



Post Office Limited (POL)

Overview

May 2015

RESTRICTED – POLICY & COMMERCIAL

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SUMMARY AND KEY ISSUES

Government is sole shareholder of Post Office Limited (POL), setting requirements which POL must meet, then allowing it to operate commercially

POL is loss making and relies on Government subsidy; however it is in the middle of a complex transformation programme to reduce that subsidy

This is ambitious but achievable, and with political support will place POL on a sustainable long term footing within this Parliament

The Post Office is a relatively small and discrete policy area, but one which attracts a significant amount of interest from both Parliament and the public. On one hand, Post Offices are held in high esteem as hubs of the community (particularly rural communities) providing essential services to often vulnerable people; at the same time, many see them as outdated, inefficient, and increasingly less relevant to modern life.

Government policy on the Post Office has tended to strike the balance between recognising the social and economic functions that Post Offices provide, with the need for the company to operate commercially and taxpayers paying no more to support it than is necessary. POL's transformation programme should see the company moving towards a more sustainable long term footing within this Parliament, with a "steady-state" subsidy of around £70m or less by 2017-18 (down from a peak of £210m in 2012-13).

This pack gives a high-level overview of how POL is set up, the areas in which it operates, and its long term strategy. There are also some short term matters (below) which you need to understand and may require prompt action. We recommend you receive more detailed advice on each.

Network Transformation (slide 10) is a 6-year programme to both transform individual branches (e.g. modernisation and investment) and update the contract terms of subpostmasters by making their remuneration fully variable. POL has made good progress since 2012 and is now taking more active steps to maintain momentum and complete transformation of the whole network.

A small but vocal number of mostly former-subpostmasters have raised concerns about **POL's Horizon IT system**, which they claim has caused their businesses losses. Over two years' worth of independent investigation has found no systemic faults in Horizon and there is a mediation scheme to consider individual cases, but campaigning and media interest persists and BBC's Panorama is due to broadcast a programme on this on 22 June. See slide 13.

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STRUCTURE AND OWNERSHIP

POL is one of the largest retail business in the UK with a 350 year history, operating a network of c.11,700 branches across the country

It was separated from Royal Mail in April 2012 and is 100% Government owned, via a holding company that also owns the remaining stake in Royal Mail

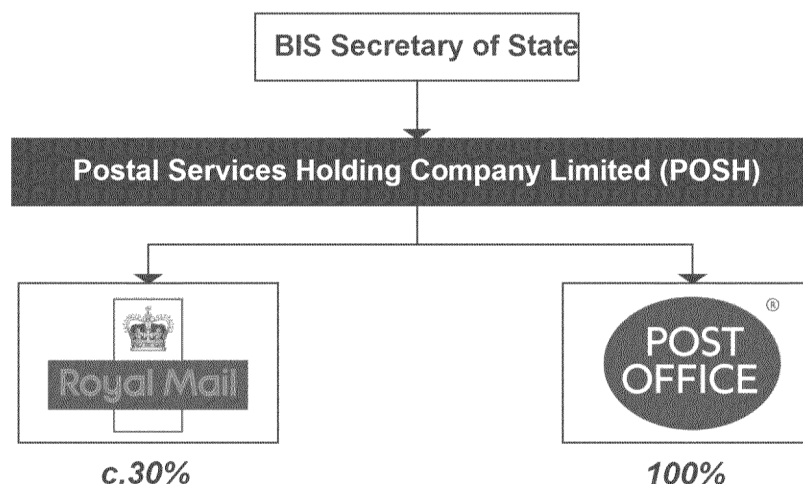
Government does not seek to influence POL's day-to-day operations

POL is a commercial business that operates independently of Government. It has a Chief Executive and a Board of Directors, who are responsible for running POL day-to-day and for providing strategic oversight, respectively.

The Government owns 100% of POL, through the Postal Services Holding Company (POSH) which also owns the Government's remaining stake in Royal Mail. These two shareholdings are entirely separate.

The Post Office team in the Shareholder Executive (ShEx) manage the Government shareholding in POL. This includes a non-executive seat on POL's Board. The Government has various shareholder rights in areas such as Board appointments, remuneration, and POL's strategic plan.

The Postal Services Act 2011 requires POL to be wholly public-owned, but allows for the move to a mutually-owned structure in the future. Any alternative structure or ownership model would require further primary legislation. Mutualisation will only be possible if POL is financially sustainable, and Government should consider what kind of future ownership model would be appropriate for POL.



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FUNDING

Government funds POL to enable it to maintain a network of post offices beyond its optimal commercial size, and to make that network more efficient

Without support, POL would not be a going concern

Government has committed nearly £2bn between 2010 and 2018

Funding benefits POL's customers, and also helps to reduce POL's overall reliance on taxpayer support

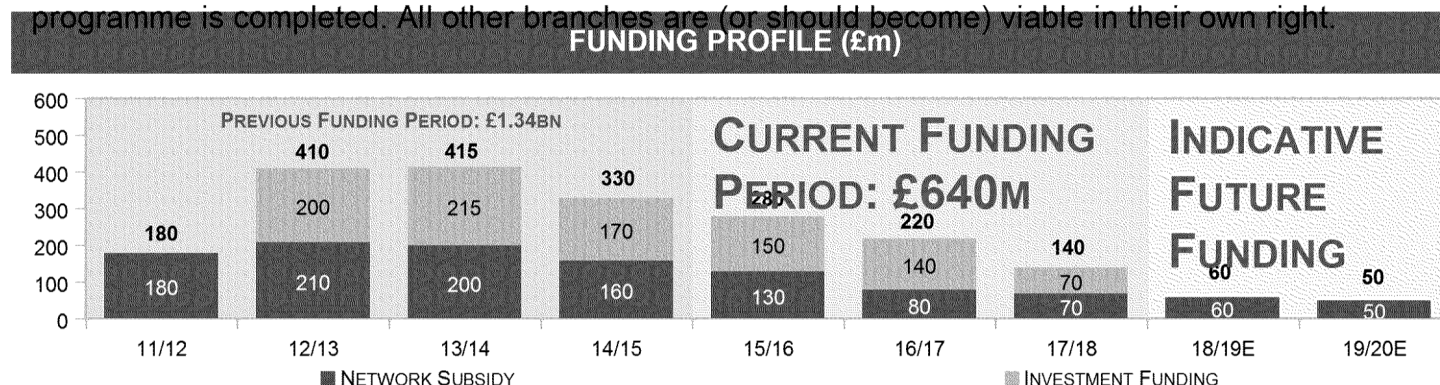
Government provides funding to POL in order to maintain a network beyond its optimal commercial size and footprint. Currently the requirement is a network of more than 11,500 branches which meets 5 clearly defined access criteria (e.g. 99% of the UK population must live within 3 miles of their nearest post office). There is a legally-binding funding agreement between Government and POL.

