



UK Government
Investments

Post Office Ltd

Portfolio Summary

16 April 2019

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Overarching Questions for Portfolio Management

What difference does UKGI make?

Why is UKGI doing this?

Could the Department undertake the same role?

What learnings can be applied from UKGI's work on this company to others in the portfolio?



UK Government Investments

Matters arising from previous meeting (Oct 18) [to be updated by Tom A]:

Provide the following written or verbal updates at the next meeting:

1. Updated Chair letter to be sent out in early 2019	Letter was sent in early January and the Perm Sec has met the Chair
2. Team to consider Tom Cooper sitting on NomCo	Tom has recently been appointed to RemCo and will keep NomCo aside for now. Additionally, Tom is on the recruitment panel for the new CEO alongside other NEDs.
3. Re-appointments of 2 NEDs whose terms expire in February 2019 (includes the SID)	These re-appointments were approved by Ministers in December 2018, with an extra 3 year term on the same pay
4. Team to look into the possibility of running an external audit on 19/20 budget	Still being discussed within the team. The CFOO has not provided a draft budget yet so the comfort over it is unclear.
5. Alex Chisholm to meet with SID to discuss findings of the Chair review (i.e.. Annual appraisal of the chair)	Chair's term runs to October, so will start engagement with SID in July 2019
6. Tim Parker to meet with Mark Russell & Tom Cooper	No plans to do this separately. The Chair will meet the Perm Sec to discuss the Chair's letter and we are instigating regular shareholder meetings between the CEO/Chair and UKGI/BEIS.

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Asset Summary

Asset's strategic objectives	<ul style="list-style-type: none"> • Post Office Ltd (POL) must provide postal and other services at a minimum of 11,500 branches and the network must meet stringent geographical access criteria. • POL also competes on a commercial basis in financial services, insurance and telecoms. • HMG and POL agreed a three year strategy to April 2021 that provides for £160m of subsidy (£60m/£50m/£50m) and £210m of investment funding (split between 18/19 and 19/20). • Aim for full financial sustainability without need for HMG subsidy, from the early 2020s.
Key risks / contextual factors which may impact strategic objectives	<ul style="list-style-type: none"> • Resignation of CEO provides uncertainty and concerns over management effectiveness • Long run decline in some core products (mails and government services) • Defending a series of litigation trials which started in November 2018, which may have consequences for its operational model (as well as to finances and reputation) • Major change programme, including IT upgrades • Renegotiating core third party contracts (in particular with Royal Mail and Bank of Ireland) • Inability to access external finance means must agree viable financial settlement in the 2019 SR
What levers does UKGI have?	<ul style="list-style-type: none"> • POL is a public corporation, with an independent fiduciary Board • BEIS SOS is 100% shareholder and UKGI acts as representative, with a NED on the board and RemCo • Approval of Board appointments and remuneration, and transactions above £50m • Approval of investment funding on a quarterly basis and the annual strategic plan • Regular shareholder meetings with Chair and CEO to begin in Spring 2019
What are UKGI's overarching objectives?	<ul style="list-style-type: none"> • Monitor POL's operational and financial performance against its agreed commitments and goals • Provide constructive challenge on POL's strategic decisions • Actively review the Board's governance, performance and decision-making, ensuring that it complies with relevant codes and government requirements • Connect POL and Government, including encouraging opportunities of mutual interest
Timeframe	<ul style="list-style-type: none"> • Ongoing
UKGI resource and skills required	<ul style="list-style-type: none"> • 1 Director (30% time allocation), 1 Exec Director (80%), 2 Managers (50% + 50%) and 1 HEO (80%).

