (Investments) Limited and Chairman of Christian Salvesen.

RICHARD HANOVER

Richard (59) was appointed to the Board on 1 January 2003. He is Chairman of the Nomination Committee, and a member of the Remuneration Committee. He is Chairman of the Adult Learning Inspectorate and Business in the Community Education Leadership, and is a Non Executive Director of the Nationwide Building Society. He was Chairman of WH Smith plc until 31 January 2005.

SIR MICHAEL HODGKINSON

Mike (61) was appointed to the Board on 1 January 2003. He is the Senior Independent Director, and a member of the Remuneration Committee. In May 2003, he was appointed Chairman of Post Office Limited and he is also Chair of the Corporate and Social Responsibility Governance Committee. He was Chief Executive of BAA plc until retiring in June 2003. He is Board Member and Chairman of the Finance Committee of Transport for London, a Non Executive Director of FKI plc and The Bank of Ireland Limited, and the Non Executive Chairman of First Choice Holidays plc.

JOHN NEILL CBE

John (57) was appointed to the Board on 1 January 2003, and is a member of the Audit and Risk Committee. He has been Group Chief Executive and Deputy Chairman of the Unipart Group of companies since 1987. He was formerly a Director of the Court of the Bank of England, and a Non Executive Director of Charter plc. He is also Vice-President of the Society of Motor Manufacturers and Traders, and a Director of the SMMT Industry Forum, Business in the Community and Vestcave Limited.

BARONESS MARGARET PROSSER

Margaret (67) joined the Board on 1 November 2004, and is a member of the Audit and Risk Committee. She has been a member of the House of Lords since 2004. She is a Non Executive Director of the Trade Union Funds Managers, and has been Chair of the Women and Work Commission since July 2004. She is also a member of the Low Pay Commission, and Chair of the Women's National Commission.

BOB WIGLEY

Bob (44) joined the Board on 1 April 2003, and is Chairman of the Audit and Risk Committee. He is Chairman of Merrill Lynch's business in Europe, the Middle East and Africa, a Trustee of the children's mobility charity, Whizz-Kidz and a director of Business in the Community.

Executive Directors

ADAM CROZIER (CHIEF EXECUTIVE)

Adam (41) joined the Company on 1 February 2003. He is Chairman of the Management Board, the Parcelforce Supervisory Board and the Letters Board. He had previously been Chief Executive of the Football Association since 2000. Before then he had held a number of senior roles at Saatchi and Saatchi Advertising, including that of Joint Chief Executive from 1995.

DAVID MILLS (CHIEF EXECUTIVE, POST OFFICE LIMITED)

David (61) joined the organisation as an Executive Director and Chief Executive of Post Office Limited on 15 April 2002. He is also a member of the Management Board. He began his career with Midland Bank (now HSBC Bank plc) in 1962, where he conceived and established First Direct. In December 1999, he was appointed General Manager, Personal Banking. He is currently Chairman of Post Office Financial Services and the Employers' Forum on Disability, a Director of Camelot plc, and a Trustee of the Royal Association for Disability and Rehabilitation (RADAR).

MARISA CASSONI (GROUP FINANCE DIRECTOR)

Marisa (53) joined the Company on 1 February 2001, and is a member of the Management Board, and Chair of the Pensions Committee, Chair of the Risk Management Committee, a Trustee of the Royal Mail Pension Plan, and a member of the GLS Supervisory Board and the Parcelforce Supervisory Board. She was previously with Britannic Assurance plc, where she had been Group Finance Director from 1998. Prior to that she had been Finance Director of Prudential's UK Division since 1994. She became a Non Executive Director of Severn Trent plc in September 2001.

TONY McCARTHY (GROUP DIRECTOR PEOPLE & ORGANISATIONAL DEVELOPMENT)

Tony (49) joined the Company on 6 January 2003, and is a member of the Management Board, the Pensions Committee and the Corporate and Social Responsibility Governance Committee. He had previously been Group Human Resources Director of BAE Systems, where he had worked in a variety of HR roles since 1978.

DAVID BURDEN (GROUP CHIEF INFORMATION OFFICER)

David (58) joined the Company on 1 November 2002, and was appointed to the Board on 1 July 2004. He is a member of the Management Board and the Risk Management Committee. He had previously held the position of Executive General Manager, Technology and Services at Qantas Airways Ltd. He led the development of an integrated IT infrastructure and applications portfolio, and was a member of the Executive Committee during the transition to it becoming a successful public company.

Royal Mail Holdings plc

Royal Mail Holdings plc Board (continued)

JONATHAN EVANS (COMPANY SECRETARY)

Jonathan (53) joined the organisation directly from university in 1974. He is a member of the Management Board and Pensions Committee, Secretary to the Audit and Risk, Remuneration and Nomination Committees, and a Trustee of the Royal Mail Pension Plan. Before his appointment as Company Secretary in 1999, he held a wide range of management positions throughout the Group.

Former Director who resigned during the year

ELMAR TOIME (EXECUTIVE DEPUTY CHAIRMAN) resigned from the Board on 16 November 2004.

Royal Mail Holdings plc

Directors' Report

The Directors present the Group Accounts for Royal Mail Holdings plc. These accounts relate to the 52 weeks ended 27 March 2005 (2004 52 weeks ended 28 March 2004).

Principal activities

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

Review of the business and future developments

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

Results and dividends

The profit on ordinary activities before taxation amounted to £207m (2004 £105m). After taxation, the profit was £235m (2004 £7m). The Directors do not recommend a dividend (2004 nil dividend).

Political and charitable contributions

During the year the Group made charitable contributions of £2m (2004 £0.6m). No political contributions were made in the year (2004 £nil).

Research and development

Research and development expenditure during the year amounted to £1m (2004 £3m).

Policy on the payment of suppliers

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

Land and buildings

In the opinion of the Directors, the aggregate market value of the Group's land and buildings exceeds the net book value, based upon a historic cost accounting policy, of £1,157m (2004 £1,162m) by £466m (2004 £369m).

Directors and their interests

The Directors of the Company and details of changes during the year are given on page 32. The Secretary of State appoints the Chairman; all other Directors are appointed by the Company with the Secretary of State's consent.

HM Government is the Company's sole shareholder and accordingly the Directors have no interest in shares of the Company. The Directors' biographical details are included on pages 21 and 22.

People

Royal Mail Group employs over 196,000 people (2004 over 202,000) in our UK wholly owned subsidiaries. A reconciliation to the Group headcount is shown in note 2 to the accounts. Our people are our strategic strength and competitive advantage.

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

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

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

In 2002, the Chairman created a programme to make Royal Mail Group a 'Great Place to Work' and made it a priority for everyone across the business. The purpose of the programme is to encourage people to contribute to improving their working environment, to equip our people with the skills they need, to develop pride in and understanding of the business and to drive respect for colleagues - in short, to ensure people considerations are at the heart of all major business decisions. The programme is ongoing and will remain an integral part of our people strategy.

Royal Mail Holdings plc

Directors' Report (continued)

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

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

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

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

Corporate Social Responsibility

Royal Mail is committed to carrying out its activities in a socially responsible manner in respect of the environment, employees, customers and local communities. A Corporate and Social Responsibility (CSR) Governance Committee reports to the Board, which publishes an annual report of its activities. Further details of our CSR governance structure and activities will be available in our 2005 CSR Report, due to be published in September 2005.

Disabled employees

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

Going concern

After analysis of the financial resources available and cash flow projections for the Group, the Directors consider that it is appropriate to prepare the financial statements on a going concern basis.

Auditors

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

By Order of the Board

Jonathan Evans

Company Secretary

16 May 2005

Royal Mail Holdings plc

Corporate Governance

Statement by the Directors on compliance with the Combined Code

The Board is committed to high standards of Corporate Governance and supports the Combined Code on Corporate Governance (the Code), published in July 2003, which took effect for Royal Mail on 29 March 2004. The following statement is intended to explain our governance policies and practices in light of the Code principles and provisions in so far as they are appropriate to a public company with a single shareholder, and to provide insight into how the Board and management run the business for the benefit of the Shareholder. The Company has fully complied with the provisions of the Code except for the provision regarding the membership of the Audit and Risk Committee. When Rosemary Thorne's term of appointment ended on 25 March 2004, the composition of this Committee fell below the recommended level of three Non Executive members. Baroness Margaret Prosser was appointed to the Committee on 8 February 2005, bringing the membership back up to the recommended level. The Company is continuing its search for a further Non Executive Director with recent and relevant financial experience.

The Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance. The Board currently comprises a Non Executive Chairman, five Executive Directors and six Non Executive Directors. The biographies of each of the Directors, setting out their current roles, commitments and previous experience, are on pages 21 and 22. The Board usually meets monthly, and has defined those matters that are reserved exclusively for its consideration. These include the approval of financial statements, acquisitions and disposals, material agreements, non-recurring projects, major capital expenditure and strategic plans. It also delegates responsibilities to the Board Committees detailed below. For each scheduled meeting of the Board, the Company Secretary, on behalf of the Chairman, collates and circulates the papers, aiming to allow sufficient time for the Directors to review the information provided. The Board is confident that all its members have the knowledge, talent and experience to perform the functions required of a Director of the business. Executive Directors have rolling 12-month contracts and Non Executive Directors are generally appointed for a three-year term.

The Board considers that each of the six Non Executive Directors is independent. This means that in the view of the Board, they have no links to the Executive Directors and other managers, and no business or other relationship with the Company that could interfere with their judgement. Sir Michael Hodgkinson is the Senior Independent Director. There is also a clear division of responsibilities between the Chairman and the Chief Executives. Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis. In 2004 the Board initiated a systematic approach to the evaluation of the effectiveness of the Board, its Committees and individual Directors. This was undertaken by the Chairman and implemented in collaboration with the Committee Chairmen and with the support of the Company Secretary. The evaluation was conducted by way of a formal questionnaire that enabled Directors' perspectives on the effectiveness of the Board and Committees to be fed back to the Chairman and the full Board. Performance evaluations of Board Committees were conducted on behalf of the Chairman by the Chairmen of the respective Board Committees. The Non Executive Directors, led by the Senior Independent Director, reviewed the performance of the Chairman and the Executive Directors.

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

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

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

Royal Mail Holdings plc

Corporate Governance (continued)

Number of meetings	Board	Audit and Risk Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	11	7	6	3
Non Executive				
Allan Leighton	11			1
David Fish	9		6	3
Richard Handover	9		5	3
Sir Michael Hodgkinson	10		5	
John Neill	10	7		
Baroness Margaret Prosser ¹	4	1		
Bob Wigley	9	7		
Executive				
Adam Crozier	11			
David Mills	9			
Marisa Cassoni	11			
Tony McCarthy	11			
David Burden ²	8			
Former Director				
Elmar Toime ³		4		
1. Attended four out of the five Board meetings held since becoming a Director and one out of the one Audit and Risk Committee meetings held since becoming a Committee member.				
2. Attended eight out of the eight meetings held since becoming a Director.				
3. Resigned 16 November 2004.				