Since 2010, Government funding for POL has been focused on two areas:

NETWORK SUBSIDY: Payment to maintain a network of post offices in line with Government's requirements. Recognised by POL as revenue in its accounts.

INVESTMENT FUNDING: Funding for POL to invest in its network, to make it more efficient and less reliant on taxpayer funding. It is recognised by POL as a direct cashflow in its accounts

Investment helps reduce the overall funding requirement. Subject to POL's performance and wider market developments, we anticipate a future "steady state" funding of around £50m from 2019/20. This would support c.3,000 branches which serve a social purpose but would not be financially viable in their own right, and hence will continue to require funding after POL's investment programme is completed. All other branches are (or should become) viable in their own right.



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FINANCIAL OVERVIEW

*Last financial year
POL generated
revenue of £870m
which was a 0.3%
increase on 2013/14*

*Underlying operating
profit (i.e. after
adjusting for a £40m
reduction in network
subsidy) was higher
by £33m, and in line
with expectations*

*POL's profitability is
expected to improve
further in 2015/16
although revenue is
forecast to fall
marginally, due to
ongoing difficult
market conditions*

In 2014/15 POL generated revenue of **£870m** (£1,030m including Network Subsidy) and an operating profit of **£100.5m**.

Revenue was below budget, mainly due to underperformance in Mails and Retail and Telephony and Other.

However due to tight cost control operating profit was in line with expectations. This is reassuring.

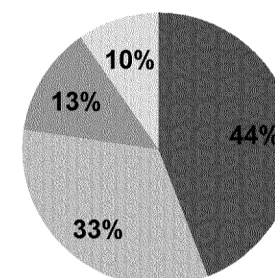
POL's most significant cost is payments made to subpostmasters - in 2014/15 **£438m** was paid out to **c.11,400** subpostmasters, averaging **c.£38,000** per branch.

Due to Network Transformation these costs are now more closely linked to sales volumes and are becoming increasingly flexible.

After subpostmaster payments, POL's largest expenditures are: Staff Costs (**c.£234m**); IT (**c.£90m**); and Property (**c.£61m**).

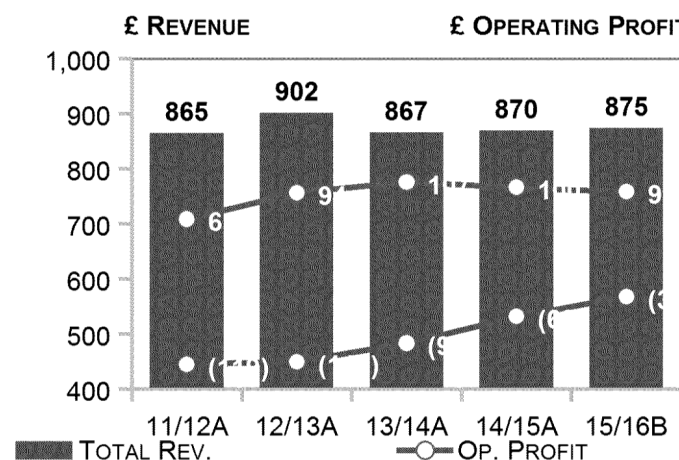
REVENUE SPLIT (% TOTAL)

Total 2014/15 Revenue: £870m



■ Mails and Retail
■ Government Services
■ Financial Services
■ Telephony and Other

REVENUE & PROFIT PERFORMANCE (£m)



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LONG-TERM STRATEGY

POL's strategy was developed in 2013 and although ambitious, represented a continuation of its established plan

It focused on completing Network Transformation, growing revenue, and improving the efficiency of POL's operations

Market conditions have however been more challenging than expected, and in response POL is working on a refresh of its strategic plan

POL's strategy was developed in 2013 and covers the period to March 2020. It was part of the basis on which POL secured Government's recent £640m funding commitment and focuses on delivering a financially sustainable POL, less reliant on subsidy. The strategy is centred on three core pillars.

NETWORK TRANSFORMATION

- **Aim:** Complete the network investment strategy, modernising branches to improve customers' experience and making them less reliant on taxpayer support
- **Status:** Generally NT has progressed in line with plans

REVENUE GROWTH

- **Aim:** Increased sales in existing areas and launch of new products and services, focusing on particular strengths in Mails, Government Services and Financial Services
- **Status:** Slower than expected progress, with low demand growth, fewer new contracts than expected (particularly in Government Services) and intense competition

TRANSFORMATION AND EFFICIENCY

- **Aim:** Reduce costs through a significant transformation of POL's IT infrastructure and a restructuring of the corporate overhead
- **Status:** Again, progress has been slower than expected, particularly due to frequently volatile or hostile relations with key stakeholders including the subpostmaster and employee representatives

POL has been working on a refresh of its strategic plan for the past few months, which is expected to be presented to Government in mid-2015. We expect the main objectives and pillars will remain the same, but some details might change and financial targets will be reduced. However, POL is confident that it will be able to deliver the refreshed strategy in line with the available funding.

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SERVICES: MAILS AND RETAIL

Through its exclusive relationship with Royal Mail, POL is the leading provider of retail mails services in the UK and is responsible for c.£2.5bn of Royal Mail's revenue

Recent years have been challenging: traditional mails products are in decline whereas key growth markets (e.g. Click and Collect) are evolving and highly competitive

POL is the leading provider of retail mails in the UK, offering access to Royal Mail services for retail and small business customers

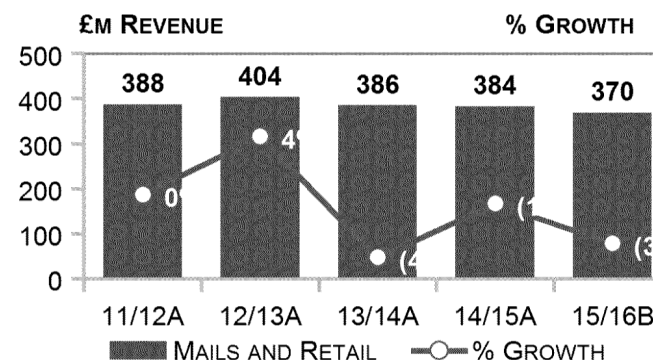
Range includes stamps and labels, special delivery, Parcelforce, signed-for and Home Shopping Returns; also provides selected retail services including lottery, packaging and Royal Mail / Royal Mint collectibles

A 10-year exclusive Master Distribution Agreement (MDA) was agreed with Royal Mail in 2012 on an arms length basis – this was the longest period permitted at the time by the European Commission

Royal Mail services are offered at all POL branches – this is a bigger and denser network than Royal Mail needs to meet its Universal Service Obligation

Mails is in structural decline but parcels is growing, particularly due to online retail. However competition is fierce in this segment (e.g. Collect+, MyHermes, Amazon) and the market direction is unclear

REVENUE



RECENT DEVELOPMENTS / LIVE ISSUES

ROYAL MAIL RELATIONSHIP: Despite having a scheduled opportunity to renegotiate in 2017 POL might look to amend certain aspects of its contract with Royal Mail in the coming year

