UKGI00042083

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Shareholder Executive

HM Government

Post Office Limited ("POL")

Annual Review

January 2014

RESTRICTED – POLICY & COMMERCIAL

UKGI00042083

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1 Executive Summary

While POL's profile is similar to how it looked in December 2012 management have continued to make progress in a number of areas…

…the business has a new strategic plan and long term funding and has performed acceptably in relation to a number of its key strategic goals…

…however risks remain. These could start to impact performance in the coming months – at a time when the plan starts to put management under increased demands

- **Since the last annual review in December 2012 considerable progress has been made at POL**
  - POL has developed a new strategy for the period to 2019/20 that addresses key weaknesses with its previous plan
  - A new funding agreement has been secured for POL. The business is now fully funded up to the end of 2017/18
  - Network Transformation has moved fully into implementation. 1,467 branches are now operating as new models
  - Crown Transformation has been taken forward and franchising, investment and automation activities are currently "live"
  - The work of the stakeholder forum is substantially complete. This marks a key milestone in POL's mutualisation process
  - POL's relationship with the NFSP has matured – this is more collaborative, and exhibits new ways-of-working for both sides
- **However headwinds / risks have emerged in a number of areas. While these do not undo the results achieved to date they could start to impact the business or its performance in the near term**
  - After a strong year in 2012/13 POL's financial performance has softened in 2013/14 at the same time as targets have got more challenging. Management also believe that the plan for 2014/15, while deliverable, is extremely ambitious
  - Industrial action in the Crown estate (and more recently Supply Chain) by both CWU and CMA members has been ongoing for more than nine months. While progress is being made, hostile stakeholder relations bring with them considerable risk
  - Developments with Royal Mail, DWP and DVLA highlight how exposed POL and its network are to a small number of key contracts. It is also not clear whether POL's relationships with these high-value clients reflects this positioning
  - POL's relationship with HMG remains a key area of risk – this includes commercially (e.g. VOA, NS&I), in respect of future strategy (e.g. DWP, Cabinet Office) and in relation to stakeholders (e.g. NFSP)
  - While considerable progress has been made around POL's mutualisation, progress has been slow. There is still some internal resistance to the process which could start to impact progress, particularly given continued Ministerial interest

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Executive Summary (cont'd)

The structure of POL's new strategy makes an assessment of the business's (and management's) performance easier…

…this is supported by the ShEx POL team's increasingly strong and collaborative relationship with senior and commercial management…

…both points are important as the business moves into an important period in respect of its financial and commercial goals

- **In the ShEx POL team's last Annual Review there was limited commentary around the business's strategy – while it had only been prepared in 2010/11 the forecasts set out in the plan were no longer relevant**
  - This current Annual Review incorporates POL's new strategy. While this is consistent with POL's previous plan, disconnects between forecasts and actual trading have been addressed meaning a more detailed assessment can now be presented
- **Despite this – and in line with the approach taken in the last Annual Review – it remains challenging to construct a meaningful valuation of POL**
  - The business continues to be loss making and combined with a need for continued HMG funding any "value" attributable to HMG's shareholding is highly sensitive to a small number of key assumptions
- **Questions around the capability of management were highlighted in 2012. These remain**
  - Churn among the senior team is high, and it is not clear whether appropriate succession planning is in place for key roles. In addition while the team knows the business well, time is needed to demonstrate their ability to deliver the strategy
- **POL has had another good year, however its track record of successes is no indicator of future performance**
  - Recent trading has softened, and moving into the second half of 2013/14 and 2014/15 an increasing number of strategic initiatives move into a challenging delivery phase. Managing delivery of these in parallel is likely to be challenging
- **The ShEx POL team works closely with POL management at many levels and our relationship with the business has improved considerably over the course of the past 12 months**

WHAT WAS OUR KEY FOCUS FOR 2013?
1.) Develop revised plan and funding proposal for the next spending review *[Completed subject to State Aid approval]*
2.) Push through Network Transformation, Crown Transformation and Revenue Growth (incl. Government Services) *[Cautious progress made]*
3.) Progress POL's mutualisation process *[Progress made, but at a fairly modest pace. Further work / engagement is required]*

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2 Business Overview

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Business Overview

POL operates the #1 retail footprint in the UK, managing a network of c.11,800 branches and delivering a range of around 170 services across a number of markets including Mails and Retail, Financial Services, Government Services and Telephony…

…the business has been independent of Royal Mail since April 2012 – it is currently 100 per cent. owned by the SoS through Postal Services Holding Company Limited

Post Office Limited

12/13A Net Income(1) £902m, 12/13A Operating Profit £94m (10.4% margin), 12/13A Headcount 7,798

Mail and Retail

12/13A Sales: £404m (44.8% total sales ex. NSP)

- Provision of stamps, labels, international mail, special delivery and parcel services on behalf of Royal Mail
- Also active in in-branch and online retail with stationary, collectibles (e.g. stamps, Royal Mint coins) and lottery (in-branch only)

Financial Services

12/13A Sales: £280m (31.0% total sales ex. NSP)

- Broad range of financial services including bill payments, SME banking services (e.g. deposits and withdrawals), retail banking services for UK high-street banks, ATMs, foreign exchange, insurance and savings products

Government Services

12/13A Sales: £133m (14.8% total sales ex. NSP)

- Range of services on behalf of Government departments, including POCA (e.g. benefits exception for claimants opting not to use a bank account), passport check-and-send, DVLA driving licence renewals, and a range of identity services

Other

12/13A Sales: £86m (9.5% total sales ex. NSP)

- Retail home phone and broadband services provider with c.500k subscribers (53 per cent. divisional total sales)
- Also provides a small range of miscellaneous services (e.g. cash-transit and warehousing)

The Network

- POL's network of c.11,800 branches is distributed across an owned estate of c.370 "Crowns", c.8,900 privately owned branches operated by subpostmasters (incl. symbol groups), c.1,400 branches operated by multiple retailers and c.1,100 "Outreach" post offices (i.e. limited hours service in remote locations where a permanent branch is not viable)
- Of the c.1,400 branches owned by retail partners, c.300 are managed by The Co-operative Group (c.500 by co-operative groups more generally), c.400 by Martin McColl's and c.200 by OneStop (owned by Tesco). c.80 ex-Crown branches are operated by WH Smith under a franchise agreement (to increase to at least c.100 branches after the current round of franchising)

(1) References to Net Income relate to revenue less cost of goods sold. This is used by POL as a proxy for revenue and ensures a greater degree of comparability between different activities (e.g. Mails where CoGS are c.1 per cent. gross revenue and Telephony they are >70 per cent.)

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Market Overview and Competitive Positioning

POL has a strong and trusted brand across a wide range of markets – this is increasingly a crucial differentiator for the business…

…however the speed of product launches have not met expectations – collect and return, current accounts and mobile telephony were all due to "go live" in early 2013 but saw delayed launches…

…at the same time POL is seeking to address gaps in customers' knowledge of the breadth of its offer

Post Office Limited

Mail and Retail

Selected Key Competitors
collect+ · myHermes ParcelShop · STAPLES · Ryman the stationer

- Clear leader in retail mails although this is widely seen as a declining market
- Also strong in higher growth packets and parcels, where competition is stronger
- Recently started rolling out a collect and returns offer – slightly later than planned – which will be a key medium term growth driver. Enables POL to respond more effectively to competitive threats
- Strategy to transform the estate and customer experience through Network and Crown Transformation initiatives

Financial Services

Selected Key Competitors
Lloyds TSB · Travelex · Santander

- Competitive offer in almost all segments where POL is active
- Brand equity is also a key differentiator in many areas – especially when POL competes against high-street banks
- Launched current account pilot in 2013 with plans to start rolling out nationwide in 2014
- Key growth driver of new strategy – both in SME (e.g. development of integrated basket of services) and retail (e.g. mortgages, savings, insurance) markets

Government Services

Selected Key Competitors
PayPoint · epay · payzone

- High level of competition in low value-add transactional services (e.g. payment processing)
- Less competition in more complex areas where POL can leverage its footprint, relationships with Govt. and its branch / staff security profile
- Landscape is evolving (e.g. PayPoint entering payout services) and commercial environments are increasingly challenging (e.g. DVLA pricing and volumes, and tax disc withdrawal)

Telephony and Other

Selected Key Competitors
TalkTalk · BT · sky · British Gas (???)

- Competitive price driven market, with a large number of players
- Peers are often able to offer a broader range of services than POL (e.g. triple- or quad-play) – however POL is planning to launch mobile in 2014
- Subscriber base is seen to be both low-churn but also low-spending / price conscious. Risk on ability to up-sell / cross-sell
- New strategy looks at launching additional products (e.g. Home-Services). Detailed plans not yet worked up

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3 Long Term Strategy

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Long Term Strategy – Introduction

POL's new "Vision 2020" plan will start to be implemented in early 2014…

…while it maintains the same objectives as POL's existing strategy the new funding enables POL to make improvements in a number of areas which help to derisk delivery (e.g. in Network Transformation)…

…at the same time it remains highly ambitious and potentially more so than the plan put together by POL in 2010/11

- **POL's new "Vision 2020" strategy was developed over a 12 month period between Autumn 2012 and Autumn 2013 and covers the period 2013/14 to 2019/20**
  – Represents a continuation of POL's existing strategy, with its focus on delivering a financially sustainable POL that is less reliant on HMG funding. Also ensures POL is able to continue to meet HMG's objectives for it and its network
  – Achieved through a large scale transformation and modernisation of the post office network, growth of revenues in established and new markets and through driving change and efficiency in the way the day-to-day POL business operates
- **£640m funding was recently secured for the 3-year period from 2015/16 to 2017/18. A State Aid notification will be made in 2014 to ensure that an approval is received before the existing funding agreement comes to an end in March 2015**
  – It is additional to the £1.34bn agreement reached in 2010/11 for the period 2011/12 to 2014/15, and enables the completion of all transformational strategic initiatives
- **While further funding will still be needed for the final two years of the "Vision 2020" plan it is expected that any future commitment will be made on a different basis to the current and new agreements**
  – Investments prior to 2017/18 mean that it will be possible to put in place a more "contractual" funding that is directly tied to the performance of the structurally unviable portion of the post office network (e.g. remote loss making "Community" branches)

Mar YE (£m)	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Network Subsidy Payment	180	210	200	160	130	80	70	60	50
Other Government Funding	0	200	215	170	150	140	70	0	0
Total Funding	**180**	**410**	**415**	**330**	**280**	**220**	**140**	**60**	**50**

£1.34bn funding for 2011/12 to 2014/15

£640m funding for 2015/16 to 2017/18

Indicative future "steady state" funding

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Long Term Strategy – Financial Summary

While the commercial objectives of POL's new strategy are the same as under the old plan the financial profile / mix is very different…

…this reflects differences in recent sales performance compared to what had been expected (e.g. strength in Mails and Retail and Financial Services and weakness in Government Services). This also means forecasts are now relevant and therefore can be monitored more effectively

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Mail and Retail	388	404	415	430	425	448	482	515	546
Financial Services	261	280	277	295	328	379	427	464	492
Government Services	136	133	116	117	158	174	173	190	206
Telephony and Other	81	86	92	98	136	160	182	190	195
Income Contingency	n.m.	n.m.	n.m.	(15)	(40)	(60)	(80)	(100)	(120)
Net Income (ex. NSP)	**865**	**902**	**900**	**925**	**1,007**	**1,101**	**1,184**	**1,259**	**1,319**
% growth	*n.a.*	*4.3%*	*(0.3%)*	*2.8%*	*8.9%*	*9.3%*	*7.5%*	*6.3%*	*4.8%*
Network Subsidy Payment	180	210	200	160	130	80	70	60	50
Net Income (in. NSP)	**1,045**	**1,112**	**1,100**	**1,085**	**1,137**	**1,181**	**1,254**	**1,319**	**1,369**
% growth	*n.a.*	*6.4%*	*(1.1%)*	*(1.4%)*	*4.8%*	*3.9%*	*6.2%*	*5.2%*	*3.8%*
Total Costs	(1,015)	(1,050)	(1,030)	(1,029)	(1,064)	(1,141)	(1,175)	(1,251)	(1,312)
Income Contingency Costs	n.m.	n.m.	n.m.	9	24	36	48	60	72
% Net Income (ex. NSP)	*(117.3%)*	*(116.4%)*	*(114.4%)*	*(110.3%)*	*(103.3%)*	*(100.4%)*	*(95.2%)*	*(94.6%)*	*(94.0%)*
JV Income	31	32	32	34	33	35	37	41	41
EBITDA	**61**	**94**	**102**	**99**	**130**	**111**	**164**	**169**	**170**
EBITDAS	*(119)*	*(116)*	*(98)*	*(61)*	*0*	*31*	*94*	*109*	*120*
% margin	*5.9%*	*8.5%*	*9.3%*	*9.1%*	*11.4%*	*9.4%*	*13.1%*	*12.8%*	*12.4%*
Operating Cashflow	**21**	**19**	**9**	**(83)**	**(103)**	**0**	**64**	**104**	**114**