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UKGI Quarterly Priorities (Q1 and Q2)

	Q1 (April – June)	Q1 Progress Report	Q2 (July – Sept)	Q2 Progress Report
UKGI's quarterly priorities	<ul style="list-style-type: none"> • Agree information sharing protocol with POL ahead of hearings on the Horizon IT litigation case • Agree Framework Agreement between UKGI and POL • Agree transfer of responsibilities from UKGI to BEIS • Advise POL on acquisition of Payzone and negotiations with BOI • Secure £50m intra-day loan facility from BEIS • Ensure network commitments are met • Finalise arrangements for financial reporting and release of funding 	<ul style="list-style-type: none"> • Legal protocol agreed with POL • Framework agreement mostly agreed with BEIS • Loan facility agreed with BEIS and HMT • In principle agreement for transfer to BEIS • Acquisition of Payzone finalised • HMT agreement for £50m facility (Q2) 	<ul style="list-style-type: none"> • Monitor and challenge on prep for litigation case • Monitor / challenge preparations for negotiations with BOI including potential buyout of JV • Finalise handover of policy role to BEIS • Agree framework document with HMT/POL • CST sign off for CEO and CFO remuneration 	<ul style="list-style-type: none"> • POL meeting Minister on the litigation case (Q3) • Met with POL and advisers on BOI and negotiations are ongoing • Handover to BEIS completed • Framework document sent to POL and HMT • 2017/18 pay approved by CST
How will these be achieved/monitored?	<ul style="list-style-type: none"> • Generally the above rely on the team working with POL, BEIS, and HMT, facilitated by our seat on the Board. <p>Specifically:</p> <ul style="list-style-type: none"> • Work closely with UKGI and BEIS legal teams on developing legal protocol • Meeting with Perm Sec and BEIS officials to agree transfer of policy role • Work with POL and advisers Fenchurch on BOI and use Board sub-committee to finalise Payzone • Quarterly network meetings 		<ul style="list-style-type: none"> • Brief Perm Sec and minister on litigation • Invest time in developing relationship with BEIS policy team and achieving clarity of roles • Review Board papers to prepare NED for meetings 	

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UKGI Quarterly Priorities (Q3 and Q4)

	Q3 (Oct – Dec)	Q3 Progress	Q4 (Jan – March)	Q4 Progress
UKGI's quarterly priorities	<ul style="list-style-type: none"> Preparation for upcoming litigation case: informing ministers, comms strategy and preparing for settlement Scrutinise POL's reforecast of investment spending and review of financial controls Advise POL on negotiations on Banking Framework and Bank of Ireland Review / approve Q3 funding request Clarify shareholder team's mission Agree framework document with HMT / POL Agree audit process for POL's SGEI services Develop 'cabinet paper' with POL and BEIS Advise on potential insurance acquisition Review POL's proposed corporate restructure Agree Board Effectiveness Review Approve NED reappointments 	<ul style="list-style-type: none"> Minister and Perm Sec kept updated during first trial (judgment expected in January). HMT briefed and settlement discussed New reporting packs being developed, Q3 funding released BOI negotiations are continuing. POL have submitted BF terms and banks have until March 2019 to respond Q3 funding approved Draft team mission prepared FD agreed with HMT and POL have begun to engage on it and the Articles Audit process for SGEIs agreed Cabinet paper' reworked as ministerial letter to support banking negotiations Insurance acquisition on hold BEIS lawyers and UKGI working with POL on legal entity restructure Board Effectiveness review commissioned 2 NEDs reappointed in Dec 18 	<ul style="list-style-type: none"> CEO exit terms agreed and CEO recruitment process underway Deal with outcome of first trial, including appeal and settlement Agree POL annual plan/budget Back Office Transformation (IT migration) – Jan 19 Review / approve Q4 funding Reprioritisation process complete and improved investment reporting agreed Post Implementation Review of Network Transformation prog Chair letter issued and establish Shareholder meetings Support on RM/BOI negotiations Framework Doc, Articles and corporate restructuring Approval for CFO pay for 18/19 Discuss employee engagement on POL board Start NED recruitment process 	<ul style="list-style-type: none"> CEO exit terms have been approved CEO recruitment process is underway Back office transformation successfully completed Draft PIR complete Chair letter issued, first shareholder meeting held NED recruitment process underway SID has been elected as worker representative under FRC Code
How will these be achieved/ monitored ?	<ul style="list-style-type: none"> Close & constructive working with POL, BEIS, and HMT. Specifically: UKGI legal team to lead development of settlement preparations Meet with POL and advisers on Banking Framework and Bank of Ireland Active engagement with POL finance and change teams on reforecast Quarterly network meetings Reviewing of board papers before Board 		<ul style="list-style-type: none"> Engage CFO on annual budget in advance of March Board Agree pay issues with HMT Specialist legal advise on Corporate restructuring, and make approval conditional on new Framework doc Sub for minister before Back Office transformation 'go-live' Liaise with BEIS, HMT, POL on settlement/appeal. Monitoring litigation 	