COMPETITION: The UK parcels market is increasingly fast moving and competitive. This is impacting POL as the largest provider

MAILS STRATEGY: Since separating from Royal Mail POL has scaled up its Mails team and is currently undertaking a strategic review looking at this part of its business

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SERVICES: FINANCIAL SERVICES

POL's financial services business has been transformed in recent years with the launch of a number of new services and the POL Money brand

POL has also benefited from customers' perception of it as a trusted brand

Opportunities for future growth are strong, but not without challenges

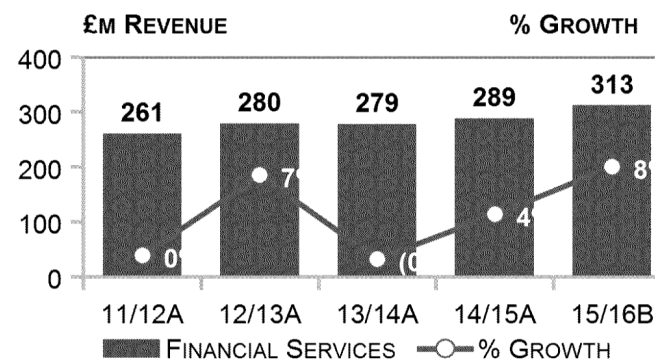
POL is a leading challenger in the UK Financial Services market, offering POL branded products – many in partnership with Bank of Ireland ("BoI") – and 3rd party services. POL's relationship with BoI was renewed in 2013 for 10 years

POL branded products, offered under the Post Office Money fascia, cover insurance, savings, travel money, current accounts, loans, mortgages and ATMs

3rd party services include bill payments, counter services for high street banks' customers (e.g. cash withdrawal and deposit), Premium Bonds and money transfers

Recent years have seen POL focus more on its higher value branded services, e.g. launch of current accounts and mortgages, and transformation of its insurance business

This requires close strategic alignment with BoI; POL provides the retail front-end of the relationship and BoI provides balance sheet and support functions

REVENUE**RECENT DEVELOPMENTS / LIVE ISSUES**

BoI RELATIONSHIP: POL and BoI are not perfectly aligned although they are working together to develop a shared long-term strategy. This might also touch on the period post-2023 when the current contract expires

NS&I: POL's Premium Bonds contract expires in September 2015 and NS&I are advising HMT Ministers on options, which could lead to this service being withdrawn from POL (this could raise significant presentational issues)

COUNTER SERVICES: POL is working with banks and the BBA to develop a standardised counter service for all customers

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SERVICES: GOVERNMENT SERVICES

Revenue from Government Services has fallen in recent years, despite efforts from both POL and Government to progress the “front office for Government” ambition

POL has won its place on a number of key frameworks

There could be new opportunities for POL in Identity Assurance and Assisted Digital in particular, but POL will need to ensure they can seize these opportunities

POL is the #1 provider of over-the-counter Government Services in the UK. Its largest contracts are:

DWP for Post Office Card Account (POCa)

DVLA for driving license renewals and vehicle tax payment

Home Office for Passport Check and Send

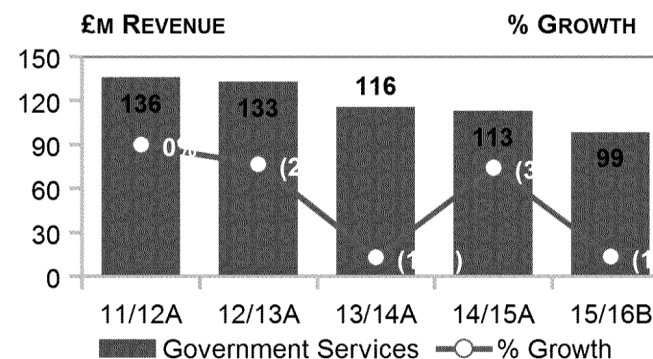
POL also provides rod licenses, Security Industry Authority verification, and visa services

Despite POL’s ambition to be the “front office for Government”, there have been significant challenges in recent years: it is illegal to simply award contracts to POL; competition has been intense in a number of segments; and more services have moved online

Key contracts have been extended but on less favourable terms, and with increased volumes migrating to direct channels (e.g. online)

New opportunities have been slow to emerge and where they have, volumes have fallen short of expectations

REVENUE



RECENT DEVELOPMENTS / LIVE ISSUES

FRONT OFFICE COUNTER SERVICES (FOCS): POL is exclusive provider on this framework, which enables Departments to contract with POL easily and cheaply. Progress however has been slow.

DIGITAL: The move to digital channels conflicts with POL providing face-to-face services and impacts POL’s ability to win new contracts

NEW OPPORTUNITIES: Areas where POL could play a key role (e.g. Assisted Digital, Identity Assurance) have been slow to come to market, although on ID assurance the picture is looking more positive

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SERVICES: TELEPHONY AND OTHER

The UK telecoms market is competitive and fast evolving – POL's products have particular strength among older customers who trust the brand

POL is responding to market developments with new product launches and a broader review of its market position

POL's cash distribution business is a source of external revenue, although it is not currently efficiently run

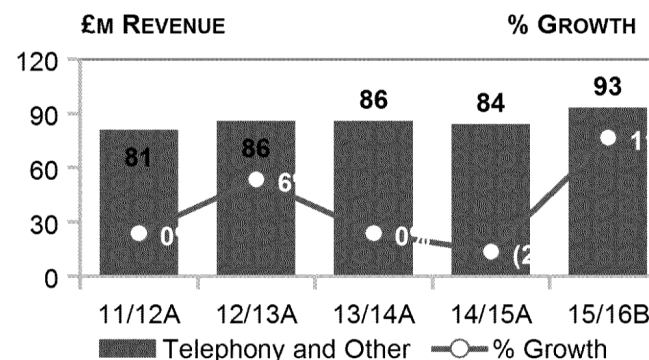
TELEPHONY: POL is the fifth largest provider of home phone and broadband services in the UK with c.450k customers. It focuses on value and has a particular strength among older customers.

POL's telephony product is provided by Fujitsu and Post Office branded. It moved across from BT in 2013, causing problems for many customers which lost a number of subscribers.

The telecoms market is evolving with consolidation among telecoms firms and the line between telecoms and media also fading. POL has plans to launch mobile and high-speed internet in 2015, but is also reviewing its long-term telephony strategy and market position.

OTHER: POL is the third largest cash distributor in the UK, selling "spare" capacity in its cash distribution infrastructure to third parties. These include Royal Mail and a number of high-street retailers (e.g. Primark). POL also earns revenue from Royal Mail from warehousing services.

REVENUE



RECENT DEVELOPMENTS / LIVE ISSUES

STRATEGIC REVIEW: POL is reviewing its place in the telecoms market, as competitors evolve and as customers get more demanding. A long term strategy could see POL exit this market, although in the short term telephony is a cash cow for POL.