- **In response to weaknesses identified with POL's previous strategy the new plan has been developed bottom-up and in a level of detail that should make it possible to put in place detailed monitoring and assessment structures**
  - The plan is supported by measurable commercial assumptions, and it has been prepared on consistent a basis with the way management accounts are reported. This was not the case under the previous strategy
  - Despite being challenged the approach that POL is taking to budgeting remains broadly unchanged. The timing of this process (e.g. between October and March) is not considered ideal and is not believed to be in line with market practice
- **POL is currently going through a detailed planning process to ensure implementation strategies are in place for each initiative underlying the new plan. These will be reviewed, and subject to challenge, by the ShEx POL team in early 2014**

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Long Term Strategy – Network Transformation

Network Transformation will see a widespread restructuring of POL's estate, changing how customers interact with branches and how POL interacts with its network…

…while POL has experience of delivering large transformation programmes, the scale of the current strategy is unprecedented…

…the challenges POL identified in implementation over the first 12 months set the context for POL's new strategy and the recently announced funding to 2017/18

- **Network Transformation was developed in 2010/11 as a 5 year strategy to transform and modernise the non-Crown estate of c.11,400 branches**
  - increases the viability of branches operated by subpostmasters, improves the customer and in-branch experience, delivers financial benefits and flexibility to POL and ensures a reduced reliance of POL and the network on HMG funding
- **The first phase was due to run for three years to March 2015 and was envisaged to see up to 6,000 branches convert to one of the new Local or Main operating models**

	"MAIN" MODEL	"LOCAL" MODEL
Typical Branch	Mostly town centres, processing >1,200 transactions pw	Mostly urban fringe and rural, processing <1,200 transactions pw
POL Services Offer	Full range of POL services	95% POL services by transaction volume
POL Positioning in Branch	Primary counter separate from retail with subsidiary counter integrated	Fully integrated into retail

- **However soon after rollout of the strategy began in late 2012 the rate of conversions started to fall behind expectations**
- **POL has sought to address this underperformance in its new strategy. With the support of the NFSP management are proposing to put in place a number of changes that will accelerate the pace of conversions**
  - More funding has been secured to incentivise the right behaviours among subpostmasters (e.g. increased compensation and investment) and the timeline has also been extended by one year – completion is now expected by March 2018
  - Since it remains a largely voluntary strategy, the profile of conversions has also changed. Although fewer than 6,000 branches are now expected to convert by March 2015 overall targets to convert all branches that can be converted remains
  - A new "Community" designation has also been introduced that will ensure that where branches should not convert (e.g. due to the impact on their viability) they will not be forced to do so. Service provision among this population will be protected
- **The new plan is materially different from the one originally proposed by POL in early 2013**
  - addresses BIS Ministers' concerns related to execution risk, possible public resistance and the lack of stakeholder support (in particular from the NFSP). These changes brought with them a c.£200m increase in the programme's funding need

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Long Term Strategy – Network Transformation (cont'd)

Status: ???

- ***Materially under-performing the original plan – this set the context for the new network strategy***
- ***Too early to take a firm view of the impact of recent changes. The first months of 2014 are therefore critical***
- ***Key to retain support of the NFSP – POCA, NS&I and VOA all represent possible risks to this***

- **POL is currently behind on the delivery of the Network Transformation compared to the original strategy**
  - Having met its 1,200 contract signature target for 2012/13 it was envisaged that 2,400 further contracts would be secured in 2013/14. Re-profiled targets instead set out a goal of 1,430 (Threshold) to 2,150 (Stretch) contracts by the end of the FY
  - The gap between signatures and open branches has been stable during the course of the 2013/14 and is currently c.900. This means that by the end of 2013/14 POL expects to have c.1,950 post offices open and operating on the new models
- **The next two / three months (i.e. the retail survey[(1)] and appeals processes) will be critical in setting out an indicative profile of much of the remainder of Network Transformation. <u>This will influence any forward looking RAG rating</u>**
  - Management information will help POL validate its desktop network segmentation, giving it a better sense of what branches are likely to convert onsite / offsite, conversion timescales, budgets and possible communication risks
  - Branches, and in particular unsuitable hosts of Local model post offices, will receive a communication informing them of the "managed exit" process. This will also allow POL to engage with multiples and symbol groups in a more strategic way
- **The support of the NFSP is expected to be key in helping to increase the rate of conversions (e.g. making messaging that no further funding is available more credible and helping to manage subpostmasters concerns around "managed exits")**
  - Collaborative approach to this relationship is embedded within an agreement reached between POL and the NFSP in relation to the NFSP's future (i.e. supporting a shift from a union-like body to an organisation more like a trade body)
- **As part of the new plan POL can also trigger a "compensation cliff" in September 2015 that gives it the right to change levels of compensation and investment available to subpostmasters and the structure of the Core Tier Payment**
  - Makes the continued availability of compensation / fixed-pay uncertain, encouraging early engagement of subpostmasters
  - Has the support of the NFSP and forms a core part of the messaging around the new plan

SHEX ACTIONS

Monthly meetings take place to monitor Network Transformation and POL also provide ShEx with weekly updates on shorter-term developments. Also as part of the planning process of the new strategy ShEx is meeting with POL in early 2014 to discuss network mix and revised conversion targets.

<u>Note 1:</u> All subpostmasters have been asked (but are not obligated) to fill in a simple retail survey through the Horizon system in December / January. This will provide POL with important management information with which to plan the implementation of an amended Network Transformation strategy

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Long Term Strategy – Crown Transformation

POL's Crown estate faces a number of legacy costs, mainly related to property leases and employee pay, that contribute to a loss of c.£40 million per year…

…delivering breakeven is a key milestone of POL's broader strategy. It is an important signal of progress towards making POL a more sustainable business...

…the current strategy is POL's third Crown plan. This reflects the challenge that a breakeven target represents

- **POL's strategy to restructure the Crown estate targets reaching operating profit breakeven by March 2015**
  - understood to have been loss-making for a considerable period of time, and in 2012/13 these branches made an operating loss of £37m (versus £46m in 2011/12)
  - current plan is the third iteration of POL's strategy – the first plan had to be reassessed due to complications linked to employee TUPE'ing and the second due to over-reliance on income growth that was considered undeliverable
- **This new strategy is similar to the "re-cut" second plan and remains focused on four pillars: (i) people and productivity (e.g. redundancy and automation); (ii) income; (iii) property; and (iv) other (e.g. franchising and merger activity)**
  - management believe that this new strategy - in place since late 2012 - is more achievable

Mar-YE (£m)	Second Crown Plan *(March 2012)*	Third Crown Plan *(Current)*
People and Productivity Benefits	12	20 (1)
Income Benefits	18	10 (2)
Property Benefits	4	4
Other (incl. Franchising / Mergers)	7	7 (3)
Cumulative Benefit by March 2015	**41**	**41**

Cumulative benefit target in line with 2012/13 budget operating loss (i.e. financial year in which the plan was developed). Actual result for 2012/13 was £37m, c.£4m ahead of budget

1 *Includes £5m from 2012/13 voluntary redundancy programme and £ 11m from automation (and linked to this, a second round of voluntary redundancies)*

2 *£9m increase in Government Services revenue in the Second Crown Plan now revised to a £1.5m reduction and £11m growth from Financial Services now targeted to be £6m. Remainder of Third Crown Plan income driven by "other" revenues (e.g. Mails and Retail, Telephony and renewals and retentions)*

3 *£8m benefit assumed to be derived from Franchising and Merger activities, offset by reductions in "Gamma" income (i.e. fixed fee income from BoI linked to POL's old relationship)*

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Long Term Strategy – Crown Transformation

POL's recent results show that significant progress has been made already towards a March 2015 target of breakeven…

…however a number of initiatives have only recently commenced and as such it is not certain that POL will be able to deliver the expected benefits from these…

…2014/15 is therefore a critical year. In addition unless POL's relationship with the CWU is improved continued industrial action might start to impact deliverability

- **The highest risk areas of the plan are people and productivity benefits and income benefits – together these account for c.75 per cent. of the targeted savings**
  - People and productivity savings require the effective rollout of new "Post & Go" machines, many in untested locations, and for POL to manage employee restructuring initiatives smoothly. Lack of support from the CWU makes this difficult
  - Income benefits require POL to grow revenue, which has been a challenge this year. Income headwinds will be less pronounced in 2014/15, and despite targets being lower than previous iterations of the plan this remains ambitious
- **The Crown strategy is also a key enabler of other initiatives (e.g. Mails and Retail and Financial Services growth) such that delays in delivery could impact other areas of POL and POL's ability to meet financial targets in its broader plan**

Mar YE (£m)	2012/13A	2013/14B	2013/14 (YTD to Sept)
Total Income	**153**	**150**	**73**
Direct Product Costs	(8)	(5)	(3)
Staff Costs	(118)	(106)	(54)
Property Costs	(37)	(35)	(17)
Other Branch Costs	(6)	(5)	(2)
Infrastructure Costs	(22)	(23)	(10)
Allocated Costs	(8)	(8)	(4)
Total Costs	**(200)**	**(182)**	**(91)**
% net income	*(130.4%)*	*(121.4%)*	*(125.3%)*
POL Crown Operating Profit	**(47)**	**(32)**	**(18)**
% margin	*(30.4%)*	*(21.4%)*	*(25.3%)*
Financial Services JV Income	9.6	9.1	6.6
Group Crown Operating Profit	**(37)**	**(23)**	**(12)**
% margin	*(24.1%)*	*(15.3%)*	*(16.3%)*

Assuming a full year effect of 2013/14 initiatives run-rate loss assumed to be £17-19m by the end of 2013/14

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Long Term Strategy – Crown Transformation (cont'd)

Status: AMBER

- ***Management remain confident of achieving breakeven target by March 2015***
- ***Considerable progress has been made but risks remain – in particular in relation to income growth***
- ***It will be critical to ensure expected benefits from "live" activities are delivered***
- ***Discussions with the CWU are ongoing – they are a risk but are not currently impacting delivery***

- **Over the past 12 months POL has started to implement the different strands of its Crowns strategy**
  - A first round of voluntary redundancy was closed successfully and a second round – for between 500 and 600 FTEs – has recently started. Based on work undertaken by POL and the CWU management are confident of meeting savings targets
  - The £70 million branch investment programme is on track with works at c.140 branches expected to be completed by the end of 2013/14. This includes rolling out new automation equipment which enters a testing process with Royal Mail in January
  - The franchising and merger of c.70 branches is ongoing. Consultations have been completed / remain live in relation to 26 branches, leaving 44 still under negotiation with prospective partners. The first branches are due to open in **February**
  - Other initiatives – including property savings and various changes being made to employee roles and responsibilities – are also ongoing and are on course to deliver expected benefits in time and on budget
- **Of the more measurable targets income growth is behind budget for 2013/14 year-to-date and sales mix is also different versus the plan. This is a concern – going into 2014/15 income growth becomes an important driver of reduced losses**
  - e.g. so far in 2013/14 Government Services and Renewals and Retentions have outperformed budget, and have been offset by soft trading in Mails and Retail, Telephony and Financial Services (e.g. areas where growth will be key in 2014/15)
- **It is also critical that the results emerging from the "live" Crown initiatives are monitored and assessed closely**
  - While POL is delivering various commercial milestones on plan and to target the financial benefits accruing from these are not certain. These also rely on interdependencies elsewhere in POL's strategy – e.g. improvements in sales capabilities
- **In addition it will also be important for POL to continue to work on making inroads in its discussions with the CWU**
  - A continuation of the hostile stakeholder landscape has a high chance of impacting POL's Crown targets in 2014/15 – e.g. through making it harder to deliver income growth, or put in place people and productivity efficiencies
  - It could also have longer term consequences on the Crown estate after March 2015 (e.g. reversing the benefits achieved to date) in addition to holding back other initiatives that form part of POL's new strategy

SHEX ACTIONS

Monthly meetings take place with POL, and there is regular dialogue with key members of network management, the Crown Transformation team and other management with an interest in the Crowns (e.g. IT). Franchising activities and branch investments are monitored closely from both financial and stakeholder / communications perspectives.

