RMG00000342

Royal Mail Holdings plc
Annual Report and Financial Statements
2011-12

Royal Mail Group



RMG00000342

Annual Report and Financial Statements 2011-12

Contents

Overview	Who we are	01
	Where we want to be	04
	Financial and business performance highlights	05
	Chairman's statement	07
	Chief Executive Officer's review	09
Strategy	Our strategy Be brilliant at the basics Build a commercial future Drive profitable growth	12
	Key performance indicators	14
	Our strategy in action: parcels and marketing mail	16
Performance	Our customers	18
	Modernising Royal Mail	22
	Our people	25
	Regulation	28
	Our businesses UK Parcels, International & Letters (UKPIL) Post Office Limited General Logistics Systems (GLS)	31 32 34 36
	Financial performance overview	38
	Financial review	40
	Business risk	50
	Corporate responsibility	53
	Transparency	57
Governance	Our Board of Directors	60
	Directors' report	63
	Corporate Governance	64
	Directors' remuneration report	72
Financial statements	Consolidated income statement	83
	Consolidated statement of comprehensive income	84
	Consolidated statement of cash flows	85
	Consolidated balance sheet	86
	Consolidated statement of changes in equity	87
	Notes to the Consolidated financial statements	89
	Basis of preparation and significant accounting policies	133
	Group five year summary (Unaudited)	143
	Royal Mail Holdings plc – parent Company financial statements 2011-12	148
	Pro-forma 2011-12 financial statements for Royal Mail Group excluding Post Office Limited (unaudited)	155
Other information	Forward looking statements	162
	Corporate information	163

RMG00000342

Who we are

As the sole provider of the Universal Service in the UK, Royal Mail Group reaches everyone. We deliver six days a week, to over 29 million addresses across the UK, at affordable and competitive prices.

The Group is a key component of the UK's economic and social infrastructure, providing services to private individuals, companies and communities. In 2011-12, we employed nearly 159,000 people in the UK, contributing £5.3 billion to the economy in wages and other related people costs, and a further £2.4 billion buying goods and services.

We are proud to deliver the Universal Service. But, it does require a high fixed-cost network. Our strategy aims to tackle the key challenges facing Royal Mail Group to build a sustainable, diversified business, secure the future provision of the Universal Service and attract external capital.

The Postal Services Act 2011 has set out the steps the Group must take to secure external investment. We have made good progress restoring the Group to financial stability, obtained significant deregulation and secured European approval of the transfer of almost all of the Royal Mail Pension Plan's pension liabilities and pension assets to HM Government.

A great deal remains to be done to secure further profitable revenue growth and deliver the efficiencies required through the modernisation of our core network. This report explains how we will seek to do so.

Our modernisation programme – one of the largest ever undertaken in the UK – is about managing the structural decline in the traditional letters market by making our network more efficient and effective.

To succeed in one of the most liberalised and competitive markets in the EU, we are adapting our network, which has traditionally focused on delivering letters, to also accommodate ever increasing parcel volumes. This is a major strategic priority.

On 1 April 2012, Royal Mail Group Ltd separated from Post Office Limited. References to "Royal Mail Group" or "the Group" with respect to the financial year ending 25 March 2012 (including financial information) include Post Office Limited unless expressly stated.

In forward looking statements or comments, including those with regard to the business strategy, "Royal Mail Group" or "the Group" excludes Post Office Limited. See the diagrams on p3 for changes to the Group's structure.



Five year Group revenue (£m)

2012	2011	2010	2009	2008
9,532	9,156	9,349	9,560	9,388

Five year Group operating profit/(loss) after modernisation costs[1] (£m)

2012	2011	2010	2009	2008
211	39	180	122	(482)

Five year Group free cash inflow/(outflow) (£m)

2012	2011	2010	2009	2008
234	(213)	(545)	(678)	237

[1] Before other operating exceptional items.

RMG00000342

Who we are (continued)

Our parcels businesses now account for 48 per cent of Group revenue (excluding Post Office Limited). They contributed £4.2 billion of revenues to the Group in 2011-12, including £1.6 billion from our European logistics business, General Logistics Systems (GLS).

Despite increasing parcel volumes, the core UK parcels network is loss-making. We are taking steps to reduce these losses and make the network more efficient. At the same time, we are seeking to grow our profitable networks like Parcelforce Worldwide.

Royal Mail Group is building its marketing mail business, which delivers promotional direct marketing mail to UK homes and businesses, as well. It already accounts for more than £1 billion of our annual Group revenue. Working with a number of commercial partners, we will provide to businesses, large and small, a "one stop shop" covering creative development, production, distribution and customer data management for advertising mail. This strategy is in the early stages of its delivery as we seek to add value for our customers at each point in the value chain.

Our business is changing

We are embedding our strategy – and its delivery – across Royal Mail Group. Later in this document (p12), we set out the main elements of this strategy, the ways in which we will deliver it and the Key Performance Indicators (KPIs) we will use to track our progress.

Royal Mail has obtained significant deregulation. Last year, more than 80 per cent of our revenues were subject to direct price regulation. Following the announcement of Ofcom's new regulatory approach on 27 March 2012, direct price control now affects almost 10 per cent of Royal Mail's revenues.

Revenue by business and market (£m)

	Growth		Traditional			
Business segment/ product	Parcels	Marketing mail	Letters & other mail[2]	Counter services	Other services	Total
UK Parcels, International & Letters (UKPIL)	2,592	1,063	3,509	–	–	**7,164**
General Logistics Systems (GLS)	1,562	–	–	–	–	**1,562**
Post Office Limited	–	–	–	801	–	**801**
Other	–	–	–	–	5	**5**
	4,154	**1,063**	**3,509**	**801**	**5**	**9,532**

Percentage of revenue by market

	Group revenues	Group revenues (Excluding Post Office Limited)
Parcels	44 per cent	48 per cent
Letters & other mail[2]	37 per cent	40 per cent
Marketing mail	11 per cent	12 per cent
Counter services	8 per cent	–

Information key:

Case studies

Go online for more information

[2] Includes traditional white letters, publishing, data and philatelic.

RMG00000342

Overview

To reflect Royal Mail Group Ltd's separation from Post Office Limited on 1 April 2012, we are reporting our revenues including and excluding Post Office Limited. We are also showing the contributions of traditional and growth revenue streams to our business. We will continue to consolidate Post Office Limited's financial performance in future reports.

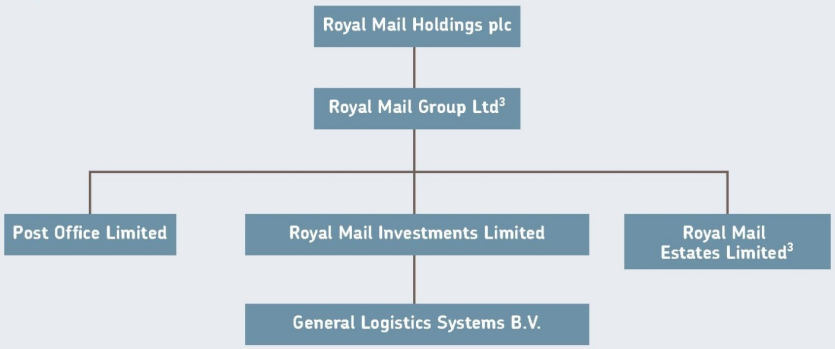
Group legal structure

Royal Mail Holdings plc is directly owned by HM Government. It is the ultimate parent company of Royal Mail Group Ltd. The Group primarily operates within the United Kingdom, including a number of subsidiaries, associates and a joint venture. It also has a presence in most European countries, mainly through General Logistics Systems. The basic legal structure of the Group as at 25 March 2012 is shown in Diagram one.

On 1 April 2012, Post Office Limited was transferred from under the ownership of Royal Mail Group Ltd to become a direct subsidiary of Royal Mail Holdings plc. The revised Group structure at this date is as shown in Diagram two.

Further details on the principal subsidiaries are shown in note 28 to the Group financial statements.

25 March 2012 – pre-separation
Diagram one



1 April 2012 – post-separation
Diagram two



[3] The UK Parcels, International & Letters (UKPIL) business unit is not a separate legal entity and is included within Royal Mail Group Ltd and Royal Mail Estates Limited. See p32 for details of the UKPIL business unit.

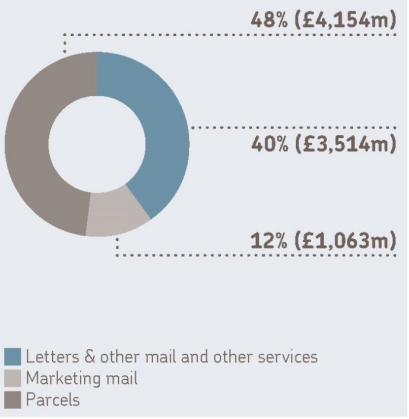
RMG00000342

Where we want to be

The UK postal services market has changed dramatically. We have a strategy in place to deal with these changes:

- **We are adapting our core network, which has primarily delivered letters, to become more efficient and accommodate ever increasing parcel volumes;**
- **We are diversifying our business model to secure a sustainable future for the Universal Service and to attract external capital; and**
- **The recent significant deregulation by Ofcom means we have the opportunity to generate a reasonable rate of return on our products and services.**

Royal Mail Group's revenues
(excluding Post Office Limited)



Our strategy
Our business strategy, outlined on pages 12-13, has three parts:

- Be brilliant at the basics;
- Build a commercial future; and
- Drive profitable growth.

The strategy sets out how Royal Mail Group is diversifying its business model to meet the challenges of a rapidly changing market, secure a sustainable future and attract private capital.

Adapting our network
Royal Mail's share of communications is declining year after year. It delivered 15 billion inland addressed items in the UK this year. This compares to 129 billion text messages sent annually[1]. We delivered around 80 million items a day in 2006. Today, that number has fallen to 58 million.

We expect traditional letter volumes to fall by approximately five per cent a year in the medium-term. We will seek to manage this structural decline in the letters market by improving efficiency through the modernisation programme and a range of other measures.

We are also adapting our core UK network to accommodate the ever increasing number of parcels we deliver.

Recent research suggests that online retailing will account for 12.4 per cent of UK GDP in 2016[2] – signifying the importance of online retailing to future growth. Royal Mail is already the trusted partner of some of the UK's largest online retailing companies. Supported by continued growth in online retailing, UKPIL domestic parcel volumes grew six per cent this year. GLS parcel volumes grew by three per cent.

As we adapt our operations to accommodate increasing parcel volumes, we will seek to address the fact that our core UK parcels network – Royal Mail – is loss-making.

Growing our share of marketing mail
Marketing mail, promotional direct marketing mail delivered to homes and businesses across the UK, currently accounts for 12 per cent – or £1.1 billion – of our revenues (excluding Post Office Limited). Royal Mail has the most extensive distribution network in the country. But, we want to increase our share of the marketing mail value chain, working with key partners to provide businesses with a service covering creative development, production, distribution and customer data management.

Our specialised sales team is targeting the UK's top 3,000 advertisers with our full service offer. We will provide an update on our progress in future reports.

We will also extend the availability of our customer data to key partners, as we look to expand our data business for business customers.

[1] Ofcom: Communications Market Report UK – published 4 August 2011.

[2] Boston Consulting Group: "The £4.2tn Opportunity, the Internet Economy in the G20".

RMG00000342
RMG00000342

Financial and business performance highlights

Our financial performance

Business unit	External revenue 2012 £m	External revenue 2011 £m	Operating profit/(loss) after modernisation costs[1] 2012 £m	Operating profit/(loss) after modernisation costs[1] 2011 £m
UK Parcels, International & Letters (UKPIL)	**7,164**	6,857	**23**	(120)
General Logistics Systems (GLS)	**1,562**	1,485	**128**	118
Other	**5**	38	**1**	20
Royal Mail Group excluding Post Office Limited	**8,731**	8,380	**152**	18
Post Office Limited	**801**	776	**59**	21
Royal Mail Group	**9,532**	9,156	**211**	39

Revenues and volumes

- Group external revenue increased by four per cent from last year to £9.5 billion, after two successive years of decline. Parcels are the single biggest contributor to Group revenues.
- Revenues in UKPIL, our core UK business, increased from £6.9 billion to £7.2 billion.
- UKPIL domestic parcel volumes were up six per cent during the year. Traditional letter volumes declined by six per cent, compared to five per cent in the prior year.
- UKPIL parcels revenue increased 10 per cent to £2.6 billion, driven by strong growth in online retailing. Revenues at GLS, our continental European parcels business, increased by five per cent to £1.6 billion.
- UKPIL letters & other mail revenue increased to £3.5 billion as a result of necessary price increases. Marketing mail revenues increased to £1.1 billion (2011 £1 billion).

Profits and margin

- Group operating profit after modernisation costs[1] increased from £39 million to £211 million.
- UKPIL returned to operating profit after modernisation costs[1] of £23 million (2011 £120 million loss).
- The UK parcels operation is currently loss-making. The cost allocation methodology for this part of the business is under review. We recognise that steps must be taken to grow margin, revenues and volumes and to make the operation more efficient.
- GLS and Post Office Limited remain the biggest contributors to Group operating profit after modernisation costs[1]. Their contributions were £128 million and £59 million respectively.
- The Group's overall operating profit margin after modernisation costs[1] increased from 0.4 per cent in the prior year to 2.2 per cent. However, the margin remains low compared to many other major postal operators. At 0.3 per cent, UKPIL's operating profit margin after modernisation costs[1] is also very modest.

Cash flow

- Addressing the Group's cash position has been a major priority. The Group recorded a free cash inflow of £234 million, compared to a free cash outflow of £213 million last year. Excluding disposals, the Group's free cash outflow was £8 million, compared to an outflow of £450 million in the previous year.
- No pension deficit payment to the Royal Mail Pension Plan (RMPP) was made during the year. This was a result of the transfer of almost all of the pension liabilities and pension assets of the RMPP to HM Government on 1 April 2012. In the previous year, a payment of £292 million was made.
- Significant cash items in the year were: £467 million (2011 £479 million) spent on ongoing pension contributions and £429 million (2011 £377 million) on modernisation investment in UKPIL.

Events after the balance sheet date

- On 1 April 2012, almost all of RMPP's pension liabilities and pension assets, built up until 31 March 2012, were transferred to HM Government, leaving the RMPP fully funded at that date.
- However, ongoing pension costs relating to the pensions of approximately 115,000[2] active members, will continue to be material.

Going concern

- In light of the events after the balance sheet date, Royal Mail Group is a going concern.

[1] Before other operating exceptional items.

[2] Excludes Post Office Limited.

RMG00000342

Financial and business performance highlights (continued)

Our business performance

Our modernisation programme

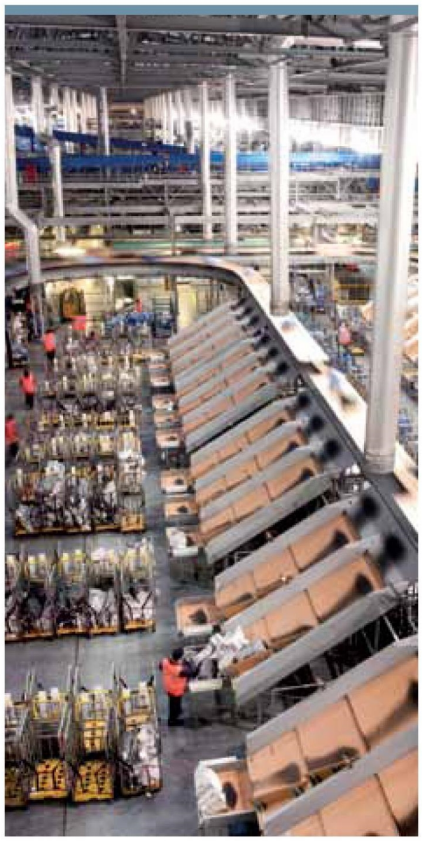
- The modernisation programme, one of the largest business transformations in the UK, is delivering efficiencies and a more customer-focused Royal Mail:
  - Reduction in gross frontline (upstream and downstream) hours[3] of three per cent;
  - 75 per cent of all letters are now automatically sequenced to reflect the order in which they are delivered, this compares with eight per cent in 2009-10, after the first year the programme was deployed;
  - Group reported accidents and injuries in the workplace have reduced by 22 per cent during the year; and
  - New delivery methods have now been introduced in 448 delivery offices. The maximum period of change is now underway. 908 operating delivery offices remain to be modernised.

Our customers

- Royal Mail handled over 58 million UK inland addressed items daily, compared to nearly 62 million in the previous year. Across its domestic and international operations, the Group handled 1.2 billion parcels during the year.
- Against the backdrop of the modernisation programme, Royal Mail achieved a 92.7 per cent First Class retail Quality of Service performance. At 93 per cent, the First Class retail Quality of Service target is the highest of all major EU countries. With a 98.7 per cent performance, Royal Mail exceeded the Second Class retail Quality of Service target of 98.5 per cent.
- During Christmas 2011, a key trading time for Royal Mail in the UK, 1.4 billion UK inland addressed items were handled, including 86 million parcels. A high quality service was successfully delivered to customers throughout this important period.
- A number of customer initiatives were successfully introduced, including the delivery to neighbour trial, which received a customer satisfaction rating of 92 per cent.

Regulation

- The announcement by Ofcom of a new regulatory framework on 27 March 2012 has significantly increased Royal Mail's commercial freedom. Direct price controls now affect almost 10 per cent of our revenues.





[3] Includes processing hours.

RMG00000342

Chairman's statement



With State Aid approval, a more flexible regulatory framework in place, and an improved financial position, Royal Mail Group is making progress on the path to a sustainable financial future and potential private ownership.

Donald Brydon
Chairman

When I joined Royal Mail Group as Chairman in March 2009, it was very clear to me that a great deal needed to be accomplished. Years of restrictive regulation, a declining traditional letters market and out of date technology had all taken their toll on the business.

To deal with these challenges, the Board was rebuilt and oversaw the creation of a new, reinvigorated executive management team. We were delighted to appoint Moya Greene, formerly head of Canada Post, to the role of Chief Executive Officer in July 2010. Moya had a strong track record in her previous roles as Chief Executive Officer and President of Canada Post. Royal Mail Group has benefited from her vast expertise and experience in a number of key areas, including the establishment of our business strategy. Many of the strategic milestones of the past year, such as the successful achievement of State Aid authorisation and securing an improved regulatory structure, would not have been achieved without her unwavering determination.

2011-12

We have delivered improved financial results in what is a very challenging economic climate. I am pleased to be able to report a free cash inflow for the Group for the first time in four years. Overall revenues were four per cent higher than the previous year and are returning to similar levels to those last seen in 2008-09. Group operating profit[1] also improved to £211 million, after modernisation costs of £231 million, with UK Parcels, International & Letters (UKPIL) moving from an operating loss[1] of £120 million to an operating profit[1] of £23 million, and both General Logistics Systems (GLS) and Post Office Limited recording growth in revenues and operating profits[1].