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UKGI Quarterly Priorities – year ahead

	Q1 (April – June 19)	Q1 Progress	Q2 (July – Sept 19)	Q2 Progress
UKGI's quarterly priorities	<ul style="list-style-type: none"> Interim CEO in place, and a new CEO to be appointed by end of Q1 Final tranche of investment funding to be released Spending review preparations to get underway Complete Bank of Ireland and Royal Mail negotiations Ministerial approval of Framework Doc, Articles and corporate restructuring Continued oversight of litigation New retail strategy to be agreed, including proposals for Agent Pay Banking Framework 2 to be finalised Plan in place for POCA transition Agree process for CEO appraisal 	<ul style="list-style-type: none"> Al Cameron has been appointed as interim CEO, POL has extended an offer of appointment to an interim CFO. Remuneration package for new CEO has been approved by the CST and Minister. £50 million loan facility approved 	<ul style="list-style-type: none"> New CEO to take office Annual report approved and laid in parliament Network report laid in parliament SR settlement agreed, including dividend policy, funding and subsidy Continued oversight of litigation Review of strategy in Insurance and Telco CST sign off for CEO and CFOO pay (FY 19/20) New NED appointed and in office Finalise protocol between UKGI and BEIS setting out respective roles 	
How will these be achieved/monitored?	<ul style="list-style-type: none"> UKGI Director to participate in CEO recruitment panel Active engagement with POL finance and change teams Close relationship with BEIS finance, who lead on SR negotiations Act as a critical friend in the negotiations and on strategy UKGI legal team to lead on litigation Quarterly network meetings Shareholder meeting with Chair and CEO Fortnightly meeting with CFOO 		<ul style="list-style-type: none"> Active engagement with POL finance and change teams Close relationship with BEIS finance, who lead on SR negotiations Act as a critical friend in the negotiations and on strategy UKGI legal team to lead on litigation Quarterly network meetings Every other week meeting with CFOO On appointments working closely with BEIS, HMT and POL Board Secretariat 	

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UKGI Quarterly Priorities – year ahead

	Q3 (Oct – Dec 19)	Q3 Progress Report	Q4 (Jan - Mar 20)	Q4 Progress Report
UKGI's quarterly priorities	<ul style="list-style-type: none"> • Continue to liaise on litigation • Annual appraisal of Chair • Succession planning for rest of Board • Shareholder Meeting 		<ul style="list-style-type: none"> • Continue to liaise on litigation • Board effectiveness review and Chair letter to be completed 	
How will these be achieved/ monitored?	<ul style="list-style-type: none"> • Active engagement with POL finance and change teams • Quarterly network meetings • Every other week meeting with CFOO • Shareholder meeting with Chair and CEO • Act as a critical friend on strategy • UKGI legal team to lead on litigation 		<ul style="list-style-type: none"> • Active engagement with POL finance and change teams • Quarterly network meetings • Every other week meeting with CFOO • Act as a critical friend on strategy • UKGI legal team to lead on litigation 	

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Threshold requirements, company culture and board appointments

	All quarters
Threshold reqs. (What MUST be in place)	<ul style="list-style-type: none"> • Clarity on team's role, especially the degree to which it engages in POL's strategy and operations • Sufficient UKGI resource to match ambitions for team role. AD (Nick Parker) has left the POL team, and his activities have redistributed across the team • Open engagement from POL senior team • Strong relationship with BEIS sponsorship team, Ministers offices and HMT
Company culture/ people considerations	<p>We have a good relationship with the CEO, chair and NEDs, as well as most of our day to day POL contacts. However, POL can be protective about sharing information specifically in relation to</p> <ul style="list-style-type: none"> • Financial performance • Litigation case • Other legal matters including framework document <p>This appears to be partly a matter of personalities, and partly due to different understandings of UKGI's role. At times the team needs to have 'difficult conversations' with key stakeholders – we have identified this as an area for training & development</p>
Board composition and appointments	<ul style="list-style-type: none"> • CEO has resigned and so there is uncertainty over senior management. However, current CFOO Al Cameron has been appointed as interim CEO • 2 NEDs, including the SID, were reappointed for 3 years in December 2018 • We have concerns of over-stretch in POL's executive team, especially the combining in single roles of CFO and COO, and (separately) IT and Business Change • Board is very ambitious – there is a risk that this is beyond the capacity of the business, leading to over-stretch and lack of focus • Chair has agreed to annual appraisals of the Board and the SID will appraise the Chair