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Long Term Strategy – Revenue Growth

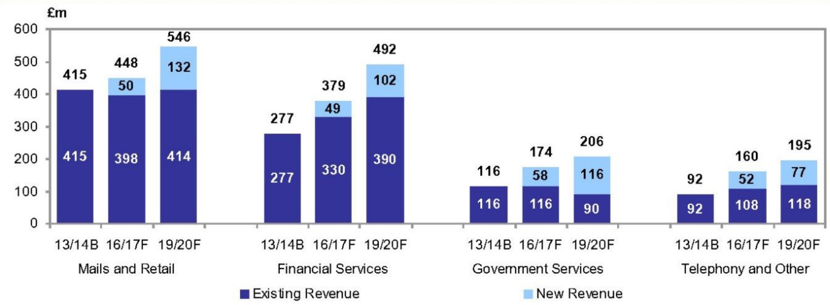
POL's new revenue growth strategy is ambitious – both in respect of management's ability to protect existing revenues and in relation to new products and services…

…as the plan progresses there is a greater reliance on new launches which increases the risk profile of this strategy…

…this is particularly acute in Government Services and Telephony and Other

- **Revenue growth was a key initiative in POL's old plan and while this remains an important part of POL's new strategy, targets and the sales mix profile differs materially**
  - Has been prepared in more detail than the old plan – unlike that plan there is now visibility around individual product launches and related commercial assumptions, contract renewals and "enabling" initiatives (e.g. IT Transformation)
- **Mails and Retail:** Existing revenues expected to remain broadly stable with growth coming from Collect and Returns (62 per cent. new revenues by 2019/20) and "New Retail" (38 per cent. new revenues by 2019/20)
- **Financial Services:** Broad growth in existing products and new products in existing areas - e.g. insurance planned to increase by £120m (75 per cent. of this is existing business). Savings and Investments and Payment and Banking Services also important
- **Government Services:** Mix within existing business changes materially with growth in HMPO partially offsetting POCA revenue losses. Growth is mainly in new activities – e.g. Assisted Digital and ID Assurance (£96m of £116m "new" revenue by 2019/20)
- **Telephony and Other:** Homephone to grow 57 per cent. by 2019/20 but only accounts for c.25 per cent. overall divisional growth. Growth mainly driven by mobile (66 per cent. 2019/20 "new" revenue) and HomeServices (c.33 per cent. 2019/20 "new" revenue)

POL Revenue Growth 2013/14 – 2019/20



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Long Term Strategy – Revenue Growth (cont'd)

Status: AMBER

- ***New strategy is more detailed than the old plan. However it still lacks detail some areas, leading to risks***
- ***Highly ambitious. Also too early to take a firm view on performance / outlook***
- ***Dependent on other strategies / third parties – this increases the plan's risk profile***
- ***More easily assessed than POL's previous strategy. ShEx needs to monitor closely***

- **Despite POL's strategy only being approved over the last few months recent developments in POL's markets highlight the risk associated with its new revenue growth plan**
  - Mails and Retail has had a difficult year so far due to price / product changes put in place at the start of 2013/14. A response has been developed although this shows that "existing" revenues – even in core markets – are far from secure
  - New product launches (e.g. Collect and Returns, Current Accounts, Mobile) are all expected to go-to-market later than planned. Even with detailed delivery strategies delays appear to be frequent
  - POL relies heavily on third parties in a number of areas and delays they experience do impact POL (e.g. Cabinet Office in relation to Assisted Digital and ID Assurance and Bank of Ireland in relation to new Financial Services products)
- **At the same time POL is planning to launch a number of other new products between today and 2016/17 – in many cases detailed plans are not yet in place (e.g. "New" Retail, Assisted Digital, ID Assurance, HomeServices)**
  - This is currently a priority for POL's Commercial teams and over the Christmas / New Year period plans are being developed. These will be discussed with ShEx in January 2014
- **POL's revenue growth strategy is also interdependent with a number of other strategic initiatives. These are key to ensuring the right incentives, environments and capabilities are in place across the network**
  - The Agency network needs to be modernised to ensure customers have convenient access and that branch environments are attractive. Network Transformation will also drive stronger selling-behaviours among subpostmasters
  - The Crown network needs to be transformed – new technologies need to be rolled out (e.g. for Government Services growth) and consulting rooms / compliance training needs to be in place (e.g. for Financial Services)
  - POL's counter IT and IT infrastructure needs to change to ensure in-branch systems can support clients and that CRM systems allow POL to manage customers in a more integrated (and effective) manner
- **In addition to the risks and uncertainties outlined above the ShEx POL team also has questions in relation to whether a simple revenue growth plan is appropriate at all – e.g. these targets make no / little reference to costs of growth**
  - It may be more appropriate for revenue and contribution to be looked at together

SHEX ACTIONS

Work to support Government Services and Financial Services growth ambitions and there is also close monitoring of both financials and key commercial areas on a regular basis. With the new strategy and funding now in place the team will be working with POL in the early stages to ensure appropriate and monitorable plans are in place.

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3

Long Term Strategy – Mutualisation

With a history that stretches back >350 years and a turnover of almost £1bn, the mutualisation of POL will be the largest and most complex transaction of its type ever undertaken…

- **Establishing the opportunity for POL to be mutualised was one of the commitments outlined in the "Securing the Post Office Network in the Digital Age" report, published by BIS in November 2010**
  - the Postal Services Act 2011 put in place the legislation that made such a transfer of ownership possible, and between December 2011 and July 2012 Government ran and responded to a public consultation on POL's mutualisation
- **In its response to the public consultation, Government made it clear that it wants "clear progress to have been made towards mutualisation of POL by the end of this parliament". However it also identified four key targets that will need to be met before POL can be mutualised**
  - (i) a mutual needs to be both financially and commercially sustainable, minimising the need for Government intervention in the event of financial distress
  - (ii) the right culture needs to be developed, encouraging stakeholder engagement and marking a move away from the established "top-down" style of management
  - (iii) POL's strategic plan needs to be delivered successfully – this plays a role in making POL sustainable and viable
  - (iv) Government must endorse a mutualisation (which represents VfM), and Parliament must vote for an ownership transfer

…while progress has been slow progress is being made – from a standing start in 2010 POL has sought to work collaboratively with stakeholders in ways neither side are used to

Oct-10	Nov-10	May-11	Sept-10 to Jun-11	Sept-11 to Jul-12	Current
"Post Office: Made Mutual" *Mutuo*	**"Securing the Post Office Network in the Digital Age"** *BIS*	**"Options for a Mutual Post Office"** *Co-Operatives UK*	**Postal Services Act 2011**	**"Building a Mutual Post Office"** *Public Consultation*	**POL Stakeholder Forum ("PSF")**
• Published as part of a series of documents on mutuals in the Public Sector • Identified need to define / protect public benefit, and to capture the interests of a diverse range of stakeholders	• Policy statement to set out plans for transformation of POL • Announced commissioning of Co-Operatives UK report and plans for public consultation	• Commissioned by BIS to explore options for POL's mutualisation • "Logical solution" for ownership to include producers, consumers and communities, but not HMG (contractual relationship only)	• Legislation to allow for the transfer of POL's ownership to a mutual • Must act for the public benefit and have members with an interest in the use by the public of such services	• Emphasises need to develop a suitable culture and ensure financial stability • Not prescriptive around structure but outlines next steps (e.g. successful delivery of strategy, stakeholder forum and engagement)	• Frequent meetings held with PSF and working groups in 2013 and an engagement process is ongoing on POL's "public benefit purpose" • Results are planned to be published in early 2014, with a broader public update on POL"s mutualisation

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Long Term Strategy – Mutualisation (cont'd)

Status: AMBER

- ***Implementation slow to start following the 2012 consultation response***
- ***Progress with the PSF – the "public benefit purpose" will be published in early 2014***
- ***Challenging stake-holder landscape (e.g. CWU withdrawal)***
- ***Strategy / funding puts in place a foundation for further progress***
- ***Uncertain impact of changes to POL team***
- ***Ongoing questions around Board's commitment***

- **A number of meetings of the PSF – set up to define the public benefit purpose of a mutual POL – took place during 2013/14. The work of this group is now substantially complete**
  - After a promising start and the participation of all stakeholders the CWU withdrew from the process in the Summer. This was linked to discussions related to the Crowns and the perception that the mutualisation process lacked credibility
- **POL and its remaining stakeholders are currently working on an engagement process to solicit the views of the public, employees and subpostmasters in relation to what form a final "public benefit purpose" might take**
  - Expected to come to a close in early 2014 and a final "public benefit purpose" is expected to be published in the Spring
  - Will be accompanied by a broader update on mutualisation that was announced by Jo Swinson in November 2013
- **This will enable other mutualisation workstreams to be taken forward. Many of these are centred around POL's culture which has emerged as one of the main challenges – including on a business-as-usual basis – over the past 12 months**
  - Includes the launch of the Post Office Advisory Council which represents a landmark for POL in the way it engages with stakeholders and employees in the way that it runs its business. This will start recruiting members in early 2014
  - Plans are also being developed to launch a joint NFSP and POL communications forum (e.g. to ensure internal and external messaging is aligned) and business user groups that give employees and stakeholders a voice in new areas of the business
- **At the same time POL has been making progress in a number of areas that complement its mutualisation process**
  - The new strategy sets out a roadmap to financial sustainability, a key prerequisite for any mutualisation transaction
  - New ways of working between POL and the NFSP have emerged through the development of POL's strategic plan
  - The "superbriefer" programme – originally mobilised to support the Crowns – has been extended
  - Launch of a new magazine written for and by Crown employees to increase levels of employee engagement
- **No material progress has been made in relation to the Governance of a possible mutual, which the POL Board believes would be premature in the current stakeholder environment**

SHEX ACTIONS

ShEx sits on the PSF and has actively participated in each of the working groups convened during 2013/14. We also have a regular dialogue with the POL team leading day-to-day mutualisation activities and will be actively supporting them to shape what the process looks like, its speed and direction. At the same time it is critical for us to ensure progress is made within acceptable parameters given that Parliamentary approval will be required for any final mutualisation.

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3

Long Term Strategy – Other Key Strategic Initiatives

POL's new strategic plan is complex and brings together a large and diverse range of different initiatives…

…some are a continuation of existing strategies developed in 2010/11 (e.g. Network Transformation, Revenue Growth) while others are new…

…importantly they are all interdependent – failure or delays in one area can easily have wide-ranging impacts elsewhere

Initiative	Commentary
Cost Transformation	▪ **Ambitious target to keep certain costs flat in nominal terms (e.g. Supply Chain) and reduce others by up to 35 per cent. over the course of the plan period to 2019/20** – While POL does have a good track record of managing / cutting costs these targets are highly ambitious – Require management to restructure how POL operates in a number of areas, including how the network is delivered and how customers needs are met ▪ **POL is currently developing detailed plans to support different strands of this strategy. These will be presented to and assessed by ShEx in early 2014**
Customer Value Propositions	▪ **A central theme of POL's strategy is a planned move away from it being a business centred around its network to one focused on its customers** – Requires integrated customer strategies to be developed (e.g. SMEs, students, "new arrivals") and for diverse areas of the business to work together in ways they have not done so before
IT Infrastructure Investment	▪ **Transformation of POL's IT infrastructure from a single-provider model to a "services integration' approach that is more modern, more flexible and lower cost** – Good progress to date, but this has been focused on procuring new providers not on implementation ▪ **Once commissioned new systems should bring a number of significant benefits to POL** – e.g. improved management information, better ability to understand customer behaviours and more effective management of customer interactions
Rollout of In-branch Technology	▪ **Plan to develop, commission and rollout a replacement to the now dated Horizon system which currently serves as the backbone of all in-branch IT across the post office network** – Modernises and future-proofs POL's systems and allows different channels to be integrated effectively (e.g. different in branch channels, and branches with online and call-centres) ▪ **Also plan to procure a range of enabling technologies to support income growth (e.g. counter based IT, Assisted Digital technologies, systems to support ID Assurance)** – Some work has been undertaken but it is not clear what many future services will look like – As such detailed plans can not be developed / implemented – this gives rise to forecasting risk