The Group has further opportunities for improved efficiency and continues to face real challenges. The cost of delivering the Universal Service is significant: traditional letter volumes are falling, as the number of households and businesses to which we must deliver increases. Management is committed to press on with one of the most complex modernisation programmes ever undertaken in the UK.

Legislative and regulatory change

The past twelve months have marked an important transitional phase for the Group. One of the most significant achievements this year has been the successful passage through Parliament of the Postal Services Act 2011, which received Royal Assent in June 2011. We are very grateful to both the Department for Business, Innovation and Skills (BIS) and, in particular, the then Parliamentary Under-Secretary of State for Postal Affairs, Edward Davey, for their role in the successful passing of this important legislation.

On 1 April 2012, after the reporting date, almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP) were transferred to HM Government. This will improve our future cash generation, as we complete our modernisation programme, reducing costs and improving the efficiency of the network. We are again grateful to BIS for the delivery of this crucial element of our strategic plan. Jane Newell, Chair of the Trustee of the Royal Mail Pension Plan, has also worked tirelessly to secure a more certain future for our people. Jane has announced her intention to step down, and I would like to take this opportunity to thank her, on behalf of all our people, for her commitment and counsel.

Just after the year end, we welcomed the introduction of a new regulatory regime by Ofcom. Royal Mail now has the freedom – already enjoyed by most other companies – to decide the price of most of the services it provides. We know how hard it is for businesses and households in the current economic climate. It has been necessary, however, to raise prices. But, we have thought very carefully about the impact of price rises on our customers and our business.

[1] After modernisation costs before other operating exceptional items.

RMG00000342

Chairman's statement (continued)

I have also established an independent inquiry, to be led by Sir Gordon Langley, into the prevalence of dog attacks on our postmen and women. It is an offence to decency that good people should suffer these attacks when carrying out their daily jobs and serving the public. I hope to be able to update you in next year's report on our progress on this important issue for our people, upon which we are working closely with the Communication Workers Union.

Change continues at pace

Progress continues on the modernisation of the business. When complete, we will have delivered a complete overhaul of our entire delivery operations, and the way in which our people work. The process is complex and affects over 127,000 frontline colleagues employed in the UKPIL business. It is akin to changing a car engine at 70mph on the motorway without stopping. There are inevitably challenges along the way. We are disappointed that the introduction of new delivery routes and practices has caused us to just miss our Quality of Service target in some areas. We will strive to maintain our standards, which are amongst the highest in Europe.

We are focused on finding alternative sources of growth in a structurally declining mail market. Our unique position in the UK market gives us some very significant opportunities for development. One of our strategic focuses will be our strong and growing parcels businesses. No other operator can match our network and reach in this growing market. In addition, our European coverage through GLS leaves us perfectly placed to capture growth in overseas markets.

Revenues generated outside the UK from GLS and UKPIL currently represent approximately 20 per cent[2] of our annual revenues[3]. They will continue to be valued contributors to the Group's success in years to come.

Moya Greene and her team are to be commended for the steps that they have taken to reshape our relationship with our union colleagues. Against a backdrop of such change and uncertainty, it is to the credit of our trade unions, the Group and, of course, our hardworking colleagues that we are managing so many complex changes so effectively. The Board is delighted to see this important relationship evolving positively.

I am also delighted to report plans for a new home for The British Postal Museum & Archive (BPMA). The new site will be Calthorpe House, on London's Mount Pleasant site, where the country's oldest mail centre is located. It will allow the BPMA to once again exhibit objects from its fascinating museum collection, which is currently held in storage.

Our Board

We saw two departures from the Board in the year to 25 March 2012. I announced Richard Handover's retirement in my statement last year. David Smith left the Group in June 2011, having joined the Board in April 2010.

On 1 April 2012, Post Office Limited and Royal Mail Group became sister companies, to facilitate operational independence and appropriate governance. At this point, all the Directors of Royal Mail Holdings plc (see p60) became Directors of Royal Mail Group Ltd, with the exception of Paula Vennells, now Chief Executive Officer of Post Office Limited. I remain Chairman of the Board of Royal Mail Holdings plc, and continue as Chairman of the Board of Royal Mail Group Ltd. I was delighted to appoint Alice Perkins as the Chair of the Post Office Limited Board. Her government and private sector experience will be an excellent addition to Post Office Limited. Alice joins me on the Board of Royal Mail Holdings plc, the parent company of both Royal Mail Group Ltd and Post Office Limited. I very much look forward to working with her.

Thank you

Moya and I are both proud of what Royal Mail Group has delivered as a business in the past year, and we are acutely aware of the role of all our colleagues in this achievement. As the wholesale changes to the structure and culture of the business continue, we will be relying on our people to continue to support the delivery of our change programme. I would like to offer my sincere thanks to all of my colleagues, not only for what we have achieved to date, but for the commitment and diligence I know they will demonstrate in the future.



Donald Brydon

[2] Comprises GLS (£1.6 billion) and UKPIL Royal Mail International (£0.2 billion).

[3] Excludes Post Office Limited revenue.

RMG00000342

Chief Executive Officer's review



Our Group operating profit margin[1] has improved to 2.2 per cent from 0.4 per cent last year. This remains modest, however, compared to other major postal operators.

Moya Greene
Chief Executive Officer

A year of significant progress

In my first review as Chief Executive Officer last year, I explained that the Group was in a precarious financial position and there were many significant regulatory and legislative milestones to achieve.

I am pleased to say we have made significant progress on all fronts. Most importantly, we are now on the way to restoring Royal Mail Group's financial health. Details of our key financial and business achievements can be found on p5. However, it is worth repeating that the business is cash positive[2] for the first time in four years. We have grown revenues in UK Parcels, International & Letters (UKPIL) and it has returned to profitability. General Logistics Systems (GLS) and Post Office Limited have also increased revenues and operating profits[1] during the year.

Of course, this is only the beginning of the process of returning the business to a sound financial footing. Our Group operating profit margin[1] has improved to 2.2 per cent from 0.4 per cent last year. This remains modest, however, compared to other major postal operators.

Regulatory and legislative environment

Last year, Royal Mail Group was balance sheet insolvent and had been for some years. That is why, just after the year end on 1 April 2012, we welcomed the transfer of almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP) to HM Government. We are grateful to the Secretary of State and his colleagues at the Department for Business, Innovation and Skills (BIS) for their tireless commitment to delivering this transformational milestone.

On 27 March 2012, we were also pleased with the introduction of a new regulatory framework. Our new regulator, Ofcom, has recognised that the prior framework was not appropriate, that price controls had failed and that there was a very real risk to the sustainability of the Universal Service. The new regulatory approach provides us with increased commercial freedoms, to better position us to earn a reasonable return on the services we deliver. This new approach underpins the regulator's primary duty and commitment to safeguarding the Universal Service in the UK.

Much remains to be done

Royal Mail Group continues to face significant challenges. The traditional letters market remains in structural decline. Volumes in this market have fallen by more than 25 per cent since 2005-06. We will continue to manage this decline by improving efficiency through the modernisation programme and a range of other measures. We will also adapt our network, which has traditionally handled and delivered letters, to accommodate the ever increasing number of parcels in the traffic mix.

Our core parcels network in the UK – Royal Mail – remains loss-making. We will address this in the coming years with a number of measures that are designed to return parcels to profitability, while adding value through service enhancements our customers want.

We will also continue to deliver significant productivity gains across the business. More than 50,000 people have left the Group in the last decade. As we have said before, we will be a smaller, but a more sustainable, business in the years to come. However, as we are taking costs out, we need to do so without jeopardising our ability to deliver on our Universal Service commitments at the service levels which our customers expect.

Becoming the best delivery and marketing mail business in the UK

Our business strategy is about:

Being brilliant at the basics

Building a commercial future

Driving profitable growth

I will now deal with each in turn.

Brilliant at the basics

Royal Mail Group is the only business that can deliver the Universal Service – overnight, to more than 29 million addresses across the country, six days a week.

To achieve this, we need to engage and equip our people to deliver a consistently high quality service. Royal Mail must deliver on the promises it makes to its customers and make the right products available at the right prices. In addition, we need to continue to modernise, introduce new technology and delivery methods, cut costs and improve productivity across the business.

[1] After modernisation costs before other operating exceptional items.

[2] Free cash inflow.

RMG00000342

Chief Executive Officer's review (continued)

Our people
Royal Mail's postmen and women meet our customers every day on the doorsteps of their homes and businesses. They are our ambassadors: a credit to the company.

Nothing is more important to me than the safety of our employees in the workplace and out on their delivery rounds. Over the course of the year, reported accidents and injuries at work have reduced by 22 per cent. Tragically however, in the past 12 months, seven people have lost their lives due to road traffic accidents. A number of initiatives, including safety courses for all our drivers, are being rolled out across the country to maintain our focus in this critical area. See "Our people" (p25) for more detail.

To ensure all of our people are jointly engaged in our success, we have taken significant steps to overhaul our internal communications. From the beginning of the financial year to mid-April 2012, we published 17 regular and special editions of Courier, our employee magazine. Many senior managers have visited all 11 Royal Mail regions in the UK, talking to around 23,000 colleagues and listening to their concerns. Weekly programmes on Royal Mail TV (RMTV) keep our frontline staff up-to-date on changes we are making and competitive challenges we must meet. So too does myroyalmail.com, our extranet for colleagues.

Our customers
We need to continue to put our customer at the centre of every discussion we have – from the Boardroom to the delivery office. Our customer satisfaction levels for business customers are improving, but are still lower than we would like.

We are focused on successfully addressing the root cause of customer complaints. That is why we are working with our customers to identify the five key areas in which we can improve customer service – redirections, misdeliveries, "Something for You" cards, redeliveries and proof of delivery. We have already introduced a range of measures to address them.

Royal Mail is the only postal operator in the UK that is required to publish its performance against delivery targets every quarter. I am proud that we exceeded our target to deliver 98.5 per cent of Second Class retail mail on time. We ended the year just shy of our 93 per cent target for First Class retail mail, with a performance of 92.7 per cent. Against the backdrop of the UK's largest ever business transformation, we still delivered 1.53 billion First Class retail items on a next day basis.

Modernisation
Every process that we are involved in – collecting, transporting, sorting and delivering mail – is changing as part of our modernisation programme. The aim of this process is to make our network more efficient: increasing productivity, improving the service our customers receive and reducing the cost of maintaining the Universal Service.

We are optimising our mail centre network, and have closed 16 mail centres in recent years. We are also investing: the automation of the handling of mail in our mail centres is nearly complete. We have installed 64 intelligent letter sorting machines, easing the load on our delivery centres. We are a year ahead of plan in our installation of our walk sequencing equipment. We have put in 574 walk sequencing machines. This means that 75 per cent of mail is now route-ready for our postmen and women.

We are now implementing a fundamental change in the way we work across our delivery operations. This is in order to accommodate the changing traffic mix – more parcels and fewer letters. Delivery revisions have taken place in 448 delivery offices since the modernisation programme began. We need to modernise the remaining 908 operating delivery offices and deliver the targeted savings consistently across the country. The executive management team and our union colleagues agree that the need for transformation is clear and pressing. We are working closely with the Communication Workers Union (CWU) to ensure the consistent and timely implementation of delivery revisions. Together, we will deliver our change agenda as sensitively and transparently as possible.

Building a commercial future
Building a commercial future is the second part of our business strategy.

Ofcom's new regulatory approach, announced just after the end of the financial year, is a key first step. The new regulatory approach provides us with increased commercial freedoms. But, more remains to be done in this area.

We have had to increase our prices over the last few years. Of course, nobody likes to raise prices in the current economic climate. But, like all businesses, we must earn a reasonable return for the services we provide. Our rate of return is improving but is still well below commercial levels.

The development of end-to-end competition, where a new entrant could target the most profitable business (typically in urban areas) without having to meet the obligations that we must, is one of the biggest threats to the Universal Service.

If Royal Mail's competitors are able to target profitable business through focused end-to-end competition, of course, the cost of delivering the balance of our competitors' mail increases, as the revenue available to pay these costs is siphoned away. We are planning to review our Access contracts during the coming year and will be looking at this issue amongst many others; we will be seeking the views of our customers and Ofcom.

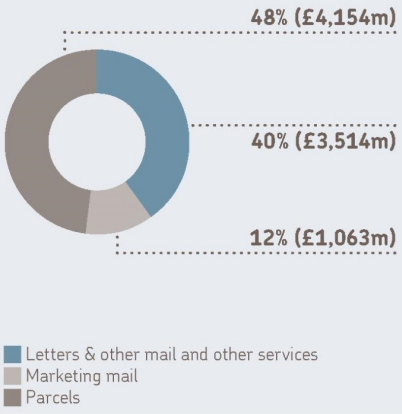
Royal Mail Group Ltd and Post Office Limited became sister companies on 1 April 2012. In January 2012, both companies signed a major commercial agreement, which provides continuity and a close working relationship over the long-term. Post Office Limited, with the largest retail network in the country, including a significant presence in rural areas, will remain a key partner in our future. Our mutual commercial success is best served by working closely together for the benefit of customers.

RMG00000342

Profitable growth

The third and final part of the business strategy is to create profitable revenue growth in marketing mail, parcels and data to counter the decline in the traditional letters market.

Royal Mail Group's revenues
(excluding Post Office Limited)



We are a significant British company, with a growing proportion of our revenues generated by incoming and outgoing international mail. Revenues generated outside the UK from GLS and UKPIL now form 20 per cent[3] of our annual revenues, excluding Post Office Limited.

Royal Mail Group currently has a £4.2 billion revenue-generating parcels business that includes UKPIL's Royal Mail UK network and Parcelforce Worldwide; and GLS. Parcels made up 48 per cent of Group revenue[4] across the year. Our UKPIL parcels business grew its revenue by 10 per cent, while GLS's revenue grew by five per cent.

By 2016, online retailing is expected to account for 23 per cent of the UK's overall retail spend[5]. In addition, UK consumers will buy products online from overseas providers, benefiting both our parcels and international businesses. Royal Mail Group is well placed to benefit from these growth trends. Our parcels businesses are best-in-class operators in their respective markets.

During Christmas 2011[6], Royal Mail's core network delivered around 79 million parcels and Parcelforce Worldwide nearly seven million express parcels. Parcelforce Worldwide achieved a 96.6 per cent first-time delivery rate during this period alone. Growing our parcels business is a key strategic priority.

We are also developing our marketing mail business, which contributed £1.1 billion in revenues this year. Utilising our own assets, and with the support of several partners, we will be able to offer a full service solution for businesses, large and small, covering creative development, production, distribution and customer data management for advertising mail. See "Our strategy in action" on p16 for more details.

Outlook

We are in a stronger financial position. But, much remains to be done to ensure we are leveraging every opportunity our business has to offer.

The EU State Aid decision has improved our cash position. As a result of deregulation, we are better able to generate a reasonable return in the core UK business. Our margin is improving, albeit from a very low base. Our strategies and initiatives are geared towards delivering, in time, the 5-10 per cent margin set by our regulator, and a more commercial margin as compared to other successful postal operators.

Looking forward, we expect that continued growth in online retailing will benefit our domestic and international parcels businesses. The decline in our core letters business is expected to continue. We will press on with our modernisation programme, cutting costs in the network. We will also adapt the network to carry increasing numbers of parcels.

We are developing alternative sources of future profitable revenue growth, leveraging our key strengths and focusing on our marketing mail and data businesses.

Very few companies face the prospect of continued change on the scale that we do. I am very grateful for the continued help and support we have received from HM Government: Secretary of State for Business, Innovation and Skills, Vince Cable; both Edward Davey and Norman Lamb as Parliamentary Under-Secretary of State for Postal Affairs, and their officials. In addition, the Group has continued to benefit greatly from the guidance and thoughtful oversight of our Board of Directors. I also thank our union colleagues Dave Ward, Deputy General Secretary (Postal) of CWU and Brian Scott, Assistant National Secretary, Unite, for their ongoing engagement and constructive challenge to ensure our success.

And, of course, I would like to thank all our colleagues across the Group. I know what we are asking of them is difficult. I am grateful for their continued dedication, hard work and commitment. They continue to be the main driver of our success as we look towards a secure and profitable future.

GRO

Moya Greene

[3] Comprises GLS (£1.6 billion) and UKPIL's Royal Mail International (£0.2 billion).

[4] Excludes Post Office Limited revenue.

[5] Boston Consulting Group: "The £4.2tn Opportunity, the Internet Economy in the G20".

[6] 28 November 2011-25 December 2012.

RMG00000342

Our strategy

Royal Mail Group has a clear strategy to become the best delivery and marketing mail business in the UK.

This means responding to the changing mail market: adapting our core network, which has traditionally carried letters, to accommodate increasing numbers of parcels; grasping the opportunities offered by significant deregulation and using our unique strengths to develop profitable revenue growth in parcels, marketing mail and data.

We are making progress. But, there is a good deal to do to achieve our objective of attracting private capital.

Our business strategy has three parts:

Firstly, to **be brilliant at the basics**. We need to become more efficient and customer-focused. This means completing the automation of our core letters network, reducing the hours taken to complete delivery and getting it right first time; every time.

Secondly, **building a commercial future** puts the onus on us to use the new regulatory framework to earn a reasonable return for the products and services we offer. Last year, 80 per cent of Royal Mail's revenues were subject to direct revenue control. Today, this figure has fallen to almost 10 per cent.

Thirdly, we are continuing to respond to changing customer needs, building the business outside our traditional revenues streams to **drive profitable growth**. We are developing our parcels, marketing mail and data propositions to contribute to the future success of a financially stable, diversified Royal Mail Group.

As part of our objective to attract private capital, we are significantly improving our disclosure. This year we are for the first time outlining our twelve KPIs that align to our business strategy. These KPIs are replicated in our Corporate Balanced Scorecard, against which we assess the performance of all our managers. They are outlined in more detail on the following pages.





RMG00000342

Part one

Be brilliant at the basics



Definition

To continue on our journey to become one of the world's most modern and efficient postal services.

We are focusing our efforts on delivering excellent customer service, backed up by efficient and cost effective operations.

Key initiatives

- **Focused on the safety and well being of our workforce;**
- **Modernising our entire network and introducing "World Class Mail", a comprehensive system to improve safety, customer service, quality and productivity, to meet today's market needs;**
- **Investing in engaging with all of our employees and our unions to improve their understanding of our strategy and to listen to their concerns; and**
- **Customer experience is a major focus for our business as we seek to improve and adapt our products and invest in technology to support new services.**

Part two

Build a commercial future



Definition

To compete on a level playing field with other companies, we need to deliver a reasonable rate of return under the new regulatory framework, so as to attract private capital.

We need to be a more customer-responsive company, now that deregulation means we have considerably more commercial freedom.

Key initiatives

- **Making changes for our customers to secure the benefits of our new, more flexible regulatory framework; and**
- **As we prepare to attract external capital, we will take steps to maintain our strong corporate reputation with our people, the unions and the general public.**

Part three

Drive profitable growth



Definition

To diversify our business model, capitalising on our expertise in the growing markets of parcels, marketing mail and data.