HOME SERVICES: POL has previously looked at launching energy supply services (aligned to its trusted brand) but this is currently on hold.

CASH DISTRIBUTION: POL's supply chain activity is high-cost and inefficient. Changes to improve performance are underway and POL is looking at other options to improve results.

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NETWORK

Post Office's branch network stands at around 11,700 branches across the UK.

Of this network, only c.300 are owned and operated by POL; the remainder are sub post offices operated by independent businesspeople or retailers

POL's Network Transformation (NT) programme is making good process at modernising the branch network, although there is still work to be done

POL operates the largest retail network in the UK, larger than the network of the four major banks combined. Post Office's funding from Government requires it to operate a network above a commercially-optimal size and meet a set of strictly-defined access criteria.

The vast majority (97%) of Post Office branches are not operated by POL directly, but by a subpostmaster or a multiple retailer (e.g. WH Smith, Londis, Tesco) – these are known as sub post offices or agency branches. The contract between a subpostmaster or multiple retailer and POL is similar in nature to that of a franchisee. Often, agency branches are co-located in another retail premises, typically a shop or convenience store.

NETWORK TRANSFORMATION (NT) is a central element of POL's strategy and sees an historic level of investment over six years to transform and modernise POL's agency branch network (of around 11,400 branches).

Network Transformation:

- ✓ Improves customer experience by investing in branch environments
- ✓ Improves operator performance by driving footfall and enabling more efficient branch operation
- ✓ Makes POL's cost base more flexible, allowing costs to move more closely with revenue
- ✓ Reduces POL's reliance on taxpayer support

Over 75% of branches eligible for NT have either completed their transformation or have contracted to do so. More detail on the Network and its transformation programme is provided in the annexes.

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BOARD AND MANAGEMENT

POL's Board will undergo significant changes this year with both the Chair, Senior Independent Director and Audit Committee Chair stepping down

The new Chair will have the opportunity to consider the performance and balance of the Board, as well as the wider management team

For POL's senior executives in particular, remuneration is and will continue to be a key issue

MANAGEMENT OVERVIEW

POL's Board consists of a Chair and five Non-Executive Directors, together with the Chief Executive Paula Vennells and Chief Financial Officer Al Cameron.

The current Non-Executives are:

- Alice Perkins, Chair (steps down in July)
- Neil McCausland, Senior Independent Director (steps down in September)
- Virginia Holmes, NED
- Tim Franklin, NED
- Alasdair Marnoch, NED (steps down in July)
- Richard Callard, NED (ShEx representative)

Overall, we consider that the Board works well. Their primarily private sector specialisms (particularly retail and financial services) drive a more commercial outlook for the company.

Ministers approve remuneration for the CEO and CFO, including base pay and bonuses. Remuneration has been a sensitive issue, balancing public sector pay restraint with attracting and retaining private sector talent.

CURRENT APPOINTMENTS

We are in the process of recruiting a new Chair, in preparation for Alice Perkins' departure in July. We are seeking candidates with a commercial background, preferably with experience of large companies, in the retail space with significant business turnaround experience.

We plan to complement the new Chair's commercial skill set with public sector experience through the appointment of the new Senior Independent Director in the autumn, to ensure a balanced Board. We will seek the new Chair's views on this, and will very shortly begin the recruitment process.

Alasdair Marnoch, who chairs POL's Audit & Risk Committee, had considered renewing his term but has now decided against this and will step down in July. POL are responsible for recruiting a new NED and will very shortly begin the process for this, again, with input from the new Chair (once appointed).

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KEY STAKEHOLDERS

In general, stakeholders support the large scale investment in the post office network

Some stakeholders are less convinced on other aspects of POL's transformation agenda, and continued work is needed to make the case for changes to make POL a more viable business

There are small but vocal groups campaigning against various aspects of POL's strategy and transformation plans

NATIONAL FEDERATION OF SUB POSTMASTERS (NFSP)

The NFSP is the representative body recognised by POL to negotiate on subpostmasters' behalf and has over 6,000 members. The NFSP supports investment in modernising branches but has naturally tried to optimise outcomes for its members (e.g. in 2013 it was instrumental in increasing the level of compensation for subpostmasters exiting the network).

NFSP membership has been declining for some time, partly driven by the fact new subpostmasters are less likely to be members, and the organisation is trying to reposition itself as a trade association representing these more varied types of business that operate Post Offices. After more than 18 months of negotiations the NFSP is within weeks of signing a 15 year funding deal with POL which is expected to meet this objective. Further advice can be provided on this if required.

COMMUNICATIONS WORKERS UNION (CWU) & UNITE COMMUNICATION MANAGERS ASSOCIATION (CMA)

A high proportion of POL's directly employed personnel are represented by the CWU (mostly non-managerial grades) and the CMA (mostly managerial level). There is also a small but vocal "CWU postmasters" section which claims a small number of subpostmasters as members (c.200), although it is not officially recognised by POL to negotiate on their behalf.

POL works to strike a balance between delivering business strategy and avoiding industrial action; more recently it has taken a robust view on industrial relations and has persevered through strike action to drive through the changes needed to transform the business. Industrial relations are an operational matter for POL and ShEx does not engage with either Union directly.

CITIZEN'S ADVICE BUREAU (CAB)

The postal watchdog role of Consumer Futures has been transferred to the CAB who have proven, on occasion, to operate outside their remit and to be quite hostile to some elements of NT.

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HORIZON SYSTEM AND MEDIATION SCHEME

There has been over two years of independent scrutiny of POL's Horizon IT system and no evidence of systemic flaws has been found

In 2013 POL agreed a mediation scheme for subpostmasters who believed that Horizon had caused losses for which they were liable

The mediation scheme continues to consider cases

The scheme is independent of Government, and details of individual cases are confidential

Following complaints from a small number of (mostly former) subpostmasters about the Horizon IT system, in 2012 the Post Office commissioned an independent firm, Second Sight, to examine the system for systemic flaws that could cause accounting discrepancies.

Second Sight's interim report, published in July 2013, and final report, published in April 2015, both make clear that there is no evidence of system-wide problems with Horizon.

The interim report raised some questions about the training and support offered to some subpostmasters, and Post Office implemented a series of measures to improve its processes and also created a mediation scheme to consider individual subpostmasters' cases.

A Working Group was created to set up the mediation scheme, consisting of POL, Second Sight and the Justice for Subpostmasters Alliance (JFSA) and with an independent Chair: Sir Anthony Hooper, a former Court of Appeal judge.

Each case in the scheme was subject to a re-investigation by POL and independent review by Second Sight, after which the case could proceed to mediation overseen by an independent mediator. Mediation is voluntary and requires the consent of both parties. It is not a compensation scheme, although an outcome of mediation could be for POL to offer some compensation.