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4 Operating Performance

4 Operating Performance – Actual Performance vs. Budget

Mar YE (£m)	2010/11			2011/12			2012/13			2013/14 YTD *(6m to September)*		
	Target	Actual	*variance*	Target	Actual	*variance*	Target	Actual	*variance*	Target	Actual	*variance*
Mails and Retail	378	370	*(7.5)*	373	388	*14.8*	404	404	*0.2*	199	183	*(16.2)*
Financial Services	266	261	*(4.8)*	250	261	*11.9*	275	280	*4.9*	141	139	*(2.4)*
Government Services	131	129	*(1.9)*	139	136	*(2.9)*	140	133	*(6.7)*	60	60	*(0.7)*
Telephony	55	44	*(11.0)*	46	41	*(5.1)*	46	45	*(0.7)*	24	25	*1.0*
Other	41	43	*2.1*	38	39	*1.3*	34	41	*6.9*	20	20	*0.4*
POL Net Income	**871**	**848**	***(23.2)***	**845**	**865**	***20.1***	**898**	**902**	***4.5***	**444**	**426**	***(18.0)***
Memo: incl. Netw. Subs.	1,021	998	*(23.2)*	1,025	1,045	*20.1*	1,108	1,112	*4.5*	544	526	*(18.0)*
Staff Costs	(250)	(253)	*(2.9)*	(248)	(251)	*(3.4)*	(269)	(257)	*11.5*	(130)	(130)	*(0.8)*
Agents Costs	(474)	(475)	*(0.6)*	(478)	(483)	*(4.6)*	(483)	(478)	*4.7*	(239)	(220)	*18.9*
Non-Staff Costs	(259)	(228)	*31.5*	(160)	(149)	*10.6*	(166)	(162)	*3.9*	(82)	(83)	*(1.1)*
Interbusiness	-	-	*n.a.*	(92)	(85)	*6.8*	(83)	(84)	*(0.3)*	(42)	(40)	*2.2*
Depreciation	-	-	*n.a.*	(1)	(0)	*0.3*	(1)	(0)	*0.4*	(1)	(0)	*0.3*
Group Overhead Alloc.	(21)	(17)	*4.1*	(20)	(20)	*0.8*	(17)	(15)	*2.0*	(7)	(7)	*0.0*
POL Op. Profit	**(133)**	**(124)**	***8.9***	**(154)**	**(123)**	***30.5***	**(121)**	**(94)**	***26.7***	**(55)**	**(54)**	***1.5***
% margin	*(15.3%)*	*(14.7%)*	*0.6%*	*(18.2%)*	*(14.2%)*	*3.9%*	*(13.5%)*	*(10.4%)*	*3.0%*	*(12.4%)*	*(12.6%)*	*(0.2%)*
Financial Services JVs	33	25	*(8.0)*	28	31	*2.8*	33	32	*(0.2)*	21	23	*1.2*
Op. Profit (pre-POOC)	**(100)**	**(99)**	***0.9***	**(125)**	**(92)**	***33.3***	**(88)**	**(62)**	***26.5***	**(34)**	**(31)**	***2.7***
% margin	*(11.5%)*	*(11.7%)*	*(0.2%)*	*(14.8%)*	*(10.7%)*	*4.2%*	*(9.8%)*	*(6.9%)*	*3.0%*	*(7.6%)*	*(7.3%)*	*0.3%*
Project One Off Costs	(20)	(15)	*4.7*	(18)	(26)	*(8.3)*	(38)	(53)	*(15.7)*	(18)	(16)	*2.5*
Op. Profit (post-POOC)	**(120)**	**(114)**	***5.6***	**(144)**	**(119)**	***25.0***	**(126)**	**(115)**	***10.7***	**(52)**	**(47)**	***5.1***
% margin	*(13.8%)*	*(13.5%)*	*0.3%*	*(17.0%)*	*(13.7%)*	*3.3%*	*(14.0%)*	*(12.8%)*	*1.3%*	*(11.7%)*	*(11.0%)*	*0.7%*
Network Subsidy	150	150	*0.0*	180	180	*0.0*	210	210	*0.0*	100	100	*0.0*
Op. Profit (post-NSP)	**30**	**36**	***5.6*** 1	**36**	**61**	***25.0*** 1	**84**	**95**	***10.7*** 1	**48**	**53**	***5.1*** 1
% margin	*3.4%*	*4.2%*	*0.8%*	*4.3%*	*7.1%*	*2.8%*	*9.4%*	*10.5%*	*1.1%*	*10.8%*	*12.5%*	*1.7%*

- **POL has consistently outperformed its budget at operating profit level for the past three financial years (see 1)**
  - In the face of mixed revenue performance (i.e. between years and against each years' budget) results have mainly been driven by strong cost performance – in particular Non-Staff and Overhead Allocations typically seem to be managed well. This is supported by the "flexing" of discretionary one-off project costs
- **While the current year's performance looks like it will beat budget again there have been a number of timing effects in the first half which are expected to unwind between September and March. Currently POL expects to be in a position to meet budget for the year**

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4 Operating Performance – 2012/13 Budget Reforecast

Mar YE (£m)	2013B				H2 Win / Loss vs. H1 Perf.	
	Budget	Q2 R'cast	£ var	% var	YTD vs. Bud.	FY vs. Bud.
Mails and Retail	415	407	(7.8)	*(1.9%)*	(16.2)	8.5
Financial Services	277	277	(0.0)	*(0.0%)*	(2.4)	2.4
Government Services	116	116	(0.4)	*(0.3%)*	(0.7)	0.4
Telephony	50	51	0.3	*0.6%*	1.0	(0.7)
Other	42	37	(4.6)	*(11.0%)*	0.4	(5.0)
POL Net Income	**900**	**888**	**(12.4)**	***(1.4%)***	**(18.0)**	**5.6**
Memo: Net Income (incl. NSP)	1,100	1,088	(12.4)	*(1.1%)*	(18.0)	5.6
Staff Costs	(256)	(259)	(3.1)	*1.2%*	(0.8)	(2.3)
Agents Costs	(480)	(469)	11.1	*(2.3%)*	18.9	(7.8)
Non-Staff Costs	(160)	(165)	(4.7)	*3.0%*	(1.1)	(3.6)
Interbusiness Expenditure	(84)	(83)	1.2	*(1.5%)*	2.2	(1.0)
Depreciation	(1)	(1)	0.0	*(5.9%)*	0.3	(0.3)
Group Overhead allocations	(14)	(14)	(0.0)	*0.3%*	0.0	(0.1)
POL Op. Profit	**(95)**	**(102)**	**(7.9)**	***8.4%***	**1.5**	**(9.4)**
% margin	(10.5%)	(11.5%)	(0.0)	*9.9%*	(0.0)	(0.0)
Financial Services JVs	32	33	1.5	*4.6%*	1.2	0.3
Group Op. Profit (pre-NSP)	**(63)**	**(69)**	**(6.5)**	***10.3%***	**2.7**	**(9.2)**
% margin	(7.0%)	(7.8%)	(0.0)	*11.8%*	0.0	(0.0)
Project One Off Costs	(35)	(29)	6.5	*(18.6%)*	2.5	4.0
Group Op. Profit (post-POOC)	**(98)**	**(98)**	**0.0**	***(0.0%)***	**5.1**	**(5.1)**
% margin	(10.9%)	(11.0%)	(0.0)	*1.4%*	0.0	(0.0)
Network Subsidy Payment	200	200	0.0	*0.0%*	0.0	0.0
Group Op. Profit (post-NSP)	**102**	**102**	**0.0**	***0.0%***	**5.1**	**(5.1)**
% margin	11.3%	11.5%	0.0	*1.4%*	0.0	(0.0)

- **At the end of September POL provided an updated forecast for the full year, reflecting trading performance during the first 6 months of 2013/14**
  - At the half year net income was £18m behind budget (see 1), mainly driven by weakness in Mails and Retail, of which c.£8m is expected to be recovered during the second half of the year. Financial Services and Government Services are also expected to recover a large amount of their H1 underperformances
  - Operating profit was £5m ahead of budget at the half year but is expected to end 2013/14 in line with expectations (see 2). This largely reflects increased agents costs and deferred costs budgeted for H1 being incurred in H2. These are partially offset by a reduction in spending on one-off projects in H2

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4 Operating Performance – Income Statement

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
POL Net Income (pre-Cont.)	865	902	900	940	1,047	1,160	1,264	1,359	1,439
Contingency	*n.m.*	*n.m.*	*n.m.*	*(15)*	*(40)*	*(60)*	*(80)*	*(100)*	*(120)*
POL Net Income	**865**	**902**	**900**	**925**	**1,007**	**1,100**	**1,184**	**1,259**	**1,319**
% growth	*n.a.*	*4.3%*	*(0.3%)*	*2.8%*	*8.9%*	*9.2%*	*7.7%*	*6.3%*	*4.7%*
Agents Pay	(483)	(478)	(480)	(490)	(510)	(536)	(549)	(582)	(611)
Staff Costs	(251)	(257)	(256)	(236)	(225)	(222)	(220)	(219)	(218)
Central and Supporting Costs	(280)	(314)	(293)	(303)	(329)	(382)	(406)	(450)	(483)
Contingency (assoc. costs)	n.m.	n.m.	n.m.	9	24	36	48	60	72
EBITDAS (pre-JVs)	**(149)**	**(147)**	**(129)**	**(95)**	**(33)**	**(5)**	**57**	**68**	**79**
% margin	*(17.2%)*	*(16.3%)*	*(14.3%)*	*(10.3%)*	*(3.2%)*	*(0.4%)*	*4.8%*	*5.4%*	*6.0%*
Financial Services JVs	31	32	32	34	33	35	37	41	41
EBITDAS	**(118)**	**(115)**	**(97)**	**(61)**	**0**	**30**	**94**	**109**	**120**
% margin	*(13.7%)*	*(12.8%)*	*(10.8%)*	*(6.6%)*	*0.0%*	*2.8%*	*8.0%*	*8.7%*	*9.1%*
Network Subsidy Payment	180	210	200	160	130	80	70	60	50
EBITDA	**62**	**95**	**103**	**99**	**130**	**110**	**164**	**169**	**170**
% margin	*7.1%*	*10.5%*	*11.4%*	*10.7%*	*13.0%*	*10.0%*	*13.9%*	*13.5%*	*12.9%*

- **After 2 years of revenue growth – the first growth in POL's top line in many years – and increasing profits, 2013/14 and 2014/15 targets are seen by management to be extremely challenging (see 1).**
  - Considerable new revenue needs to be secured in order to offset the impact of some contracts ending (e.g. NS&I), others being renewed on less attractive terms (e.g. DVLA) and planned mid-contract changes to remuneration structures (e.g. business banking with Santander)
  - Network Subsidy will also decrease from £210m in 2012/13 to £160m in 2014/15 meaning POL needs to recover £50m of additional "lost" revenue (e.g. by increasing revenue or managing costs more effectively) in order to maintain a flat / positive trajectory in operating profit
- **Moving forward POL is however expected to recover a positive growth profile, largely as the benefits of new product launches start to emerge (see 2)**
  - Some are closely aligned to POL's established strengths (e.g. Collect and Returns in Mails and Retail, ID Assurance in Government Services) while others are not (e.g. HomeServices in Other, Assisted Digital in Government Services)
  - These are wide ranging across almost all areas of the POL business which on the one hand decreases risk / reliance of the strategy but on the other puts pressures on management capacity and capability
- **Together with close management of costs – including in a number of areas a strategic rethinking of how POL's cost base should be structured – operating profit is expected to reach breakeven pre-subsidy in 2015/16, £94m in 2017/18 and £120m in 2019/20**

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Note: POL's forecasts have been prepared on an EBITDA / EBITDAS basis, unlike its historical results which are presented after accounting for depreciation - this reflects the expectation of management that at some point over the new planning period POL will stop impairing capital expenditure in-year. Historical results in this table and on subsequent pages have therefore been amended to account for this treatment of depreciation.

4 Operating Performance – Mails and Retail Revenue

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Stamps	32	35	34	34	32	31	30	29	28
Labels	84	100	106	121	122	123	125	126	127
Other Mails	230	223	223	227	217	235	250	265	283
Total Mails	**345**	**358**	**363**	**382**	**371**	**389**	**405**	**420**	**438**
Retail and Lottery	42	46	52	48	54	59	77	95	108
Total Mails and Retail	**388**	**404**	**415**	**430**	**425**	**448**	**482**	**515**	**546**
% growth	*n.a.*	*4.2%*	*2.6%*	*3.7%*	*(1.1%)*	*5.3%*	*7.7%*	*6.8%*	*6.1%*
% group revenue	*44.8%*	*44.8%*	*46.1%*	*46.5%*	*42.2%*	*40.7%*	*40.7%*	*40.9%*	*41.4%*

- **POL's new strategy closes the gap between actual trading performance and expectations in Mails and Retail that emerged with the old strategic plan**
  - Expectations in POL's old plan were conservative, with more pressure on pricing and volumes expected than actually emerged. As a result revenue performance has been much stronger than planned
  - While market conditions are still expected to remain challenging, core revenue is now forecast to remain broadly stable through the planning period. Growth is expected to emerge from the late 2013/14 launch of Collect & Returns (e.g. accounts for £70m revenue in 2017/18 and £80m in 2019/20) (see 1)
- **In 2016/17 POL's 10 year Master Distribution Agreement with Royal Mail is up for a mid-term review (see 2)**
  - This is a risk point in POL's strategy given the importance of Mails income to POL, of Mails footfall to the broader business and due to the income / other benefits it brings to subpostmasters. Likely that Royal Mail will have the stronger hand in any negotiation
  - Most material risk is linked to the exclusivity of the existing contract and the terms on which POL is remunerated – both on a fixed income and variable income basis. Material changes are likely to have wide ranging impacts on POL's financial performance, its strategy and the stability of the broader network
  - POL's position will be strongest in any negotiation if it can take forward Network Transformation as planned, if it can exploit the benefits of an integrated SME proposition successfully and if it can successfully roll out new IT systems across the network
- **There are also risks around POL's Retail and Lottery strategy, and in particular in the period after 2015/16 (see 3) when income is assumed to start being generated by "New Retail" activities**
  - Recent success has been driven by retail benefits of the 2012 Olympics / Royal Wedding, a rollout of new lottery terminals and the launch of the Health Lottery. Going forward results are likely to be softer, being impacted by delays to new terminals being commissioned and the recent Camelot price change
  - The lack of a detailed plan around "New Retail" (i.e. which accounts for £25m revenue in 2017/18 and £50m in 2019/20) is a major risk. While areas of growth have been identified (e.g. payment on delivery, sustainable packaging, in-branch ordering) detailed plans are still under development

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Operating Performance – Financial Services Revenue