We are addressing losses in our core UK parcels business – Royal Mail.

We will also continue to seek international partnerships and opportunities, an area where we have a significant and growing presence.

Key initiatives

- **Ensuring that we get packet and parcel delivery right every time, including providing further delivery options;**
- **Refocusing our mail products and launching new services that will make marketing mail much easier to use;**
- **Developing new ways to make marketing mail pieces more relevant in the digital world;**
- **Working with our postal partners around the world to help UK businesses exploit the massive growth in export online retailing; and**
- **Growing our data business, expanding existing services and building new ones for our business customers.**

RMG00000342

Key performance indicators

The four quadrants below (People; Customer; Performance and Financial) and their respective KPIs reflect our Corporate Balanced Scorecard for the year 2011-12. As the business changes, we may adapt our KPIs in future years to reflect changing priorities.

KPI	Measured by	Key activities in the year
People		
Safety	Number of RIDDORs[1] per 1,000 people in the UK businesses.	Our Zero Accidents Programme, focusing on road safety risks, and our basic programmes on slips, trips and falls, continue to drive down the rate of accidents across our businesses.
Engagement	An annual survey measuring what our people think about Royal Mail, including leadership and strategic direction.	Following a benchmark survey in Autumn 2011, our inaugural survey took place in Spring 2012, with a 69 per cent response rate.
Customer focus	An annual survey measuring how focused our people are on delivering for our customers.	
Customer		
First Class Quality of Service	Quality of Service for First Class retail products, including force majeure[2] adjustment.	As part of one of the most comprehensive change programmes ever undertaken in the UK, delivery revisions have taken place in 331 delivery offices across the UK. This is about a more efficient and effective Royal Mail.
Net customer satisfaction	Customer satisfaction scores on a number of issues, including price, service quality and customer experience.	A customer satisfaction questionnaire is completed by approximately 700 business customers per month, helping us to identify key areas for action.
Customer complaints	Number of complaints captured by our Customer Service team[3].	We continue to take action to focus on redelivery, misdelivery, "Something for You" cards and redirections, with considerable progress in redirections and redeliveries.
Performance		
Group revenue	Group revenues.	Price increases were implemented across the business, including an eight per cent increase for letters in April and May 2011. Traditional letter volumes declined by six per cent during the year, while UKPIL domestic parcel volumes increased by six per cent in the same period.
Delivery hours reduction	Percentage year-on-year reduction in the gross hours spent on delivery activities.	Delivery revisions were completed in 331 delivery offices during the year, reducing the gross hours spent delivering mail.
Process sequencing	Percentage of our mail sequenced into delivery order for our postmen and women.	235 new, refurbished or upgraded processing machines were installed during the year.
Financial		
Operating costs	Expenditure before modernisation and other exceptional costs for our UK businesses.	We continued our modernisation programme in our frontline operations and completed the reorganisation of Group central functions.
Group operating profit	Group operating profit before exceptional items.	An increase in Group operating profit was generated by necessary price rises and cost reductions.
Free cash flow	Free cash flow excluding Royal Mail Pension Plan (RMPP) deficit payments and finance leases.	We focused on delivering the RMPP transfer, the sale of non core activities and properties, and working capital management.

[1] Reporting of Injuries, Diseases and Dangerous Occurrences Regulations.

[2] This accounts for the impact of factors which are beyond Royal Mail's control, such as floods or the Icelandic volcanic eruptions.

[3] We also provide detailed annual disclosure on customer complaints to our regulator, which is publicly available.

RMG00000342

Strategy

Strategic links	More information
People	
	See "Our people" on pages **25-27**
	See "Our people" on pages **25-27**
	See "Our customers" on pages **18-21**
Customer	
	See "Our customers" on pages **18-21**
	See "Our customers" on pages **18-21**
	See "Our customers" on pages **18-21**
Performance	
	See "Financial performance overview" on pages **38-39**
	See "Modernising Royal Mail" on pages **22-24**
	See "Modernising Royal Mail" on pages **22-24**
Financial	
	See "Financial performance overview" on pages **38-39**
	See "Financial performance overview" on pages **38-39**
	See "Financial performance overview" on pages **38-39**

Strategic links key

Being brilliant at the basics
We are on a journey to make Royal Mail one of the world's most modern and efficient postal services.

To do this we need to deliver excellent customer service, backed up by efficient and cost effective operations.

Building a commercial future
To compete on a level playing field with other companies, we need to deliver a reasonable rate of return under the new regulatory framework, so as to attract private capital.

We need to be a more customer-responsive company, now deregulation means we have considerably more commercial freedom.

Driving profitable growth
We are diversifying our business model, capitalising on our expertise in the growing markets of parcels, marketing mail and data.

We are addressing losses in our core UK parcels business – Royal Mail.

We will also continue to seek international opportunities, an area where we have a significant and growing presence.

This icon is used to indicate reporting against a KPI throughout the document.

RMG00000342

Our strategy in action: parcels and marketing mail

Royal Mail Group is more than just a UK-focused, letter delivery business.

We are leveraging our capacity, reach and expertise to grow profitable revenue streams in parcels and marketing mail. This is a key part of our strategy as we seek to attract private capital.

Parcels

Our parcels business has three networks in the UK: Royal Mail's UK parcels operation; Parcelforce Worldwide and Royal Mail Specialist Services. Internationally, it has Royal Mail International (which uses Royal Mail's UK parcels network), and our European parcels operator, General Logistics Systems (GLS).

Together and with the support of global partners, these businesses handled 1.2 billion parcels. Over the last year, this represented a six per cent increase in UKPIL domestic volumes and a three per cent increase in GLS' volumes. Total parcel revenues for the year stood at approximately £4.2 billion, with GLS generating £1.6 billion.

Our UK parcel networks:

- Royal Mail's UK parcels operation delivered 585 million Universal Service Obligation (USO) and account tracked and untracked parcels during the year;
- Parcelforce Worldwide, our express parcels business, has a separate UK network. It has one of the highest quality of service performances in the UK express parcel market, with a first-time delivery rate of 96.8 per cent; and
- Royal Mail Specialist Services is a small but growing part of our parcels operations, servicing bespoke delivery needs, including sameday, parts distribution and very high value deliveries.

Our main parcels businesses

	UKPIL			GLS
	Royal Mail UK parcels network	Parcelforce Worldwide	Royal Mail International	
Revenues (£bn)	1.7	0.4	0.5	1.6
Volume growth (%)	6	5	1[1]	3
Items handled (m)	585	66	179	375
Network	57 operating mail centres and 1,356 operating delivery offices	52 depots and two delivery "hubs"	Heathrow "hub"	660 depots 37 central shipment points
Fleet	37,287 vehicles	2,009 vans		16,510 vehicles

International operations:

- Royal Mail's International operation handled and delivered 179 million import and export parcels. It works closely with other overseas postal administrations to connect businesses and individuals in the UK and abroad;
- GLS, our continental European logistics business, is a significant contributor to profits. Revenues grew five per cent to £1.6 billion, primarily driven by higher volumes. Its margin is 8.2 per cent; and
- GLS has shown it can grow in an uncertain European market. But, competition continues to be intense and prices remain under pressure. There is significant overcapacity in the market, putting downward pressure on prices, especially in core markets like Germany.

Our strategy

By 2016, online retailing is expected to account for 23 per cent of the UK's overall retail spend[2]. Our strategy is to maximise profitable revenue growth by utilising our multi-network parcels platform in highly competitive markets in the UK and overseas.

The Royal Mail UK parcels operation is loss-making. We recognise that steps must be taken to address these losses and make it more cost efficient.

We need to continue to improve customer experience across all our businesses. In the core UK operations, initiatives such as our delivery to neighbour trial, aim to do just that.

We continue to focus on our presence in the business to business market, which is closely linked to GDP growth.

We are pursuing growth in Europe through GLS. Working with Royal Mail International, it is well-positioned to benefit from future growth in borderless online retailing.

[1] Based on a simplified basis which is currently being refined.

[2] Boston Consulting Group: "The £4.2tn Opportunity, the Internet Economy in the G20".

RMG00000342

Our strategy in action
case study **1**

Marketing mail
We aspire to become the best marketing mail and services company in the UK. Approximately £1.1 billion of Group revenues in 2011-12 (equivalent to 12 per cent[3]) came from marketing mail.

We believe there is potential in this market, where targeted addressed and unaddressed marketing mail is delivered to consumers across the UK.

Royal Mail is well-positioned to manage the distribution of this mail. Working with a number of commercial partners, we will hone a full-service offer for businesses covering creative development, production, distribution and customer data management.

Working across the value chain, we aim to increase our share of this lucrative market. Our specialist sales team has already begun contacting some of the UK's biggest advertisers and securing campaigns.

Businesses thrive thanks to Royal Mail Tracked

Parcel delivery is an increasingly important part of Royal Mail's business. Growth in online retailing gives us an opportunity to build our capability in this area if we get fulfilment right.

Serving businesses of every size, we connect them with their customers. We help enterprises thrive and grow. From their shops and warehouses to their customers' front doors, Royal Mail Tracked gives businesses peace of mind and confidence in our ability to deliver their goods safely and in good time.



Royal Mail is a key service provider for TalkTalk, a leading broadband supplier. TalkTalk sends out hundreds of parcels every week and needs to know where the goods are at any stage in the mail pipeline. Royal Mail Tracked enables them to do just that.



"We use Royal Mail Tracked because we believe it is the best value for money."

says Mike Wakley, the company's head of supply chain logistics at TalkTalk.

"We value the fact that the equipment that goes to our customers is fully traceable."

For more information visit
www.royalmailgroup.com

[3] Excluding Post Office Limited.

RMG00000342

Our customers

One way to improve our service is by finding out what customers really think about Royal Mail Group: what they like and what they want to see improved.

That is what we did in 2011-12, with particular focus on five specific customer-identified problems. It was a salutary exercise, entirely consistent with the way that the Group is changing.

After years of having to put regulatory requirements first, we are increasingly operating as we need to, focusing our energies and resources on meeting customers' needs.

Building on our strengths

As one customer kindly tweeted on our recently established Twitter account:

"I love the Royal Mail. Fantastic British institution. Be proud."

We are proud that Royal Mail remains a trusted brand. Over 95 per cent of adults polled by Ipsos MORI say they know about us; 77 per cent of our customers perceive us favourably.

After all, we are vital to the UK economy. Royal Mail Group connects people and makes commerce happen. Many companies claim to go the extra mile for their customers. We literally do just that, by land, sea and air.

As a result, customers the length and breadth of the UK continue to enjoy unrivalled access to our products and services.

Royal Mail is required to regularly report on its Quality of Service performance against publicly stated targets. Our performance in this important area is one of the reasons why our customers continue to choose Royal Mail.

We delivered 92.7 per cent of First Class retail products overnight in 2011-12 as we pressed on with one of the largest change programmes ever undertaken in the UK. The target was 93 per cent.

In 2010-11, we achieved a 91.4 per cent performance rate, before adjustment for extreme weather and disruptions caused by Icelandic volcanic ash.

This year, we delivered 98.7 per cent of Second Class retail products; on time; first time. The target was 98.5 per cent.

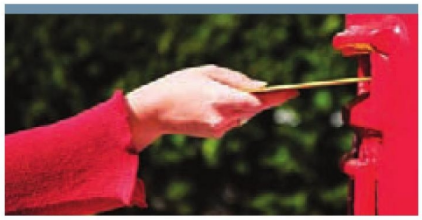
A new commercial agreement secured during the year has played an important part in ensuring the long-term future of our retail Post Office network throughout the nation. With a wider range of services and longer opening hours, Post Office Limited is making good use of HM Government funding to invest in improvement to its business model and to better meet customers' needs.

What are the five main causes of customer complaints?

- Not doing redirections daily or continuing to redirect when the redirection has finished;
- Delivery of mail to the wrong address (Misdeliveries);
- Posting "Something for You" cards when someone is in to receive their mail/ not filling them out;
- Not carrying out redeliveries properly; and
- Not obtaining signatures for deliveries that require them.

What are we doing to tackle them?

- Introducing dedicated redirections sorting frames to ensure they are carried out daily and we don't miss any;
- Reminding our employees of the correct procedure for using "Something for You" cards;
- Extending our delivery to neighbour trial, as regulation now permits this;
- Keeping open around 600 enquiry offices up to two hours later on Wednesdays and Saturdays to give customers more flexibility to pick up items; and
- Increasing the use of Postal Digital Assistants (PDAs) to capture signatures – we currently have more than 44,000 in use.



RMG00000342

Our customers
case study **1 of 2**

Using our new commercial freedoms
Crucial to Royal Mail Group's commercial future is deregulation.

With greater freedom, we are becoming more responsive to customer needs. We can now charge commercially viable but competitive rates for the services that are in demand.

We can also be more innovative.

For instance, customers want parcels delivered at the first go – whether they are at home or not. But, many items are simply too big to fit through letterboxes and some require a signature. The result: frustration for the sender, the recipient and the postman or woman who is not able to get the job done.

Previously, the less than ideal solution had been to leave a "Something for You" card that asked the recipient to get in touch to restart the delivery process.

A successful trial scheme has shown a better way.

Our delivery to neighbour trial has earned customer satisfaction ratings of 92 per cent. We extended that trial during the year with great success. We aim, following a consultation period, to roll out this delivery method across the UK.

It is up to us to make the most of our new freedoms. Part of that process is ensuring that people know about the innovations we are putting in place.

Increasingly, we are also using our people as ambassadors of change.

After all, they meet Royal Mail customers every day. They are better placed than anyone else to serve as company advocates. A programme of weekly face-to-face meetings and regular facility visits by senior managers is ensuring that our people understand – and can effectively explain to customers – the changes underway and planned.

Sterling praise

One of Britain's most northerly businesses, Orkney-based Sheila Fleet Jewellery, regards Royal Mail as "a lifeline". We link one of Scotland's leading creators of naturally-inspired silver, gold and platinum pieces with many customers throughout the UK and around the world.

Having started out in a converted shed, the company now employs 55 skilled craftspeople in a dedicated workshop and showroom. As one of the Orkney Islands' biggest and best-known exporters, Sheila Fleet counts on the expertise and dedication of the Kirkwall delivery office.

"We have used Royal Mail since the start of our business twenty years ago and know that the local team will always provide a service that truly does go the extra mile. Royal Mail's networks cover the whole country and the air service to and from Orkney is invaluable."

says Martin Fleet, director of the business.

"Royal Mail enables us to send packages to customers throughout the United Kingdom with confidence that every parcel will reach its destination safely and on time.

"This is particularly important with internet shopping. We know that no other courier service can match Royal Mail in terms of price and speed of delivery. And special delivery comes into its own during the Christmas period.

"Royal Mail is an integral part of our business and we cannot praise the work they do throughout the country highly enough."



For more information visit
www.royalmailgroup.com

RMG00000342

Our customers (continued)

Our customers
case study **2 of 2**

Direct mail; direct benefits

Marketing mail is a simple and effective way for advertisers and businesses to reach new and existing companies.

Royal Mail's unique ability to reach every UK address provides a significant advantage for companies and organisations that want to do door-to-door drops.

That is why we have embarked on a plan to grow this part of our business over the coming years.

For national charity Children With Cancer, we have already delivered 28.5 million items through major campaigns. This effort was part of a UK-wide campaign to raise awareness of the organisation's work, which includes life-saving research and related welfare projects.

Founder, Eddie O'Gorman, OBE says:

"Although we are into our 25th year, we're still not very well known. So, using Royal Mail's services in this way was the most efficient way of reaching people across the country."





Pricing

After years of regulation that kept Royal Mail tariffs artificially low, we took the difficult but necessary steps to increase our prices. Effective from 30 April 2012, the price of a First Class stamp for a standard letter rose from 46p to 60p; a Second Class stamp for a standard letter went up from 36p to 50p.

This was the right action to take in a difficult economic climate. The increase is safeguarding the Universal Service while helping us to earn a reasonable rate of return for the work we do. It is also enabling us to accelerate modernisation, ensure our commercial future and drive growth through investment in IT and development of the products and services customers most want.

Yet we also recognise how hard any increase is for households and businesses at a time when economic conditions are so difficult. For Christmas 2012 only, we are offering stamps to people in low income households at 2011-12 prices.

Whenever possible, we link higher prices to higher levels of service. That is what has happened with our Parcelforce Worldwide business. Free of the regulatory constraints that have held back other parts of our business, Parcelforce Worldwide consistently earns top scores on customer satisfaction.

For more information visit
www.royalmailgroup.com

RMG00000342

Giving customers what they want

We want customers to continue to choose Royal Mail Group. This depends on us becoming more commercially responsive and providing excellent customer service.

A series of customer focused KPIs are built into the Corporate Balanced Scorecard, to measure every aspect of customer service:

- *A new "customer focus" measure tracks the way our people think about our customers, putting them at the centre of business and operational decisions. We achieved a score of 70 per cent in our first year of measurement;*
- *Our net customer satisfaction score improved, standing at 36 per cent for 2011-12, compared to 31 per cent for the second half of the prior year[1]. We aim to further improve this performance in 2012-13; and*
- *Customer complaints have risen slightly from 423,700 in 2010-11 to 439,600 this year. We have already made progress in redirections and redeliveries. We will continue to focus on the main complaint types to reduce this number, which should be considered in the context of around 15 billion inland addressed items we deliver annually.*

One example of our commitment to customers was the concerted effort to provide an excellent service in the months leading up to Christmas 2011. To ensure that the contents of the festive mailbag (around 1.4 billion UK inland addressed items) reached their destinations on time, we invested an additional £15 million on top of the usual seasonal operation funding.

Customers want to know where their items are in the mail pipeline at any given time. We have invested heavily in tracked services that enable online and catalogue retailers to improve their own customers' delivery experience. We handled 159 million tracked express parcels during the year. Retailers can now choose to offer recipients the option of receiving text or email messages to let them know their parcel is on the way.

Improving our product portfolio was a top priority in 2011-12. One result was the simplification of our bulk mail services to make it easier for business customers to buy and use them. This marked the biggest improvement to our contract mail products in many years.

We now have four distinct account products: Advertising Mail, Sustainable Advertising Mail, Publishing Mail and Business Mail. Each product can be tailored to meet a customer's specific needs.

Direct contact with customers is making the changeover to these new products clear and easy for them.

We have developed another product – confidential waste and document destruction – out of our scheduled collection and delivery service for time-sensitive items such as cheques. This is called Secure Document Solutions.

Developments like this are part of Royal Mail's determination to become the best delivery and marketing mail business in the UK.

[1] Measurement frequency moved from quarterly to monthly during the year. Therefore, 2010-11 performance is based on last six months' average.

RMG00000342

Modernising Royal Mail

The modernisation of Royal Mail is well underway.

Modernising means improving every aspect of our operation: collections, processing, sorting and delivery. It also means reducing the hours it takes to process and deliver the mail.