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Traffic Light Analysis (1)

	10/18	01/19	Current	Comments
Company Relationship ("C")				<ul style="list-style-type: none"> Relationship with POL is generally open and fairly collaborative but with room for improvement. Some key individuals are more challenging and we have had difficulty obtaining information relating to financial and legal matters, although this has been steadily improving.
Governance ("G")				<ul style="list-style-type: none"> POL has begun to engage with us on a framework document and has also created a draft set of new articles that are more fit for purpose to support its legal entity optimisation. However this process has stalled due to the litigation case. The key elements of the shareholder relationship are set out in POL's articles, a contractual funding agreement and the entrustment letter. A Chair letter has been sent to Tim Parker and the SID has agreed to an external Board effectiveness review. Formal financial meetings every month and quarterly reports on investment performance. Access to senior management and other relevant members is also good. Policy moved to BEIS in October 2018 and this has been a smooth transition for all.
Quality of Management Team & Board ("T")				<ul style="list-style-type: none"> The CEO has resigned and will leave the business in Spring 2019 and a search for her replacement is underway. Al Cameron has been appointed as interim CEO and a candidate has been identified to become interim CFO, POL is waiting for the candidate to accept the offer. The associated uncertainty of Al accepting the interim CEO position is that if he is not appointed as permanent CEO, he may consider leaving POL. Head of IT and Business Change has a wide and varied portfolio and we think there would be some benefit achieved in splitting the role. Board and exec team are generally of good quality and have overseen strong improvements at POL. Chair term is until 2022 and 2 strong NEDs have recently been renewed for 3 years. Annual Chair Appraisal to start in 2019. Board Effectiveness Review scheduled to complete in Jan 19. Previous reported in Jan 17 SID has been elected as worker representative under FRC Code
Departmental Relationship ("D")				<ul style="list-style-type: none"> Policy function has successfully been transferred to BEIS which will mean that POL will have direct policy sponsorship. UKGI also working closely with departmental ministerial by being on hand for meetings and providing a regular updates on POL to the Minister

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Traffic Light Analysis (2)

	06/18	10/18	Current	Comments
Financial Performance ("F")				<ul style="list-style-type: none"> POL's financial performance is much improved over the last five years. After a first profit in 16 years in FY 16/17, this increased to £35m in 17/18. POL is forecasting improved profitability over the next 3 years (c£60m in 18/19) but there are several downside risks which will require close onward monitoring (e.g. Royal Mail contract, Bank of Ireland renegotiation, digital identity). Better performance has partly been driven by significant cost reductions, although there is scope to do more and McKinsey is working on this. New technology provides capability for POL to considerably improve its Management Information. Amber rating is due to POL relying on government funding to subsidise uncommercial branches and for investment spending. POL is currently reforecasting its planned investment spend over the next three years, largely financed by HMG. We know that it has substantially over-spent on one IT project (Back Office Transformation), so will need to identify savings elsewhere.
Balance Sheet & Risk ("B")				<ul style="list-style-type: none"> POL has an adequate capital structure - £370m funding agreed to be provided by BEIS over the 3 year period to 2021, State Aid Approval obtained, and a £950m loan facility extended to March 2021. Treasury has also approved a £50m facility for emergency intra-day cash needs for POL's network. These all need to be reviewed as part of the 2019 Spending Review. POL face a series of litigation trials relating to its contracts with agents and the Horizon IT system. The magnitude of potential claims is still unknown but could be substantial. POL's auditors have agreed POL's accounting treatment of this, which is not to create a provision given the lack of claim details. POL is considering the buy-out of a JV with Bank of Ireland. At over £250m, this would require additional capital funding – we have begun to engage BEIS/HMT.

Asset

Priorities, quarterly objectives, risks and contextual factors

Assessment

Lead



Outlook – key issues/upcoming risks, including reputational:

The Company is waiting for the candidate to accept the offer of appointment.