Outside appointments

The Board believes that there are significant benefits to both the Company and the individual from Executive Directors accepting Non Executive Directorships of companies outside of the Group, and for which the Director may retain the fees (see the Directors Remuneration Report on page 35 for details). The Board's policy is normally to limit Executive Directors to no more than one Non Executive Directorship.

The following Committees deal with specific aspects of the Group's Governance. The terms of reference for each of the principal Committees are available on the Company's website (www.royalmail.com) or on written request from the Company Secretary:

Management Board

Chair	Adam Crozier, Chief Executive, Royal Mail Group plc
Membership	David Mills, Chief Executive, Post Office Limited Marisa Cassoni, Group Finance Director David Burden, Group Chief Information Officer Tony McCarthy, Group Director People & Organisational Development Jonathan Evans, Company Secretary Mary Fagan, Group Corporate and Government Affairs Director
Role	The Management Board comprises all Executive Directors of Royal Mail Holdings plc and Royal Mail Group plc and certain other senior executives of the Group. Its responsibilities include: <ul style="list-style-type: none"> ▪ to develop and monitor deployment of the Group's strategy, annual operating plans and budgets for Board approval; ▪ to review operational activities, and set policies where these are not reserved to the Board; and ▪ to allocate resources, both people and financial, across the Group. <p>The Holdings Board has delegated authority to the Investment Committees of the Management Board and Post Office Limited to make investment decisions of up to £10m.</p>

Royal Mail Holdings plc

Corporate Governance (continued)

Audit and Risk Committee

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

Remuneration Committee

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

Nomination Committee

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

Royal Mail Holdings plc

Corporate Governance (continued)

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

Corporate and Social Responsibility Governance Committee

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

Pensions Committee

Chair	Marisa Cassoni, Group Finance Director
Membership	Tony McCarthy, Group Director People & Organisational Development Jonathan Evans, Company Secretary
Role	The Committee's responsibilities include: <ul style="list-style-type: none">▪ to review funding, benefits, scheme structure and strategic developments impacting on the Group's occupational pension schemes; and▪ to represent the Group in discussions with the Trustees of the Group's occupational pension schemes.

Non-audit services provided by the external auditors

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

Qualifying third party indemnity provisions for Directors

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

Royal Mail Holdings plc

Internal Control

Overview

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

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

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

Audit and Risk Committee

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

Risk Management Committee

This is a sub-committee of the Audit and Risk Committee. It sets the framework for risk management within the Group and ensures integration with strategic planning. It also facilitates regular reporting of key risks and the actions to manage the risks to a desired level. The members of this Committee include Marisa Cassoni (Chair), David Burden, the Group Treasury Director, the Internal Audit and Risk Management Director, the Director Corporate and Social Responsibility and other senior executives from across the Group.

Key control processes

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

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

Risk Management process

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process has been in place throughout the year under review, and up to the date of approval of the Annual Report and Accounts, and accords with the Turnbull guidance. The effectiveness of the process is reviewed annually by the Audit and Risk Committee, which then reports to the Board.

The process consists of:

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

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

Royal Mail Holdings plc

Directors' Remuneration Report

Information not subject to audit

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

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

The Remuneration Committee

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

The Remuneration Committee is made up wholly of independent Non Executive Directors. Membership of the Committee is disclosed on page 27. The Chief Executive of Royal Mail Group plc, Adam Crozier, and the Director People & Organisational Development, Tony McCarthy, may attend these meetings by invitation but are not present at the discussion of their own remuneration.

Advice to the Remuneration Committee

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

During 2004-05, advice on the performance of key executives was given by the Chairman and the Chief Executive. External professional advice was given by Mercer Human Resource Consulting LLC, the Hay Group and Watson Wyatt Worldwide. Internal support is primarily provided by the Director People & Organisational Development, Tony McCarthy, advised by Ernst & Young LLP, and from the Company Secretary, Jonathan Evans. Other advice has been provided by specialists from People & Organisational Development and Finance.

During the year, advice was given to the Company by Watson Wyatt Worldwide on pension and actuarial matters, and Ernst & Young LLP, the Group external auditors, on taxation and regulation matters.

Remuneration policy

The Company's policy on Directors' remuneration is that:

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

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

The Committee regularly reviews the structure of the package and its competitiveness against appropriate marketplaces. The Committee aims to ensure that the package is proportionate and effective, and that it is developed in accordance with accepted best practice. During 2004-05, as part of its regular review, the Committee has reviewed the current base pay and annual and long-term incentive arrangements.

The main components of remuneration

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

Base salaries

The Committee believes that base salaries should be set at levels that are sufficient to recruit and retain high calibre executives. In making its judgement, the Committee is informed by a variety of data aimed at making a fair comparison with enterprises of a similar size and complexity to Royal Mail. This data is provided by independent consultancies. Increases are recommended where the Committee believes that it is necessary to reflect performance, increased individual responsibilities and market levels. All increases are approved by the Secretary of State for Trade and Industry.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Performance-related, personal annual bonus 2004-05

The Chairman and Executive Directors may earn a performance-related bonus for achievement of financial and customer targets. These bonuses are based on targets that were set each year in line with the Renewal Plan and agreed with the Secretary of State for Trade and Industry, and for 2004-05 are as follows:

	Maximum annual bonus
Non Executive Chairman	£180,000
Chief Executive, Royal Mail Group plc	75% of basic pay
Other Executive Directors	40% of basic pay

75% of potential bonus earnings relates to financial performance whilst 25% relates to quality of service targets. 80% of the Chief Executive of Post Office Limited's potential bonus earnings is based on achievement of targets of Post Office Limited, whilst 20% is based on Group targets.

Each year Directors can defer up to 50% of their performance-related, personal annual bonus into Bonus Awards within the Long-Term Incentive Plan (see below).

The Executive Directors are also entitled to a Share in Success payment.

Performance-related, personal annual bonus 2003-04

Last year the Non Executive Chairman and Executive Deputy Chairman (who subsequently resigned on 16 November 2004) voluntarily decided to defer 100% (£144,000) and 50% (£150,000) respectively of their 2003-04 performance-related, personal annual bonus on the basis that it would be paid this year provided the four key quality of service targets (1st Class, 2nd Class, Maisort 2 and Maisort 3) were achieved in the final quarter of 2004-05.

Long-Term Incentive Plan 2002-03 to 2004-05

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

The LTIP consists of Annual Company Performance Awards and Bonus Awards, both of which are made at the discretion of the Remuneration Committee. Annual Company Performance Awards will accrue on a sliding scale above a threshold level of financial performance of the Group, in line with the Renewal Plan targets for profit from operations, and subject to satisfactory personal performance. The Renewal Plan operating targets are based on moving the Group from a level of loss from operations in 2001-02 to a targeted profit in 2004-05. Executive Directors can also defer up to 50% of their performance-related, personal annual bonus into the Bonus Awards. Awards therefore accrue as follows:

	Annual target performance		
	Below 87.5%	On target	120% or above
Annual Company Performance Award (on base salary)	nil	25%	37.5%
Bonus Award	Up to 50% of the performance-related, personal annual bonus		

At the end of the three-year period the value of the above accrued awards can be enhanced, on a sliding scale, based on performance against a three-year cumulative target as follows:

	Cumulative target performance		
	Below target	On target	Maximum
Enhancement of LTIP award	No enhancement	33%	100%

All awards under the LTIP are subject to payments being made under the Share in Success scheme to our people. If no payments are made to our people under this scheme, no Annual Performance Awards will be paid and there will be no enhancement to Bonus Awards. The Share in Success scheme is designed to pay £800 to all our qualifying people for achieving on-target profits for the financial year ending March 2005 and more if targets are exceeded. The maximum enhancement is applicable when the target is exceeded by £124m or above.

Benefits

Benefits include the provision of company cars, health insurance, relocation expenses, plus the cash-equivalent of any benefits not taken.

Pensions

The Group has a liability to pay pensions in respect of Directors' services and for some Executive Directors makes contributions to pension schemes for this purpose. The Company has set up a retirement pension arrangement, which will provide benefits to Directors whose contributions to the Company scheme are restricted by the Inland Revenue earnings cap.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

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

The following highlights that a substantial proportion of Executive Directors' remuneration for 2004-05 is driven by performance, and thus is subject to risk if performance is not delivered. For 2004-05, 23% of their total remuneration related to fixed elements, whilst 77% related to performance elements:

Fixed = 23%	Performance-related = 77%	Total
Base salary	Annual bonus	LTIP
23%	5%	72%

As the current Long-Term Incentive Plan matures in June 2005, the Remuneration Committee is currently reviewing incentive arrangements for Executive Directors. The objectives of this review, which includes both long-term and annual incentives, include ensuring that a substantial part of the remuneration package is at risk to performance and that measures are used which properly reflect the organisation's commercial and public service objectives.

Service contracts

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

The rolling service contracts and letters of appointment of the Directors include the following terms:

	Date of contract	Expiry date of current service contract ¹	Unexpired term (months)
Non Executive Chairman			
Allan Leighton ²	25 March 2005	25 March 2008	36
Executive Directors			
Adam Crozier	1 February 2003		12
David Mills	15 April 2002		12
Marisa Cassoni	1 February 2001		12
Tony McCarthy	6 January 2003		12
David Burden	1 July 2004		12

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

Non Executive Directors

Sir Mike Hodgkinson	1 January 2003	31 December 2005	9
David Fish	1 January 2003	31 December 2005	9
Richard Handover	1 January 2003	31 December 2005	9
John Neill	1 January 2003	31 December 2005	9
Baroness Margaret Prosser	1 November 2004	31 October 2007	31
Bob Wigley	1 April 2003	31 March 2006	12

¹ All Executive Directors have a contracted 12-month notice period from the Company; the Director must give six months notice. The standard term for compensation for loss of office is a maximum payment of 12-months basic salary. The Company is committed for the full three-year term for Non Executive Directors, including the Chairman.

² The Secretary of State has consented, in accordance with the Articles of Association, to the reappointment of Allan Leighton as Chairman for a further term of three years ending 25 March 2008.