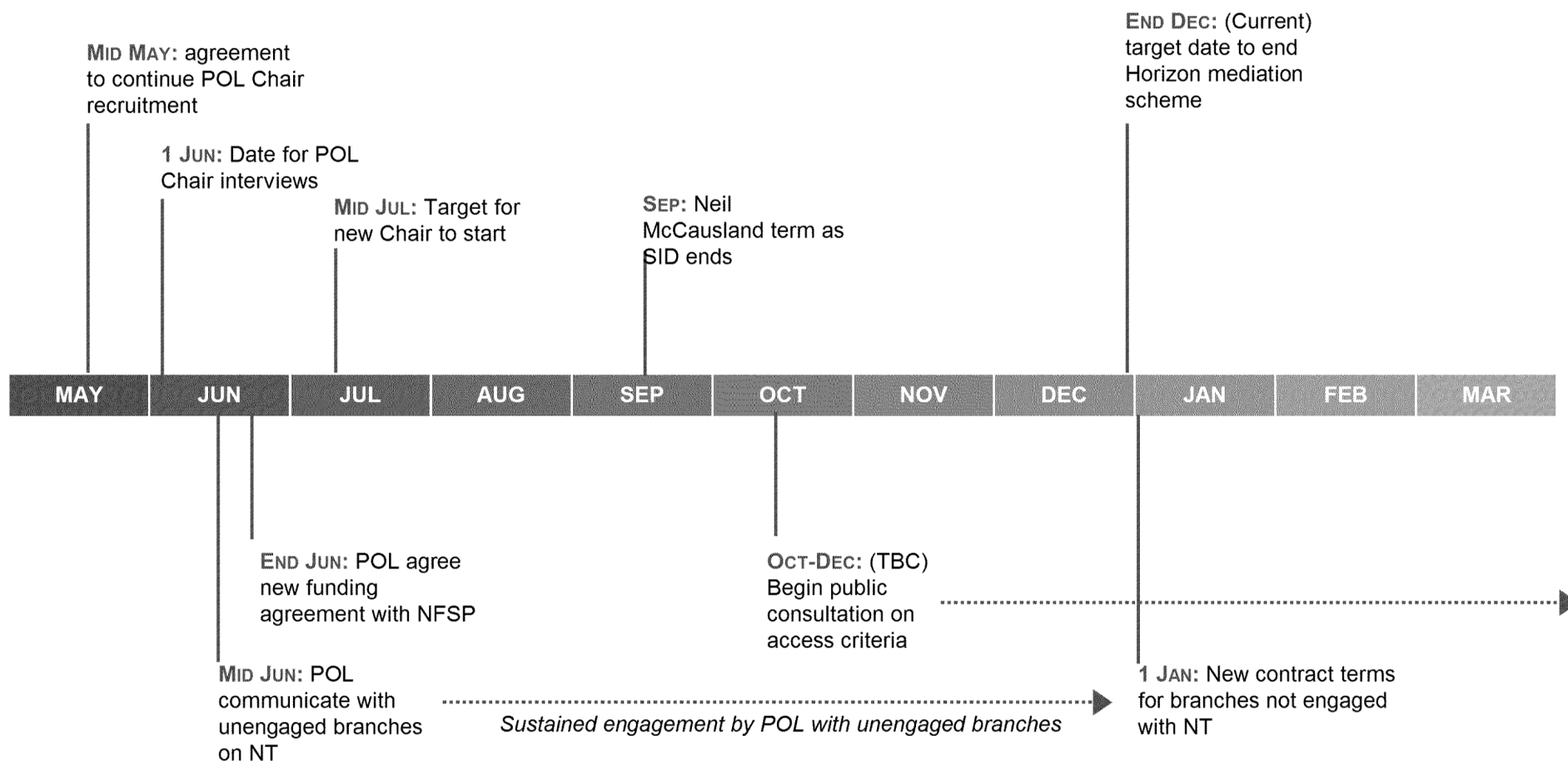
Individuals who had criminal convictions (usually for theft or false accounting) were eligible for the scheme, but on the basis that mediation cannot overturn a Court judgment. POL consider whether to mediate these applications on a case-by-case basis. Any individual who feels their conviction is unsafe can pursue legal avenues, regardless of whether they enter into mediation.

POL hopes to complete mediation on all remaining cases by the end of 2015. However JFSA are attempting to delay any future mediations and are campaigning for a new independent scheme. We will provide separate advice on this.

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TIMELINE TO MARCH 2016 (KEY DATES)



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Annexes

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Upcoming submissions

- w/c 1 June** Further advice on Network Transformation and next steps
Further advice on Horizon mediation scheme and plans for BBC Panorama programme
- c. 5 June** Advice on appointable candidates for Post Office Chair role (decision required by mid June)
- Mid June** Advice on POL's 2014-15 financial performance and publication of annual report & accounts
Agreeing remuneration for appointment of new NED and new SID, and for CEO and CFO
- Late June** Advice on future network policy and consultation on access criteria

Key meetings (all TBC)

- Mid June** Introductory meeting with Paula Vennells, CEO
Meeting with Alice Perkins, outgoing Chair
Meetings with appointable Chair candidates
Attend POL Board awayday on 17 June
- June/July** Meet George Thomson, Chair of National Federation of Subpostmasters
- Early July** POL event for Parliamentarians – you may like to drop in

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Post Office operating models

| Model Name | Number* | Overview |
|---------------|---------------|--|
| Crown | 295 | Branches owned and operated by POL, typically located in city centres. These are mostly the largest and highest volume branches in the network and offer the widest range of services. They account for only c.3% of branch numbers but represent c.16% of revenue. |
| Main | 2,163 | A high-volume model designed as part of NT that offers customers an effectively complete range of post office services. A majority of these are standalone although some are co-located with a retail business. In converting from a Traditional Branch these post offices benefit from investment that refreshes branch environments and extends opening hours. Main Model Agency Branches do not receive fixed remuneration – all payments for post office services are linked to transaction volumes. |
| Local | 1,851 | A lower-volume model co-located with a retail business designed as part of NT that offers customers an extensive range of post office services. In converting from a Traditional Branch these post offices benefit from investment that refreshes branch environments and extends opening hours. Co-location of the retail till also frees up space for retail use, and frees up employee time which delivers efficiency and cost-savings for subpostmasters. Local Model Agency Branches do not receive fixed remuneration – all payments for post office services are linked to transaction volumes. |
| Traditional** | 4254 | Traditional post offices that are capable of converting to be a Main or Local, or which exist in a community with suitable premises that could host such a Branch (e.g. an existing post office might convert “offsite” by closing and being replaced by a Main or Local Model Agency Branch in a new location). Traditional branches are often underinvested, operate short opening hours, use “fortress” positions not aligned to modern retail markets and receive some fixed remuneration. |
| Community | 2,072 | A branch that cannot convert to a Main or Local due to it being unviable as one of these models, or due to the lack of alternative hosts nearby (e.g. “last shops”). These maintain current pay structures but can access the £20 million Community Branch Fund which allows them to invest in their branch. |
| Outreach | 1,049 | Post offices operating in shared premises (e.g. a community centre for a scheduled amount of time each week) or mobile from secured vehicles (e.g. with scheduled routes). These are also considered to be “Community” branches and can access the £20 million Community Branch Fund. |
| Total | 11,684 | |

*Numbers correct as of 21 May 2015

**Includes branches signed to convert to Main or Local (454 and 476 respectively)

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NETWORK TRANSFORMATION

NT allows POL to improve the operating efficiency of its network, reducing and making costs more flexible while at the same time also aligning the interests of subpostmasters to the overall business

It also brings considerable benefits to customers and operators – both groups have welcomed the changes NT brings and satisfaction ratings are high – and the taxpayer, through reduced subsidy.