We will deliver the Universal Service, while maintaining an efficient and profitable overall network.

Royal Mail's modernisation programme is one of the UK's biggest industrial transformation projects. This work is having a positive impact on safety and customer service. UK Parcels, International & Letters (UKPIL) headline injury accident frequency has reduced by around 40 per cent in the past two years.

Before the current modernisation programme started in 2006-07, most mail was hand-sorted – a slow and cumbersome process.

Early in 2012, we completed our automation programme for letters on time and below budget. This involved the installation, refurbishment and upgrading of over 900 highly efficient machines, including intelligent letter sorters processing up to 40,000 items per hour. Nearly two thirds of this equipment consists of Compact Sequence Sorters, putting letters in the order in which our postmen and women deliver mail out on the streets of the UK.

Reducing the hours taken to deliver the mail is central to improving the efficiency of our core network. Three quarters of our mail is now walk-sequenced, compared to 34 per cent at the end of 2010-11.

This has contributed to a 2.2 per cent reduction in gross delivery hours – one of the key efficiency metrics we use to assess our performance against our modernisation goals. This reduction compares to 1.8 per cent in the prior year.

We have made significant progress in changing the way Royal Mail delivers. Traditionally, postmen and women carried the full mail weight on their shoulders and travelled on bicycles. During the year, we continued to make greater use of safer high-capacity trolleys, lightweight trolleys and two-person vans, reducing the risk of back injury. There are now more than 22,300 new trolleys and around 7,500 new vans in operation.

And by the end of the year, we had also acquired an additional 10,600 Postal Digital Assistants (PDA). These hand-held electronic devices, issued to postmen and women during collection and delivery rounds, enable us to track mail at key points throughout the pipeline.

A market-led initiative

Why is modernisation on this scale so important for customers, external stakeholders and Royal Mail employees?

While traditional "white letters" have declined dramatically in numbers, parcel volumes are increasing due to growth in online retailing. This changing mail mix inevitably presents challenges. Parcels require more space to process and transport and demand more customer interaction in delivery. Growth in parcels also provides opportunities, and modernisation is enabling us to provide more customer-focused solutions.

But, we have not let any of this activity distract us from our ongoing obligations. By the end of the year, we had succeeded in creating an infrastructure of fully-modernised letter processing and exceeded our regulator's fourth quarter First Class retail delivery target – having narrowly missed the target for the full year during a period of substantial change.

The modernisation programme we are implementing is affecting the working lives of more than 127,000 frontline colleagues in UKPIL. We understand that change is not always easy to accept, particularly when it means working in different ways and keeping different hours. And as we become a smaller workforce, better suited to changing market conditions, voluntary redundancies will mean the departure of many colleagues.

To help those leaving as a result of this process, we have a comprehensive programme in place. This involves help in finding new work through job searching skills and career advice as well as the provision of financial advice. Throughout the modernisation process, we are committed to treating Royal Mail people with the dignity they deserve.

Fewer, more productive facilities

By the end of the year, Royal Mail had fewer, but more productive, facilities. As with everything to do with our modernisation programme, this reflected changes in market demand.

In 2011-12, we closed four mail centres: Hemel Hempstead, Stevenage, Southend and Watford. Subject to consultation, we also announced plans to shut Derby, Leicester and Worcester and initiated review processes for Cambridge, Gloucester and Shrewsbury.

Modernising Royal Mail does not always mean closures. Where appropriate, and to best serve our customers, we are also upgrading and opening new mail centres.

RMG00000342

Modernising Royal Mail
case study **1 of 2**

We have completed the first phase of the £32 million investment programme at Mount Pleasant – our biggest mail centre in London. This included the installation of four new Intelligent Letter Sorting Machines (iLSMs). Each can process over 40,000 items per hour. To get the most out of these machines, we provided 96 Mount Pleasant employees with three days of comprehensive training.

Royal Mail also opened the Medway Mail Centre in Kent and Home Counties North Mail Centre in Hemel Hempstead. These flagship facilities represent major investment in our processing units with state-of-the-art machinery and modern working environments.

In new and existing facilities, the embedding of our World Class Mail programme is revolutionising the way we work.

Developed in-house and based on leading global practice and expert advice, World Class Mail is a comprehensive system for improving safety, customer service, quality and productivity.

By the end of the year, 45 mail centres had launched World Class Mail continuous improvement of performance – almost four times as many as there were two years ago.

Following an independent external audit, the progress made this year by teams at Leeds and Norwich Mail Centres was recognised with Bronze awards. They join previous Bronze-winning colleagues in Belfast, Cardiff and Gatwick. All five mail centres are now working towards Silver status.

Glasgow Mail Centre delivers on safety

Glasgow Mail Centre has gone more than a year without a single day off work due to an on-site accident. Minor incidents requiring only minimal first aid were down to four.

John McPaul, Deputy Manager and former CWU health and safety representative attributes this record to the development of risk prediction cards for every job in the facility as part of the company's World Class Mail (WCM) programme.

"Everything is covered, from lifting a mailbag to operating the most complex machinery,"

he says.

"With WCM's highly visual approach it's easy to follow the correct processes. Before we had these, we had to rely on complex charts and descriptions. The new cards, with their clear images and colour coding, fit the bill."

WCM is now in place in all mail centres, with implementation expanding to other parts of processing and delivery offices as well. Ultimately, it will become an integral part of the way Royal Mail operates.





For more information visit
www.royalmailgroup.com

RMG00000342

Modernising Royal Mail (continued)

Modernising Royal Mail
case study **2 of 2**

Swansea succeeds

Thanks to the installation of Compact Sequence Sorters in Swansea Mail Centre, the facility has hit its targets for putting mail in correct street delivery sequence – delivering an across-the-board bonus for all.

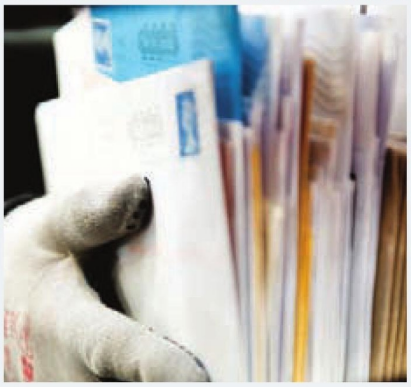
"Machines sort mail better and faster than by hand. They represent a major investment in our business that benefits customers and – as we've seen by the special payment – employees as well."

says Lionel Jones, Swansea's Automation Manager.

As postman John Davies explains,

"With machinery doing the sorting, I don't have to spend time preparing for my round. That gives me more time to deliver the bulkier mail that often involves getting signatures or filling out paperwork for redelivery."

Progress in Swansea also extends to upgrades on existing machines that do everything up to and including putting mail into regional batches ready for sequencing.





Royal Mail achieved a great deal in 2011-12. We plan to do even more.

In 2012-13 we are spreading the implementation of new delivery methods and associated equipment to more delivery offices.

By 2016-17 we will have closed around half of our mail centres, with high productivity in place at the remaining sites.

Modernisation is a key way to ensure that Royal Mail's core business – based on the Universal Service – is placed on a sound, secure and sustainable footing. This is already having a positive impact on our customers and our employees' working lives.

Modernisation milestones since the programme began:

- Installed 574 walk sequencing machines to date;
- Introduced 64 Intelligent Letter Sorting Machines, which can sort over 40,000 letters an hour, at nearly twice the speed of older machines;
- Upgraded and extended 225 Integrated Mail Processing machines to date;
- Achieved sequencing of 75 per cent of the mail;
- Closed 16 mail centres since the modernisation began. In 2011-12 we closed four mail centres, announced the closure of a further three and began consultation on the closure of three more; and
- Completed delivery revision in 448 delivery offices.

For more information visit
www.royalmailgroup.com

RMG00000342

Our people

Royal Mail's people set our brand apart.

In Ipsos MORI research conducted in November 2011, 82 per cent of our customers said they were either "fairly satisfied" or "very satisfied" with the service they received. The same percentage rated our people as "helpful" on a scale that ranged from "fairly good" to "excellent" – among the highest ratings for any company in the survey.

Royal Mail's people serve our customers well.

In 2011-12, we introduced management assessment against a Corporate Balanced Scorecard featuring four quadrants: People; Customer; Performance and Financial.

Monthly updates against Scorecard criteria are now helping to drive responsiveness, accountability and alignment for all our managers throughout the UK.

This system is also ensuring that Royal Mail rewards performances and behaviours that will advance our key strategies.

In 2011-12, Royal Mail Group employed nearly 159,000 people in the UK through UKPIL and Post Office Limited. As part of our effort to improve efficiency and competitiveness, we have regretfully reduced our UK workforce by 4,000 people – a large proportion of whom were managers.

In times like these, it is essential that everyone in the Group understands the motivation and the benefits of Royal Mail's modernisation programme.

Our inaugural annual employee engagement survey, independently run by Ipsos MORI, took place in Spring 2012. This achieved a score of 56 per cent, focusing on employee alignment, involvement and loyalty. The survey will form the foundation of a specific engagement KPI for years to come. We will publish the results annually to chart how our people are feeling about the company, its leadership and strategic direction.

A benchmark survey, conducted by Ipsos MORI in Autumn of 2011, provided initial findings that enabled us to take immediate action.

We learned that employees want to know more about our organisation's strategy, their role in it and what customers think of Royal Mail. We reacted and undertook a programme of activity to improve this.

There were plenty of encouraging outcomes. Over three quarters of people understand the need for change within Royal Mail. Two thirds of people feel their line manager treats them fairly and with respect and well over half are proud to work for Royal Mail.

Safety: an enduring priority

As Royal Mail changes, one thing remains constant: our commitment to the health and safety of our people.

We are committed to doing everything in our power to reduce the number of accidents to zero over time.

We are pleased to report a 22 per cent reduction in RIDDORs (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations) to 14.3 accidents per 1,000 employees during the year, compared to 18.3 accidents per 1,000 people in the previous year.

Efficiency gains in Royal Mail operations are actually helping to improve our safety performance.

The World Class Mail programme (see "Modernising Royal Mail" p22) is producing some encouraging results, significantly reducing our accident rate. One of the programme's 10 work areas is safety. We have found that when people are given the right time and tools to do their jobs, they work more safely.

Safety on the roads is essential. Royal Mail and Parcelforce Worldwide now have nearly 39,300 vehicles delivering the length and breadth of the UK. It is our obligation to ensure that all of them are in the best road condition and under the control of people with professional driving skills.

Our Zero Accidents Programme (ZAP) focuses on specific road safety risks. Primary training includes pre-use vehicle checks, followed by three hours of in-cab tuition with a qualified instructor, targeting the main causes of collisions experienced by our drivers.

These efforts are succeeding, with significantly reduced road traffic collision rates in the past year. Among our younger drivers, collisions are down 52 per cent during the year. Such progress notwithstanding, it is with deep regret that Royal Mail Group recorded seven road deaths associated with our operations in 2011-12, four of which were third-party fatalities.

Developing skills for a changing business

As Royal Mail is modernising, so are the skills of our people. We are achieving this through extensive development programmes internally, as well as through a policy of recruitment to help young people and the long-term unemployed to get into employment. In 2011-12, we invested a total of £11.2 million in training and skills development. We have also spent £1.9 million on outplacement programmes for employees taking redundancy.

RMG00000342

Our people (continued)

Our people
case study **1 of 1**

Sorted: a new generation

In 2011-12, 18 new recruits joined Royal Mail's engineering team. Their mission: to learn all they need to know to keep our sorting equipment running at its best.

That includes Royal Mail's latest machines, which are helping to make Royal Mail safer and more efficient.

Within the course of their three year programme, our novice engineers will become masters of equipment that processes up to 40,000 items per hour.

Individual responsibility is a key theme of the course. And while learning on-the-job how to minimise breakdowns and maximise output through ongoing maintenance and repairs, apprentices are also working towards a BTEC and NVQ Level 3.

Programme participant Alexandra Allsop says:

"The apprenticeship is a good way of entering the engineering environment. I'm looking forward to working my way up."





Royal Mail's apprenticeship programme has been one of our most encouraging training endeavours. It is open to current employees as well as the wider community.

In 2011-12, we revived our engineering apprentice scheme, which is now running in parallel with a similar programme for vehicle technicians. Both lead to a Level 3 National Vocational Qualification (NVQ) within three years.

More advanced apprenticeship training is helping to identify and shape Royal Mail's future leaders. This programme focuses on frontline operational colleagues who show an aptitude for managerial roles.

To help get a better gender balance in Royal Mail, we have taken an active approach to developing women. A new women's network is now raising both skills and awareness throughout the Group.

Royal Mail's determination in this area prompted a 2011 Silver rating in Business in the Community's (BITC) widely-respected Opportunity Now benchmark exercise.

Our workforce is also diverse in terms of race and ethnicity, reflecting the communities in which our people live and work. The proportion of black and ethnic minority (BEM) employees stands at over 10 per cent, which is slightly above the proportion of BEM citizens in the UK as a whole.

Royal Mail's approach to diversity means that we work with several organisations to recruit in places where we have local opportunities. One of those organisations is Remploy, which helps people with disabilities and health conditions rejoin the workplace.

For more information visit
www.royalmailgroup.com

RMG00000342

We are also involved with the Ready to Work programme, part of the Training Foundation. Since 2005, more than 450 people have had Royal Mail work experience. This year, we agreed to take part in an HM Government initiative to offer work experience for up to 83 young people to spend four weeks working for us on a voluntary basis.

We are additionally involved with BITC's Business Action on Homelessness, which supports people as they gain and sustain employment.

All of these efforts rightly promote fairness and opportunities for all in Royal Mail. But, we never lose sight of our prime objective, which is to raise levels of customer service throughout the Group.

For instance, in 2011-12 we identified a need to equip staff in our enquiry offices with the right skills for what is a key customer-facing role. As a result, we introduced a new NVQ-based training scheme specifically targeted towards improving our performance in this area.

At Royal Mail, learning is supported by the activities of our Learn Centres. There are 100 of these throughout the nation.

At our Glasgow Mail Centre, for example, all 1,100 employees have access to lifelong learning opportunities in the workplace. Since 2009, 482 postmen and women have taken part in over 50 courses covering a wide range of topics.

During a recent visit to the facility, First Minister of Scotland, Alex Salmond, acknowledged the importance of the scheme.

"Employers, workers, unions and communities working in partnership with HM Government to promote workplace learning benefits all of us – which is why it's so important to recognise achievements like those here."

Alex Salmond



Improving career management

With such a huge workforce, it is critical that Royal Mail has the right people management system.

Our new end-to-end integrated People System Management Programme (PSP) went live during the reporting year. Now, we are better able to manage employees' careers from recruitment to departure and so significantly enhance working life at Royal Mail.

More than 50 per cent of our workforce used PSP in 2011-12. Our aim is to have everyone on the system by August 2012.

PSP won the Gold Award in SAP's 2011 UKI Quality Awards in the New Business Application Implementation category.

PSP is part of a wider effort to simplify working life at Royal Mail. Having accumulated over 200 human resources policies over time, in the past year we reviewed and simplified this portfolio. Today, we are concentrating on 39 core people policy areas, with revised policies and procedures in place that are easier to understand and implement for employees and managers alike.

We have accomplished all of this with the cooperation of our unions, the Communication Workers Union and Unite.

	Year end people numbers	
	2012	2011
UK Parcels, International & Letters	151,156	155,181
Post Office Limited	7,798	7,782
UK wholly owned subsidiaries	**158,954**	**162,963**
UK partially owned subsidiaries	3,926	4,254
General Logistics Systems	13,362	13,167
Group total	**176,242**	**180,384**

RMG00000342

Regulation

The past year has seen major reform to the regulatory framework under which Royal Mail operates.

Ofcom has acknowledged that "the traditional approach to price regulation" had failed.

We welcome the significant changes that have been made. However, some areas of concern remain in regard to the regulation of postal services.

Royal Mail has played an active part in bringing about regulatory change.

We are confident that reform represents an important step forward in securing the Universal Service. Royal Mail is grateful to the Government, and in particular to the ministers at the Department for Business, Innovation and Skills and their officials, for driving through the legislation that has brought about much-needed change.

The new framework has seen a substantial reduction in detailed, intrusive ex-ante price regulation. In its place is a more commercially-oriented ex-post framework, based largely on the principles of competition law. Some ex-ante conditions and controls remain, around Universal Service and Access services.

The new regulatory regime places significant responsibility on Royal Mail. In this section, we set out the main changes to the regulation of our market. We also explain how we will adapt our operational approach to work successfully within the new framework.

The Postal Services Act 2011

The Postal Services Act 2011 (the Act), which received Royal Assent on 13 June 2011, provided the framework for regulatory reform. The Act's provisions came into force on 1 October 2011. This was when the old licence-based regime was replaced by a General Authorisation regime with Regulatory conditions.

The new law allows for a regulatory framework in which Royal Mail can compete in a liberalised market and respond and adapt to structural decline in our core business revenues. Importantly, the Act continues to safeguard the "one price goes anywhere", six-day-a-week Universal Service.

The Act comprises three pillars:

- Regulatory reform;
- A solution to Royal Mail Group's historic pension deficit; and
- Restructuring of Royal Mail Group, providing a framework that allows for private capital investment.

Two of the three key measures of the Act have already been implemented.

The legislation allowed for a change in regulator and regulatory approach. In addition, on 1 April 2012, after the reporting date, almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP) were transferred to HM Government, following State Aid approval.

Preparation for the third measure – securing private investment for Royal Mail – is underway. Post Office Limited formally separated from Royal Mail Group Ltd on 1 April 2012. It will remain publicly owned. Royal Mail Group and Post Office Limited signed a long-term commercial agreement in January 2012. This secures the excellent existing relationship with Royal Mail's main retail partner – a benefit to both businesses and the customers we serve.

The regulatory provisions of the Act respond directly to the significant financial challenge faced by Royal Mail in providing the Universal Service. The provisions include three very clear protections to the Universal Service within the Act:

- Ofcom's primary duty is to protect the provision of the Universal Service, which only Royal Mail is currently in a position to provide;
- Ofcom must have regard for the need for the Universal Service Provider to earn a "reasonable commercial rate of return"; and
- Ofcom has the power to impose conditions on anyone who seeks to enter the mails market to provide end-to-end competition, where necessary, to safeguard the provision of the Universal Service.

Regulatory developments this year

Implementation of the reforms mandated by the Act has led to substantial change to both the nature and extent of postal services regulation. The responsibility for regulating the postal sector transferred from Postcomm to Ofcom. This reflects the changing position of post. It is no longer a discrete sector, but one of several options open to consumers within the wider communications market.

We have worked with Ofcom to help put in place a major new approach to regulation. The direction taken is reassuring for the financial security of the six-day-a-week, one price goes anywhere Universal Service. The reforms will allow Royal Mail's Universal Service Obligation to make a reasonable commercial rate of return. This was a supplementary duty placed on Ofcom under the Postal Services Act 2011.