On 15 March, judgment was handed down on the first “Common Issues” trial, finding that the contract between Post Office and its Postmasters is relational and, as a result, various terms must be implied into it. It is now POL’s responsibility to prove that there has been a loss in-branch caused by a postmaster and that POL has carried out a fair investigation, which presents significant operational challenges. POL will appeal this judgement (deadline 16 May) and may adjust its own legal strategy as a more positive outcome was expected.

POL's financial performance in 2018/19 was strong and initial forecasts suggest that trading profit will reach £60m, up from £35m in 2017/18 and well ahead of a target of £50m.

POL have requested more time to finalise their budget for 2019/20, to enable them to consider implications stemming from the litigation judgment

Re-negotiation of third party contracts (Royal Mail and Bank of Ireland) are commercially critical for PQI.

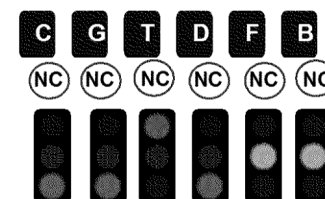
Renegotiation of the terms of the Banking Framework, whereby POL provides basic cash banking services on behalf of high street banks. Banks have been given the proposal which doubles the value to POL and had until March to opt-out. 3 major banks did not meet the deadline.

POL want to complete a corporate restructure to accommodate financial regulation

Post Office needs to meet its network commitment and we are agreeing a process for external validation of their service provision

Ramping up of the DMB franchising programme may cause some negative stakeholder interest.

Enhancements in governance: Chair has recently agreed to NED-only meetings, annual appraisals of directors, employee representation on the Board. Chair letter has been issued, with first shareholder meeting held. going forward there will be shareholder meetings held every 6 months.



Tom Cooper

BEIS

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Proposed discussion topics

1. CEO recruitment
2. Potential implications on the judgement handed down by Judge Fraser on the litigation – impact on POL/UKGI/BEIS.
3. Employee engagement. POL's board have proposed the SID as representing workers on the board, but no detail yet. Is there any learning from other UKGI assets?

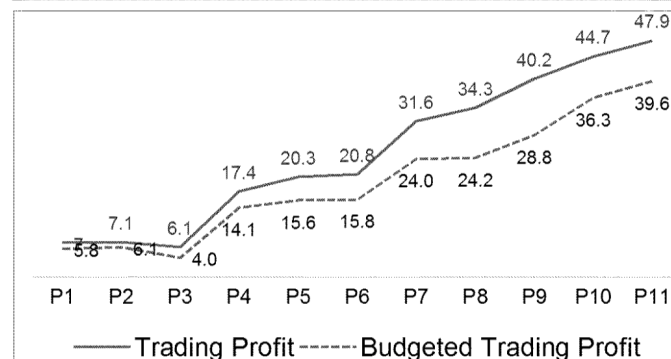
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Appendices

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2018/19 Financial Performance

£m	Year to Date (Apr 2018 - Feb 2019)			
	Actual	Budget	Variance	YoY
Retail	521.4	518.4	3.0	0%
FS&T	290.6	303.9	(13.3)	3%
Identity	50.8	43.8	7.0	6%
Other	12.0	13.2	(1.2)	-8%
Total Revenue	874.8	879.3	(4.5)	1%
Cost of Sales	(116.4)	(115.9)	(0.5)	4%
Net Income	758.4	763.4	(5.0)	1%
Agents Pay	(330.0)	(335.6)	5.6	-4%
Staff Costs	(174.5)	(166.4)	(8.1)	2%
Admin Expenses	(249.0)	(264.1)	15.1	-5%
FRES	30.9	31.1	(0.2)	-4%
Other Income	13.0	11.0	2.0	n/a
Trading Profit	48.8	39.4	9.4	277%



Retail

Mails is the main Retail revenue driver and is on budget, but in a declining market

However, there is a medium-term threat here as the Royal Mail contract is being renegotiated, with downward pressure likely to rise after recent RM profit warnings

Banking services are performing well due to bank branch closures increasing reliance on POL to plug the gap. A new Banking Framework has been designed to enable POL to capture more of the benefits it provides banks

FS&T

PO Money is above budget due to a minimum fixed fee on savings accounts being agreed with Bank of Ireland which is above the budgeted revenue

Travel Money is behind budget as the overall travel market is down due to a weaker pound and excellent UK weather prompting more domestic holidays

Total Telco volumes and revenue per customer are both behind budget. A November price hike didn't boost revenues. Furthermore, a historic accounting error regarding revenue accruals was corrected in 2017/18 but has led to a £5m overstatement in budgeted revenues for 2018/19.