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Payments and Banking Services	138	134	117	120	120	122	128	134	141
Savings and Investments	23	43	58	61	71	79	85	93	97
ATMs	29	30	33	34	34	34	33	33	32
Transactions and Lending	16	20	22	29	34	38	42	50	53
Insurance	14	14	18	24	43	79	110	122	137
NS&I and Other	17	13	4	3	0	0	0	0	0
Travel Money	25	24	25	24	26	28	30	32	32
Total Financial Services	**261**	**280**	**277**	**295**	**328**	**379**	**427**	**464**	**492**
% growth	*n.a.*	*6.9%*	*(0.8%)*	*6.3%*	*11.0%*	*15.7%*	*12.5%*	*8.8%*	*6.0%*
% group revenue	*30.2%*	*31.0%*	*30.8%*	*31.9%*	*32.5%*	*34.5%*	*36.0%*	*36.9%*	*37.3%*

- **Financial Services has been a growth engine for POL in recent years, largely offsetting Government Services' underperformance compared to the 2010/11 plan. In the process it has materially outstripped the forecasts set out for it in 2010/11**
  - The environment for selling financial services has been considerably less challenging than expected, and POL has been able to benefit from an untainted reputation and a security "halo" following the financial crisis and subsequent issues experienced by other financial services providers (e.g. mis-selling scandals)
- **The division is expected to remain an important source of growth going forward, in particular in three main areas:**
  - Savings and Investments (see 1): Doubling of balances to c.£37bn, with a shift to high margin variable rate products (e.g. investment products and annuities)
  - Transactions and Lending (see 2): Continued rollout of POL's mortgage offer and a redevelopment / relaunch of its credit card and personal lending activities
  - Insurance (see 3): Restructuring of the business model to take POL further up the insurance value chain, including integrating its various insurance products
- **Success in these areas (and others) also requires POL to deliver four other strands of its strategy successfully**
  - Branch Transformation: Critical in Crowns and the branch network to ensure environments are attractive and appropriate for selling financial products
  - Sales Training Capability: To ensure POL employees and agents are compliant and can sell effectively, and that CRM structures are in place and work well
  - Current Account: Forms part of POL's revenue strategy but is mainly critical to ensure customers are "sticky" and products can be cross- / up-sold
  - Customer Value Proposition: POL is able to deliver an integrated "view" across different divisions for distinct customer groups (e.g. SMEs, students, etc.)

4

Operating Performance – Government Services Revenue

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
POCA	70	66	59	60	51	48	31	24	21
Motoring	32	32	21	15	16	17	17	17	18
Passports	19	21	20	26	40	40	40	40	40
Assisted Digital	0	0	0	1	9	17	23	34	43
ID Assurance	0	0	0	3	28	33	38	46	53
Other	14	14	15	12	13	19	23	29	31
Total Government Services	**136**	**133**	**116**	**117**	**158**	**174**	**173**	**190**	**206**
% growth	*n.a.*	*(1.8%)*	*(13.0%)*	*0.7%*	*35.2%*	*10.1%*	*(0.7%)*	*9.8%*	*8.6%*
% group revenue	*15.7%*	*14.8%*	*12.9%*	*12.6%*	*15.7%*	*15.8%*	*14.6%*	*15.1%*	*15.6%*

- **Government Services has materially underperformed expectations set back in 2010/11 when HMG made a commitment for POL to become a "genuine Front Office for Government". This has caused tensions with stakeholders, and was an influence on the recent funding process**
  - Mainly due to fewer new contract opportunities emerging and tighter commercial terms being negotiated / volumes being lower than expected
  - Means that if POL's 2013/14 budget is met, revenue will be c.26 per cent. lower than the £156m 2013/14 target set in 2010/11 (see 1)
- **Although POL's new plan is more considered and cautious in relation to Government Services growth it is still ambitious**
  - POCA (see 2): POL is currently in discussions with DWP in relation to the future of POCA – it is not clear what an extension might look like in March 2015 when the current contract is able to be renewed or what any successor product might look like. Both of these points, and the terms negotiated, are key risks
  - Assisted Digital (see 3): Cabinet Office's digital ambitions create significant opportunities for POL both in Assisted Digital and digital step-out markets, however although POL is engaging with HMG Departments, the strategy has suffered delays. This has meant clarity around products and pricing has been poor
  - ID Assurance (see 4): POL already delivers ID services for HMG however Cabinet Office's programme for ID Assurance is expected to be a key source of growth going forward. POL is well positioned but there is continued uncertainty around timing, what the service will look like, expected volumes and pricing
- **The remainder of POL's Government Services strategy is also challenging, in relation not only to growth in new areas but also in respect of POL's ability to protect existing revenues (e.g. see DVLA with the recent contract renewal, the unexpected termination of tax discs and progress made to date on FOCS)**
- **Success in Government Services is interdependent on other areas of POL's strategy – and in particular the successful delivery of Network Transformation and the rollout of new technologies across the network**

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Operating Performance – Telephony and Other Revenue

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Homephone	-	-	-	53	57	63	69	70	70
Other Telephony and Mobile	-	-	-	4	4	3	3	3	3
Mobile	0	0	0	9	25	39	48	51	53
Telephony Total	**41**	**45**	**50**	**66**	**86**	**106**	**120**	**124**	**125**
HomeServices	0	0	0	3	8	13	17	21	24
Supply Chain and Other	39	41	42	38	42	41	45	45	45
Budget Adjustment	*n.m.*	*n.m.*	*n.m.*	*(9)*	*0*	*0*	*0*	*0*	*0*
Total Telephony and Other	**81**	**86**	**92**	**98**	**136**	**160**	**182**	**190**	**195**
% growth	*n.a.*	*6.2%*	*7.5%*	*5.9%*	*39.4%*	*17.4%*	*14.1%*	*4.4%*	*2.5%*
% group revenue	*9.3%*	*9.5%*	*10.2%*	*10.5%*	*13.5%*	*14.5%*	*15.4%*	*15.1%*	*14.8%*

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- **Recent performance in POL's Telephony and Other revenue activities has primarily been driven by growth in Homephone, where pricing has held up well and where the business continues to maintain a user base numbering just under 500k subscribers**
  - Other Telephony activities – including mobile topups and phonecards – continue to face a number of structural challenges (e.g. post-pay and channel migration and declining customer usage) while POL's 3rd party supply chain activities have been maintaining a broadly stable revenue performance
- **Going forward Telephony is expected to grow by £70m (or 140 per cent.) between 2013/14 and the end of the new funding period in 2017/18 (see 1)**
  - Driven by the recent Homephone migration from BT to TalkTalk, more "intelligent" selling of telephony products (e.g. double / triple play) and the rollout of mobile which – after a delayed launch – is expected to go-to-market in 2014 as pre-pay SIM-only (i.e. later moving to post-pay SIMs and handsets)
- **Management also believes that there are opportunities for POL to grow in new areas, mainly through leveraging POL's brand equity and by rolling out services in new markets in the same way it does in Financial Services (see 2)**
  - Initial focus on energy and utilities where there are similarities with POL's Homephone business (e.g. a market which has suffered considerable reputational damage in recent years). Growth from £0m in 2013/14 to c.£20m by 2017/18, while ensuring POL's brand value is protected, is expected to be a challenge
- **In addition to growth in Telephony and HomeServices POL is also looking to "sell on" excess capacity in its supply chain**
  - While growth assumptions are modest (see 3) POL's new plan sets out a target for the business to hold Supply Chain costs fixed in nominal terms. Given inflationary pressures and the high level of unionisation in this part of the business this target is believed to be ambitious

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4 Operating Performance – Contribution Analysis

- **POL does not look at activity level profitability as a management tool to monitor or incentivise performance across the business. From a day-to-day management perspective:**
  - The Commercial teams are incentivised to deliver Product Contribution (i.e. Net Income less variable agents' pay and Direct Product Costs); and
  - The Network team is incentivised to deliver the branch network efficiently and at lowest cost
- **Product Contribution is the lowest level in the P&L where management have comfort that financial performance is reflected fairly. Below this are the fixed costs of POL's network – costs that need allocating in order to derive divisional profitability**
  - Some allocations such as Direct Branch Costs (c.£377m in 2011/12) can be made "intelligently", however management are still cautious about this contributing to a meaningful profit number (i.e. since the branches would still be required even if a service was not delivered)
  - Other allocations, such as for POL's Horizon system (c.£55m in 2011/12) or the Network Subsidy Payment, are far more difficult given assumptions that have to be made (e.g. allocating by share of revenue, transaction volumes, etc.)
  - Any allocation based analysis is also made difficult by the change to the allocation methodology made between 2010/11 and 2011/12
- **Management acknowledge these limitations and are currently developing systems that will allow them to measure profitability in a more accurate (and "local") way**
  - This includes looking at both activity-level and channel-level (e.g. Crowns, online, subpostmaster branches)
  - It is also critical for business planning purposes that POL's different Commercial teams understand the cost implications of revenues
- **Such a platform is also an important influence on future subsidy payments – this type of look-through would make it easier for HMG subsidy to be targeted at loss making activities or branches**

Net Income		Direct Product Costs		Product Contribution		Direct Branch Costs		Channel Contribution		Other Costs, Subsidy and JV Income		Operating Profit
£904m	+	(£428m)	=	£476m	+	(£377m)	=	£100m	+	(£5m)	=	£94m
		not allocated				*"intelligent" allocation*				*simplified allocation*		

incl. £193m of infrastructure costs

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Operating Performance – Contribution Analysis *(cont'd)*

Mails and Retail (Mar YE £m)	10/11A	11/12A	12/13A
Variable Income	266	287	334
% growth	*n.a.*	*7.9%*	*16.4%*
Fixed Income	108	105	75
% growth	*n.a.*	*(3.0%)*	*(28.4%)*
CoGS	(3)	(4)	(5)
% growth	*n.a.*	*16.7%*	*23.8%*
Net Income	**370**	**388**	**404**
% growth	*n.a.*	*4.6%*	*4.2%*
Agents Variable Pay	(165)	(176)	(181)
Direct Product Costs	(4)	(15)	(17)
Product Contribution	**202**	**197**	**205**
% margin	*54.5%*	*50.8%*	*50.8%*

Financial Services (Mar YE £m)	10/11A	11/12A	*growth*
Variable Income	236	240	268
% growth	*n.a.*	*1.5%*	*11.7%*
Fixed Income	26	25	13
% growth	*n.a.*	*(4.3%)*	*(46.5%)*
CoGS	(1)	(3)	(1)
% growth	*n.a.*	*362.2%*	*(52.2%)*
Net Income	**261**	**261**	**280**
% growth	*n.a.*	*0.0%*	*6.9%*
Agents Variable Pay	(81)	(76)	(73)
Direct Product Costs	(10)	(27)	(30)
Product Contribution	**171**	**158**	**177**
% margin	*65.3%*	*60.6%*	*63.5%*

Government Services (Mar YE £m)	10/11A	11/12A	12/13A
Variable Income	144	146	147
% growth	*n.a.*	*1.1%*	*0.8%*
Fixed Income	15	18	17
% growth	*n.a.*	*17.8%*	*(8.4%)*
CoGS	(31)	(28)	(30)
% growth	*n.a.*	*(8.4%)*	*7.3%*
Net Income	**129**	**136**	**133**
% growth	*n.a.*	*5.4%*	*(1.8%)*
Agents Variable Pay	(47)	(45)	(43)
Direct Product Costs	(5)	(6)	(10)
Product Contribution	**76**	**85**	**80**
% margin	*59.2%*	*62.4%*	*59.9%*

Telephony (Mar YE £m)	10/11A	11/12A	12/13A
Variable Income	12	24	20
% growth	*n.a.*	*89.2%*	*(15.4%)*
Fixed Income	121	97	110
% growth	*n.a.*	*(19.8%)*	*13.1%*
CoGS	(89)	(79)	(85)
% growth	*n.a.*	*(11.2%)*	*6.8%*
Net Income	**44**	**41**	**45**
% growth	*n.a.*	*(6.4%)*	*8.7%*
Agents Variable Pay	(7)	(5)	(5)
Direct Product Costs	(24)	(25)	(25)
Product Contribution	**13**	**11**	**15**
% margin	*30.2%*	*26.9%*	*32.5%*

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4 Operating Performance – Cost Analysis

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Fixed Agents Pay	(172)	(164)	(139)	(111)	(99)	(81)	(65)	(61)	(60)
Variable Agents Pay	(311)	(314)	(341)	(379)	(411)	(455)	(484)	(521)	(551)
Total Agents Pay	**(483)**	**(478)**	**(480)**	**(490)**	**(510)**	**(536)**	**(548.5)**	**(581.8)**	**(610.9)**
% fixed	*35.6%*	*34.3%*	*29.0%*	*22.6%*	*19.4%*	*15.2%*	*11.8%*	*10.4%*	*9.9%*
% net income	*582.9%*	*578.1%*	*580.0%*	*589.5%*	*609.5%*	*636.3%*	*648.5%*	*681.8%*	*710.9%*
Staff Costs	(251)	(257)	(256)	(236)	(225.4)	(222)	(220)	(219)	(218)
% net income	*(29.0%)*	*(28.5%)*	*(28.5%)*	*(25.6%)*	*(22.4%)*	*(20.2%)*	*(18.6%)*	*(17.4%)*	*(16.5%)*
Non-Staff Costs	(281)	(315)	(294)	(303)	(329.1)	(382)	(406)	(450)	(483)
% net income	*(32.4%)*	*(34.9%)*	*(32.6%)*	*(32.8%)*	*(32.7%)*	*(34.7%)*	*(34.3%)*	*(35.7%)*	*(36.6%)*
Income Contingency Costs	*n.m.*	*n.m.*	*n.m.*	*9*	*24.0*	*36*	*48*	*60*	*72*
Total Costs	**(1,015)**	**(1,050)**	**(1,030)**	**(1,020)**	**(1,040)**	**(1,105)**	**(1,127)**	**(1,191)**	**(1,240)**
% net income	*(117.3%)*	*(116.4%)*	*(114.4%)*	*(110.3%)*	*(103.2%)*	*(100.4%)*	*(95.2%)*	*(94.6%)*	*(94.0%)*