Non Executive Directors

The fees paid to the Non Executive Directors are determined by the Executive Directors and approved by the Secretary of State. Independent market surveys are consulted in determining them. Fees may comprise a basic fee for Board membership and, as appropriate, additional fees for the membership or chairmanship of the Audit and Risk, Remuneration and Nomination Committees. Details of the fees are given on page 34.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Audited information

Directors' remuneration, excluding pensions and Long-Term Incentive Plan, was as follows:

	Current annual salary/fees	Salary/ fees	Annual performance bonus		Total annual performance bonus £000	Deferred bonus from prior years £000	Benefits £000	Compensation for loss of office £000	Total excluding pensions and Long-Term Incentive Plan	
	£000	£000	Performance- related bonus £000	Deferred into LTIP £000					2005 £000	2004 £000
Non Executive Chairman										
Allan Leighton										
Executive										
Adam Crozier										
David Mills										
Marisa Cassoni										
Tony McCarthy										
David Burden ¹										
Non Executive										
Sir Michael Hodgkinson										
David Fish										
Richard Handover										
John Neill										
Baroness Margaret Prosser ¹										
Bob Wigley										
Former Directors										
Jerry Cope										
Elmar Toime ¹										
Rosemary Thorne										
Total 2005										
Total 2004										

1. Elmar Toime left the Company 16 November 2004, and David Burden and Baroness Margaret Prosser joined the Board on 1 July 2004 and 1 November 2004 respectively.

The figures in the table represent emoluments earned and receivable as Directors during the financial year, whenever paid. Such emoluments are normally paid in the same financial year with the exception of the annual, performance-related bonus, which is paid in the year following that in which it is earned.

GRO

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Performance-related, personal annual bonuses for 2004-05

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

The details of the scheme are outlined on page 31. For 2004-05, the Remuneration Committee concluded that all of the financial targets and the majority of the quality of service targets set for the Group had been met triggering payment of 91% of maximum bonus potential to the Chairman and Executive Directors with the exception of the Chief Executive of Post Office Limited.

The Committee also concluded that Post Office Limited had achieved all of the targets set, triggering payment of 80% of maximum bonus potential to the Chief Executive of Post Office Limited. The achievement of 91% of maximum bonus potential for Group targets triggered a further 18%, giving him a total of 98% of maximum bonus potential.

The Executive Directors are also entitled to a Share in Success payment of £1,074.

Performance-related, personal annual bonuses for 2003-04

In relation to the deferred bonus payment described on page 31, the Non Executive Chairman was awarded all of his performance-related, personal annual bonus for 2003-04 of £144,000 because all of the four key quality of service targets were achieved in the final quarter of 2004-05.

Annual Performance and Bonus Awards held under the Long-Term Incentive Plan at 27 March 2005

	Awards held at 29 March 2004 £000	Awards lost in 2004-05 £000	LTIP awards during 2004-05 in respect of 2003-04 £000	Awards to be made in 2005-06 in respect of 2004-05 £000	Enhancement of LTIP awards £000	Total £000
Executive						
Adam Crozier						
David Mills						
Marisa Cassoni						
Tony McCarthy						
David Burden						
Former Directors						
Elmar Toime						

GRO

The amounts awarded into the Long-Term Incentive Plan in 2004-05 include the Annual Company Performance Award and the Bonus Award. Of the total of £5,541,000, which will be paid in June 2005, £912,000 relates to deferred bonus and £4,629,000 relates to LTIP award.

Non Executive Directors

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

Since 2001, the fees for Committee membership have been £1,500, with Committee Chairmen receiving £2,500. During the year the Executive Directors commissioned a survey of fees paid in other major organisations to assess market movements since the last review, including the impact of the greater role for Board Committees arising from recent reviews of the Combined Code on Corporate Governance. As a result, the Executive Directors agreed that a more appropriate fee structure would now be £5,000 for membership, £10,000 for chairmanship, £12,500 for chairmanship of the Audit and Risk Committee and £10,000 for the Senior Independent Director. However, at the suggestion of the Non Executive Directors, the implementation of this new Committee fee structure has been deferred and as an interim measure the following changes were introduced with effect from 1 October 2004 - £2,500 for Committee membership, £5,000 for Committee chairmanship, £7,500 for chairmanship of the Audit and Risk Committee, and £5,000 for the Senior Independent Director. Sir Michael Hodgkinson receives additional fees of £37,500 (2004 £37,500) for his position of Chairman of Post Office Limited and is also a Non Executive Director of the Bank of Ireland, the fee for which he has agreed to waive.

Payments to former Directors

On 16 November 2004, Elmar Toime left the Company on agreed terms. His remuneration and benefits up to then are given in the Directors' emoluments table on page 33.

His entitlement to all Company Awards held under the Long-Term Incentive Plan (LTIP) was lost, as was any entitlement to an annual bonus or LTIP award for 2004-05.

He received £500,000 as compensation for one year's basic salary and £159,200, representing the cost of 12 months' contributions to his Funded Unapproved Retirement Benefits Scheme (FURBS). His car and private medical insurance benefits ceased on 27 March 2005, resulting in a benefit of £4,065, and he paid the cost of insuring his car between 16 November 2004 and that date. Contractual entitlements to Mr Toime and his family were honoured and £56,388 was paid to him against receipts for travel to New Zealand and the tax liability arising on it. He is contractually entitled to have his relocation costs back to New Zealand paid for by the Company. The agreement restricts the period in which they can be claimed to 3 years following departure.

As described on page 31, the Executive Deputy Chairman voluntarily decided to defer 50% (£150,000) of his 2003-04 performance-related personal annual bonus on the basis that it would be paid this year provided the four key quality of service targets (1st Class, 2nd Class, Mailsort 2 and Mailsort 3) were achieved in the final quarter of 2004-05. As these targets were met he will be paid £150,000.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Mr Toime's own contributions to the Royal Mail Senior Executive Pension Plan and the accrued funds in his FURBS have been repaid to him. These amounts were £11,064 and £285,283 gross respectively. He has also been repaid £164,360, representing Bonus Awards, which had been placed in the LTIP in recognition of annual bonuses for 2002-03 and 2003-04 having been reduced by the equivalent amount.

Executive Directors outside appointments

The Executive Directors may retain fees from their Directorships. The fees received and retained by Executive Directors in respect of their Non Executive Directorships are shown in the table below:

Directorship	2005	2004
	£	£
Marisa Cassoni ⁽¹⁾	Severn Trent plc	
David Mills ⁽²⁾	Camelot Group plc	

GRO

⁽¹⁾ £3,900 (2004 £2,800) of the aggregate fees are paid in the form of Severn Trent plc shares.

⁽²⁾ In relation to his Royal Mail shareholder-nominated Directorship of the Camelot Group plc

Pensions

The Group normally offers its most senior people membership of the Royal Mail Senior Executive Pension Plan (RMSEPP). Details of the RMSEPP are set out in note 19 to the accounts. The Plan is a funded, Inland Revenue-approved final salary occupational pension scheme. The scheme provides for a two-thirds final pensionable salary at normal retirement age, subject to the necessary pensionable service and Inland Revenue earnings cap. Pensions in payment are increased annually in line with Retail Prices Index (RPI), subject in some cases to a cap. Pensions are also payable to dependants on the death of the member and a lump sum is payable if death in service occurs.

For senior executives whose membership of the RMSEPP is restricted by the earnings cap, pension provision is made by a combination of the Company scheme and an appropriate Funded Unapproved Retirement Benefits Scheme (FURBS) or equivalent. Gross employer contribution rates range between 25% and 55% of base pay above the earnings cap. The Company has made provision for retirement pension arrangements at a rate of 40% for Adam Crozier, 55% for Marisa Cassoni and 40% for David Burden from 1 July 2004. A reserve has been established for the additional pension for Tony McCarthy to provide the total retirement pension, including the pension from his previous employer's pension scheme, of two-thirds of base pay at normal retirement age. The total provision for Adam Crozier, Marisa Cassoni, Tony McCarthy and David Burden at the year end is £1,209,573 (2004 £734,191). In addition, David Mills receives cash supplements of 24.2% of base pay below the pensions cap and 55% of base pay above, giving a total of £134,272 (2004 £84,358).

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

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

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

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

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

Age	Accumulated accrued benefit at 27 March 2005 £000	Increase in accrued benefits during the period* £000	Increase in accrued benefits during the period (net of inflation)* £000	Transfer value* of increase before inflation less Directors' contributions £000
Executive Directors				
Adam Crozier				
David Mills				
Marisa Cassoni				
Tony McCarthy				
David Burden ¹				

GRO

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

¹ Benefits accrued since appointment on 1 July 2004.

Elmar Toime resigned on 16 November and took a refund of his employee contributions.

Age	Transfer value at 29 March 2004 or at date of appointment to Board if later £000	Plus transfers-in received £000	Sub total £000	Transfer value at 27 March 2005 £000	Movement in the period less Directors' contributions £000
Executive Directors					
Adam Crozier					
David Mills					
Marisa Cassoni					
Tony McCarthy					
David Burden ¹					

GRO

¹ Benefits accrued since appointment on 1 July 2004.

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

By Order of the Board

Jonathan Evans
Company Secretary
16 May 2005

Royal Mail Holdings plc

Statement of Directors' responsibilities in respect of the accounts

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

In preparing those accounts Directors are required to:

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

Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy, at any time, the financial position of the Company and of the Group, and which enable them to ensure that the accounts comply with the Companies Act 1985. Directors are also responsible for ensuring that the assets of the Group are safeguarded and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Royal Mail Holdings plc

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

We have audited the Group's financial statements for the year ended 27 March 2005 which comprise the Group profit and loss account, the Group and Company balance sheets, the Group cash flow statement and associated notes, the Group statement of total recognised gains and losses, the reconciliation of movements in Group shareholders' funds, accounting policies and the related notes 1 to 23. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report, including the financial statements which are required to be prepared in accordance with applicable United Kingdom law and accounting standards as set out in the Statement of Directors' responsibilities in relation to the financial statements. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Group is not disclosed.

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

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 27 March 2005 and of the profit of the Group for the year then ended; and the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Registered Auditor

London

16 May 2005

Royal Mail Holdings plc

Accounting policies

The following accounting policies apply throughout the Group:

Financial year

The financial year ends on the last Sunday in March and accordingly, these accounts are made up to the 52 weeks ended 27 March 2005 (52 weeks ended 28 March 2004).

Basis of preparation

The accounts on pages 39 to 67 have been prepared in accordance with applicable accounting standards under the historic cost accounting convention and the requirements of the Companies Act 1985, except for investments in Government gilt-edged securities as described in the current asset investments accounting policy.

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

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

These accounts have been prepared in accordance with the current accounting standard SSAP 24 Accounting for pension costs. The Group has also adopted the transitional arrangements of the latest pensions accounting standard, FRS 17 Retirement benefits, which is disclosed in note 19 to the accounts.