Insurance has been underperforming, weighed down by the weak travel market and a recent 25% discount campaign that didn't have any material positive impact

Identity

POL's Verify offering has seen huge growth during the year, but Cabinet Office have unilaterally reduced rates effective from Q3 which will hurt short-term revenue

Rivals may quit the market, boosting POL's already dominant market. Developing a viable private sector offering is the main avenue for profitability and strategy work is ongoing

Costs

A reduction in agents pay has been driven by smaller Mails volumes

Admin expenses are beating the budget due to IT and property costs being lower

Unspent marketing budgets are another driver behind the savings as the spend was ineffectual

Overall

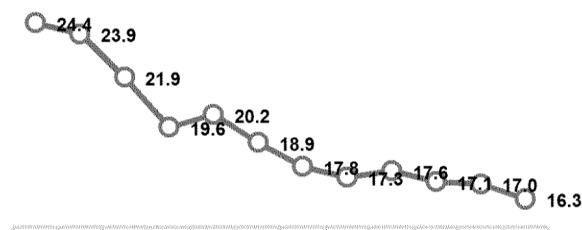
P12 is traditionally the month with highest profitability due to some revenue items being recognised annually, such as the BOI value share. POL remains on track to beat its £50m trading profit target for 2018/19 and is currently forecasting £67m. However, revenue is slightly behind target and so cost savings have been the driver for this performance

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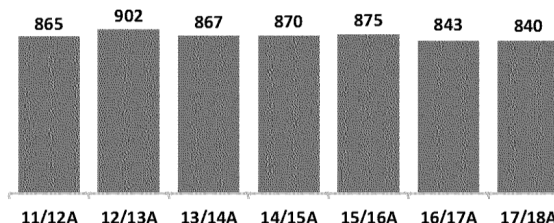
Context: changes since 2011/12

Since separating from Royal Mail POL has delivered progress in many areas of its business. With HMG support the network has been stabilised, pre-subsidy losses have been eradicated, and customers and operators have benefitted through network transformation

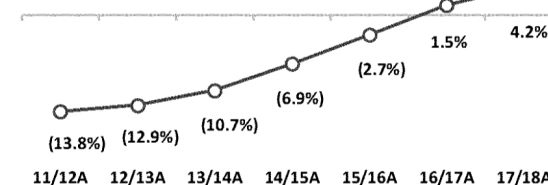
DOWNWARD TREND IN GOVERNMENT FUNDING
(£M TOTAL FUNDING PER YEAR)



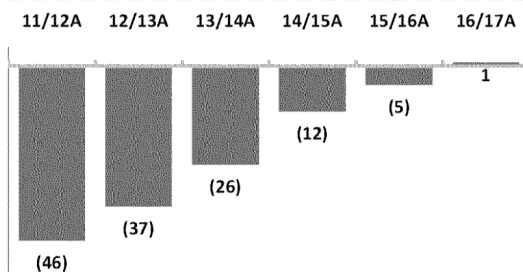
FLAT REVENUE IN COMPETITIVE OR DECLINING MARKETS
(£M GROUP NET REVENUE, POST-DIRECT COST OF SALES)



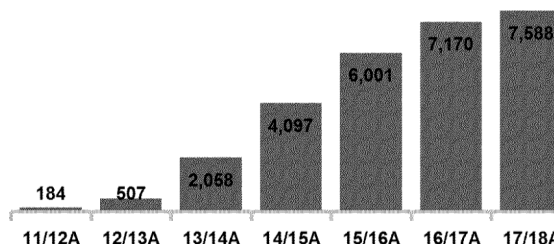
REDUCED COSTS DRIVING INCREASED PROFITABILITY
(EBITDA PRE-SUBSIDY % MARGIN, AND £M)