NT is a combination of:

PHYSICAL CHANGES: Modernising and investing in the branch environment to make it brighter and more welcoming, and extending opening hours. This includes reducing the number of “fortress” style counters in favour of open plan positions in Mains, and in Locals allowing the post office till to be co-located with the retail till (in the process this frees up space previously used for the “fortress”).

CONTRACTUAL CHANGES Variablising remuneration structures and linking them to transaction volumes; this aligns subpostmasters interests with those of POL (i.e. subpostmasters are better incentivised to sell more effectively). The change involves removing the fixed element of subpostmaster pay worth about £10k p.a. (known as the “Core Tier Payment” or CTP).

Under NT there are three Post Office models:

MAIN

High-volume branches that offer customers an effectively complete range of post office services. The majority of these are standalone businesses although some are co-located within a retail business.

LOCAL

Lower volume branches, usually located within a retail business that offers customers an extensive range of post office services (97% of services by volume).

COMMUNITY

Branches which are the last shop in a community but would be unviable as a Local or Main. 95% of these branches are in rural areas. These, together with Outreach branches, continue to receive a fixed payment and are eligible for a dedicated £20m investment fund.

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Board & Management profiles

GRO

Alice Perkins, Chair

Alice steps down from the Chair role in July, which she has held since 2012. She is a former Civil Service group HR director, and formerly on Boards of Littlewoods, BAA and TNS. Alice is also currently a NED on the BBC Executive Board.

Alasdair Marnoch, NED

Alasdair is currently CFO of CPA Global (software company), and former CFO of Equiniti Group. He has recently renewed his term for three years to May 2018.

Paula Vennells, Chief Executive Officer

Paula became Chief Executive in 2012 having been the managing director of the network prior to that point. Her previous roles include commercial director at Whitbread plc and has worked at other major retailers including Argos and Dixons.

GRO

Neil McCausland, SID

Neil steps down as SID when his term ends in September 2015. Neil holds a number of senior Board appointments including Chair of Snow & Rock and Skin. He is also a former Chair of footwear company Kurt Geiger.

Tim Franklin, NED

Tim is a former Chief Operating Officer of Co-operative Banking Group, Managing Director of savings at Barclays, and NED of Link Cash. He is mid-way through his current term as NED, ending September 2016.

GRO

Virginia Holmes, NED

Virginia is currently Chair of the USS pensions scheme, and on the Board of Standard Life and the Alberta Investment Management Corp. She has recently renewed her term for three years to April 2018.

Richard Callard, NED

Richard is the head of the Post Office team in the Shareholder Executive and is the ShEx representative on the Board. He previously worked at Deloitte before joining BIS.

Al Cameron, Chief Financial Officer

Appointed in January of this year, Al had a number of roles at Centrica plc, including finance director of British Gas. He was brought in for his experience of turning around businesses that required significant cost reductions in a regulated customer oriented environment. He has made a strong initial impact but it is too early to judge his likely longer term performance at this stage.

GRO

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Remuneration

Remuneration of the Executive members of the Board must be approved by the Secretary of State and the Chief Secretary to the Treasury each year. This involves approval of their base pay and bonus arrangements. The Remuneration Committee of POL (RemCo) present their proposals to the Shareholder each year to seek approval.

The packages for Paula and Al are noted below, but it is worth noting that remuneration has tended to be a sensitive topic for ministers and the Board alike:

- The Board, via the RemCo, seek to motivate, attract and retain talent through offering sufficient pay packages to the executives, balanced against pay restraint required by the public sector.
- Paula's base salary has not increased for four years, and benchmarking would suggest that her remuneration is significantly behind that of a similarly sized commercial company. Furthermore, salaries of other members of the executive team (below Board level) have increased and the gap between them and Paula has become much smaller.
- Nevertheless, Paula's pay (and Al's) are high compared to most public sector levels, and the shareholder team continues to try and balance these competing tensions.

Details of Paula and Al's pay are as follows, reflecting the outturns for the respective years. **Note that 2014-15 figures are not yet public**

| Paula Vennells | 2013-14 | 2014-15 |
|----------------------------|--------------|--------------|
| Base Pay | £250k | £250k |
| Other benefits | £71k | £71k |
| Short Term Incentive Plan* | £76k | £88k |
| Long Term Incentive Plan** | £145k | £112k |
| Total for year | £543k | £521k |
| For info, 12/13 | £697k | |

| Al Cameron*** | 2014-15 (actual) | 2014-15 (full year equivalent) |
|----------------------------|---------------------|--------------------------------------|
| Base Pay | £60k | £240k |
| Other benefits | £18k | £70k |
| Short Term Incentive Plan* | £15k | £96k |
| Long Term Incentive Plan** | n/a | £120k |
| Total for year | £93k | £525k |

* Targets for the STIP are based on metrics such as revenues, profits, customer satisfaction, network transformation etc.

** The LTIP target is based on maintaining a minimum level of branches and achieving profit targets

*** Al joined POL in January, so the outturn reflects a pro-rated year. The exiting CFO's remuneration will also be reported in the forthcoming annual report

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Legal Structure

POL is 100% owned by Government, via a holding company that also owns the remaining stake in Royal Mail

The two shareholdings are entirely separate; there are legal and financial implications if attempts are made to use one to influence the other

POL is subject to Companies Act provisions, competition law, and European framework (i.e. State Aid)

OVERVIEW

POL separated from Royal Mail in 2012 prior to the sale of Royal Mail shares. It is now 100% directly owned by Government through POSH

- Set up to hold Government's stake in Royal Mail and its shareholding in POL
- POSH Board is made up of 3 directors (2x ShEx and 1x Other BIS)

Through POSH Government holds a special share in POL

- Gives a range of rights including approving appointment of directors and directors' remuneration
- Other rights relate to matters such as sale of assets, changes to strategy, changes to governance structures, etc.