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

Post Office Limited had net current assets of £48m at 27 March 2005 and continues to operate at a loss. To become viable in the longer term, new profitable business areas are being developed to replace the lost contribution from benefits income. Post Office Limited is therefore currently dependent on continuing financial support from its ultimate parent company, Royal Mail Holdings plc.

Up to £300m of funding for the rural network until March 2008 has been agreed, subject to a State Aid clearance process that has still to be completed.

Post Office Limited successfully concluded negotiations with its parent, ultimate parent and the Government to provide additional capital contributions to meet short term funding requirements of £145m through to March 2007. Beyond this date, additional funding will be required to refinance the company's operations, including the existing working capital facilities of £1.15bn, which mature in March 2010.

As part of these funding negotiations, Post Office Limited has entered into a process with its parent, ultimate parent and the Government to review the funding implications of returning the business to profitability and the capital requirements of the company. Whilst these discussions remain in their early stages, after careful consideration the Directors of Post Office Limited are confident that the business will be able to meet future obligations as they fall due.

The Directors of Post Office Limited consider that it is appropriate that its accounts be prepared on a going concern basis assuming that:

- the £300m of rural funding receives appropriate State Aid clearance;
- Post Office Limited will meet its revenue and expenditure targets; and
- a satisfactory resolution of the longer term funding requirements of Post Office Limited is achieved with its parent, ultimate parent and the Government within the agreed timetable.

On the basis of the above arrangements, the Directors consider it appropriate to include Post Office Limited in the consolidated accounts on a going concern basis.

Basis of consolidation

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

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

Turnover

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

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

Goodwill

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

Royal Mail Holdings plc

Accounting policies (continued)

Tangible fixed assets

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

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

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

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

Leasing and hire purchase

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

Fixed asset investments

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

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

Stocks

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

Current asset investments

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

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

Deferred tax

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

Deferred tax is not recognised in the following instances:

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

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

Pensions and other post-retirement benefits

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

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

Royal Mail Holdings plc

Accounting policies (continued)

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

Research and development

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

Foreign currencies

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

Financial instruments

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

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

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

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

Royal Mail Holdings plc

Group profit and loss account

for the years ended 27 March 2005 and 28 March 2004

Notes	2005			2004		
	Before exceptional items £m	Exceptional items (note 4) £m	Total £m	Before exceptional items £m	Exceptional items (note 4) £m	Total £m
Turnover: Group and share of joint ventures' turnover	9,080	-	9,080	8,768	-	8,768
Less: share of joint ventures' turnover	(124)	-	(124)	(135)	-	(135)
Turnover	1	8,956	-	8,956	8,633	-
Costs:	(8,591)	(277)	(8,868)	(8,582)	(64)	(8,646)
Staff costs	2/4	(5,038)	(252)	(5,290)	(4,888)	(68)
Depreciation and amortisation	3	(156)	-	(156)	(195)	-
Impairment	3/4	-	(23)	(23)	-	(41)
Other operating charges	3/4	(3,397)	(2)	(3,399)	(3,499)	45
Group operating profit/(loss)	1/3	365	(277)	88	51	(64)
Share of operating profit in joint ventures		34	-	34	23	-
Share of operating profit in associates		-	-	-	14	-
Total operating profit: Group and share of joint ventures and associates		399	(277)	122	88	(64)
Net profit on disposal of tangible fixed assets	4	-	70	70	-	67
Loss on disposal of subsidiary undertakings	4	-	(3)	(3)	-	(3)
Profit on ordinary activities before interest		399	(210)	189	88	-
Net interest receivable	5	18	-	18	17	-
Profit on ordinary activities before taxation		417	(210)	207	105	-
Taxation	6			28		(98)
Profit retained for the financial year				235		7

Royal Mail Holdings plc

Group statement of total recognised gains and losses

for the years ended 27 March 2005 and 28 March 2004

	2005 £m	2004 £m
Profit/(loss) for the financial year excluding share of profit in joint ventures and associates	201	(30)
Share of joint ventures' profit for the year	34	23
Share of associates' profit for the year	-	14
Profit for the financial year	235	7
Exchange differences on retranslation of net assets	8	(3)
Unrealised gain on joint venture transaction	-	46
Total recognised gains for the financial year	243	50

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

Reconciliation of movements in Group shareholders' funds

	Note	2005 £m	2004 £m
Opening shareholders' funds	16	2,138	2,088
Total recognised gains for the financial year (see above)		243	50
Closing shareholders' funds	16	2,381	2,138

Royal Mail Holdings plc

Balance sheets

at 27 March 2005 and 28 March 2004

Notes	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Fixed assets				
Intangible assets	7	144	123	-
Tangible assets	8	1,591	1,550	-
Investments:	9	135	138	2,330 2,146
Share of gross assets of joint ventures		80	139	-
Share of gross liabilities of joint ventures		(39)	(64)	-
Share of net assets of joint ventures		41	75	-
Investments in associates		87	56	-
Other investments		7	7	2,330 2,146
Total fixed assets	1,870	1,811	2,330	2,146
Current assets				
Stocks		27	32	-
Debtors - receivable within one year	10	1,090	1,171	-
Debtors - receivable after more than one year	10	865	784	-
Investments	11	1,141	999	-
Cash at bank and in hand		890	1,049	-
		4,013	4,035	-
Creditors – amounts falling due within one year	12	(2,684)	(2,590)	-
Net current assets	1,329	1,445	-	-
Total assets less current liabilities	3,199	3,256	2,330	2,146
Creditors – amounts falling due after more than one year				
	13	(548)	(543)	-
Provisions for liabilities and charges	15	(266)	(575)	-
Total net assets	2,385	2,138	2,330	2,146
Capital and reserves				
Called up share capital	17	-	-	-
Profit and loss account	16	1,346	999	2,330 2,146
Mails Reserve	16	801	765	-
Rural Network Reserve	16	171	311	-
Other reserves	16	63	63	-
Equity shareholders' funds	2,381	2,138	2,330	2,146
Equity minority interest		4	-	-
Total capital employed	2,385	2,138	2,330	2,146

The accounts on pages 39 to 67 were approved by the Board of Directors on 16 May 2005 and signed on its behalf by:

Allan Leighton
Chairman

Marisa Cassoni
Group Finance Director

Royal Mail Holdings plc

Group cash flow statement

for the years ended 27 March 2005 and 28 March 2004

	Notes	2005 £m	2004 £m
Reconciliation of operating profit to net cash outflow from operating activities			
Group operating profit before exceptional items	(c)	365	51
Depreciation and amortisation		156	195
Changes in working capital and other non-cash items:		(486)	(75)
Decrease in stock		5	1
Decrease in debtors		60	42
Increase in creditors		19	340
Decrease in client balances		(444)	(287)
Decrease in provisions		(126)	(171)
Cash payments in respect of operating exceptional items	(b)	(255)	(412)
Net cash outflow from operating activities		(220)	(241)
Group cash flow statement			
Net cash outflow from operating activities		(220)	(241)
Dividends received from joint ventures and associates		19	21
Dividends received from joint ventures		10	6
Dividends received from associates		9	15
Returns on investments and servicing of finance		10	17
Interest received		52	52
Interest paid		(42)	(35)
Taxation			
Corporation tax recovered		13	12
Capital expenditure and financial investment		(124)	(56)
Purchase of intangible fixed assets		-	(2)
Purchase of tangible fixed assets		(219)	(158)
Purchase of fixed asset investments		-	(5)
Sale of tangible fixed assets		95	100
Sale of fixed asset investments		-	9
Acquisitions and disposals		(2)	25
Purchase of subsidiary undertakings		(4)	-
Net cash acquired with subsidiary undertakings	9	6	-
Purchase of interest in joint ventures and associates		-	(4)
Payment of deferred consideration in respect of prior years' acquisitions		(2)	-
Disposal of subsidiary undertakings		-	29
Net cash disposed of with subsidiary undertakings		(2)	-
Cash outflow before use of liquid resources and financing		(304)	(222)
Management of liquid resources			
Net movement in current asset investments	(a)	(142)	251
Net cash (outflow)/inflow before financing		(446)	29
Financing		287	(40)
Repayment of finance leases and hire purchase agreements	(a)	(34)	(32)
New loans		325	-
Repayment of loans		(4)	(8)
Decrease in cash in the period		(159)	(11)

Royal Mail Holdings plc

Group cash flow statement (continued)

for the years ended 27 March 2005 and 28 March 2004

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

	2005 £m	2004 £m
Decrease in cash in the period	(159)	(11)
Repayment of finance leases and hire purchase agreements	34	32
New loans (of which £310m relates to Post Office Limited)	(325)	-
Repayment of loans	4	8
Cash flow from management of liquid resources (net movement in current asset investments)	142	(251)
Change in net funds resulting from cash flows	(304)	(222)
 Movement in net funds in the period	(304)	(222)
Opening net funds	1,451	1,673
Closing net funds	1,147	1,451

Notes to the cash flow statement

(a) Analysis of net funds

	At 29 March 2004 £m	Cash flows £m	At 27 March 2005 £m
Cash at bank and in hand	1,049	(159)	890
Loans due beyond one year	(507)	1	(506)
Loans due within one year	(53)	(322)	(375)
Finance leases and hire purchase agreements due beyond one year	(2)	-	(2)
Finance leases and hire purchase agreements due within one year	(35)	34	(1)
Current asset investments	999	142	1,141
Total	1,451	(304)	1,147

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

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

Net cash outflow relating to:	2005 £m	2004 £m
Current year exceptional items	12	3
Prior year exceptional items	243	409
Total	255	412

The net cash outflow of £255m comprises the £218m in respect of exceptional provisions (as shown in note 15) and a further £37m relating to the settlement of the prior year non-cash redundancy liability, which was recorded within creditors.

(c) Group operating profit of £88m (2004 £13m loss) includes £277m of operating exceptional charges (2004 £64m charge) which have been added back to derive a Group operating profit before exceptional items of £365m (2004 £51m).

Royal Mail Holdings plc

Notes to the accounts

1 Segmental information

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

Analysis of turnover by class of business	2005			2004		
	£m			£m		
	Total turnover	Turnover between segments	External turnover	Total turnover	Turnover between segments	External turnover
Mails and Parcels	8,001	(21)	7,980	7,678	(22)	7,656
Counter Services	1,287	(311)	976	1,278	(301)	977
Total	9,288	(332)	8,956	8,956	(323)	8,633

As shown above, there are a number of interbusiness services – the main one being the provision of Counter Services by Post Office Limited for both Royal Mail and Parcelforce Worldwide – on a basis of charges reached through a negotiation between the respective businesses.