- **Effective cost management has been key to POL's ability to meet – and also beat – its financial targets in recent years. This remains a key driver of operating profit in POL's new plan**
  - POL has also sought to migrate its cost base to an increasingly variable structure, and in particular results have been achieved in relation to Agents Pay where the fixed element of remuneration has fallen in both nominal terms and as a proportion of Total Agents Pay over the last three years (see 1)
  - This outcome is closely linked to the successful rollout of Network Transformation, due to contractual terms of the new operating models, and as such as further progress is made in converting the estate over the coming years this increasing variability of POL's cost base will continue (see 2)
- **Cost management represents a central pillar of POL's new plan – POL's Board has put in place a challenge that will see all non-Supply Chain costs fall by 15 per cent. and 35 per cent. in nominal terms between 2013/14 and 2019/20 (at the same time as Supply Chain costs are expected to remain constant)**
  - While management does have a track record of cutting costs, such significant savings are higher risk and will require the extensive restructuring of a number of areas of POL's business; services, POL's infrastructure, the network and support functions will all need to be delivered in new (and more efficient) ways
  - Detailed plans are currently being worked up by POL's Commercial and Network teams – these will be reviewed in detail early in 2014

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4 Operating Performance – Balance Sheet

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Fixed Assets	101	71	75	81	81	84	87	92	94
Working Capital	(156)	1 (250)	(118)	(154)	(157)	(157)	(157)	(117)	(152)
Provisions and Grants	(15)	(26)	(17)	0	0	0	0	0	0
Pension Debtor / (Creditor)	3 (206)	96	70	96	96	96	96	96	96
Client Balances	(194)	(267)	(243)	(200)	2 (255)	(185)	(180)	(220)	(190)
Network Cash	759	1 870	755	730	900	725	725	750	725
Net Trading Funds	(329)	(197)	(212)	(365)	(627)	(512)	(428)	(358)	(225)
Net Assets / (Liabilities)	**(40)**	4 **277**	**310**	**188**	4 **38**	**51**	**143**	**243**	**348**
Reserves	(40)	277	310	188	38	51	143	243	348

- **Recently POL has driven significant improvements in its working capital profile, managing to keep funds tied up in working capital flat at the same time as its top line has been growing (note the 2012/13 spike in working capital, client balances and network cash was due to an end of year timing effect – see 1)**
  - While forecasts in the new plan – which suggest this trend will continue – are constructed in a top-down manner (e.g. high level targets) and not from the bottom-up (e.g. linked to revenue / contract performance) few new services that POL plans to launch are expected to require significant working capital
- **POL also expects to be able to maintain Network Cash broadly flat through the planning period (i.e. setting aside single year timing effects), despite significant growth in revenue. Again these forecasts have mainly been planned in a top down way (see 2)**
  - Demand for cash is mainly driven by POCA, business banking for Santander and POL's ATM activities and as such any material change to these contracts could have a significant impact on POL's and the network's need for cash
  - Few new services that POL plans to launch are expected to require balance sheet capacity (e.g. even in Financial Services, where this includes current accounts – where the overall impact is expected to be net neutral – investment products and mortgages)
- **Following the approval of its pensions deal in 2012 Royal Mail undertook a revaluation of its pension scheme – this has led to a material strengthening of POL's pension exposure from a £206m deficit to a c.£96m surplus (i.e. POL is allocated a c.7 per cent. share of Royal Mail's surplus / (deficit)) (see 3)**
  - Since 2012 POL's balance sheet has been solvent and this positive net assets position is expected to be maintained in the future (see 4). In particularly after 2015/16 – a key inflection point in POL's plan – POL's is expected to be able to establish a strengthening net assets profile

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4 Operating Performance – Cashflow Statement

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
EBITDAS	**(118)**	**(115)**	**(97)**	**(61)**	**0**	**30**	**94**	**109**	**120**
Network Subsidy	180	210	200	160	130	80	70	60	50
EBITDA	**62**	**95**	**103**	**99**	**130**	**110**	**164**	**169**	**170**
Capex	(36)	(77)	(168)	(179)	(232)	(106)	(96)	(59)	(54)
Other Cash Movement	(5)	1	73	(3)	(1)	(4)	(4)	(6)	(2)
Operating Cash Flow	**21**	**19**	**9**	**(83)**	**(103)**	**0**	**64**	**104**	**114**
Res., Provs., Exceps.	(27)	(66)	(199)	(333)	(188)	(131)	(54)	(10)	(10)
Other Government Funding	0	200	215	170	150	140	70	0	0
FCF (pre-Interest and Tax)	**(6)**	**153**	**25**	**(246)**	**(141)**	**9**	**80**	**94**	**104**
Working Capital	(9)	(21)	(41)	(23)	(122)	105	5	(25)	30
Free Cash Flow (pre-Funding)	**(15)**	**132**	**(16)**	**(269)**	**(263)**	**114**	**85**	**69**	**134**

- **In recent years POL's cashflow performance has been mainly driven by a balance between its strengthening financial performance on the one hand (e.g. recurring improvements in EBITDA) and the cash required to deliver its strategy on the other (e.g. Network, Crown and IT Transformations) (see 1)**
  - Some of the cash required is recognised as a P&L "investment" (e.g. one off Project Costs incurred "above the line") while the rest is either exceptional (e.g. compensation payments for subpostmasters or redundancy payments to employees) or is more conventional capital investment (e.g. in-branch spending)
- **While POL's financial performance is expected to continue improving – the business is expected to reach EBITDAS breakeven in 2015/16 – the implementation of Network and IT Transformation is expected to keep operating cashflow negative until the end of 2015/16**
  - After this point much of POL's key strategic spending will be materially complete. As such POL's operating cashflow is expected to be breakeven in 2016/17 and, driven by continued improvements in operating performance, to strengthen each year thereafter (see 2)
- **This means that by the end of the current funding period in 2017/18 POL is expected to have reached a position of "financial sustainability"**
  - This is a pre-requisite to any mutualisation and means that by this time POL will have started to establish an externally financeable track record. Once a track record has been set down (e.g. after c.3 years) it will be possible for POL to take forward its mutualisation in more substantially material ways

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Operating Performance – Capex Profile

Mar YE (£m)	11/12A	12/13A	13/14B	14/15F	15/16F	16/17F	17/18F	18/19F	19/20F
Network Transformation	4	66	179	292	223	180	40	0	0
Crown Transformation	0	14	65	60	0	0	0	0	0
IT Repl. / Transformation	18	22	41	46	114	30	24	17	12
Products and Multi-channel	6	9	15	44	14	6	22	14	14
Supply Chain, POS / Mobile Vans	2	11	20	22	22	9	35	22	22
Other	8	23	32	49	47	12	30	16	16
Total Capex and Exceptionals	**38**	**145**	**352**	**512**	**420**	**237**	**150**	**69**	**64**
% of revenue	*4.3%*	*16.1%*	*39.2%*	*55.4%*	*41.7%*	*21.5%*	*12.7%*	*5.5%*	*4.9%*
Memo: Cashflow Capex	**4**	**66**	**179**	**292**	**223**	**180**	**40**	**0**	**0**

- **POL's capex investment is budgeted to ratchet-up from c.£38m in 2011/12 to a peak of >£500m in 2014/15 as Network Transformation and a number of other strategic initiatives enter full implementation**
  - Spending on Network Transformation remains high through to 2016/17 after which point the bulk of the network will have been converted. However this spending is linked to expected conversion rates, meaning that any change in the profile of conversions will materially impact the timing of investment (see 1)
  - Crown Transformation is expected to come to an end in 2014/15 at which point the Crown estate is expected to have reached a breakeven position. This will have seen c.70 branches franchised or merged and more than £70m invested in the fabric of the rest of the estate (see 2)
  - IT transformation is made up of a number of initiatives related to POL's separation from Royal Mail (i.e. between 2011/12 and 2013/14), the replacement of existing counter technologies (see 3) and investment in enabling technologies to support POL's revenue growth ambitions (see 4)
- **Business-as-usual capex is believed to be £40m - £70m per year – this position was last seen in 2011/12 and is expected to be re-established from 2018/19 when capital investment will be primarily focused on replacement spending (e.g. IT and sales infrastructure and the supply chain network)**

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Note: Difference between Total Capex and Cashflow Capex is due to timing effects of when liabilities are "booked" internally versus when spending is recognised for accounting purposes

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4 Operating Performance – Opportunities

Opportunity	Commentary	Current Performance
Performance in Existing Activities	▪ While POL's revenue forecasts are challenging there is some limited upside potential in a number of areas (e.g. rollout and customer acceptance of Collect and Returns in Mails, growth in new Financial Services products)	▪ Under POL's old plan revenue upsides were more wide-ranging given the conservative approach that had been taken to planning (and the stronger than expected performance that POL was able to deliver since that plan was agreed). ▪ While the new strategy is more aggressive, some upside does remain – however this is typically dependent on third parties (e.g. Royal Mail) or faster delivery of organisational improvements (e.g. CRM systems and financial advisers in Financial Services)
Financial Services (incl. Current Account)	▪ It could be possible for the rollout / takeup of POL's current account to be faster or better than expected, and for POL to up- or cross-sell new customers more effectively than planned. This would deliver direct and indirect benefits to POL and to subpostmasters through increased revenue and footfall	▪ POL is exploring an expansion of the current account piloting area in early 2014/15 which should see the number of branches participating increase from c.40 to c.110. By the end of 2014/15 POL believes that it could have up to 2,000 branches offering these accounts – a rollout that will happen in parallel to extensive training of financial services specialists, investments in the Crown estate and the implementation of new CRM systems
Network Transformation	▪ Network Transformation is an important strategy in its own right but it is also a critical enabler of a number of other initiatives being undertaken by POL. If POL can deliver the conversion of the agency estate faster than expected then it might also be possible to accelerate other initiatives that bring with them considerable financial benefits (e.g. faster rollout of Collect and Returns, quicker reductions / transformation of POL's cost base, other new contract wins, etc.)	▪ Over the last 12 months POL's performance in Network Transformation has been – at best – in line with expectations which suggests outperformance is unlikely ▪ While the new structure of Network Transformation is more attractive to subpostmasters, the near-term profile of conversions will only be known in early 2014 once the retail survey element of the plan comes to an end. Until this point there is possibility of some upside (e.g. revenue growth driven by new remuneration structures or cost savings driven by conversions)

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Operating Performance – General Threats

Risk	Commentary	Mitigation
Network Transformation	▪ POL's new plan incorporates a number of changes that are expected to drive an acceleration in the rate of branch conversions. However these changes have only recently been announced – they are set to be introduced in 2014 ▪ It therefore remains to be seen whether POL's desktop planning has been accurate, both in relation to Network Transformation itself and the range of other strategic initiatives that are interdependent with it	▪ ShEx is working closely with POL to ensure there is discipline in their monitoring of the programme – there are regular meetings to assess performance, the pipeline and to monitor emerging trends ▪ The new plan is also endorsed by the NFSP. This is a key change versus the old strategy and it is hoped that it will to encourage a greater degree of subpostmaster engagement and participation
Crown Transformation	▪ The Crown strategy is ambitious, and its success requires POL's Network and Commercial teams to work together closely and for POL to be able to deliver a wide range of interdependent strands of its plan simultaneously ▪ It also assumes that no consolidated pay deal is reached with the CWU, since any such agreement would have a material impact on economics of the Crowns by adding in significant recurring costs	▪ ShEx is working closely with POL to monitor progress towards Crown targets and to ensure local concerns / opposition are managed effectively. This relationship has improved significantly over the course of the past year ▪ There is also a constructive dialogue established between POL and the CWU and, to a lesser extent, between ShEx and the CWU
Management Capacity and Capability	▪ POL's financial targets require a wide range of strategic initiatives to be delivered in parallel, while at the same time trading across the underlying business continues to improve. This raises questions around the capacity of management (e.g. given the number of initiatives) and their capability (e.g. given the scale and pace of change, and the growth in new markets where POL does not have a track record or, in some areas, detailed plans in place)	▪ POL has recently put in place a number of changes to its management team that strengthen its delivery capabilities. At the same time the ShEx team is monitoring progress carefully and with Richard Callard's imminent appointment as a NED this oversight (and influence) is expected to improve further
Revenue Growth	▪ POL's plan assumes growth in established and new markets, both of which represent possible threats to POL's near term financial performance (e.g. given the terms of recent contract renewals and delays to product launches) ▪ Growth is also reliant on the successful delivery of Network Transformation and other enabling strategies – these dependencies also give rise to possible risks	▪ POL's new plan has been developed in more detail than its old strategy, making detailed monitoring easier. This means the ShEx team is able to support POL more effectively (e.g. in Government Services)