RMG00000342

Ofcom has lightened Royal Mail's regulatory load. This includes ex-ante regulation of pricing, which Ofcom has scaled back to cover standard Second Class letters, Second Class large letters, and (in future) standard parcels up to 2kg, intended to act as safeguard products. We will also have to comply with an ex-ante price control set to meet the requirements for a margin differential between retail and wholesale services. Removal of other price caps has allowed us to start the process of rebalancing our prices and redesigning our product portfolio to better meet the needs of customers. These processes will also enable Royal Mail to cover all of its costs and earn a reasonable commercial rate of return.

Ofcom has also revised another regulatory requirement that previously hindered Royal Mail's performance: the regulatory obligation which established a guaranteed price differential for competing mail carriers. From 2005, Royal Mail was obliged to process and deliver mail collected by our rivals. This requirement, known as Downstream Access (DSA) was subject to strict price controls. Nearly 48 per cent of the letters posted within the UK that we handle are now DSA mail. While we are happy to do this, regulated access has cost Royal Mail hundreds of millions of pounds in recent years. The removal of an explicit price advantage to other players provides a more level playing field. Our competitors retain regulatory safeguards for access to the network through the margin control condition.

The table below summarises the key changes brought about by Ofcom's decision on the new regulatory framework, announced in March 2012.

Before	After
Intrusive and complex price regulation on Universal Service Obligation (USO) and non-Universal Service Obligation products and services.	No price cap on the majority of products and services. A "safeguard" price cap will remain for Second Class standard letters, Second Class large letters, and standard parcels up to 2kg.
More than 80 per cent of Royal Mail's revenues subject to direct price regulation.	Royal Mail is now able to set prices that account for over 90 per cent of revenues, subject to price control of Access through margin control.
Royal Mail's rivals had potential access to any part of Royal Mail's Universal Service network and explicit price advantage through a prescriptive price control.	Access is mandated to a limited part of Royal Mail's Universal Service network but Royal Mail is able to set fair and reasonable commercial terms and to set Access prices that give a reasonable commercial return. Access prices will be monitored under a "margin squeeze price control" test. Access is now restricted to letters and large letters at the inward mail centre only.
Royal Mail was generally obliged to provide three months' notice when changing prices or terms and conditions for products. These restrictions limited innovation.	Royal Mail is now able to change prices and terms of service with no regulatory notice period for non-USO products and 30 days' notice for USO services. This allows us to innovate and introduce new products more quickly.
Royal Mail's competitors were able to take substantial volumes of business mail from its end-to-end letters business under a regulatory licensed regime, which established a guaranteed price differential between upstream and downstream mail activities, subject to those competitors complying with their licence conditions.	Competitors will have to provide notice to Ofcom if they decide to introduce or expand any part of their letters business along the end-to-end delivery pipeline. Ofcom has the ability to impose regulatory conditions on operators offering services on parts of or on the entire end-to-end delivery pipeline where there is a demonstrable threat to provision of the Universal Service.
No explicit statutory requirement for the regulator to have regard to the need for the Universal Service Provider to make a commercial rate of return on its USO activities.	As part of its primary duty, Ofcom must now have regard for the need for the Universal Service Provider to make a "reasonable commercial rate of return" on its Universal Service activities. Ofcom has determined that 5-10 per cent EBIT is the appropriate range, but acknowledges that in the short-term Royal Mail may need to return a higher margin.

RMG00000342

Regulation (continued)

Summary of developments:

- May 2010: Postcomm launched a set of consultations on changes for 2011, which resulted in a number of incremental changes to narrow price controls and started the process of reforming the regulatory framework;
- August 2011: bulk mail products were removed from the Universal Service;
- October 2011 and January 2012: Ofcom launched a set of consultations, which resulted in a substantially different regulatory framework;
- November 2011: start of delivery to neighbour trial; and
- March 2012: Ofcom set new regulatory framework.

Next steps

Operating in a deregulated environment

Royal Mail welcomes Ofcom's acknowledgement that there are now strong commercial incentives to treat our customers fairly; that we understand their needs; and that we must offer services that customers want to buy at the right price. Royal Mail is focused on reorienting the business to place customers at the heart of everything we do.

The new regulatory regime gives real incentives to innovate. It provides the ability to respond to our customers' needs in a much more commercial way in terms of speed and price, whilst continuing to provide safeguards for users of the Universal Service.

Further regulatory change

The reform of the regulatory framework over the past year represents a major step forward for the future sustainability of the Universal Service.

However, regulatory reform will continue as Ofcom seeks to more closely match regulatory requirements to a dynamic postal market. Ofcom will be conducting a "Review of User Needs", as required by the Postal Services Act 2011, which will conclude by March 2013. Ofcom will also be conducting a number of further consultations on the regulatory framework.

Royal Mail will address a number of areas where we believe that further regulatory change is necessary. This includes the framework around Access contracts and the process through which both mandated and non-mandated access services are provided.

Ofcom will continue to closely scrutinise the postal services market, and our own performance, in order to ensure the new regulatory framework is correctly balanced to deliver a safe and sustainable Universal Service. We will work closely with Ofcom to help achieve a better understanding of the rapidly changing marketplace and our place within it.

RMG00000342

Our businesses

The Group's main businesses

Royal Mail Group is organised into three main businesses, which are covered in the following pages.

UK Parcels, International & Letters (UKPIL) processes and delivers letters and parcels in line with its Universal Service Obligation. It is also a leading provider of collection and delivery services for express parcels through Parcelforce Worldwide, providing both businesses and consumers with a full range of timed delivery options. UKPIL is responsible for the design and production of the UK's stamps and philatelic products. It is also responsible for the processing of international mail under reciprocal arrangements with other overseas postal administrations.

Within UKPIL are:

- Commercial
  corporate parcels, international and domestic mail;
- Consumer and network access
  consumer, stamps & collectibles and wholesale products;
- Operations and modernisation
  collection, trunking and delivery operations; and
- Central functions.

Post Office Limited has a national network of branches and is represented in many communities across the country. It provides a trusted access point for around 170 different products and services including savings, insurance, loans, mortgages, credit cards, HM Government services, telephony, foreign currency, travel insurance and retail mails services.

Royal Mail Group Ltd and Post Office Limited became sister companies on 1 April 2012. The two companies have signed a major commercial agreement, which provides continuity and a close working relationship over the long-term. The mutual commercial success of both companies is best served by Royal Mail and the Post Office working closely together for the benefit of customers.

General Logistics Systems (GLS) delivers high-quality parcel and express services as well as value added logistics solutions throughout Europe. GLS is one of the biggest ground-based parcel service providers in Europe today. GLS provides a network coverage of 42 countries through wholly owned and partner companies and is globally connected via contractual arrangements.



RMG00000342

UK Parcels, International & Letters

Trading performance	2011-12	2010-11
External revenues (£m)	**7,164**	6,857
Operating profit/(loss) after modernisation costs (£m)[1]	**23**	(120)
Margin (%)	**0.3**	(1.7)
Inland addressed volumes (m)	**14,997**	15,909
People employed	**151,156**	155,181

UK Parcels, International & Letters (UKPIL)

UKPIL delivers letters and parcels to more than 29 million addresses in the UK, in line with the Group's Universal Service Obligation.

In addition, the business is also responsible for:

- Express parcel services through Parcelforce Worldwide;
- Design and production of UK stamps and philatelic products;
- Processing incoming and outgoing international mail; and
- The growing marketing mail business.

Trading performance

Revenues increased for the first time in four years, rising four per cent to £7.2 billion.

The increase in revenues resulted in an operating profit after modernisation costs[1] of £23 million, compared to a loss of £120 million the previous year. This generated an operating margin after modernisation costs[1] of 0.3 per cent, which remains very modest compared to other major postal operators.

Parcels

- Revenues increased by ten per cent to £2.6 billion;
- Domestic volumes grew six per cent to 651 million; and
- Parcelforce Worldwide first time delivery Quality of Service was 96.8 per cent.

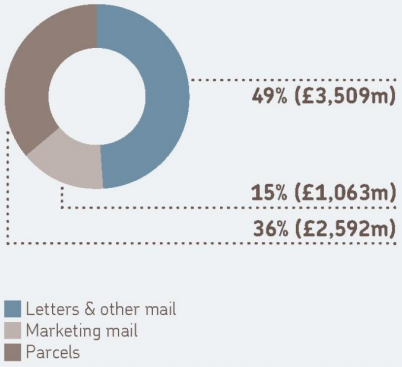
"Our strategy in action" (p16) provides further detail on our Group parcels strategy, of which UKPIL is an integral part.

Our customers include:

amazon.co.uk · MARKS & SPENCER · ASOS · SCREWFIX · BT

Parcels volumes (m)	2011-12	2010-11	Growth
Royal Mail UK domestic parcels network	**585**	551	6%
Parcelforce Worldwide	**66**	63	5%
Total UKPIL domestic parcels	**651**	614	6%

UKPIL revenues



Letters & other mail and marketing mail

- Revenues have increased by one per cent to £4.6 billion, this included £3.5 billion from letters & other mail and £1.1 billion from marketing mail;
- We delivered over 14 billion inland addressed letters and large letters, and over three billion inland unaddressed items;
- Inland addressed volumes declined by six per cent; and
- First Class retail Quality of Service performance was 92.7 per cent.

Marketing mail

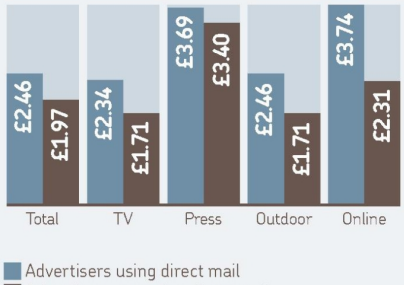
£1.1 billion of our Group revenues were generated by marketing mail in 2011-12.

We are prioritising the development of this business as a key driver of future profitable growth. The business' strategy is to reinvigorate our share of the advertising market and increase our share of the value chain by targeting the UK's top 3,000 advertisers – many of whom do not use direct mail in their direct marketing mix and do not realise its potential.

[1] Before other operating exceptional items.

RMG00000342

Return on Investment of direct mail



Source: OMD/Brand Science (2009)

Letters & other mail

Across letters and other mail, necessary price increases were offset by volume decline in inland addressed letters items of six per cent. The number of addresses we deliver to continues to grow, expanding by almost one per cent every year.

Social mail

Social mail includes stamped letter mail of a consumer to consumer (C2C) or consumer to business basis (C2B). This part of the mail market is declining as UK consumers move to other forms of digital communication.

Business mail

Business mail comprises statements, orders, invoicing and bill payments that are generally of a business-to-business (B2B) and business-to-consumer (B2C) nature. This is the part of the mail market experiencing the largest decline due to competition from online and other digital media.

Royal Mail believes that it can reduce the decline in business mail by repositioning it as a high value and durable customer communication. This supports customer retention and loyalty when complemented with other media.

Special stamps

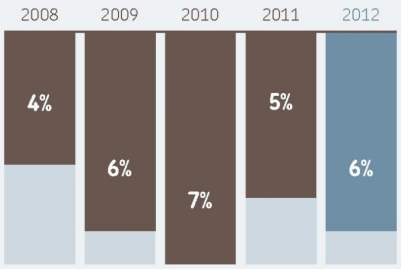
Royal Mail's stamp programme has had a successful year. Among the highlights were the stamps we produced to mark the Royal Wedding. We issued these, featuring the official engagement photographs by Mario Testino, shortly before the day itself.

Stamps produced for the two great events of 2012, the Queen's Diamond Jubilee and the London 2012 Olympic and Paralympic Games, could prove to be even more successful.



Further information regarding our special stamps can be found at: www.royalmail.com/stamps

Decline in addressed inland letter volumes



RMG00000342

Post Office Limited

Trading performance	2011-12	2010-11
External revenues (£m)	**801**	776
Operating profit after modernisation costs (£m)[1]	**59**	21
People employed	**7,798**	7,782
Post Office branches	**11,818**	11,820
Customer satisfaction (%)	**87**	85

Post Office Limited is visited by nearly 20 million customers a week through its network of 11,818 branches, providing around 170 different products and services. This includes savings, insurance, loans, mortgages, credit cards, Government services, telephony, foreign currency, travel insurance and retail mail services.

External revenues increased by £25 million in 2011-12 to £801 million. Growth in identity related work, lottery, retail and personal financial services was more than offset by the decline in traditional products such as bill payment and from a reduction in the number of telephony customers. The main driver of this growth, therefore, was a £30 million increase to the Network Subsidy Payment to £180 million (2011 £150 million).

The £25 million external revenue increase was the main driver of the improvement in operating profit after modernisation[1] from £21 million to £59 million.

On 1 April 2012, Post Office Limited became a sister company to Royal Mail Group Ltd. Alice Perkins was appointed Chair of the Post Office Limited Board on 22 September 2011. Over the last year, the Post Office has undertaken rigorous planning in anticipation of this significant development. A long-term commercial agreement with Royal Mail was signed on 19 January 2012 to ensure that the Post Office continues to provide unrivalled access and retail customer service in mails and parcels services.

Post Office Limited's strategy is based around growth supported by modernisation and improved customer service and there are a number of key programmes in place to support this.

Modernising the Post Office network

In accordance with the Government funding agreement in October 2010, thousands of Post Office branches will be modernised. This will mean service improvements and longer opening hours to make Post Office branches more accessible for customers. There will be no programme of closures.

Over the last financial year, more than 124 new main and local-style Post Office branches have been opened, bringing the nationwide total to 200. After further testing and refinement of the new-style branches, Post Office Limited will roll out the modernisation programme more widely from summer 2012. By March 2015, around 6,000 branches will have been converted to the new-style branches, strengthening the overall network that reaches every community in the UK.

New features of our main Post Office branches include more modern environments with open plan counters, dedicated travel services counters and fast track services for small and medium sized businesses. Among the new technology offered in many locations are self service post & go machines and leading edge biometric data capture technology which has been instrumental in growing new Government business.

In local branches, customers now benefit from open plan counters next to retail counters that enable people to pay for their groceries and make the most of Post office products and services at the same time.

Serving as a front office for Government

As well as developing the financial services and mails business, the Post Office is increasingly becoming established as an effective front office for local and national Government. This builds on a long history of delivering essential Government services. Post Office Limited continues to manage more than three million Post Office card accounts for people receiving benefits, state pensions and tax credit payments. The Post Office is ideally positioned as an intermediary between the public and national and local Government.

Post Office Limited can offer cost-effective delivery of services; a secure IT infrastructure in seamless conjunction with back offices and full front-office service for payments, applications, identity verification, data capture and information. The Post Office also offers digital services for customers who do not have internet access, and a face-to-face channel for those transactions that cannot be done online.

Post Office Limited is working with Government departments, agencies and local councils to explore new forms of service delivery that improve accuracy, eliminate fraud and reduce costs. For example, the Post Office Application, Enrolment and Identity (AEI) unit uses advanced biometric technology to capture fingerprints, electronic signatures and digital facial images. Customers in 752 branches can now use this facility to renew photo card driving licences and, in around 100 of these branches, to apply for biometric residence permits. In February 2012, the millionth customer used this AEI digital service.

Sales strength

Post Office products continue to earn accolades: for the sixth year running, the British Travel Awards cited the Post Office as the "Best Travel Insurance Provider" and the

[1] Before other operating exceptional items.

RMG00000342

"Best Foreign Exchange/Travel Money Provider" for the fifth year running. Post Office Limited also won "Best Savings Provider" at the MoneySupermarket 2011 Supers Awards.

The mail sector continues to account for around a third of the business. Income from Royal Mail has increased this year due to an increase in volumes of parcels and international mail sold through the Post Office and the effect of necessary price increases.

Within financial services, deposits have grown to £15.8 billion and opportunities to increase the range of savings accounts are being sought. The Post Office recently launched a new Premier Cash ISA, for example, which is already proving popular with customers.

Through relationships with partner banks, around 80 per cent of all UK debit card holders now have access to cash withdrawals and balance enquiries at Post Office branches.

This year's results have been achieved against a backdrop of taking steps to secure new business and services while trialling new-style branches and preparing to roll out the largest modernisation programme in the history of the business over the next three years.









RMG00000342

General Logistics Systems

General Logistics Systems (GLS) is one of the biggest ground-based parcel service providers in Europe today.

GLS is a pan-European business, providing reliable, business-to-business, high-quality parcel and express services as well as value-added logistics solutions. Established in 1999, it has historical networks in each of the domestic markets in which it operates.

General Logistics Systems	2011-12	2010-11
External revenues (£m)	**1,562**	1,485
Operating profit after modernisation costs (£m)[1]	**128**	118
Margin (%)	**8.2**	7.9
Volumes (m)	**375**	363
People employed	**13,362**	13,167

Overview: continued success in the face of uncertainty in Europe

GLS is a European leader in quality – provided through a network coverage of 42 countries, through wholly-owned and partner companies – and is globally connected via contractual agreements.

The GLS network comprises 37 central transhipment points in Europe, made up of 660 depots and 16,510 vehicles. Its 13,362 people deliver over 375 million parcels annually for 212,000 customers throughout Europe.

Trading results

External revenues were £77 million higher than the prior year. Underlying revenues were four per cent higher than the prior year after adjusting for exchange rate movements as the Euro strengthened, compared to 2010-11.

Revenue growth was principally volume driven, with domestic volumes three per cent higher and export volumes nine per cent higher.

Operating profit increased by £10 million to £128 million, generating a margin improvement to 8.2 per cent.

Strategy in light of European uncertainty

GLS' strategy remains the same – a relentless focus on high service quality, expanding its European network, and continued innovation through investment in technology.

During 2011-12, the core GLS markets in mainland Europe experienced a weakening in demand, particularly during the second half, as governments implemented austerity measures to reduce their fiscal deficits.

Despite the challenging conditions, GLS increased parcel volumes by three per cent in total, with higher domestic and export volumes compared with the prior year.

In particular, export volume growth has benefited from the leveraging of GLS' pan-European network. GLS continued to invest in its European network in 2011-12 by strengthening its physical infrastructure through investments in operational facilities and by extending its geographical coverage.



GLS pan-European network
(including partners)

- Albania
- Andorra
- Austria
- Belgium
- Bosnia-Herzegovina
- Bulgaria
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Iceland
- Ireland
- Italy
- Latvia
- Liechtenstein
- Lithuania
- Luxembourg
- Macedonia
- Malta
- Monaco
- Montenegro
- Netherlands
- Norway
- Poland
- Portugal
- Romania
- San Marino
- Serbia
- Slovakia
- Slovenia
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- Vatican City

(As at March 2012)

[1] Before other operating exceptional items.