Analysis of operating profit/(loss) by class of business	2005					2004				
	£m					£m				
	Operational activity	Pensions deficit	Before exceptional items	Exceptional items	Total	Operational activity	Pensions deficit	Before exceptional items	Exceptional items	Total
Mails and Parcels	629	(127)	502	(242)	260	305	(121)	184	(40)	144
Counter Services	(126)	(11)	(137)	(35)	(172)	(122)	(11)	(133)	(24)	(157)
Pensions adjustment	(138)	138	-	-	-	(132)	132	-	-	-
Group operating profit/(loss)	365	-	365	(277)	88	51	-	51	(64)	(13)

Analysis of turnover and operating profit/(loss) by geographic area of origin	2005					2004				
	Operating profit					Operating profit/(loss)				
	External turnover £m	Before exceptional items £m	After exceptional items £m	External turnover £m	Before exceptional items £m	After exceptional items £m	External turnover £m	Before exceptional items £m	After exceptional items £m	External turnover £m
United Kingdom	8,040	300	23	7,795	20	(18)				
Rest of the World (principally Europe)	916	65	65	838	31	5				
Total	8,956	365	88	8,633	51	(13)				

Analysis of net assets by class of business	2005			2004		
	£m			£m		
Mails and Parcels		1,930				1,847
Counter Services		327				160
		2,257				2,007
Share of net assets of joint ventures		41				75
Share of net assets of associates		87				56
Total		2,385				2,138

All net assets other than £371m (2004 £381m) were located in the United Kingdom, with the balance principally in Europe.

Royal Mail Holdings plc

2 Staff costs and numbers

	2005			2004		
	Before exceptional items £m	Exceptional items £m	Total £m	Before exceptional items £m	Exceptional items £m	Total £m
Wages and salaries	4,328	208	4,536	4,212	14	4,226
Social security costs	319	23	342	301	-	301
Pension costs (note 19)	391	21	412	375	54	429
Total	5,038	252	5,290	4,888	68	4,956

A loan to one officer totalling £413 (2004 – one officer £2,113) was outstanding at the end of the year. Details of Directors' remuneration and pension entitlements are included in the Directors' Remuneration Report.

Staff numbers, calculated on a headcount basis, were:

	Period end employees		Average employees	
	2005	2004	2005	2004
UK Mails and Parcels	184,299	189,221	183,442	194,606
UK Counter Services	12,145	13,115	12,510	13,590
UK wholly owned subsidiaries	196,444	202,336	195,952	208,196
Romec Limited	4,873	-	4,892	-
NDC 2000 Limited	71	-	71	-
Overseas, including GLS	10,768	9,974	10,408	10,442
Group total	212,156	212,310	211,323	218,638

Romec Limited, NDC 2000 Limited and Szybka Paczka Spolka z.o.o. (included in Overseas) became part owned subsidiary undertakings during the year (see note 9).

	2005	2004
Subpostmasters at the end of the year	12,020	13,575

3 Operating profit/(loss)

	2005 £m	2004 £m
Group operating profit/(loss) is stated after charging:		
Depreciation and amortisation:	156	195
Depreciation of owned tangible fixed assets	126	161
Depreciation of tangible fixed assets held under finance leases and hire purchase agreements	21	24
Amortisation of intangible fixed assets	9	10
Exceptional impairment write-down:	23	41
Tangible fixed assets	23	17
Intangible fixed assets	-	24
Subpostmasters' costs	544	557
Research and development expenditure	1	3
Operating lease charges:	224	207
Land and buildings	131	119
Vehicles and equipment	93	88
Regulatory body costs:	20	17
Postcomm	10	7
Postwatch	10	10

Royal Mail Holdings plc

3 Operating profit/(loss) (continued)

Auditors' remuneration	2005 £000	2004 £000
Audit of statutory accounts	1,686	1,488
Audit of regulatory accounts	287	502
Other assurance services	570	438
Tax services:	602	715
Compliance services	351	493
Advisory services	251	222
 Total auditors' remuneration	 3,145	 3,143

Royal Mail Holdings plc

4 Exceptional items

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

	2005 £m	2004 £m
Operating exceptional items:		
Share in Success	(218)	-
Impairment of tangible fixed assets	(23)	(17)
Impairment of goodwill relating to subsidiaries	-	(24)
Provision for onerous contracts relating to surplus properties	-	(17)
Provision for Renewal Plan restructuring	(36)	(6)
Sub total operating exceptional items	(277)	(64)
Non-operating exceptional items:		
Net profit on disposal of tangible fixed assets	70	67
Loss on disposal of subsidiary undertakings	(3)	(3)
Sub total non-operating exceptional items	67	64
Total	(210)	-

The £277m of operating exceptional costs comprises the Share in Success incentive scheme costs of £218m (2004 £nil), impairment of tangible fixed assets of £23m (2004 tangible fixed assets of £17m and intangible fixed assets of £24m), £nil costs relating to onerous contracts for surplus leasehold properties (2004 £17m) and £36m charges relating to the Group-wide Renewal Plan (2004 £6m). The £36m charges comprise £34m in respect of employee-related costs and £2m in respect of other operating costs.

The £67m of non-operating exceptional profit (2004 £64m) comprises £70m profit arising from the sale of a number of properties (2004 £67m) and a £3m loss relating to business disposals (2004 £3m), in this instance the sale of the CitiPost (Holdings) Limited and its directly and indirectly owned subsidiaries.

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

	2005 £m	2004 £m
Disposal of subsidiary undertakings	-	39
Disposal of tangible fixed assets	(1)	(6)
Total tax (credit)/charge on non-operating exceptional items	(1)	33

5 Net interest receivable

	2005 £m	2004 £m
Interest payable on other loans	(42)	(35)
Interest receivable on investments	60	52
Total net interest receivable	18	17

Royal Mail Holdings plc

6 Taxation

(a) Tax on profit on ordinary activities

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

	2005 £m	2004 £m
UK corporation tax on income for the period	1	-
Amount receivable for surrender of losses to associates and joint ventures in respect of consortium relief	(14)	(10)
Tax (overprovided)/underprovided in previous years	(20)	4
UK current tax	(33)	(6)
Foreign current tax	12	6
Group current tax	(21)	-
Amount payable by joint ventures in respect of consortium relief	9	6
Amount payable by associates in respect of consortium relief	5	4
Share of joint ventures' current tax payable	-	1
Share of associates' current tax payable	(2)	1
Total current tax (see table below)	(9)	12
Group deferred tax	(17)	-
Share of associates' deferred tax	(2)	86
Total taxation	(28)	98

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

The tax assessed for the year differs from the standard rate of corporation tax in the UK of 30% (2004 30%). The differences are explained below:

	2005 £m	2004 £m
Profit on ordinary activities before tax	207	105
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2004 30%)	62	32
Deferred relief for asset depreciation and impairment	30	55
Gains on property disposals rolled over	(24)	(23)
Deferred relief for pension contributions	56	59
Provisions not deductible until incurred	(86)	(98)
Impairment and amortisation of goodwill	(5)	7
Losses and other reliefs not utilised	7	9
Utilisation of prior year losses	(41)	(41)
Tax (overprovided)/underprovided in previous years	(20)	4
Other	12	8
Total current tax (see table above)	(9)	12

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

(c) Factors that may affect future tax charges

The Group has unrecognised deferred tax assets of £108m (2004 £144m) relating to tax losses in subsidiaries that are available to offset against future taxable profits of those companies. The Group has unrecognised deferred tax assets of £160m (2004 £178m) relating mainly to fixed asset timing differences.

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

The Group has capital losses carried forward, the tax effect of which is approximately £11m (2004 £12m). These may be set-off in future years against capital gains. The Group has rolled over capital gains, the effect of which totals £78m (2004 £88m). Gains on qualifying assets sold in the year may be rolled over into expenditure incurred on new qualifying assets in a four year period commencing one year before the date of disposal; plans indicate that sufficient qualifying capital expenditure will be incurred to enable this rollover to occur.

Royal Mail Holdings plc

7 Intangible fixed assets

Group	Goodwill £m	Other £m	Total £m
COST			
At 29 March 2004	479	19	498
Exchange movement	7	-	7
Acquisition of businesses (note 9)	28	-	28
Disposal of business	(33)	-	(33)
At 27 March 2005	481	19	500
AMORTISATION			
At 29 March 2004	372	3	375
Exchange movement	5	-	5
Charge for the year	8	1	9
Disposal of business	(33)	-	(33)
At 27 March 2005	352	4	356
NET BOOK AMOUNT			
At 27 March 2005	129	15	144
At 29 March 2004	107	16	123

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

8 Tangible fixed assets

Group	Land and buildings						Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	
COST							
At 29 March 2004	1,488	244	457	693	190	779	3,851
Exchange movements	3	-	-	2	-	1	6
Reclassification	(48)	5	43	-	-	-	-
Additions	84	11	-	47	60	22	224
On acquisition of subsidiaries	7	-	-	3	-	1	11
Disposals	(42)	(8)	(24)	(2)	(51)	(5)	(132)
At 27 March 2005	1,492	252	476	743	199	798	3,960
DEPRECIATION							
At 29 March 2004	685	139	203	375	136	763	2,301
Exchange movements	1	-	-	1	-	1	3
Reclassification	(11)	2	9	-	-	-	-
Charge for the year	41	6	26	48	18	8	147
Impairment	6	2	7	-	4	4	23
Disposals	(24)	(4)	(25)	(1)	(47)	(4)	(105)
At 27 March 2005	698	145	220	423	111	772	2,369
NET BOOK AMOUNT							
At 27 March 2005	794	107	256	320	88	26	1,591
At 29 March 2004	803	105	254	318	54	16	1,550

Depreciation rates are disclosed within the accounting policies. No depreciation is provided on freehold land, which represents £144m (2004 £156m) of the total cost of freehold properties. The net book value of the Group's tangible fixed assets held under hire purchase contracts and finance leases amounts to £72m (2004 £86m).

Royal Mail Holdings plc

9 Fixed asset investments

Group

	At 29 March 2004 £m	Reclassification £m	Amortisation £m	Share of (loss)/ profit retained by joint ventures/ associates £m	At 27 March 2005 £m
Net investments in associates	56	38	(3)	(4)	87
Share of net assets in associates	31	38	-	(4)	65
Goodwill relating to associates	25	-	(3)	-	22
Net investment in joint ventures	75	(48)	-	14	41
Share of net assets in joint ventures	73	(47)	-	14	40
Goodwill relating to joint ventures	2	(1)	-	-	1
Other investments (Government gilt-edged securities)	7	-	-	-	7
Total	138	(10)	(3)	10	135

The amounts shown in the Reclassification column relate to:

1. The change in status during the year of Post Office Financial Services, (an agreement with the Bank of Ireland to sell Post Office® branded financial service products), from a joint venture to an associate of the Group.
2. The change in status during the year of Romec Limited from a joint venture to a subsidiary of the Group.
3. The change in status during the year of Szybka Paczka Spolka z.o.o. and NDC 2000 Limited from associates to subsidiaries of the Group.