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4 Operating Performance – Specific Threats

Risk	Commentary	Mitigation
POCA	▪ POCA is POL's most important Government Services contract – it represents c.50 per cent. of divisional revenues and accounts for much of branch footfall ▪ The contract is up for renewal / extension in March 2015 and if extended, it would still expire (at the latest) in March 2017. POL's plan assumes an extension and that material volumes are delivered from any successor product ▪ Discussions with DWP are active and while there is a commitment for POCA to continue to be available at post offices, the structure and terms of any contract have not been agreed	▪ ShEx is working closely with POL, DWP and HMT in relation to POCA – this includes both an extension and a possible successor product. Considerable work is however still required to ensure progress and a satisfactory outcome for all parties by March 2015 ▪ This is supported by Jo Swinson's announcement in November 2013 that signalled DWP's commitment to ensuring POCA will continue to be available at post offices. The wording of this announcement was agreed with DWP Ministers
Premium Bonds	▪ Although POL's contract with NS&I is due to expire in 2015, high sales volumes means that POL will have sold its £2.3bn "allocation" by March / April 2014. If no extension is agreed POL will serve notice on NS&I in early 2014 ▪ While this contract does not generate significant income for POL it is a key driver of footfall and is seen as one of POL's "landmark" products. A withdrawal would also trigger stakeholders to react, putting elements of the strategy at risk	▪ ShEx is working with HMT and POL to develop short and longer term solutions (POL is also engaged directly with NS&I). These discussions are complicated by the way the current contract is funded ▪ BIS Ministers are sighted, and HMT is working with its Ministers in seeking to identify a workable solution
VOA / ATM Rating	▪ The VOA is shortly planning to implement a change to the rating of ATMs that means POL and subpostmasters will see ATMs being rated separately to any connected retail business. In its current form this could trigger a c.£12m liability for POL and subpostmasters and an annual increase in costs of c.£4m per year ▪ This is a significant risk to POL's financial targets, both standalone and due to the impact it could have on POL's ATM strategy / subpostmasters' businesses	▪ The financial and communication risks of this proposal by the VOA are understood by BIS, HMT and DCLG Ministers and all are keen work towards identifying a solution before bills are sent out to subpostmasters. This is planned to take place in late January ▪ ShEx officials are playing an important role in these discussions alongside POL, and although progress has been made it is not clear whether a solution will be found or what it might look like
Royal Mail	▪ POL's 10 year contract with Royal Mail incorporates the option to renegotiate certain commercial terms in March 2017, after 5 years. While the contract is expected to remain in force, certain changes (e.g. loosening of exclusivity, changes to remuneration structures) could have a material impact on POL's expected financial performance	▪ The risk that Royal Mail will seek material changes to the terms of the contract will be reduced if POL can deliver its strategy successfully (e.g. Network Transformation, IT Transformation, SMEs). In parallel the ShEx POL team will be working with management to model risks and develop possible responses

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5 Valuation

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5 Valuation - Summary

- **POL is currently loss making and it generates negative cashflow even on a post-Network Subsidy basis. In 2013/14 the business is expected to "burn" £16m which is equivalent to £216m before Network Subsidy and £431m before any HMG funding**
  – However over the course of the new planning period POL expects its financial position to improve materially. By 2016/17 management expect POL to reach cashflow breakeven and generate £34m cash before Network Subsidy (or £144m after Network Subsidy) and for this to increase to £84m (or £134m) by 2019/20
- **This rapidly changing / improving profile makes it difficult to construct a meaningful valuation of POL**
  – A DCF relies on assumptions underlying POL's plan and assumptions related to future HMG funding. A positive enterprise value is therefore driven by a small number of key drivers and the extensions to management's forecasts required to define a "steady state" (i.e. from which a terminal value can be calculated)
  – A comparables approach is not possible given POL's negative earnings profile. This is further complicated by a lack of relevant peers (e.g. PayPoint is POL's closest peer but differs in a number of materially different respects)
- **The DCF analysis included here assumes HMG continues to fund POL to 2017/18 in line with the existing and new funding agreements, and that in the period after this (and into perpetuity) the "steady state Network Subsidy" is also made available (i.e. £50m per year). This requires two overriding assumptions:**
  – That the funding enables POL to implement its entire strategy successfully and that all benefits / interdependencies are achieved in line with expectations
  – That HMG policy for POL and the post office network does not change (e.g. minimum network size, access criteria, availability of services, etc.)
- **The values presented by this analysis should be viewed with a significant degree of caution given the assumptions that have had to be made**
  – A positive "value" is only achieved assuming HMG funding of >£1bn is provided to POL between the start of 2014/15 (i.e. the first year of forecasts) and 2019/20 and that £50m per year continues to be provided in perpetuity
  – POL's plan period to 2019/20 has been extended by 3 years to ensure that a terminal value is calculated on the basis of a "steady state" year (e.g. without anomalous movements in cashflow from working capital, capital expenditure, etc.)
  – The terminal value has been calculated using a a simple perpetuity growth methodology with a 1 per cent. growth rate. An indicative WACC of 8 per cent. has been used

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5 Valuation – DCF Analysis

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Net Income	940.0	1,047.0	1,160.0	1,264.0	1,359.0	1,439.0	1,505.1	1,554.7	1,585.8
Operating Profit (pre-Network Subsidy)	(61.0)	0.0	30.0	94.0	109.0	120.0	125.5	129.6	132.2
Network Subsidy	160.0	130.0	80.0	70.0	60.0	50.0	50.0	50.0	50.0
Working Capital	(23.0)	(122.0)	105.0	5.0	(25.0)	30.0	0.0	0.0	0.0
Capital Expenditure	(179.0)	(232.0)	(106.0)	(96.0)	(59.0)	(54.0)	(52.7)	(54.4)	(55.5)
Reserves, Provisions and Exceptionals	(333.0)	(188.0)	(131.0)	(54.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)
Other Cash Movements	(3.0)	(1.0)	(4.0)	(4.0)	(6.0)	(2.0)	0.0	0.0	0.0
Other HMG Funding	170.0	150.0	140.0	70.0	0.0	0.0	0.0	0.0	0.0
FCF	**(269.0)**	**(263.0)**	**114.0**	**85.0**	**69.0**	**134.0**	**112.8**	**115.2**	**116.7**
discount factor	92.6%	85.7%	79.4%	73.5%	68.1%	63.0%	58.3%	54.0%	50.0%
PV of FCF	(249.1)	(225.5)	90.5	62.5	47.0	84.4	65.8	62.3	58.4

Net Present Value of remaining secured funding period: (£321.6m)

Net Present Value of additional 2-years' management forecasts: £131.4m

Net Present Value of forecast extension: £186.5m

Net Present Value of terminal value: £842.6m

(£321.6m)
+
£131.4m
+
£186.5m
+
£842.6m
=
£838.0m

Perpetuity Growth Rate	WACC 7.0%	7.5%	8.0%	8.5%	9.0%
0.0%	923.2	817.8	726.3	646.1	575.4
0.5%	997.9	**880.2**	**778.8**	**690.8**	613.6
1.0%	1,085.0	**952.1**	**838.9**	**741.4**	656.7
1.5%	1,187.9	**1,036.0**	**908.2**	**799.3**	705.5
2.0%	1,311.4	1,135.2	989.1	866.1	761.3

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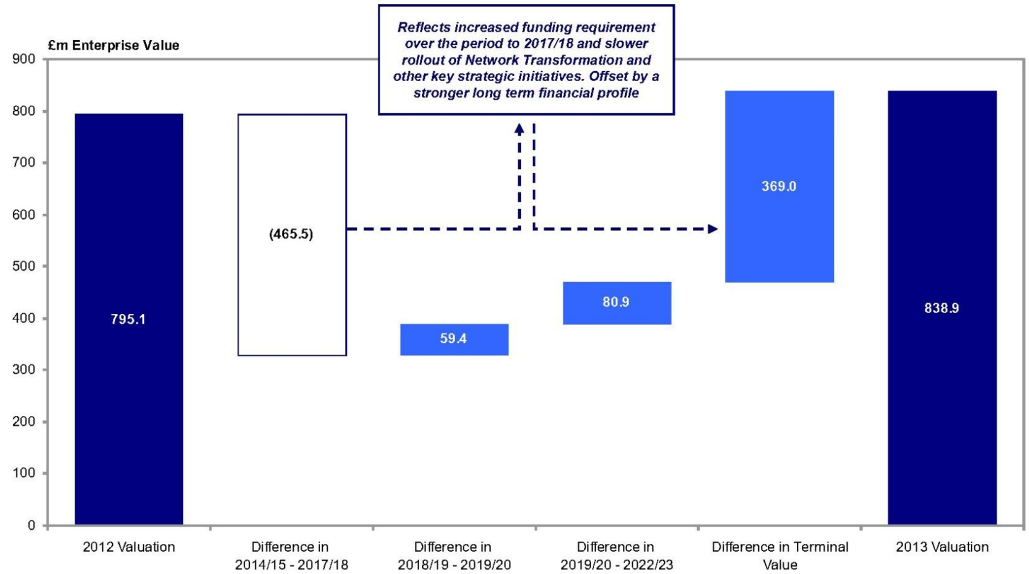
5 Valuation – 2012 DCF vs. 2013 DCF Value Bridge



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6 Board and Management

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Board and Management - Summary

While POL now has a settled Board the senior management team has recently undergone a number of significant changes…

…some of these address important gaps that needed to be filled while others create possible new gaps (and risks)…

…it is therefore important that the ShEx team monitors progress carefully, ensuring that the good progress that has been made across the business in 2013/14 is maintained

- **POL has had a full Board in place since mid-2012 when the final NEDs were appointed following the separation of POL from Royal Mail in April of that year. The Board has a mix of backgrounds and provides active support to senior management**
  - comprised of 2 Executive Directors (i.e. POL's CEO and CFO) and 5 Non-Executive Directors (including Alice Perkins, POL's Chair)
  - Susannah Storey is soon to be replaced by Richard Callard as HMG's representative
- **During the course of 2012/13 and to date in 2013/14 POL's senior management team has undergone a number of changes. While many of these address weaknesses identified last year they also trigger a number of possible new risks / exposures**
  - **Martin Moran** (Commercial Director) left in Summer 2013 – no direct replacement is being appointed and his responsibilities have been spread across other senior management (e.g. see Martin George below)
  - **Susan Crichton** (General Counsel) left in Summer 2013. She has been replaced by **Chris Aujard** (formerly General Counsel at Centamin and Company Secretary of Royal London Mutual Insurance) who had initially been appointed in an interim capacity
  - **Sue Barton** (Director of Strategy) is due to leave POL in January for a 12 month career break. In the period before she returns to POL her strategy and stakeholder management roles will be shared among other senior Commercial and Financial management
  - **Martin George** joined in the Autumn as Chief Marketing and Commercial Director from BUPA. At POL he has cross-cutting responsibilities across all commercial areas of the business including digital and marketing. He appears to have settled well
  - **Neil Hayward** will join in February 2014 as Group People Director, leaving BT where he was Group Director of Employee Relations. He takes on roles held by Susan Crichton, who had held HR responsibilities since POL's previous head of HR left in 2012/13
  - Responsibilities for mutualisation have shifted from **Sue Barton** and **Belinda Crowe** and now sit with POL's communications team. While communications is an important element of mutualisation it is not clear what broader impact, if any, this change might have
- **Quality of management team is AMBER in POL's traffic light assessment**
  - The changes highlighted above need to "bed down" before a firm view can be taken. A number of gaps have been filled – which is reassuring – however a number of others have now emerged
  - Questions also remain around the ability of the remaining management to deliver POL's strategy effectively. The team is relatively untested in a number of areas (e.g. new products, cost transformation) and the breadth of the plan is also likely to stretch capacity

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Remuneration – 2012/13 Actuals

The remuneration framework for POL's CEO and CFO requires approval from the SoS and the Chief Secretary to the Treasury...

...the SoS is also able to provide comments to POL's RemCo on the Company's performance before actual payments decided...