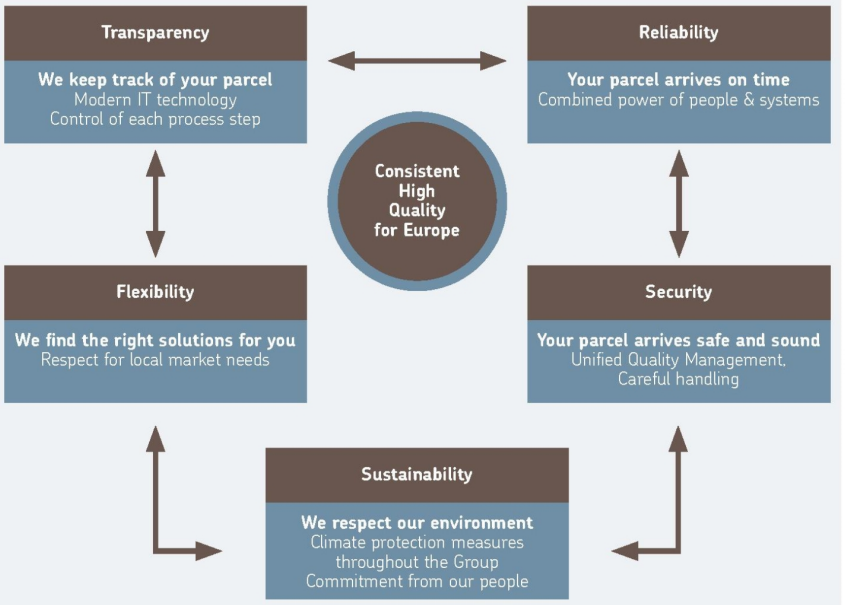
RMG00000342

In May 2012, GLS teamed up with Itella Logistics for the export and delivery of parcels to Lithuania and Latvia. As both parcel specialists have already been working together in Estonia since 2009, this now means they can serve all three Baltic states.

Innovating through technology

The parcels market in Europe continues to develop, with growth increasingly driven by online retailing. GLS has invested and will continue to invest in technology which will optimise delivery services. New flexible delivery solutions are being developed which will enable GLS to communicate directly with recipients, so that parcels can be delivered to locations most convenient to them.

Vision & core values of GLS



RMG00000342

Financial performance overview

There are four KPIs relating to financial performance that are described on p14. These relate to: Group revenue; Group operating profit before exceptional items; operating costs before modernisation and other exceptional costs (for UK businesses); and free cash flow (excluding Royal Mail Pension Plan (RMPP) deficit payments and finance leases). A summary of performance against these KPIs has been referenced in italics in this section, including a comparison against the prior year.

Group revenue increased by £376 million to £9.5 billion in 2012. This was principally driven by UKPIL, as the impact of necessary price increases more than offset overall volume declines. UK inland addressed letter volumes declined by six per cent, UKPIL domestic parcel volumes increased by six per cent and GLS parcel volumes increased by three per cent;

- Operating costs increases are lower than inflation and comprise a reduction in people costs, offset by expected increases in non-people costs, mainly distribution and conveyance costs.

Operating costs before modernisation and other exceptional costs for UK businesses increased by two per cent to £7.7 billion, lower than inflation and mainly due to expected increases in distribution, fleet and fuel costs;

Group operating profit before exceptional items has increased by 80 per cent, from £246 million last year to £442 million in 2012;

Profit and loss summary	2012 £m	2011 £m
Group revenue	**9,532**	9,156
Operating costs	**(9,122)**	(8,938)
Share of post tax profits from joint venture & associates	**32**	28
Group operating profit before exceptional items	**442**	246
Modernisation costs	**(231)**	(207)
Operating profit after modernisation costs[1]	**211**	39
Other net exceptional items	**90**	21
Profit before financing and taxation	**301**	60
Net finance costs (including net pension interest)	**(38)**	(212)
Taxation charge	**(10)**	(106)
Profit/(loss) for the financial year	**253**	(258)

- Modernisation costs in 2012 were £231 million (2011 £207 million). 2011 included a £109 million credit relating to the legacy share scheme. Underlying costs have reduced mainly due to lower redundancy costs;
- Operating profit after modernisation costs[1] of £211 million is £172 million higher than last year, a margin of 2.2 per cent compared with 0.4 per cent in 2011;
- Other net exceptional items of £90 million include profit on disposal of property, plant and equipment of £157 million;
- Net finance costs of £38 million have reduced by £174 million, mainly due to a non-cash pension interest credit in 2012, driven by changes in long-term pension assumptions; and
- Taxation charge of £10 million mainly relates to GLS profits, compared with 2011 which included £79 million relating to the write-down of UK deferred tax assets.

[1] Before other operating exceptional items.

RMG00000342

- EBITDA before pension costs of £1.1 billion is £169 million higher than last year due to improved trading performance;
- The Group is no longer required to make pension deficit payments into the main pension plan, RMPP (2011 £292 million payment). Significant ongoing/other pension cash costs of £467 million remain;
- Modernisation investment continues; and

Free cash inflow of £234 million (excluding RMPP deficit payments of £nil) showed a £155 million improvement on last year (excluding RMPP deficit payments of £292 million).

Free cash flow summary	2012 £m	2011 £m
EBITDA before pension costs	**1,131**	962
Working capital	**–**	(49)
Ongoing/other pension payments[2]	**(467)**	(479)
Pension deficit payment for the Royal Mail Pension Plan (RMPP)	**–**	(292)
Modernisation investment in UKPIL	**(429)**	(377)
Other capital expenditure and other exceptional costs	**(242)**	(241)
Other (dividends from joint venture and associates, tax, interest)	**(1)**	26
Cash outflow before disposal of assets	**(8)**	(450)
Disposal of property and non-core businesses	**242**	237
Free cash inflow/(outflow)	**234**	(213)

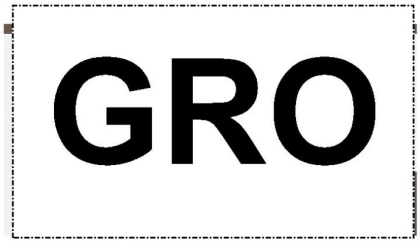
- Net debt has decreased by £63 million, mainly due to cash generation, partly offset by increases in finance leased assets and non cash interest;
- The accounting pension deficit decreased from £4.5 billion in 2011 to £2.9 billion in 2012, mainly due to a net £4 billion improvement in the market value of pension assets – primarily investments in bonds;
- Pension escrow investments increased by £222 million, mainly as a result of increased gilt investment values and interest accrued;
- On 1 April 2012, after the balance sheet date, almost all of the RMPP pension liabilities and pension assets, built up until 31 March 2012, were transferred to HM Government. This arrangement left the RMPP fully funded on an actuarial basis in respect of historic liabilities at that date;
- After the balance sheet date, £149 million of pension escrow investments held by Royal Mail Group Ltd were made available to that company; and
- Royal Mail Holdings plc continues to hold £1.2 billion of investments which previously were held in pension escrow and which will not be transferred to Royal Mail Group Ltd or Post Office Limited.

Balance sheet summary	2012 £m	2011 £m
Net operating assets and investments in joint venture and associates	**1,177**	1,160
Net debt (cash/cash equivalents, less loans/borrowings, finance lease obligations)	**(902)**	(965)
Other net liabilities/assets (taxation, derivatives)	**(5)**	38
Net assets before pension deficit and pension escrow investments	**270**	233
Pension deficit	**(2,922)**	(4,501)
Pension escrow investments:		
– in Royal Mail Holdings plc	**1,234**	1,074
– in Royal Mail Group Ltd	**149**	87
Net liabilities	**(1,269)**	(3,107)

[2] Includes pension payments relating to redundancy of £39 million (2011 £30 million), all of which relates to modernisation, and £8 million (2011 £7 million) pension deficit payments relating to the Royal Mail Senior Executives' Pension Plan.

RMG00000342
RMG00000342

Financial review



Matthew Lester
Chief Finance Officer

Summary Group results

The Group has delivered an improved financial performance in 2011-12, with each of the three key business segments, UK Parcels, International & Letters (UKPIL), General Logistics Systems (GLS) and Post Office Limited growing both revenues and profits both before and after modernisation costs. Importantly, the UKPIL business broke even after modernisation costs, but its margins are still very low given the risks and challenges it faces and when compared to other major postal operators.

The trading performance resulted in EBITDA of £712 million (2011 £504 million). In addition, the Group generated a free cash inflow - for the first time in four years - of £234 million compared to an outflow of £213 million last year. This improvement was mainly as a result of a £292 million pension deficit payment to the company's main pension plan, the Royal Mail Pension Plan (RMPP), last year, for which there has been no such payment in 2011-12.

The following table highlights the segmental results of each business unit:

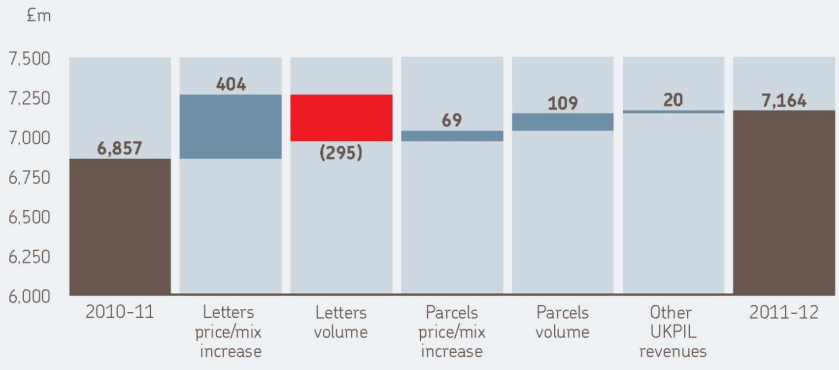
	External revenue		Operating profit before modernisation costs[1]		Operating profit/(loss) after modernisation costs[1]	
Business unit performance	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
UK Parcels, International & Letters (UKPIL)	**7,164**	6,857	**252**	72	**23**	(120)
General Logistics Systems (GLS)	**1,562**	1,485	**128**	118	**128**	118
Other businesses	**5**	38	**1**	20	**1**	20
Group excluding Post Office Limited	**8,731**	8,380	**381**	210	**152**	18
Post Office Limited	**801**	776	**61**	36	**59**	21
Group totals	**9,532**	9,156	**442**	246	**211**	39

Segment performance is discussed in the relevant preceding sections.

External revenue

The Group's external revenue increased by £376 million to £9.5 billion, the main driver being revenue growth in UKPIL of £307 million, as shown in the table below.

UKPIL External Revenue
Prior year to current year



UKPIL revenues were £307 million higher at £7.2 billion, due to a 10 per cent improvement in parcel revenues (driven by higher volumes and price increases). Letter price increases in April and May 2011 have offset the volume decrease in letters of six per cent.

[1] Before other operating exceptional items.

RMG00000342

GLS revenues
GLS revenues increased by £77 million to £1.6 billion and, excluding the foreign currency exchange impact on GLS' Euro revenues, underlying growth was four per cent. GLS parcel volumes increased by three per cent, with strong growth in international volumes, and prices also increased by one per cent. There was some softening of growth in the second half of the year, due to a weakening in the European economies and an increase in competition for domestic parcel volumes from the major European postal operators.

Post Office Limited and other businesses revenues
Post Office Limited revenues increased by £25 million to £801 million, including an increase in the Network Subsidy Payment from HM Government of £30 million. Growth in personal financial services and identity-related services was more than offset by a reduction in telephony income due to reduced customer numbers and the decline in traditional Government and financial services, resulting in revenue decreases of £5 million.

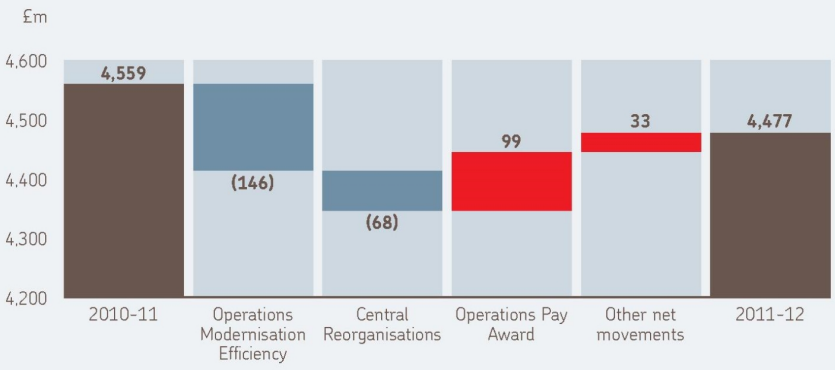
Other businesses' revenues contracted, as expected, following the sale of the Romec Services Limited business (a subsidiary of Romec Limited) early in 2011-12.

Group costs (including modernisation costs)	2012 £m	2011 £m
People costs	**(5,657)**	(5,717)
Distribution and conveyance costs	**(1,758)**	(1,619)
Other operating costs	**(1,707)**	(1,602)
Operating costs before exceptional items	**(9,122)**	(8,938)
Modernisation costs (operating exceptional items)	**(231)**	(207)
Total operating and modernisation costs	**(9,353)**	(9,145)

Operating costs before exceptional items of £9.1 billion have increased by £184 million. Excluding the foreign currency exchange impact on GLS' Euro cost base, costs increased by £159 million (two per cent). This compares favourably to an annual inflation rate of five per cent. Lower people costs have been more than offset by expected increases in non-people costs.

The decrease in people costs of £60 million was mainly due to £82 million (two per cent) lower costs in UKPIL. GLS people costs increased by £14 million due to higher volumes and bolt-on acquisitions and Post Office Limited's people costs were higher by £5 million.

UKPIL – People costs
Prior year to current year



UKPIL people costs are £146 million lower due to modernisation of the network. This resulted in a reduction in gross frontline (upstream and downstream) hours of three per cent[2] (2011 two per cent). Savings of £68 million were made from the Group reorganisation, which began in the Autumn of 2010. 2,093 people have left UKPIL on voluntary redundancy terms since September 2010. These savings were offset by higher pay costs of £99 million, comprising a 1.4 per cent pay increase and the move to a shorter working week once local modernisation targets are achieved.

[2] Includes processing hours.

RMG00000342

Financial review (continued)

Group distribution and conveyance costs of £1.8 billion have increased by £139 million, with £77 million principally due to volumes in UKPIL's Royal Mail International and GLS and £49 million higher vehicle costs – as the delivery network is modernised – and higher fuel costs in UKPIL.

Other Group operating costs have increased by £105 million to £1.7 billion, mainly due to a £25 million current year foreign currency exchange impact in GLS and £59 million higher infrastructure costs (including depreciation, IT and property costs).

Modernisation exceptional costs are £24 million (12 per cent) higher at £231 million, with £229 million relating to UKPIL as shown below.

UKPIL modernisation exceptional costs	2012 £m	2011 £m
Voluntary redundancy	**(77)**	(224)
Business Transformation costs	**(87)**	(32)
One-off project costs	**(60)**	(8)
Property onerous leases and impairments	**(5)**	(29)
Total before legacy share scheme write back	**(229)**	(293)
Legacy share scheme write-back	**–**	101
Total	**(229)**	(192)

Voluntary redundancy costs of £77 million are £147 million lower than last year as a result of the earlier provision for the significant mail centre closure programme that was announced in 2010-11. To date, 16 mail centres have been closed. A further 18 have been through the appropriate consultation process, and are expected to be closed over the period to 2015.

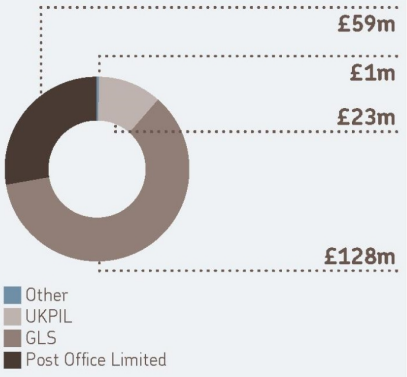
The £87 million Business Transformation costs relate to the pay and modernisation 2010 agreement whereby frontline colleagues receive payments up to £1,000 based on specific milestones and specific bonuses with respect to modernising the network in 2011-12.

£60 million has been charged within one-off project costs, mainly relating to key business modernisation projects such as Delivery Methods, Mail Centre strategy and automation kit deployment.

The legacy share scheme write-back of £101 million was recognised last year when it was confirmed that the scheme had no value.

Operating profit after modernisation costs by business unit (£m)
All four of the Group's business segments returned an operating profit after modernisation costs[1], resulting in a Group operating profit after modernisation costs of £211 million, with GLS contributing 61 per cent of the Group total as shown below.

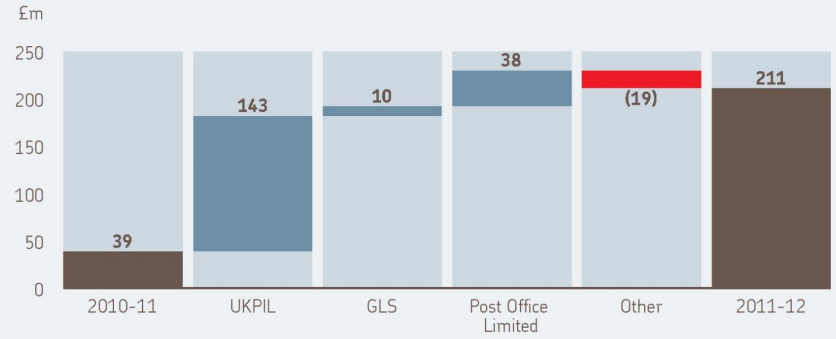
Profit after modernisation costs before other exceptional items – £m



RMG00000342

Operating profit after modernisation costs – growth/(decline) by business unit (£m)
The Group operating profit after modernisation costs[1] of £211 million is £172 million higher than last year as shown below.

Operating profit growth/(decline) after modernisation costs before other operating exceptional items



Share of post tax profit from joint venture and associates
The Group's share of post tax profit from its joint venture and associates of £32 million increased by £4 million from £28 million last year, mainly due to higher profit in the First Rate Exchange Services (FRES) Bureau de Change joint venture in Post Office Limited.

Net exceptional items, including modernisation costs

Exceptional items	2012 £m	2011 £m
Operating exceptional items:		
- Modernisation costs (see p93)	**(231)**	(207)
- Other	**(93)**	(88)
Non-operating exceptional items:		
- Asset disposals	**157**	65
- Business disposals	**26**	44
Net exceptional items	**(141)**	(186)

Modernisation costs are treated as operating exceptional items because of their nature and/or size. An analysis of these costs relating primarily to UKPIL, is shown on p93.

Other operating exceptional items mainly comprise £36 million for Post Office Limited's asset impairments, £24 million costs associated with State Aid and the Postal Services Bill and £15 million of Romec Limited transformation costs.

Non-operating exceptional items recorded during the year relate to property disposals of £157 million, £104 million of which relates to the sale of the Rathbone Place property and £26 million of business disposals, mainly £25 million from the sale of the Group's investment in Romec Services Limited (a subsidiary of Romec Limited).

RMG00000342

Financial review (continued)

Net finance and pension interest costs
Net finance and pension interest costs of £38 million (2011 £212 million) comprise £26 million net pension interest credit (2011 £167 million charge) and £64 million (2011 £45 million) net finance costs relating to cash and debt. The net pension interest credit is explained in the pensions section on p45.