Reclassification of fixed asset investments

Undertaking	Joint venture £m	Associate £m	Subsidiary £m	Total £m
Post Office Financial Services	(44)	44	-	-
Romec Limited	(4)	-	4	-
Szybka Paczka Spolka z.o.o.	-	(5)	5	-
NDC 2000 Limited	-	(1)	1	-
Total	(48)	38	10	-

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

Company	2005 £m	2004 £m
At 29 March 2004	2,146	2,180
Change in net asset value of subsidiary undertaking	184	(34)
At 27 March 2005	2,330	2,146

The fixed asset investment of the Company represents the net asset value of its investment in a subsidiary undertaking.

Royal Mail Holdings plc

9 Fixed asset investments (continued)

(i) Acquisitions during the year

The entities acquired were:

	Date of acquisition
DGE Firenze	1 August 2004
DGE Vicenza	1 October 2004
NDC 2000 Limited ²	7 October 2004
Romec Limited ¹	22 December 2004
Szybka Paczka Spolka z.o.o. ²	1 January 2005

¹ Before becoming a subsidiary, Romec Limited was a joint venture of the Group.

² Before becoming subsidiaries, Szybka Paczka Spolka z.o.o. and NDC 2000 Limited were associates of the Group.

Further details of principal subsidiary undertakings can be found in note 23 to the accounts.

The acquisition method of accounting has been used. No acquisitions are material to the Group and except where shown, the following disclosures have been made on an aggregated basis.

The following table sets out the identifiable assets and liabilities acquired at their provisional fair value to the Group, which was consistent with their book values.

	Szybka Paczka Spolka z.o.o. £m	Other £m	Total £m
Tangible fixed assets	10	1	11
Current assets			
Debtors	3	34	37
Cash and bank	3	3	6
Total assets	16	38	54
Liabilities			
Trade creditors	(10)	(30)	(40)
Net assets acquired	6	8	14
Minority interest	-	(4)	(4)
Carrying value of investment in related joint venture/associates at date of change in status to subsidiary undertaking	(5)	(5)	(10)
Goodwill arising on acquisition	19	9	28
	20	8	28
Discharged by:			
Purchase consideration paid in the year	-	4	4
Deferred purchase consideration	20	4	24
Fair value of consideration	20	8	28

The acquisitions were made for cash, subject to adjustment on agreement of completion accounts.

No adjustments were required in respect of accounting policy alignment.

(ii) Disposals during the year

On 10 December 2004, the Group disposed of its 100% interest in Citipost (Holdings) Limited. The Group's share of the net assets of Citipost (Holdings) Limited at the date of disposal was £nil and the overall loss on disposal was £3m.

Royal Mail Holdings plc

10 Debtors

	2005 £m	2004 £m
Receivable within one year:		
Trade debtors	737	673
Pension prepayment	-	128
Other prepayments and accrued income	353	370
Total	1,090	1,171
Receivable after more than one year:		
Pension prepayment	835	770
Deferred tax asset	16	-
Other debtors	14	14
Total	865	784

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

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

11 Current asset investments

	2005 £m	2004 £m
Government gilt-edged securities	134	131
Government short-term deposits (National Loans Fund)	575	583
Other deposits	432	285
Total	1,141	999

In accordance with the relevant accounting policy, Government gilt-edged securities within current asset investments are stated at market value. The difference between cost and market value taken to the profit and loss account for these investments was a loss of £4m (2004 £4m).

Within current asset investments, a total of £800m investments relate to the Mails Reserve and are restricted in their use to that permissible by the section 72 order which created the Mails Reserve (note 16). These investments include deposits of £549m, which are subject to a charge as security against the loan facilities from the Department of Trade and Industry (DTI).

12 Creditors – amounts falling due within one year

	2005 £m	2004 £m
Loans (note 14)	375	53
Obligations under finance leases and hire purchase agreements (note 14)	1	35
Client services balances	323	767
Trade creditors and accruals	1,628	1,377
Advance customer payments	224	224
Corporation tax	-	10
Other taxation and social security	102	106
Deferred consideration (note 14)	16	-
Other creditors	15	18
Total	2,684	2,590

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

Royal Mail Holdings plc

13 Creditors – amounts falling due after more than one year

	2005 £m	2004 £m
Loans (note 14)	506	507
Obligations under finance leases and hire purchase agreements (note 14)	2	2
Deferred consideration (note 14)	8	2
Other	32	32
Total	548	543

Other long-term creditors represent £20m (2004 £22m) in respect of deferred income and £12m (2004 £10m) for the home computing initiative.

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

	2005				2004			
	Loans £m	Finance leases/hire purchase agreements £m	Deferred consideration £m	Total £m	Loans £m	Finance leases/hire purchase agreements £m	Deferred consideration £m	Total £m
Amounts falling due in:								
One year or less or on demand	375	1	16	392	53	35	-	88
More than one year	506	2	8	516	507	2	2	511
More than one year but not more than two years	1	1	8	10	1	-	2	3
More than two years but not more than five years	2	1	-	3	-	1	-	1
More than five years	503	-	-	503	506	1	-	507
Total	881	3	24	908	560	37	2	599

Analysis of loans and facilities

	Loan £m	Further facility £m	Total facility £m	Average interest/interest range of loan %	Average maturity date of loan Year
DTI loans to Royal Mail Group plc	500	844	1,344	5.8	2023
HM Treasury loans to Post Office Limited	360	790	1,150	5.0	2005
Committed facilities	860	1,634	2,494		
Short-term loan from associate	14	-	14	4.8	2005
Miscellaneous long-term bank loans in overseas subsidiaries	7	-	7	3.1-6.9	2009
Total	881	1,634	2,515		

At 27 March 2005, the Group borrowing limit under section 115(6)(b) of the Postal Services Act 2000 was £5bn (2004 £5bn) subject to Government agreement.

The Group has various borrowing facilities available to it. The undrawn committed facilities available at 27 March 2005, in respect of which all conditions precedent had been met at that date, are as follows:

	2005 £m	2004 £m
Expiring in one year or less	300	500
Expiring in more than one year but not more than two years	200	-
Expiring in more than two years	1,134	1,644
Total	1,634	2,144

The undrawn amounts comprise multiple loan facilities amounting to £1,634m. £860m of the committed facilities had been utilised at 27 March 2005. The £500m loan is secured by way of a fixed and floating charge on various assets of the Group. The £360m HM Treasury loans to Post Office Limited, which are secured by way of a floating charge on various assets of the Group and a negative pledge over cash and near cash items, are short dated on a programme of liquidity management draw down on the facility that expires in 2010.

Royal Mail Holdings plc

15 Provisions for liabilities and charges

	At 29 March 2004 £m	Charged/(released) in the year £m	Utilised non-cash £m	Utilised cash £m	At 27 March 2005 £m
Mails and Parcels	429	47	(117)	(200)	159
Counter Services	50	-	(14)	(24)	12
Deferred tax	96	(1)	-	-	95
Total	575	46	(131)	(224)	266

The cash utilisation of £224m includes £218m of spend relating to exceptional rationalisation. Total cash spend in the year relating to exceptional rationalisation is shown in the cash flow statement. Included within provisions is £66m (2004 £53m) relating to onerous property contracts.

The Mails and Parcels provision includes amounts relating to redundancy and other non-redundancy items for the Heathrow Worldwide Distribution Centre project and other restructuring programmes. During the year £36m was charged to exceptional items and £11m to other operating costs. £117m was transferred to creditors due within one year mainly relating to amounts due to the pension scheme for redundancies with early retirement. £111m of this provision is expected to be utilised in 2005-06 and the remainder over the following two to three years, except for £12m relating to decommissioning costs and £20m relating to onerous property contracts, which are expected to be utilised over a longer period.

Counter Services provisions include amounts relating to the continuing headcount reduction programme. During the year £14m was transferred to creditors due within one year mainly relating to amounts due to the pension scheme for redundancies with early retirement. The balance is expected to be utilised in 2005-06.

The release of deferred tax shown above excludes associates' deferred tax, as shown in note 6(a).

Deferred tax comprises:

	2005 £m	2004 £m
Fixed asset timing differences	73	23
Pension contributions timing differences	(193)	(250)
Provisions	25	98
Losses and other timing differences	16	33
Total	(79)	(96)

Analysed as:

	16	-
Deferred tax asset	16	-
Deferred tax provision	(95)	(96)
	(79)	(96)

16 Reserves

Group

	Distributable reserves				2005 Total £m
	Profit and loss account £m	Mails £m	Rural Network £m	Other £m	
At 29 March 2004	999	765	311	63	2,138
Profit for the financial year	235	-	-	-	235
Transfer of Rural Network Reserve	151	-	(151)	-	-
Transfer of interest income	(47)	36	11	-	-
Exchange differences	8	-	-	-	8
At 27 March 2005	1,346	801	171	63	2,381

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

The Rural Network Reserve was initially set up during 2003-04 to provide funding for a three-year period to maintain the rural network of Post Offices. The Rural Network Reserve has been reduced by £151m, representing the financing required during the year.

Royal Mail Holdings plc

16 Reserves (continued)

Other reserves represent the unrealised gains arising from the acquisition of interests in associates and joint ventures in prior years.

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

Company	Profit and loss account £m	2005 Total £m
At 29 March 2004	2,146	2,146
Profit for the year	184	184
At 27 March 2005	2,330	2,330

The profit dealt with in the accounts of the parent company was £184m (2004 a loss of £34m). The Company is a non-trading company and the profit for the financial year represents the net asset value adjustment arising as a result of the accounting policy on fixed asset investments. This states that the investments in internally formed subsidiary undertakings are stated at net asset value. Accordingly, the Company's profit for the financial year is eliminated in the Group Accounts and does not therefore form part of the Group results. Further details can be found in note 9.

17 Share capital

	2005 £	2004 £
Authorised		
Ordinary shares of £1 each	100,000	100,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	100,001	100,001
Allotted and called up	2005 £	2004 £
Ordinary shares of £1 each	50,000	50,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	50,001	50,001

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

On distribution in a winding up of the Company, the Secretary of State is entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member.

The Special Share does not carry any rights to vote.