...payouts for 2012/13 were broadly in line with expectations

Key Headlines for 2012/13

- No press coverage or adverse public reaction related to the handling of payouts
- Arrangements for the CEO were carried over from those agreed while she was a RM Board Director
- Base pay for both CEO and CFO remained unchanged
- Overall maximum bonus payments under STIP and LTIP were frozen for both CEO and CFO
- RemCo proposals for increases in base pay and STIP payments were resisted

Actual Payments

	Base Salary	STIP	LTIP
CEO	• Base salary of £250k and benefits of £70k (including pension payment)	• **£157,936** (63 per cent. of base salary – down from 69%)	• **No payout** relating to 2011/12
CFO	• Base salary of £215k and benefits of £64k (including pension payment)	• **£129,053** (60% of base salary – comparison with previous year not available)	• **No payout** relating to 2011/12

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Remuneration – 2013/14 Proposals

POL's RemCo carried out extensive benchmarking of public and private sector activities with the aim of pushing for increases in base salaries and bonuses – these were resisted including strongly by HMT…

…proposals have been agreed by SROC however Jo Swinson raised concerns about targets and threshold payments – discussions will now continue with Jenny Willott

2012/13 Remuneration Framework Proposals

- CEO and CFO base salaries frozen again
- CEO STIP structure / payments unchanged, while POL's CFO is expected to move to the CEO's structure
  - Reduces total payment potential from 90 per cent. to 67 per cent. of base salary
- The on-target metric is the same as that for threshold payments for 3 out of the 6 STIP targets – this had previously only applied on 1
- LTIP structure / payments are unchanged for both
  - However changes have been made to simplify targets (i.e. reduced from 4 to 2) and to differentiate them from the STIP metrics

Next Steps

- To discuss with Jenny Willott and then clear with CST

	STIP	LTIP
CEO	• Based on "Post Office Scorecard" (80 per cent. of total) and personal objectives (20 per cent. of total) – see next slide for scorecard detail	• Gateway structure that requires a primary conditions to be met before payouts - based on a second condition - are triggered. Payments would be made at the end of 2015/16 – Condition I: Gateway target that ensures POL maintains a network of at least 11,500 post offices that also meet access criteria – Condition II: Break-even on Earnings Before Interest and Tax, Depreciation, Amortisation and Subsidy (EBITDAS)
CFO	• As above	

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POL STIP Scorecard

The KPIs have been kept the same as last year with the exception of "Easy to do Business With" which POL's RemCo now considers better reflected what POL needed to achieve…

…the metrics require management to deliver an improved performance on last year, which was a 53 week year

Key Performance Indicators		Bonus %	2012/13 Outturn	Threshold	On-target	Stretch
Growth						
Total Net Income (excl. NSP)	*existing*	20.0%	£902m	£890m	£900m	£920m
Operating Profit	*existing*	25.0%	£94m	£102m	£102m	£120m
Customer						
"Easy to do Business With"	*new*	20.0%	41%	44%	44%	46%
People						
Quarterly Engagement Index	*existing*	10.0%	65%	65%	66%	67%
Modernisation						
Crown Profit (Loss)	*existing*	12.5%	(£37m)	(£23m)	(£23m)	(£20m)
Network Conversions	*existing*	12.5%	1,450	2,880	3,000	3,600

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7 Key Stakeholders

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7 Government Stakeholders

Stakeholder	Stakeholder Interest	Assessment of Relationship with ShEx	Key Current Issues	Strategy to Obtain Support / Overcome Barriers
HMT	• HMG shareholding and lender to the business • Long term subsidy, and other capital requirements • Accounting / budget impact of business performance	• Strong ShEx working relationship with key HMT spending team and individual policy teams in respect of current issues	• Monitoring rollout of Network Transformation following recent funding agreement and Implementation Unit review • VOA's proposed business rates changes, NS&I's Premium Bonds contract with POL, POCA	• Maintaining frequent and close dialogue especially in respect of VOA, NS&I , POCA and NTP
Cabinet Office	• POL as provider of Assisted Digital / online ID Assurance • Implementation Unit report on POL (focused on Network Transformation and Government Services)	• Good working relationship with POL and ShEx with key CO teams but more required to ensure understanding of practicalities of HMG delivery (incl. areas of interest to POL)	• Digital transformation and possible Assisted Digital framework, and POL's role in supporting delivery • Face-to-face role for POL in light of shift to digital delivery	• Stress importance of contracts needing to be commercially viable • Highlight opportunity offered by POL's existing FOCS framework • Follow up recommendations of Implementation Unit review
DWP	• Contractual relationship as a current client (e.g. POCA) and as a prospective client (e.g. Child Maintenance, Universal Credit)	• Good working relationship with POL and ShEx but more work required to ensure DWP acknowledge POCA challenges (e.g. migration of working-age recipients)	• The impact of DWP's rollout of Universal Credit on POCA and POL's role in helping DWP to deliver Universal Credit • HMT's efficiency review of DWP	• Maintain close dialogue and coordinate with POL and HMT where required
DfT (DVLA)	• Contractual relationship as a client – e.g. driving license renewals, car tax	• Strong working relationship with POL and ShEx. ShEx sits on the FOCS board (run by DVLA, but contract is soon to be novated to CO)	• Need to work with DVLA , CO and POL on FOCS changes while working with DVLA on business-as-usual matters (e.g. driving licenses, car tax) • Plan to increase digitisation is a risk and opportunity to POL	• Maintain close dialogue and coordinate with POL where required • Press for transformation of the driver license offer to unlock new income opportunities (incl. to offset losses from tax discs)
Home Office (HMPO, UKV&I)	• Contractual relationship as a client – e.g. passport "check and send", biometric residence permits	• Strong working relationship with POL and ShEx	• Digitisation of passport check and send opportunity balanced against income risk of appetite to "go digital" in other areas	• Maintain close dialogue and coordinate with POL where required

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Other External Stakeholders

Stakeholder	Stakeholder Interest	Assessment of Relationship with ShEx	Key Current Issues	Strategy to Obtain Support / Overcome Barriers
NFSP	• Network Transformation • Mutualisation • Government Services • Subpostmaster pay • Future of organisation	• Constructive. They supported the Postal Services Act and also played a key role in recent negotiations around POL's amended Network Transformation strategy	• Support and implementation of Network Transformation • Role in cultural mutualisation workstreams • Government Services contracts, and current areas of risk • Seeking visibility / security around future role of organisation	• Maintain dialogue at official and Ministerial level to ensure continued support • Encourage engagement and alignment with POL to maximise impact of activities
CWU / Unite	• Crown branches • Employee pay • Mutualisation • Network Transformation • Government Services	• Strength of relationship influenced by status of discussions with POL. Engagement does take place but continued discussions with POL impact this	• Engagement with mutualisation process • Concerns about network transformation • Ongoing pensions discussions with Royal Mail	• Support ambitions for Crown estate while being sensitive to concerns • Encourage re-engagement with mutualisation process • Careful comms. around Network Transformation
Consumer Focus	• Network Transformation • Government Services • Access Criteria	• Improving but issues around accuracy of research (e.g. on Network Transformation) remain	• Implementing the recently agreed Code of Practice for on and off site conversions under Network Transformation – subject to review in Dec 2012	• Build on improving relationship with Mike O'Conner (CEO) and other day-to-day working teams
Competitors	• State Aid • Government Services • Mails (e.g. Parcels)	• Active engagement with PayPoint, but no others	• Current dialogue with PayPoint through the European Commission in relation to State Aid approval	• Maintain dialogue at official level and keep PayPoint's presence as a bill payment provider, relative to POL, under review
European Commission	• State Aid	• Good and open	• PayPoint concern on POL's State Aid approval	• Formalise discussions related to new funding agreement and commercial strategy

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8 Shareholder Executive Role

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Shareholder Executive Role

- **ShEx has a dual-role with POL, representing HMG as a responsible shareholder and acting as a voice / guide within HMG (e.g. on political and commercial issues)**
  - active relationships and frequent dialogue maintained across multiple tiers of executive and senior management
  - work closely with internal HMG stakeholders (e.g. DWP, DVLA, HMPO, Cabinet Office)
  - engage with external stakeholders including NFSP, CWU and key customer groups
  - strong relationship maintained with HMT spending team (e.g. Alim Islam, James Perry, Conrad Smewing)
  - work with selected advisers where applicable (e.g. Freshfields on legal and KPMG on accounting and finance)
- **The day-to-day POL team has undergone a number of changes over the past year**
  - Richard Callard replaced Will Gibson in December to lead the team
  - Katrina Lidbetter joined in May following Jan Hoy's earlier move to UKTI
  - Peter Batten has taken over from Mike Whitehead, with James Baugh joining to cover a number of Peter's previous responsibilities
  - Jai Nathan – the team's Faststreamer – moved to MoJ to fill an HEO role. He has not been replaced

Title	Name	Role
Director	Anthony Odgers	Head of ShEx RMPS Team
Executive Director	Richard Callard (50%)	Head of RMPS POL Team
Assistant Director	Peter Batten (80%)	Network and Stakeholder Engagement
	Katrina Lidbetter (80%)	Government and Financial Services Support
	Tim McInnes (80%)	Financial Monitoring, Strategy and Mutualisation
SEO	James Baugh (50%)	Network and Stakeholder Engagement

- **Actions raised in the December 2012 annual review and subsequent quarterly reviews have also been addressed**
  - Update ShEx on any changes to the Universal Credit proposals or POCA *[Addressed in this presentation]*
  - Ensure that POL have prepared a budget in advance of the next financial year *[ShEx concerns raised as part of business-as-usual work with POL]*
  - Refine monitoring of efficiency gains from the Crown Transformation strategy *[Addressed as part of business-as-usual work with POL]*
  - Provide an update on Network Transformation *[Addressed in this presentation]*
  - Clarify the position about the sale of tax losses to Royal Mail following its privatisation *[Addressed as part of business-as-usual work with POL]*
  - Assess what impact the loss of the driving licence paper counterpart will have on POL *[Addressed as part of business-as-usual work with POL]*
  - More detailed discussion of Government Services *[Addressed in this presentation]*

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Shareholder Executive – Top Priorities for 2014/15

Priority	Commentary
Transformation	***Network Transformation*** ▪ To continue to closely monitor Network Transformation and help POL to manage local and stakeholder concerns – this includes ensuring that implementation of the strategy is done properly and that it addresses HMG's concerns identified with the old plan. In monitoring it will be key to make sure targets continue to be met, and if not that appropriate mitigating actions are taken ***Crown Transformation*** ▪ Same as Network Transformation but with a closer focus on key stakeholder concerns (e.g. voluntary redundancy and franchising activities) and in parallel, progress being made with CWU and Unite. It is also important that the team is able to assess the impact of the actions being taken (e.g. both to ensure progress towards breakeven can be maintained and that they support other strategic activities) ***State Aid*** ▪ In support of POL's recently announced funding agreement the ShEx POL team will be working with POL throughout 2014/15 on a State Aid notification to the European Commission – the process will begin formally in late January / early February. This will ensure that approval is received before the end of POL's existing funding in March 2015
Mutualisation	***Spring Announcement on Progress*** ▪ To work closely with POL in January / February in ensuring that an update on mutualisation, which was trailed in Jo Swinson's November speech to the HoC, is made alongside the publication of the "public benefit purpose" of the post office in the Spring. It will be key to ensure that any such update is aligned to Ministerial expectations (and indications provided to Ministers by POL in December) ***Other Workstreams*** ▪ In parallel the ShEx POL team will also continue to support POL in its work on developing more mutual ways-of-working across the business and with its key stakeholders. This will include working with POL directly and, in certain areas, participating in new working groups that are being brought together
Policy and Stakeholder Issues	▪ On a business-as-usual basis it will be important for the ShEx POL team to continue to work closely with HMG stakeholders and POL to ensure that HMG's policy objectives for POL and its network can continue to be met (e.g. network size, access criteria) and that commercial or stakeholder issues that arise can be managed and dealt with quickly and effectively (e.g. NS&I, DWP / POCA, VOA, etc.) ▪ Working alongside POL's new commercial team this will also include looking at new ways in which POL and ShEx can work together – e.g. both to strengthen POL's financial performance and also to ensure that HMG's objectives can be achieved

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9 Traffic Light Analysis

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Traffic Light Analysis

	Dec-12	Jun-13	Sept-13	Current	Comments
Shareholder Relationship					• There is a good and constructive relationship with POL's Chair, and a strong relationship with the CEO who has demonstrated her clear commitment to POL's strategic plan and meeting Government's objectives. The NEDs are challenging management, and this is expected to be maintained going forward - in particular in relation to key strategic initiatives and POL's new plan.
Implementation of Shareholder Model					• Generally strong application of a shareholder model, with appropriate monitoring structures in place – this includes frequent dialogue with management. However, policy and shareholder roles are combined. Management remuneration for 2013/14 still needs to be finalised.
Quality of Management Team & Board					• ShEx are working closely with management to monitor the performance of the business, and provide support where appropriate / possible. Management could be more joined up (e.g. Government Services and Financial Services) and this is being worked on. Also succession planning has been complicated by senior management churn and recent changes to POL's organisational structure.
Strategy					• ShEx is monitoring the business closely, and is also working with management to ensure that POL has best possible chance of delivering its strategy successfully. There is frequent dialogue with POL in relation to ALL strands of its plan, both on a "business as usual" basis and in relation to the current diligence process.
Financial Performance					• POL's financial performance is monitored closely by ShEx on a monthly basis, and sessions are held with divisional management (both revenue and cost) to understand current trading and near term outlook in more detail.
Balance Sheet & Risk					• POL has a business plan in place, and it is funded to deliver this strategy. However POL is only a going concern due to Government subsidy, and makes losses which means it is unable to pay dividends (both today, and likely in the medium term also). ShEx monitors the business closely to ensure that it is meeting its targets and that any issues are identified and addressed early on.