Net finance costs of £64 million (2011 £45 million) comprise finance costs of £118 million (2011 £114 million), offset by finance income of £54 million (2011 £69 million).

Taxation
The taxation charge of £10 million (2011 £106 million) comprises £43 million current tax credit (2011 £17 million) with respect to UK operations, a £38 million (2011 £35 million) current tax charge on overseas profits, a UK deferred tax charge of £8 million (2011 £79 million) and an overseas deferred tax charge of £7 million (2011 £9 million). In 2011 the Group's UK deferred tax assets were written down and remain at a minimal level.

Free cash flow
EBITDA before pension costs of £1.1 billion is £169 million higher than £962 million last year, due to the improved Group trading performance.

Pension payments of £467 million are £304 million lower than last year's £771 million, mainly due to a £nil pension deficit payment (2011 £292 million) to the Royal Mail Pension Plan (RMPP), as a result of the transfer of almost all of the pension liabilities and pension assets of the RMPP to HM Government on 1 April 2012.

Disposal of assets of £242 million mainly comprises property sales of £203 million and the sale of Romec Services Limited of £29 million.

Modernisation investment in UKPIL of £429 million mainly comprises £129 million (2011 £108 million) redundancy related payments, £185 million (2011 £166 million) capital expenditure and £58 million (2011 £25 million) Business Transformation payments.

RMG00000342

Net debt
The table below provides a summary of the Group's net debt position, as per the balance sheet at 25 March 2012.

	2012 £m
Cash and cash equivalents (including £759m (2011 £704m) in the Post Office network)	**1,293**
Financial assets – short-term deposits (including bank, government/local government)	**31**
Interest bearing loans and borrowings (current)	**(377)**
Interest bearing loans and borrowings (non-current)	**(1,522)**
Financial liabilities – obligations under finance leases (current)	**(90)**
Financial liabilities – obligations under finance leases (non-current)	**(237)**
Total net debt	**(902)**

Net debt has decreased by £63 million year on year as shown in the table below.

	2012 £m
Net debt brought forward at 28 March 2011	**(965)**
Free cash flow (see p94)	**234**
Interest earned on pension escrow investments (included within the free cash flow above)	**(45)**
Cash purchase of pension escrow investments (not in net debt) – replacing mortgage on Rathbone Place property sold during the year	**(44)**
Increase in loans and borrowings – accrued non cash interest on shareholder loan	**(45)**
Increase in new finance lease obligations – non cash	**(33)**
Foreign currency exchange impact on cash and cash equivalents	**(4)**
Net debt carried forward at 25 March 2012	**(902)**

Pensions and events after the reporting period
On 1 April 2012 – after the granting of State Aid by the European Commission on 21 March 2012 – almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP), built up until 31 March 2012, were transferred to HM Government. On this date, the RMPP was also sectionalised, with Royal Mail Group Ltd and Post Office Limited each responsible for their own sections in future. This arrangement left the RMPP fully funded on an actuarial basis in respect of historic liabilities at this date.

Royal Mail Holdings plc continues to hold £1.2 billion of investments. which were previously held in pension escrow and which will not be transferred to Royal Mail Group Ltd or Post Office Limited. The £149 million of investments which were previously held in pension escrow in Royal Mail Group Ltd were made available to that company on 1 April 2012.

RMG00000342

Financial review (continued)

Pension Plans

Royal Mail Group Ltd is the sponsoring employer for the Royal Mail Pension Plan (RMPP) and the Royal Mail Senior Executives' Pension Plan (RMSEPP) (both defined benefit plans albeit on a career average), and for the Royal Mail Defined Contribution Plan (RMDCP). At the balance sheet date, based on assets, the RMPP is one of the largest pension plans in the UK. The assets and liabilities of the defined benefit plans, as measured under accounting standards, are reported as a net pension deficit in the Group balance sheet at 25 March 2012.

The gross assets and liabilities and the net deficit are significantly larger than any of the Group's other assets and liabilities. This results in the Group being one of the most exposed UK corporates to pension volatility, particularly with respect to movements in equity values and future expectations of inflation and bond rates.

Both defined benefit plans are now closed to new members. New employees are offered membership of the defined contribution plan, RMDCP.

	2012 £m	2012 £m
Operating pension costs	**(419)**	(458)
Exceptional pension costs (relating to redundancy)	**(15)**	(47)
Net pension interest credit/(charge)	**26**	(167)
Pension charges	**(408)**	(672)

The £39 million decrease in operating pension costs is principally as a result of market conditions, resulting in a pension charge in the RMPP that is 17.1 per cent of pensionable pay, compared to 17.8 per cent last year, together with a reduction in the number of people employed. The percentage applied to the pensionable payroll is determined at the beginning of the financial year and is intended to represent the amount by which liabilities will increase due to employing active members for one more year.

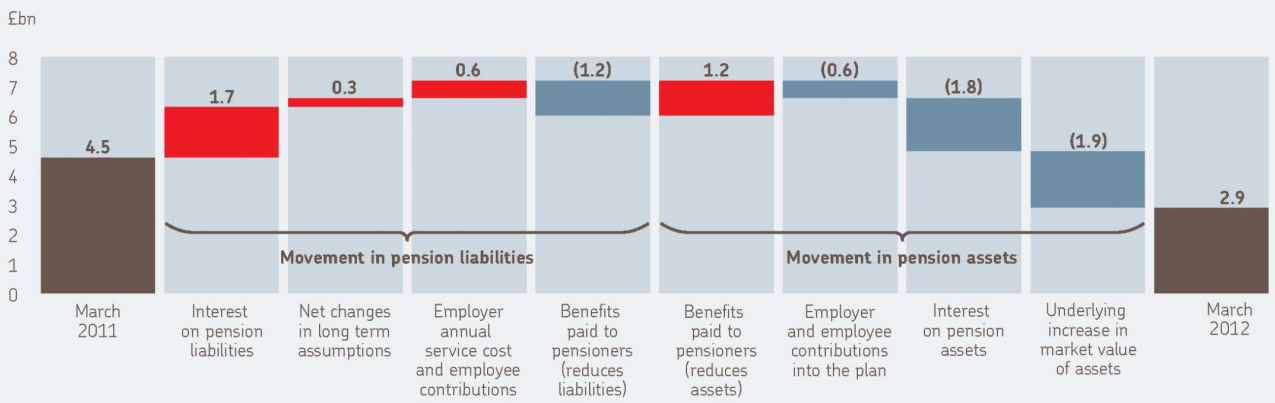
The net pension interest credit reflects the unwinding of the discount on the plans' liabilities, less the long-term expected rate of return on the plans' assets.

Whilst almost all of the pension liabilities and pension assets of RMPP were transferred to HM Government on 1 April 2012, the Royal Mail Group (excluding Post Office Limited) ongoing pension costs and plan assets/liabilities, relating to the pensions of approximately 115,000 active members, who are accruing benefits earned on a career salary basis and those within the defined contribution schemes, will continue to be material.

Pension balance sheet amounts

The balance sheet pension deficit has reduced from £4.5 billion at March 2011, to £2.9 billion at March 2012. The reduction in the deficit is shown below:

Accounting Pension Deficit Movement



RMG00000342

The movements in the pension liabilities include:

- Interest on the brought forward pension liabilities using the March 2011 discount rate – this is mainly due to the unwinding of the discount factor of 5.5 per cent on the brought forward liability of £32 billion (approximately 5.5 per cent x £32.2 billion equates to approximately £1.7 billion higher liability). In line with the relevant accounting standard IAS 19, an AA corporate bond rate has been used to discount plan liabilities;
- The changes in long-term assumptions which comprise a higher liability as the discount factor has reduced from 5.5 per cent to 5.1 per cent, offset by lower future pension payments due to RPI and CPI reducing;
- The annual ongoing pension cost of £0.4 billion charged to the income statement "people costs" line at a 17.1 per cent rate. Employee contributions increase the total to £0.6 billion; and
- Benefits paid to members of £1.2 billion which reduce the liability.

And items that impact the pension assets include:

- Benefits to members which are funded from assets and which therefore reduce the assets;
- Ongoing Group contributions to the Plan included in cash flow at a 17.1 per cent rate, together with employee contributions;
- The expected rate of return on pension assets based on the March 2011 6.5 per cent blended rate (6.5 per cent x £28 billion assets equates to £1.8 billion higher asset); and
- The additional increase in market value of pension assets, which is mainly driven by the holding in bonds.

Pension cash payments for all Plans

Following the transfer of almost all of the pension liabilities and pension assets of the RMPP to HM Government explained on the previous page, the funding of ongoing pension contributions into RMPP and deficit payments into RMSEPP will be discussed with the respective pension trustees. The amounts disclosed in the table below are based on existing arrangements for the 2011-12 financial year.

Pension cash funding: Group contributions	2012 £m	2012 £m
Regular pension contributions	**(420)**	(442)
Funding of pension deficit – RMSEPP	**(8)**	(7)
– RMPP	**–**	(292)
Payments relating to redundancy	**(39)**	(30)
Net cash payments	**(467)**	(771)

Regular pension contributions have reduced from £442 million to £420 million in line with lower pensionable pay. The regular future service contributions cash rate for RMPP expressed as a percentage of pensionable pay remained at 17.1 per cent (2011 17.1 per cent). The regular rate of employee contributions for the RMPP remains unchanged at six per cent.

Deficit recovery payments by the Group have decreased by £291 million from £299 million last year. The £8 million (2011 £7 million) deficit payment relates to the RMSEPP. There was no RMPP deficit payment as a result of State Aid clearance granted on 21 March 2012 and the subsequent transfer of almost all of the pension liabilities and pension assets of the RMPP to HM Government on 1 April 2012.

Treasury management overview

Up to 25 March 2012, Royal Mail Group operated a central Treasury function that managed £1.4 billion of financial asset investments (substantially all of which were held in escrow in favour of the pension fund trustees until April 2012) and £1.3 billion of cash and cash equivalent investments (including £759 million cash in the Post Office network funded partly by a Government loan facility), in accordance with investment restrictions set by the Government. It also managed £2.2 billion of financial liabilities (mainly Government borrowings) and acted as internal banker for all of the Group's business units. The Group finances its operations largely through cash generated from its operations, borrowings and grants.

Following the transfer of Post Office Limited from under the ownership of Royal Mail Group Ltd to Royal Mail Holdings plc on 1 April 2012, Post Office Limited now has an independent Treasury function and manages its own financial assets (including network cash) and financial liabilities (mainly Government loans).

RMG00000342

Financial review (continued)

Henceforth, the Royal Mail Group Treasury function derives its authority from the Royal Mail Group Ltd Board (in respect of the £1.2 billion investments held by Royal Mail Holdings plc it derives its authority from the Royal Mail Holdings plc Board), and provides quarterly monitoring reports for the Board's review. It only has the authority to undertake financial transactions relating to the management of the underlying business risks; it does not engage in speculative transactions and does not operate as a profit centre. All strategies are risk-averse, and the treasury policy has remained substantially unchanged during the year. The principal financial instruments are Treasury bills, Government gilt-edged securities, deposits and long and short-term borrowings.

Facilities

The terms of the Government borrowing facilities and the associated Framework Agreement impose strict constraints on the separation of cash funds within the Group and the purposes for which they can be used. During the year, Royal Mail Group Ltd generated cash but did not reduce its borrowing from Government as redrawing of the outstanding facilities was not permitted. Since the year end, one of the Royal Mail Group Ltd loan facilities was amended to increase flexibility, allowing repayment and redrawing against that facility. An associated arrangement fee was paid, and commitment fees were increased in connection with this amendment. Subsequent to this, during April and May 2012, Royal Mail Group Ltd repaid £600 million of the total outstanding amount.

Covenants

Loan covenants for Royal Mail Group Ltd are tested on a rolling 12-month basis in September and March. Early in 2011, Royal Mail Group Ltd anticipated the possible breach of covenants resulting from its forecast cash requirements during 2011-12 and an expected pension deficit payment in March 2012. To mitigate this, Royal Mail Group Ltd and the Government concluded discussions which reset a number of the key loan covenants for the 12-month testing periods ending March 2011 and September 2011 and March 2012. The revisions were considered to be on a commercial basis with an arrangement fee and an increase in the borrowing margin, and the revisions were effective up to and including 25 March 2012. The covenants and margin reverted to their original terms from that point onwards, which Royal Mail Group Ltd considers to be manageable on the basis that the pension deficit payments will be significantly reduced from April 2012. All loan covenants were met at September 2011 and March 2012.

At 25 March 2012 the Group was financed as follows:

Borrower: Royal Mail Group Ltd **Purpose**	Average interest rate of loan drawn down %	Facility end date	Facility £m	Utilised £m	Average Loan maturity date
GLS funding	5.8	2021-2025	500	500	2023
Capital Expenditure and Restructuring	2.2	2014	600	600	2014
General Purpose/Working Capital	–	2014	300	–	–
General Purpose/Working Capital	12	–[3]	422	422	–[3]
Borrower: Post Office Limited **Purpose**					
Network cash	0.8	2016	1,150	377	2012
Total facility/facilities utilised			**2,972**	**1,899**	

Financial risks and related hedging

The Group is exposed to currency and commodity price risk. The Group operates hedging policies which are described in the notes to the financial statements. The exposures for Royal Mail Group (excluding Post Office Limited) (before hedging) are set out in the table below, together with how much the 2012-13 operating profit would differ from 2011-12 as a result of the changes in commodity costs/exchange rates up to 25 March 2012, post the impact of the respective hedging programmes.

[3] Loan facilities are repayable on the later of March 2016 and the release of the pension escrow investments. The loan (and facility) increased by £45 million (2011 £40 million) as a result of accrued interest added to the loan balance. This Royal Mail Group Ltd loan is subordinate to all other creditors.

RMG00000342

Exposure – Royal Mail Group (excluding Post Office Limited)	Impact on operating profit of a 5% increase in price/ weakening of sterling (before hedging) £m (loss)/gain	Impact of no further change in price/rate on 2012-13 operating profit versus 2011-12 (post hedging) £m (loss)/gain
Diesel and Jet	(5)	(12)
US$	(5)	(1)
Euro	(15)	(1)

It is anticipated that there will be a £12 million adverse impact on profits arising from the change in effective (post hedging impact) diesel costs from 45ppl in 2011-12 to an anticipated 51ppl in 2012-13. Without hedging, this adverse variance would be £20 million (based upon closing fuel prices at 25 March 2012).

The currency exposure arises mainly from the Group's trading with overseas postal operators, the profits of GLS and inter-company loans with GLS. There is a significant degree of offset between these exposures and hedge programmes in place which reduce the impact on 2012-13 operating profit.

The Group manages its interest rate risk by maintaining a mix of fixed and floating rate debt. At the year end 61 per cent of the Royal Mail Group Ltd loans were at fixed rate to maturity. Consequently (and taking into account financial assets held but excluding the pension escrow investments), an increase of 100 basis points to interest rates during the year end would have resulted in a reduction to profit of £1 million. The impact of such a change in rates to the pension escrow investments would affect equity and would offset to some degree the impact of the interest rate change on the pension liabilities.

Counterparty risk is managed by limiting aggregate exposure to any individual counterparty based on their financial strength.

GRO

Matthew Lester
Chief Finance Officer
Royal Mail Group
27 June 2012

RMG00000342

Business risk

The Corporate Governance section describes in detail how the Group manages its risk from the Holdings Board level, its respective sub-Committees and through the organisation. Further details can be found on pages 64-71.

The table below details the principal business risks, their impact and how the Group mitigates these risks.

Principal risk	Impact	Mitigation
Changes in customer preferences		
Customer behaviours are constantly evolving and competition is increasing. Consequently, there is a risk that our product offerings and revenue diversification initiatives, and the customer experience we provide, may not meet changing customer needs. In addition, price increases could trigger significant volumes of physical mail bypassing Royal Mail, downtrading to lower revenue products and acceleration in e-substitution.	The market and our share of it may shrink more rapidly than we expect, leading to lower growth rates and profitability. Third parties may set up discrete bypass networks in urban areas.	• We have placed significant focus on the key growth area of parcels, including investment in Parcelforce Worldwide and enhancing the core network to accommodate new traffic; • We have introduced initiatives to improve our product delivery and the customer experience to drive loyalty and recommendation; • We have held discussions with key stakeholders on the risk of competitor bypass to our financial models; • The focus of our product development and sales resource is on growth opportunities with the greatest potential for added value, especially outside e-substitutable markets. This includes a ring-fenced seed fund for new ideas. At the same time we have programmes to simplify our existing product portfolio; and • We review the reliability of our price elasticity models, and have extended our analysis to give improved insight on elasticities by customer type.
Economic environment		
Historically, there has been a correlation between the state of the UK economy and the level of mail volumes. There is a risk that the continuation of flat or adverse economic conditions could impact our ability to stay profitable, either by reducing volumes or by encouraging downtrading to lower revenue products. Our price rises, though necessary, exacerbate this risk. Additionally, we have significant European operations, and current uncertainty and economic weakness in the Eurozone could impact these businesses.	Adverse economic conditions and uncertainty would have a direct impact on mail volumes and, consequently, on Group revenues and profit. Economic conditions may impact the ability of key customers or critical suppliers to continue trading. This would directly impact our revenues or day-to-day operations.	• We continually review our costs to find areas where we can mitigate the impacts of any downturn; • We have conducted a programme of organisational restructures to reduce managerial headcount in line with changing business volumes, and monitor closely our progress in realising these savings; • We have negotiated substantial loan facilities, and monitor the position of these continuously, to ensure we stay within limits and covenants; and • We have robust econometric models to provide early warnings of changes to overall volumes and the profile of postings. We continually review these models to better anticipate the impact of price rises and reflect the increasingly deregulated market.

RMG00000342

Principal risk	Impact	Mitigation
Preparing for attracting external capital		
We need to be in a position to implement the provisions of the Postal Services Act 2011, including: reaching a sufficient state of readiness to attract private capital; overseeing an efficient separation of Post Office Limited from the rest of the Group and delivering an effective pension solution. As a recipient of State Aid, HM Government must submit to the European Commission annual reports about progress with our restructuring.	Far-reaching reforms are required to protect Royal Mail's Universal Service and uniform price obligations. Without the changes provided for by the Postal Services Act 2011, we would be unable to generate sufficient cash to meet these obligations on a sustainable basis.	• We are investing in our processes and data readiness to help ensure we are in a position to meet any demands of transaction due diligence; • We are working closely with advisors on balance sheet restructuring, and engaging and involving the Shareholder to ensure it has a full understanding of our plan and business case; • Negotiations on balanced commercial arrangements between Post Office Limited and Royal Mail Group have been concluded, and detailed migration plans have been put in place and are underway; and • There is ongoing dialogue with Ofcom to minimise the risk that the regulatory regime will be a barrier to our initiatives to drive profitability.
Business modernisation		
We are undergoing a significant, extensive modernisation programme to improve our equipment and technical and IT infrastructure, and operating models. The success of the business strategy relies on successful extraction of benefits from the programme, whilst maintaining key business outcomes such as quality of service levels.	Failure to implement our modernisation programme effectively and extract benefits would impact our ability to compete. At the same time, a reduction in Quality of Service standards would result in loss of traffic and in regulatory sanctions. Failure to improve our IT infrastructure would increase the risk of delivery or security shortfalls, and the risk that the IT platform might not be able to support the business plan initiatives.	• The progress and outcomes of all revisions to operational practice are tracked on a weekly basis to ensure completion to time and the sharing of good practice and lessons learned. Quality of Service is a fundamental consideration prior to any change; • Our World Class Mail initiative is being embedded into delivery operations to ensure that operational change is backed up by cultural change; • We closely monitor our progress in realising staff number reductions, in line with what is enabled by operational changes; and • We are redesigning the IT strategy and bringing the IT system up to date to ensure that we have the infrastructure to meet the business' needs.