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

Royal Mail Holdings plc

18 Derivatives and other financial instruments

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

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

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

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

	2005				2004			
	Gross asset £m	Gross liability £m	Net book value £m	Fair value £m	Gross asset £m	Gross liability £m	Net book value £m	Fair value £m
Cash	890	-	890	890	1,049	-	1,049	1,049
Current asset investments (note 11)	1,141	-	1,141	1,141	999	-	999	999
Other investments (Gov't gilt-edged securities) (note 9)	7	-	7	7	7	-	7	7
Borrowings (note 14)	-	(908)	(908)	(898)	-	(599)	(599)	(595)
Client services balances (note 12)	-	(323)	(323)	(323)	-	(767)	(767)	(767)
Total	2,038	(1,231)	807	817	2,055	(1,366)	689	693

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

The carrying value of gilts is £141m (2004 £138m), of which £134m (2004 £131m) is included in current asset investments above and £7m (2004 £7m) in the other investments figures. The Group portfolio of gilt holdings showed a loss of £4m (2004 £4m) during the financial year when revalued.

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

The maturity profile of the Group's financial liabilities at 27 March 2005 is set out below:

	2005			2004		
	Borrowings (note 14) £m	Client balances £m	Total £m	Borrowings (note 14) £m	Client balances £m	Total £m
One year or less or on demand	392	323	715	88	767	855
More than one year but not more than two years	10	-	10	3	-	3
More than two years but not more than five years	3	-	3	1	-	1
More than five years	503	-	503	507	-	507
Total	908	323	1,231	599	767	1,366

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

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

Royal Mail Holdings plc

18 Derivatives and other financial instruments (continued)

(iv) Interest rate profile and foreign currency analysis

	2005				2005				
	Financial liabilities			Gross total £m	Financial assets				Gross total £m
	Sterling £m	Euro £m	Other £m		Sterling £m	USD £m	Euro £m	Other £m	
Fixed rate	(860)	(7)	-	(867)	1,148	-	-	-	1,148
Floating rate	(14)	(3)	-	(17)	13	-	15	6	34
Non-interest bearing	(323)	(6)	(18)	(347)	785	16	48	7	856
Total	(1,197)	(16)	(18)	(1,231)	1,946	16	63	13	2,038
									807

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

The fixed rate sterling financial liabilities of £860m have a weighted average interest rate of 5.5% and an average time to maturity of 11 years (2004 5.7% and 18 years). The fixed rate sterling financial assets of £1,148m have a weighted average interest rate of 4.73% and an average time to maturity of 46 days (2004 3.95% and 20 days).

The floating rate sterling financial assets have a weighted average interest rate of bank rate minus 1% and an average time to maturity of one day (2004 £nil).

The fixed rate euro financial liabilities have a weighted average interest rate of 6.1% and average time to maturity of four years (2004 6.1% and four years).

The floating rate euro financial liabilities have a weighted average interest rate of euro LIBOR plus 2% and an average time to maturity of three years (2004 euro LIBOR plus 2% and four years). The floating rate euro financial assets have a weighted average interest rate of bank rate minus 1% and an average time to maturity of one day (2004 bank rate minus 1% and one day).

Of the £347m of non-interest bearing financial liabilities, £323m is payable on demand and £24m has an average maturity date of one year. All the non-interest bearing financial assets are receivable on demand.

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

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

	2005	2004
	Fair value £m	Fair value £m
Foreign currency transactions	138	153
Fuel derivatives	28	16

At the balance sheet date, the Group held contracts to purchase foreign currency for £138m (2004 £153m) and £28m (2004 £16m) fuel contracts. No carrying amounts are shown as all these items are held off balance sheet. The difference between the contracted forward rate and mark to market rate was £nil (2004 a loss of £4m) for currency contracts and a gain of £8m (2004 £1m) for fuel contracts.

Royal Mail Holdings plc

18 Derivatives and other financial instruments (continued)

(vi) Forward transactions

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

	In currency (millions)		Sterling equivalents (millions)	
	2005	2004	2005	2004
Maturing within one year				
Euro	86	38	60	26
Japanese Yen	-	745	-	4
US Dollars	138	207	74	121
Australian Dollars	3	3	1	1
Fuel (US Dollars)	46	26	25	15
Maturing after one year				
US Dollars	6	1	3	1
Fuel (US Dollars)	5	2	3	1

(vii) Gains and losses on transactional exposures

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

For both 2005 and 2004 there is no material unhedged SDR exposure.

At 27 March 2005, the Group also held various open forward contracts that were taken out to hedge expected future foreign currency payments (as shown in note (vi) above).

(viii) Gains and losses on hedges

Foreign exchange exposures are hedged using currency deposits, currency borrowings, forward currency contracts and currency options. Gains and losses on these instruments are not recognised until the hedged exposure itself is recognised. Unrecognised gains and losses on these instruments used for hedging are not material.

Commodity price exposures are hedged using commodity swaps and options. Gains and losses on these instruments are not recognised until the hedged exposure itself is recognised. Unrecognised gains at the start of the financial year totalled £1m (2004 £1m) and were all realised in the current financial year. Unrecognised gains at the end of the financial year totalled £8m (2004 £1m) and are all expected to be realised in the next financial year. There are no gains/losses carried forward in the balance sheet (2004 nil).

Royal Mail Holdings plc

19 Pensions

The Group operates pension schemes as detailed below:

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

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

Pension charges in the profit and loss account

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

	2005 £m	2004 £m
Regular pension costs - defined benefit schemes	252	242
- defined contribution schemes	1	1
Regular pension costs	253	243
Pension deficiency charge under SSAP 24	138	132
Charges relating to redundancy provisions	21	54
Total net charge included in profit before tax (note 2)	412	429

Pension valuations

Valuations of the defined benefit schemes are carried out at intervals not normally exceeding three years as determined by the Trustees. The latest actuarial assessments of the RMPP and the RMSEPP were carried out as at 31 March 2003 using the projected unit method. These were performed using an assumed rate of inflation of 2.5% for both schemes. Investment returns real were assumed to be 4.9% and 4.3% respectively. Pay increases real were assumed to be 1.5% and 3.0% respectively and pensions, both in payment and deferred, were assumed to increase at 2.5% for both schemes. The market value of assets at the latest actuarial assessments was £11,954m for the RMPP and £86m for the RMSEPP. The asset cover of the benefits accrued to members after allowing for future increases in earnings was 91% for the RMPP and 82% for the RMSEPP, both as at 31 March 2003. The last valuation confirmed a cash funding shortfall of £2.5bn. An initial cash contribution of £133m towards this shortfall was made in 2003-04 and a further payment of £138m was made in 2004-05. It is anticipated that similar payments will continue in future as required. The next full valuation of both the RMPP and the RMSEPP is due to be carried out as at 31 March 2006. Key factors generating the move from surplus to deficit were investment market experience over the three years ending 31 March 2003 of some £725m, demographic changes, including increased life expectancy of members, of some £420m, and the higher assessed liabilities of some £1,350m based upon a lower discount rate.

Accounting standards

These accounts have been produced in accordance with the current accounting standard SSAP 24. The latest pensions accounting standard, FRS 17 Retirement benefits, has been adopted by the Group in accordance with the transitional arrangements.

FRS 17 disclosures

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

a) Assumptions

The major assumptions used by the actuary were:

	At 27/03/2005 % pa	At 28/03/2004 % pa	At 30/03/03 % pa
Rate of increase in salaries	4.20	4.10	3.55
Rate of increase in pensions	2.70	2.60	2.25
Discount rate	5.50	5.50	5.50
Inflation assumption	2.70	2.60	2.25
Expected average rate of return on assets	7.40	7.50	7.90

The size of the pension deficit, which is large in the context of the Company and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the deficit and overall profit and loss charge.

Royal Mail Holdings plc

19 Pensions (continued)

b) Plan assets and expected rates of return

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

At 27 March 2005

	Market value at 27 March 2005		Long-term rate of return expected at 27 March 2005 % pa
	RMPP £m	RMSEPP £m	
Equities	13,266	117	8.00
Bonds	1,978	28	4.80
Property	1,642	-	6.40
Other assets	334	2	3.70
Total market value of assets	17,220	147	
Present value of Plan liabilities	(21,126)	(189)	
Deficit in scheme	(3,906)	(42)	
Related deferred tax asset*	279	3	
Net pension liability	(3,627)	(39)	

At 28 March 2004

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

At 30 March 2003

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

*Due to improved profitability, deferred tax assets totalling £282m are recognised in relation to the pension liabilities at March 2005, whereas none were recognised in earlier years. This amount falls short of the potential asset of £1,184m due to continuing uncertainty regarding the ability of the Group to generate sufficient future taxable income to obtain tax relief for pension contributions paid.

Royal Mail Holdings plc

19 Pensions (continued)

c) Components of defined benefit costs

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

	RMPP £m	RMSEPP £m	2005 Total £m	RMPP £m	RMSEPP £m	2004 Total £m
Analysis of amounts charged to operating profit:						
Current service cost	479	4	483	394	3	397
Total charge to operating profit	479	4	483	394	3	397
Analysis of other amounts charged to profit and loss account:						
Loss due on settlements	6	-	6	-	-	-
Loss due to curtailments*	208	-	208	87	6	93
Total net operating charge	693	4	697	481	9	490
*These costs have already been recognised in the Group primary statements on a SSAP 24 basis.						
Analysis of amount charged/(credited) to other finance income:						
Interest on Pension Plan liabilities	1,059	9	1,068	909	6	915
Expected return on Pension Plan assets	(1,118)	(9)	(1,127)	(950)	(6)	(956)
Net credit to other finance income	(59)	-	(59)	(41)	-	(41)
Total profit and loss charge before deduction for tax	634	4	638	440	9	449
Analysis of amounts recognised in statement of total recognised gains and losses (STRGL):						
Difference between actual and expected return on Plan assets	(1,038)	(3)	(1,041)	(2,063)	(16)	(2,079)
Experience loss on Plan liabilities	297	4	301	73	2	75
Loss on change in assumptions (financial and demographic)	316	14	330	1,886	24	1,910
Actuarial (gain)/loss recognised in STRGL	(425)	15	(410)	(104)	10	(94)

d) Movement in (deficit)/surplus

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

	RMPP £m	RMSEPP £m	2005 Total £m	RMPP £m	RMSEPP £m	2004 Total £m
Deficit in Plan at beginning of period	(4,348)	(32)	(4,380)	(4,652)	(32)	(4,684)
Company contributions paid	661	9	670	640	19	659
Current service cost	(479)	(4)	(483)	(394)	(3)	(397)
Settlement cost	(6)	-	(6)	-	-	-
Curtailment cost	(208)	-	(208)	(87)	(6)	(93)
Accounting change in respect of joint venture	(10)	-	(10)	-	-	-
Other finance income	59	-	59	41	-	41
Actuarial gain/(loss)	425	(15)	410	104	(10)	94
Deficit in Plan at end of period	(3,906)	(42)	(3,948)	(4,348)	(32)	(4,380)