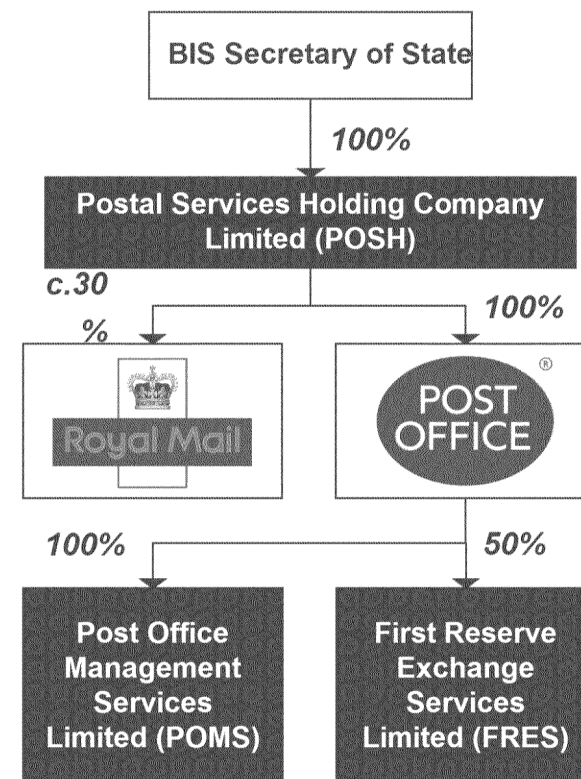
POL's regulated insurance business is run through a subsidiary called POMS

- Restructured in 2015 to allow POL to transform its insurance activities

POL also owns a 50% stake in FRES

- Joint venture with Bank of Ireland, supplying POL's bureau de change business with currency

STRUCTURE



Note: FCA regulated subsidiary that operates POL's insurance business

Note: Joint venture with Bank of Ireland. Supplies POL's foreign exchange business with currency

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Recent Developments / Live Issues – Mails and Retail

Royal Mail relationship

- POL's contract with RM was signed in 2012 before the separation of the two businesses. It is a commercial agreement agreed on an arms-length basis and, with a 10-year duration, was the longest permitted by the European Commission at the time.
- Government was not involved in the discussions and has also not sought to influence this relationship. Any such action would have significant legal and financial implications for POL and RM.
- The contract has a "renegotiation event" scheduled for 2017 when the contract can be revised, but POL is considering opening discussions with RM sooner. Formal dialogue may commence during 2015.
- POL is keen to realign certain aspects of the relationship as in recent months tensions have emerged (e.g. around POL's plans to grow its network and in relation to product structuring, pricing and new launches (e.g. Click and Collect)).

Competition

- With the letters market in structural decline POL and RM see the opportunity in parcels as the biggest source of retail Mails growth. However in recent years a number of competitors have emerged, placing pressures on both parties
- Many grocery stores now work with competing parcel delivery providers (e.g. Collect+, MyHermes) while other areas of the market are innovating fast (e.g. Amazon Logistics, retailers' Click and Collect, same-day delivery, etc.). There are now more pick-up/drop-off points for parcels (i.e. rival services) than there are Post Office branches
- The impact of increased competition is being compounded by the fact that expected growth in the parcels market has not materialised. It is also not clear whether POL and RM are offering the right product set (e.g. simplicity and price)

Mails Strategy

- Historically POL has not taken a strategic approach to its Mails business, instead seeing itself as a supplier to RM
- This has negatively impacted POL in recent years as RM's strategy has been exposed to unexpected changes in the market. In response POL is now taking action to develop its own Mails plan
- The early work coming out of POL's strengthened Mails team is encouraging and the outputs of this work are expected to feed into POL's broader strategic refresh which will be presented to Government in mid-2015
- This is focused on optimising POL's position in the market and it could look at some radical options (e.g. looking at ways POL could move away from its exclusive relationship with RM in some segments of the market)

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Recent Developments / Live Issues – Financial Services

Bank of Ireland (BoI) relationship

- The majority of POL's own-branded financial services are provided in conjunction with BoI. POL provides exclusive access to its retail network and customers, while BoI brings balance sheet capacity and product / technical support. The relationship has historically worked well and financial services has been a key growth area for POL.
- In recent months tensions have emerged (e.g. in respect of current accounts, mortgages and savings and investments) and discussions to address these issues are ongoing. It is important that progress can be made so that POL can deliver planned income growth (e.g. new product launches) and meet its financial targets.
- POL expects BoI will want some clarity for the period after 2023 when the current contract ends and are considering handling.

National Savings & Investment (NS&I)

- POL and NS&I have a long standing relationship although in recent years a number of NS&I products have been withdrawn from post offices. Today only Premium Bonds are available across post office counters.
- This is an important contract: it generates revenue of c.£8m a year for POL and it is a key footfall driver for a large number of branches.
- POL's existing contract expires in August/September 2015 and if an extension can not be arranged, then in line with its contract, POL will serve notice to NS&I in June.
- For legal reasons it is likely to be difficult for NS&I to simply extend its contract with POL. NS&I are currently advising HMT Ministers on future options. ShEx believe that they favour ending the contract but are aware of the presentational issues this would cause – we are staying close to the situation.

Counter services

- Today 98% personal current account customers and a large number of SMEs can make withdrawals and deposits at post offices and check their balances, albeit not in a consistent manner (e.g. the way to deposit differs between banks). Most recently, Santander agreed to make this service available to its current account customers.
- Since December 2014 POL has been working with the high-street banks and the BBA to launch a standardised offer that would make a consistent service available to all personal and SME customers. The challenge for POL will be to ensure the agreement works for them commercially.
- After a good start progress has slowed recently. Despite this POL remains hopeful of successfully taking the opportunity forward, in particular as it would be a welcome revenue upside for the business.

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Recent Developments / Live Issues – Govt services

Front Office Counter Services (FOCS)

- In 2012 POL won a tender for the FOCS contract, which is an exclusive framework enabling Departments to contract with POL without running separate time consuming and costly procurements. Contracts under FOCS have a duration of 7-years, with the option for a 2 year extension. This means that call-offs from FOCS can be made at any time during the life of the underlying contract for 7 years (plus the extension).
- FOCS was expected to unlock a number of new Government Services opportunities but since 2012 only existing contracts have moved to this framework (e.g. DVLA, POca and Passport Check and Send).
- Few new opportunities have emerged despite considerable work to improve Whitehall's knowledge and understanding of this opportunity, and to find ways to align the interests of FOCS with the Government Digital Service.

Digital

- Over recent years the Digital by Default agenda has been implemented across Whitehall, reflecting a growing preference by the public to interact with Government online, and as a means to reduce admin costs.
- Led by the Government Digital Service (GDS), key Government services and transactions have moved online and been adapted for the digital journey.
- However, the Digital by Default agenda conflicts directly with the ambition to make Post Office a front office for Government. Departments hosting online services have to consider the value for money case for offering non-digital offerings (e.g. post, phone, or counter services). With volumes both uncertain and diminishing, Government Services contracts are less profitable and appealing for POL.
- There have been instances where GDS has appeared to block Departments taking forward services with POL, although there are some new opportunities too (see right).