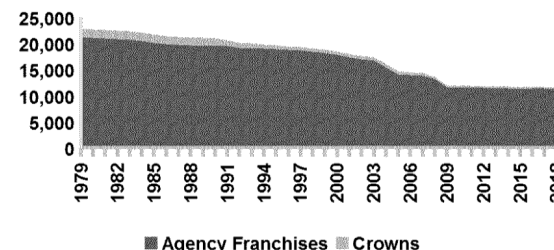
LOSSES IN THE CROWN NETWORK ELIMINATED
(£M EBITDAS)



STRONG PROGRESS IN NETWORK TRANSFORMATION
(NUMBER OF BRANCH MODERNISATIONS)



BRANCH NUMBERS ACROSS NETWORK
STATIC FOR FIRST TIME IN DECADES (# BRANCHES)

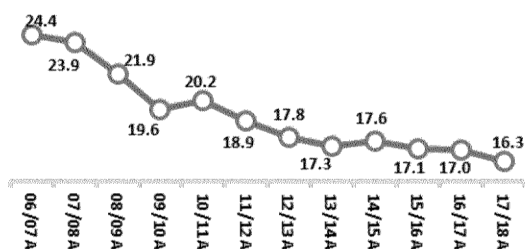


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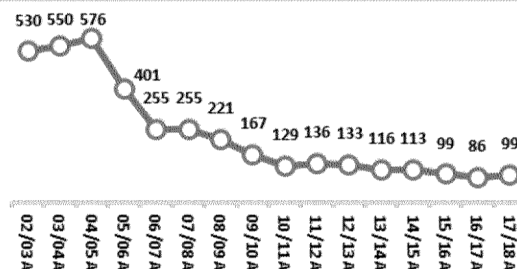
Context: challenges facing Post Office Limited

In recent years POL has had to confront declining customers, falling revenue in traditional markets and increasing competition. Recently a number of new internal challenges have also emerged, particularly around commercial contracts and POL's relationships with its subpostmasters

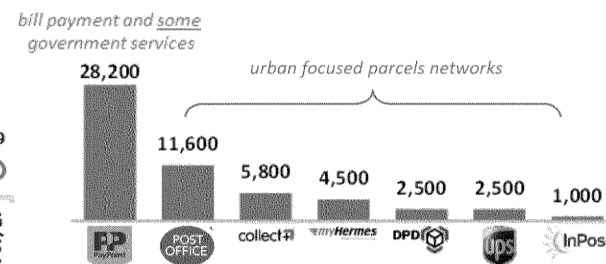
30% DECLINE IN NETWORK FOOTFALL SINCE 2006/7
(MILLIONS OF CUSTOMER SESSIONS)



80% DECLINE IN GOVT. SERVICES REVENUE SINCE 2002/03 (£M NET INCOME)



SIGNIFICANT EXPANSION OF COMPETITOR NETWORKS ERODING POL'S MARKET POSITION (# COMPETITOR OUTLETS)



POL NEEDS TO RENEGOTIATE AND REALIGN ITS LARGEST TWO COMMERCIAL RELATIONSHIPS



2016/17A Value
£337m revenue

POL's 2012 contract with RM did not envisage how mail or and parcel markets would develop (or RM's responses). An opportunity now exists to reset key aspects of the relationship



2017A Value: c.£70-90m revenue plus c.£35m FX profit share

POL plans to renegotiate its relationship with BoI to agree a shared strategy for savings and lending, to get freedom to work with other providers for certain products and to get a better share of profit in foreign exchange products

POL RELIES ON HIGH COST, POORLY SUPPORTED AND INFLEXIBLE IT WHICH OPERATES OUTSIDE OF THE BOARD'S RISK PARAMETERS



Point-of-sale system is >15 years old and POL's enterprise software is no longer supported. Front and back office outages are increasing, impacting the ability of branches to serve customers



Replacement printers are no longer available, meaning the existing estate must be cannibalised for spares to keep branches functioning



POL relies on dedicated datacentres which are more costly, less flexible and less secure than the cloud solutions used by competitors

SUBPOSTMASTER INCOME IS FALLING, INCREASING STRAIN ON LESS VIABLE BRANCHES (£M SUBPOSTMASTER COSTS)