Royal Mail Holdings plc

19 Pensions (continued)

e) History of experience gains and losses

	RMPP	RMSEPP	2005 Total	RMPP	RMSEPP	2004 Total	RMPP	RMSEPP	2003 Total
(Gain)/loss between actual and expected return on Plan assets:									
Amount (£m)	(1,038)	(3)	(1,041)	(2,063)	(16)	(2,079)	4,342	28	4,370
Percentage of Plan assets at end of period	6.0%	2.0%	6.0%	13.7%	12.9%	13.7%	35.9%	32.2%	35.9%
Experience loss/(gain) on Plan liabilities:									
Amount (£m)	297	4	301	73	2	75	(22)	5	(17)
Percentage of Plan liabilities at end of period	1.4%	2.1%	1.4%	0.4%	1.3%	0.4%	0.1%	4.2%	0.1%
Total actuarial (gain)/loss recognised in STRGL:									
Amount (£m)	(425)	15	(410)	(104)	10	(94)	4,992	37	5,029
Percentage of Plan liabilities at end of period	2.0%	7.9%	1.9%	0.5%	6.4%	0.5%	29.8%	31.1%	29.8%

f) Balance sheet presentation

	2005 £m	2004 £m
Net assets		
Net assets as stated in balance sheet	2,385	2,138
Pension prepayment recoverable beyond one year (SSAP 24)	(835)	(770)
Related deferred tax	95	95
Net assets excluding pension asset	1,645	1,463
FRS 17 pension liability	(3,948)	(4,380)
Related deferred tax	282	-
Net assets including FRS 17 pension liability	(2,021)	(2,917)
 Reserves		
Profit and loss reserve as stated in balance sheet	1,346	999
Pension prepayment recoverable beyond one year (SSAP 24)	(835)	(770)
Related deferred tax	95	95
Profit and loss reserve excluding amounts relating to pension asset	606	324
FRS 17 pension liability	(3,948)	(4,380)
Related deferred tax	282	-
Profit and loss reserve including amounts relating to FRS 17 pension liability	(3,060)	(4,056)

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

Royal Mail Holdings plc

20 Commitments

Capital commitments contracted for but not provided in the accounts amount to £93m (2004 £84m).

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

	Land and buildings		Vehicles and equipment	
	2005 £m	2004 £m	2005 £m	2004 £m
For leases which expire:				
Within one year	13	10	50	16
Between one and five years	29	21	56	51
Beyond five years	87	89	3	1
Total	129	120	109	68

21 Contingent liabilities and guarantees

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

As required by the Notes Sorting Facility rules, notes in transit to cash handling centres and those processed overnight, for which the Group has received credit, are secured by gilts deposited with the Bank of England. On default, the estimated maximum liability would be £104m.

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

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

22 Related party transactions

During the year the Group entered into transactions with related parties. The transactions were in the ordinary course of business and included administration and investment services recharged to the Group's Pension Plan by Royal Mail Pensions Trustees Limited. The transactions entered into and the balances outstanding at 27 March 2005 were as follows:

	Sales to related party		Purchases from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
Royal Mail Pension Plan	8	8	-	-	1	10	-	-
Quadrant Catering Limited	-	1	43	40	-	-	15	1
Camelot Group plc	11	9	-	-	1	-	-	-
G3 Worldwide Mail N.V. (trade name "Spring")	2	5	17	30	12	11	2	3
First Rate Travel Services Holdings Limited Group	24	19	-	-	-	-	1	-
Post Office Financial Services	1	-	-	-	-	-	-	-
Romec Limited (a subsidiary from 22 December 2004)	3	13	127	224	3	1	18	29

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

David Mills, an Executive Director, is a shareholder-nominated Director of Camelot Group plc, with whom the Group has a commercial relationship for the sale of £749m (2004 £748m) lottery products per annum.

Bob Wigley, a Non Executive Director, is Chairman of Merrill Lynch's Europe, Middle East and Africa Business. The Trustees of the Royal Mail Pension Plan, not the Company, have a commercial relationship with Merrill Lynch Investment Management, for two UK equity portfolio mandates to the value of £1.1bn (2004 £1.0bn) during the year. Bob Wigley is not a Trustee of the Royal Mail Pension Plan.

Brian Goggin, a Non Executive Director of Post Office Limited, a wholly owned subsidiary of the Company, is also the Group Chief Executive of the Bank of Ireland. The Group has a commercial relationship with First Rate Travel Services Holdings Limited Group, a joint venture company in which both Post Office Limited and the Bank of Ireland have a 50% shareholding, to undertake foreign currency activities to the value of £99m (2004 £74m) during the year. The Group also has a commercial relationship with Post Office Financial Services, a company in which both Post Office Limited and the Bank of Ireland have a 50% shareholding, to provide financial services products to the value of £5m (2004 £nil) during the year.

John Neill, a Non Executive Director, is Group Chief Executive and Deputy Chairman of the Unipart Group, which has a contract for the supply of operational support services and expertise with Royal Mail for improvements to mail centres. The total value of the contract is £4m of which £1.5m was paid during the course of the year.

Royal Mail Holdings plc

23 Principal subsidiary undertakings, joint ventures and associates

	Country of incorporation	Percentage holding %	Principal activities
Subsidiary undertakings			
Royal Mail Group plc ¹	UK	100	Mails and parcels services
Post Office Limited	UK	100	Counter and financial services
General Logistics Systems International Holdings B.V. ²	Netherlands	100	Parcel services
Romec Limited	UK	51	Facilities management
NDC 2000 Limited	UK	51	Design consultancy
Associates			
Camelot Group plc	UK	20	Lottery operations
Quadrant Catering Limited ³	UK	51	Catering services
G3 Worldwide Mail N.V. (trade name 'Spring')	Netherlands	25	Mail services
Midasgrange Limited	UK	50	Financial services
Joint ventures			
First Rate Travel Services Holdings Limited	UK	50	Bureau de Change

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

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

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

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

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

Royal Mail Holdings plc

Five-year summary

Profit and loss account	2001 £m	2002 ⁽²⁾ £m	2003 £m	2004 £m	2005 £m
External turnover	8,119	8,408	8,299	8,633	8,956
(Loss)/profit from operations ⁽¹⁾	(206)	(318)	(197)	220	537
Less share of operating (profit)/loss of joint ventures and associates	-	1	(30)	(37)	(34)
Add pensions benefit/(charge) in respect of pensions surplus/(deficit)	228	250	246	(132)	(138)
Group operating profit/(loss) before exceptional items	22	(67)	19	51	365
Operating exceptional items	(67)	(1,119)	(697)	(64)	(277)
Group operating (loss)/profit	(45)	(1,186)	(678)	(13)	88
Share of operating profit of joint ventures and associates	-	4	30	37	34
Impairment of goodwill in associates	-	(12)	(24)	-	-
Total operating (loss)/profit	(45)	(1,194)	(672)	24	122
Non-operating exceptional items	20	14	26	64	67
(Loss)/profit before interest	(25)	(1,180)	(646)	88	189
Net interest receivable	106	56	35	17	18
Profit/(loss) before tax	81	(1,124)	(611)	105	207
Taxation	(34)	179	52	(98)	28
Profit/(loss) after tax	47	(945)	(559)	7	235
Equity minority interests	2	5	-	-	-
Profit/(loss) for the financial year	49	(940)	(559)	7	235
Transfer to dividend reserve	(93)	-	-	-	-
(Loss)/profit retained	(44)	(940)	(559)	7	235
Total operating profit/(loss) before exceptional items	22	(68)	49	88	399
Balance sheet	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m
Intangible assets	421	146	156	123	144
Tangible fixed assets	2,026	1,783	1,648	1,550	1,591
Fixed asset investments	60	94	83	138	135
Net current assets	2,008	1,987	1,785	1,445	1,329
Creditors beyond one year and provisions	(977)	(1,405)	(1,584)	(1,118)	(814)
Total assets less liabilities	3,538	2,605	2,088	2,138	2,385
Cash flow	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m
Net cash flow before use of liquid resources and financing and before POL client balance movement	(229)	(96)	(553)	65	140
POL client balance movement	108	(4)	67	(287)	(444)
Net cash outflow before use of liquid resources and financing	(121)	(100)	(486)	(222)	(304)

Note

⁽¹⁾ (Loss)/profit from operations reflects the underlying performance of the Group as defined in the Operating and Financial Review.
⁽²⁾ 53 week year. All the other years are 52 week years.

Royal Mail Holdings plc

Glossary of terms

Accounting convention

The basis on which accounts are prepared.

Accounting Standards Board (ASB)

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

Capital expenditure

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

Cash

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

Client services balances

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

Counter Services

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

Creditors

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

Currency options

An option to buy or sell foreign currency.

Current assets

Cash or other assets readily convertible into cash.

Debtors

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

Deferred taxation

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

Department of Trade and Industry (DTI)

The Department of Trade and Industry.

Financial Reporting Standard (FRS)

A Financial Reporting Standard issued by the Accounting Standards Board.

Finance lease

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

Goodwill

The excess of consideration paid over net assets acquired.

Group

Comprises Royal Mail Holdings plc and its subsidiary undertakings.

Hedge

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

Historic cost basis

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

International Accounting Standards Board (IASB)

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

IFRS

International Financial Reporting Standard.

Liquid funds (cash flow)

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

Mails Reserve

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

Royal Mail Holdings plc

Glossary of terms (continued)

National Loans Fund (NLF)

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

Operating lease

A lease other than a finance lease.

Operating profit

Represents the profit (before interest and non-operating exceptional items) on ordinary activities.

Postcomm

The postal industry regulator.

Postwatch

The postal industry consumer body.

Profit and loss account reserve

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

Provisions

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

Rural Network Reserve

A reserve created to fund the rural network.

Statement of Standard Accounting Practice (SSAP)

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

Shareholder

The Company's shareholder is HM Government.

Special Share

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

Special Shareholder

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

Tangible fixed assets

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

Total recognised gains and losses

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

Universal Service Obligation (USO)

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

Value Added Tax (VAT)

An indirect tax on goods and services.

Royal Mail Holdings plc

Corporate Information

Registered Office and Group Head Office

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

Corporate website

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

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

Auditors

Ernst & Young LLP
1 More London Place
LONDON
SE1 2AF

Actuaries

Watson Wyatt Worldwide
Watson House
London Road
Reigate
Surrey
RH2 9PQ

Solicitors

Slaughter and May
1 Bunhill Row
LONDON
EC1Y 8YY

Regulator (Postcomm)

Postal Services Commission
Hercules House
6 Hercules Road
LONDON
SE1 7DB

Consumer Body

Postwatch
28 Grosvenor Gardens
LONDON
SW1W 0TT

Financial Calendar

Regulatory Accounts 2004-05	July 2005
Interim Accounts 2005-06	November 2005
Preliminary Results 2005-06	May 2006