New opportunities

- POL has faced considerable disappointment in its efforts to grow Government Services in recent years as significant revenue opportunities have been deferred or have failed to materialise, and as such, POL exercise a degree of caution in respect of the opportunities below.
- Passport Applications: POL is working with the Home Office on the possible launch of a POL digital passport applications service, with potential launch in November 2015 to coincide with HMPO's digital journey public beta.
- Assisted Digital: POL is an obvious candidate to provide AD services (for those who can't or won't use digital channels), but POL will need to be certain on future volumes and revenues to invest in both kit and training
- Identity Assurance: POL launched its IdA product on the Government Verify service in pilot phrase in April and is currently gaining around 60% of that market. Progress has been slow to date but volumes are now well above expectations – the challenge will be to sustain this and innovate further.

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Recent Developments / Live Issues – Telephony / other

Strategic Review

- In response to significant recent changes in the UK telecoms market, in the last few months POL has initiated a review of its telephony business.
- POL needs a clear long-term strategy and business case to justify investment in mobile and high-speed internet, and it also needs a plan on how it can win customers in an intensely competitive environment.
- One option POL has considered, on a very preliminary basis, is a sale of its customer base or a combination of its telephony business with one of its peers.
- It is important to note that shareholder approval will be required before any process can formally commence and before any transaction can take place.

Home Services

- When POL developed its overall strategy in 2013 it proposed setting up a Home Services business, starting with the launch of a POL branded energy supply activity.
- Given the reputational damage experienced by many energy suppliers in recent years it was thought that this would be an attractive opportunity for POL (e.g. the right product would be aligned to POL's trusted brand).
- However given POL's focus on delivering the core of its strategy and due to changes in the regulatory and competitive environment that make a launch more complex, POL has currently put this on-hold.
- While it remains a possible area for future expansion, POL is not expected to take action in the near-term.

Cash distribution

- POL's supply chain activity is high cost, highly unionised and lacks the innovation of its peers.
- While POL is taking some actions to reduce costs (e.g. redundancies, new vehicles, etc.) it is also looking at ways in which it can reposition the business (e.g. simplifying products, changing the way branches demand and manage cash).
- Changes must be managed carefully. Anything that risks branches' access to cash has significant reputational and operational implications (e.g. for POL and Government, and for vulnerable customers unable to access benefits).

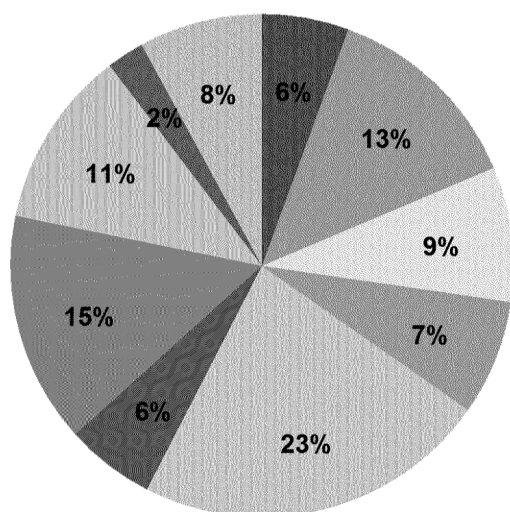
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Business Overview – Revenue Split

MAILS AND RETAIL (£m)

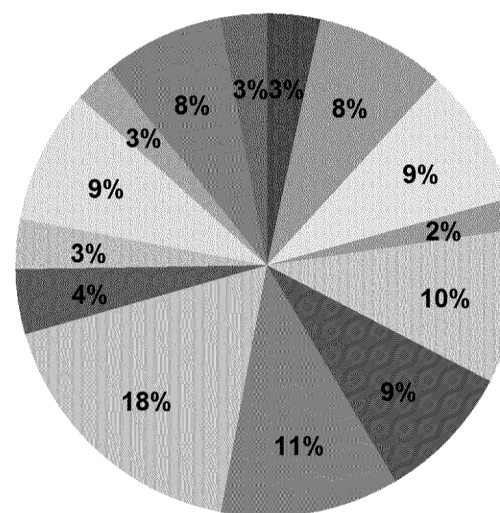
Total 2014/15 Revenue: £383.5m



- Parcelforce
- International Priority & Standard
- Labels (1st & 2nd Class)
- RM Mail Fixed
- Home Shopping Returns
- Special Delivery
- Stamps (1st & 2nd Class)
- RM Signed For
- Retail & Lottery
- Mails Other

FINANCIAL SERVICES (£m)

Total 2014/15 Revenue: £289.3m



- Bill Payment Services Direct
- Postal Orders
- Personal Banking Clients
- Business Banking
- PFS-Savings
- PFS-Lending
- Travel Insurance
- NS&I
- Bill Payment Services Reseller
- Payment Services
- DWP Exceptions
- ATM
- PFS-Insurance
- Bureau
- MoneyGram
- Other

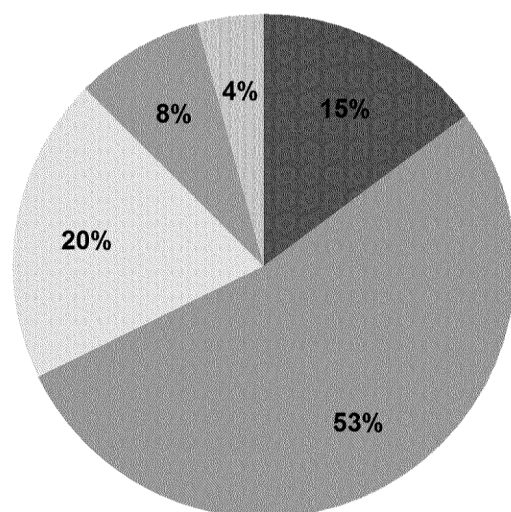
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Business Overview – Revenue Split (cont.)

GOVERNMENT SERVICES (£m)

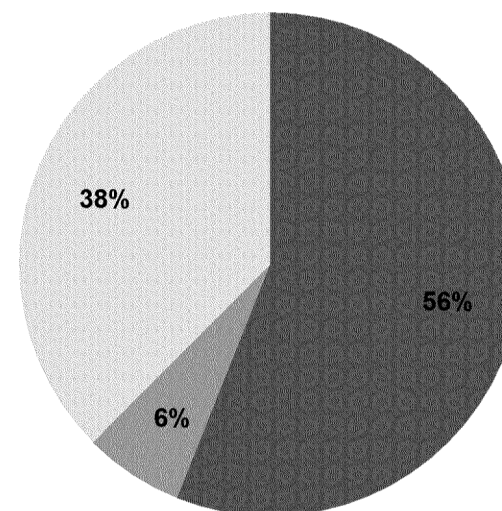
Total 2014/15 Revenue: £113.0m



- Motoring Services
- Card Account
- Check and Send
- AEI (DVLA & UKBA)
- Other

TELEPHONY AND OTHER (£m)

Total 2014/15 Revenue: £84.2m



- Telephony
- Supply Chain
- Other