RMG00000342

Business risk (continued)

Principal risk	Impact	Mitigation
Risks inherent in the postal industry		
The postal industry has specific characteristics that bring particular operational and commercial risks. Operations are at risk of disruption by, for example, adverse weather, industrial action, operational change, terrorism (either as a target or a conduit), or failure of critical suppliers. In addition to the changing regulatory regime in the postal sector, there is a risk of non-compliance with a wide range of legal and regulatory requirements, such as procurement and competition law, and financial services and data security regulations.	Breakdowns in the network would reduce quality of service, increase costs and reduce revenue, and damage our reputation. Failure to meet regulatory requirements could result in resource-hungry investigations, with potentially severe financial consequences and reputational damage.	• Business continuity plans are owned, maintained and reviewed by the Operations Executive; • We have put in place a communication model to keep customers appraised of potential or actual service impacts; • We will continue to engage constructively with Ofcom; • We are developing a structured approach to relationship management for key suppliers; contract management activity plans are deployed for all significant new contracts; • Our regulation team works with key HM Government and EU stakeholders on future legislative changes; • The Risk Management Committee conducts formal, ongoing environmental scanning to identify emerging risks and root causes of incidents that have impacted other businesses and might have implications for Royal Mail; and • We have an extensive compliance programme, including risk identification, training and communications, raising awareness, and improved processes and procedures.

RMG00000342

Corporate responsibility

Our communities

Wages and other related people costs – money that UK employees go on to spend throughout the UK economy:

£5.3 billion

Money spent on procurement related activity:

£2.4 billion

Royal Mail Group UK colleagues signed up to Payroll Givings Scheme:

over 40,000

or around one in four Royal Mail Group UK colleagues.





£45 million

donated to over 975 charities since the Payroll Giving Scheme was launched in 1989.

Awarded Guinness World Record for the most registered charities supported by a Payroll Giving Scheme.

Our environment

We were the first postal services operator to achieve the prestigious

Carbon Trust Standard



Decommissioned bikes donated to African charity partners Re-Cycle and The Krizevac Project:

2,868



Our 7,500

UK-based suppliers adhere to the UN Global Compact provisions which include clear environmental criteria.

Our customers

Proportion of our customers that think we are an important part of their local community:

81 per cent



Number of people from low-income households who could buy their 2012 Christmas stamps at 2011-12 prices:

5 million



58 million

UK inland addressed items (on average) are processed and delivered every working day.

RMG00000342

Corporate responsibility (continued)

Royal Mail Group makes a major contribution to the UK's social and economic infrastructure. As the sole provider of the Universal Service, we play a vital role, connecting millions of customers, businesses, organisations and communities – including those in the most remote rural areas.

The Group makes one of the single biggest economic contributions of any UK company. We employ nearly 159,000 people in the UK through UKPIL and Post Office Limited. In 2011-12, we paid £5.3 billion in UK wages and other related people costs – money that employees go on to spend throughout the economy.

During the financial year, Royal Mail Group also contracted business from over 7,500 UK-based suppliers, and spent £2.4 billion on procurement related activity.

Protecting the Universal Service

Royal Mail Group is committed to protecting and upholding the Universal Service against a backdrop of market decline. As the UK's sole provider, we aim to fulfil our obligation consistently and on a commercial basis. At the same time, we need to continue to leverage our unique position in the UK's economy and society to benefit all of our stakeholders.

During the year, Royal Mail Group achieved a "Platinum" ranking in Business in the Community's Corporate Responsibility Index. A recent Ipsos MORI poll showed that our employees want greater awareness of our role in communities. To that end, in 2012-13 we are further engaging our people to help drive our performance and to continue to make a positive impact in the communities we serve.

A balanced approach

Corporate responsibility is integral to the transformation of Royal Mail Group. It is as much about how we generate our revenues as how we spend what we earn. It means behaving responsibly and sustainably in relation to our people, customers, suppliers, communities and environment.

In 2011-12, we reviewed all of our corporate responsibility and community investment strategies. These now reflect the fact that our corporate responsibility activity must be focused on improving our financial performance, as well as our social and economic impact.

Our revised corporate responsibility strategy focuses on:

- Delivering economic and social benefit to the communities we serve;
- Managing our modernisation programme responsibly;
- Driving colleague advocacy of the Group and its community role;
- Reducing the environmental impact of our business operations; and
- Communicating our management of corporate responsibilities openly and transparently.

In 2011-12, we integrated corporate responsibility into Royal Mail's overall governance structures. Our Board now reviews corporate responsibility and community investment strategies on a regular basis. Major corporate responsibility initiatives now come under the scrutiny of our Chief Executive's Committee.

Embedding sustainability

The 2011-12 launch of a new Corporate Balanced Scorecard encouraged focus on the integration of Royal Mail's corporate responsibility and business strategies. The Scorecard – applicable to all managers including the senior executive team – features criteria covering:

1. What our customers think of us and how we deliver for them.
2. What our people think of our company.
3. How well we are modernising our operations, including health and safety factors.
4. The financial health of the business.

These four areas - Customers, People, Performance and Financial – are integral to our core objective: to restore the Group to financial viability on a sustainable basis.

Dedicated to customer service

Our industry is almost unique in providing both a commercial service to paying customers and a service to the receiving household. On average, every working day, we process and deliver around 58 million UK inland addressed items, covering over 29 million UK addresses. Meeting the needs of our customers – large and small – is a core part of our business strategy.

To achieve this, we are currently delivering one of the biggest modernisation programmes in UK industry. We are working hard to maintain customers' trust and loyalty throughout this period of significant change.

RMG00000342

Corporate responsibility case study **1 of 2**

Change notwithstanding, our customers rightly expect us to keep our basic service promises – collecting and delivering on time and meeting and anticipating their needs. Consistent with our Corporate Balanced Scorecard, we set high targets for our Quality of Service and customer satisfaction rates. We are working hard to reduce the number of complaints we receive. Improving our performance in these areas is key to the sustainability of our business.

See "Our customers" (p18) for more information on how we manage our responsibilities to our customers.

Giving our best

Our employees have donated over £45 million through payroll giving since 1989; the money has helped 975 charities – a figure that has earned Royal Mail a Guinness World Record. Royal Mail employees account for six per cent of all payroll giving donors in the UK. On top of their payroll generosity, our people, including Post Office Limited employees, also helped raise over £1.1 million for charities and other good causes.

We have formed partnerships with other organisations to make a big difference at a local level. Our Charity of the Year programme is our flagship fundraising initiative. We have supported colleagues in raising over £2.6 million for the children's charity, Barnardo's, since our partnership began.

Royal Mail's matched funding scheme enables employees to maximise their contributions to the charities and causes that are important to them. In 2011-12, our employees claimed over £180,000 in matched funding.

Building hope through Barnardo's

Colleagues voted for Barnardo's to become our charity partner in 2008. Since then, Royal Mail's people and the company have raised over £2.6 million. This support has helped over 10,000 children and young people who are living in poverty, coping with disabilities and battling youth unemployment.

Colleagues from across the business have generated donations by going much further than the usual extra mile in a wide range of sponsored walks, hikes, bike rides, marathons and fun runs.

In addition, over 1,000 Royal Mail Group employees made a difference by volunteering their time for Barnardo's. Royal Mail Group has offered work placements and permanent employment to over 100 young people from Barnardo's projects.



"From us all at Barnardo's, we would like to say a huge thank you to everyone at Royal Mail Group for your generous support, enthusiasm and commitment to helping us change the lives of children for the better."

Anne Marie Carrie, Barnardo's CEO



For more information visit **www.royalmailgroup.com**

RMG00000342

Corporate responsibility (continued)

Corporate responsibility case study **2 of 2**

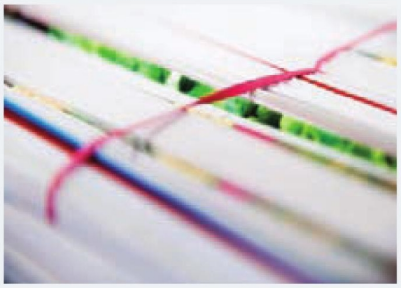
Stretch target

Royal Mail purchased around 635 million elastic bands in 2011-12 – roughly 10 per cent less than the previous year.

The reduction has been achieved through a combination of improved internal processes for the collection and reuse of bands and a coordinated communication programme targeting littering.

"Whilst this is a good start, we've still got a long way to go, which is why Royal Mail has an ongoing internal information campaign to build on this."

Geoff Hibberd, Royal Mail Senior Procurement Manager



During the year Royal Mail Group made charitable contributions of £5.2 million directly to charities and good causes across the UK, compared to £2.1 million during 2010-11.

We are removing most of the bicycles from our delivery rounds. We donate our decommissioned bicycles to the charities Re-Cycle and The Krizevac Project which ship them to Africa. Royal Mail bikes are highly prized as they are strong and able to carry heavy loads. We have donated 2,868 so far.

Better environmental management

Royal Mail operations should have a positive impact on our future and a minimal impact on the environment.

We were the first postal services operator to achieve the prestigious Carbon Trust Standard. This recognises our robust approach to measuring, managing and reducing our carbon emissions. Since 2004-05 we have reduced our carbon emissions by around 20 per cent.

In 2011-12 we bought low emission vehicles and double-deck trailers that will also help to reduce our emissions.

In 2012, we established a new Environment Governance Board with senior representation from across the Group. The Board will meet on a regular basis to drive our environmental strategy and develop longer term targets to enable us to continue improving our performance.

Treating suppliers fairly

Royal Mail Group's 7,500 UK-based suppliers are important to us. Therefore, we treat them fairly and pay them promptly.

Enforcing strict criteria regarding suppliers' social, ethical and environmental performance is a standard part of our procurement practices. All suppliers added to our supplier database are requested to confirm their adherence to the principles set out in our Responsible Procurement Policy. This policy is based on the UN Global Compact's 10 principles.

The Chartered Institute of Purchasing and Supply (CIPS) recently recognised our efforts in this area by awarding Royal Mail a certificate of excellence for our purchasing policies and procedures.

Political donations

In line with Group policy, no donations were made for political purposes (2011 £nil).

For more information visit **www.royalmail.com**

RMG00000342

Transparency

Last year, for the first time, our Annual Report included a section on transparency at Royal Mail.

As a public institution, we are legally obliged to be open about our operations. We also feel it is important to ensure information on our performance is comprehensible and comprehensive, when possible.

Freedom of information requests

Freedom of information	2012	2011
Number of requests	**604**	590
Answered in full	**236**	267
Answered in part	**111**	116
Not provided	**170**	137
Not held	**87**	70

Every day, Royal Mail receives questions about diverse aspects of our business. While we make every effort to respond to all requests fully, this is not always possible. As a commercial operation, we must decline some requests for information since answers could compromise competitiveness. Nor are we permitted to release any information that would be in breach of the Data Protection Act. In other cases, we do not hold the data requested. This year's figures on Freedom of Information requests are broadly comparable to those from 2010-11. They represent requests submitted to our Information Rights team.

Returned letters

Returned letters	2012	2011
Number of full-time employees	**140**	160
Number of items processed (m)	**21.2**	25.6
Revenue from items sold at auction (£m)	**1.2**	0.9
Cost of returned letters service (£m)	**3.4**	3.9

In 2011-12, we safely delivered the overwhelming majority of all items of mail we handled.

A very modest proportion proved to be undeliverable for a variety of reasons outside our control. These reasons included incomplete addresses, recipients who have moved without leaving a forwarding address and the lack of return addresses. For these types of mail, we hold information on the amount of mail processed at the National Returns Centre in Belfast. We do not hold an estimate of the number of items of undeliverable mail securely disposed of by other parts of Royal Mail.

Our National Returns Centre employs 140 people dedicated to either returning undeliverable items of mail to the sender or, if this is not possible, securely disposing of undeliverable mail. In 2011-12, the Centre processed 21.1 million items. That should be set against the total of some 15 billion inland addressed items of mail we handled in 2011-12.

The majority of items handled by the Centre are business mail. Under the terms of trade with our major business customers, if, for whatever reason, we cannot deliver the mail, we securely dispose of it unless a return address is included. This has been the practice for many years and is done in agreement with the customer. We store undeliverable, high-value items of mail for up to four months. The majority of items handled at the Centre have no sale value and if undelivered, are securely disposed of and recycled.

However, if an item is not claimed, and we can find no address to which to return it, and the item has some value, we put it out to auction. All the proceeds, minus a market rate commission for the auction house, are used to partially offset the considerable cost involved in seeking to reunite customers with items of undeliverable mail. The revenue from items sold at auction by the Centre for 2011-12 was £1.2 million. This income represented a modest contribution to the annual cost of £3.4 million of running the Centre and providing its service free to customers.

Exceptions to our delivery and collection service

Exceptions	2012	2011
Long-term delivery exceptions	**2,571**	2,571
Temporary delivery exceptions	**442**	414
Long-term collection exceptions	**2,100**	2,180
Temporary collection exceptions	**117**	155

Royal Mail aims to deliver and collect every item of mail that passes through our network. Sometimes this just is not possible. Our Exceptions Annual Review, published in October 2011, showed there were 3,013 addresses that were national Universal Service delivery exceptions in the UK. This was very slightly up on the number from the previous year.

Considering Royal Mail delivers to over 29 million UK addresses, the figure represents only 0.01 per cent of this total.

Long-term exceptions are typically made owing to difficulties our postmen and women experience attempting to access particular properties or where there is an unreasonable risk associated with making a delivery. As an example, if delivery required crossing hazardous terrain, we would make an exception to our normal service. Temporary delivery exceptions are less common but are mainly due to concerns for colleague safety as a result of dangerous dogs in customers' gardens.

During 2011-12, there were 2,100 long-term Universal Service collection exceptions across the UK. This represents 1.7 per cent of the 125,767 collection points across the UK. These exceptions can be caused by difficulties in accessing post boxes. There were also 117 temporary collection exceptions of more than four months. These were due to road or building works that limited access to post boxes. We report all such exceptions to Ofcom on a regular basis.

RMG00000342

Transparency (continued)

Mail security

Mail security	2012	2011
Number of prosecutions	**301**	312
Full criminal investigations into internal crime raised	**771**	993
Full criminal investigations into external crime raised	**194**	193

We are serious about the security of every item of mail we collect and deliver. Our security team works round the clock to identify any threats to the network and we have robust measures in place to deal with any breaches.

Royal Mail Group will prosecute anyone found to be stealing or interfering with mail in England and Wales. The Procurator Fiscal deals with cases in Scotland. In Northern Ireland, this is the responsibility of the Public Prosecution Service. Post Office Limited also pursues prosecutions for any thefts.

During 2011-12, 301 former employees of Royal Mail Group were prosecuted in the UK. There are nearly 159,000 UK employees and the number of prosecutions needs to be understood in this context.

Our security team proactively uses any available information to safeguard the integrity of the postal service. For the first time, we are releasing data on the team's investigation into internal and external crime. The number of investigations into external crime remained fairly constant from 2010-11 while there was a slight decrease in the number of new internal crime investigations.

Quality of Service

Quality of Service (%)	2012	2011
First Class retail	**92.7**	91.4
Second Class retail	**98.7**	98.2
Standard parcels	**96.1**	94.3
Special Delivery	**98.2**	97.8

Our figures on Quality of Service show an improvement in each of the above categories when compared to the previous year. For Second Class retail and standard parcels, we have exceeded our targets of 98.5 per cent and 90.0 per cent respectively. We are closer to our Special Delivery target of 99.0 per cent and are working hard to meet it. For First Class retail, we narrowly missed our target of 93 per cent but are over a percentage point closer to it when compared with last year. This is a challenging target. We are disappointed on behalf of our customers not to have achieved it. However, over 127,000 postmen and women remain determined to deliver the best possible service.

People

People	2012	2011
Safety (RIDDORs/1,000)	**14.3**	18.3
Engagement[1]	**56%**	N/A
Customer focus[1]	**70%**	N/A
Working days lost to strikes	**592**	89
Dangerous dog attacks	**3,186**	3,715

This new section focuses on some key metrics affecting our most important asset. The measures on safety, engagement and customer focus are derived from the Royal Mail Corporate Balanced Scorecard.

We continue to reduce injuries, diseases and dangerous occurrences. While we were helped by the mild weather conditions in early Winter 2011, this is a positive result as colleague safety is paramount.

Our employee engagement and customer focus results are taken from our 2012 employee survey, and are new measures for 2011-12.

The number of days lost to strike action has increased since last year from a very low base. This needs to be considered in the context of the total number of days worked by our people. We have robust procedures in place to mitigate the impact of strikes on our customers.

Unfortunately, dog attacks are a hazard faced by our postmen and women every working day. During 2011-12, there were 3,186 dog attacks on Royal Mail people. These attacks cause great distress and, in too many cases, serious injuries. If we feel that there is a risk from a dog, or any other animal, at an address, we are committed to working with the customer to agree simple steps to ensure that we can deliver the mail safely. We always welcome the cooperation of our customers for taking responsibility for keeping their pets under control. We also regularly communicate with our people about the dangers of dog attacks and provide advice on techniques to minimise harm in the event of an attack.

We are now working more closely with the Communication Workers Union to reduce the threat that dogs represent to our people and hope to make real progress during 2012-13. To this end, the Group Chairman, Donald Brydon, has launched an independent inquiry into the prevalence and consequences of dog attacks in the UK.

Customer

Customer	2012	2011
Net customer satisfaction (%)	**36.0**	31.0
Number of complaints	**439,600**	423,700

We always seek to deliver the highest standards of service for our customers. This is a particularly important part of our transparency and it is published here for the first time.

[1] New measure introduced in 2011-12.

RMG00000342

Our net customer satisfaction score is a measure from the Group Corporate Balanced Scorecard. An improvement plan is underway. This includes better communications with our customers to support them through this significant period of change, both operational and commercial.

We are working hard to improve performance in relation to customer complaints. This involves:

- Introducing dedicated redirections sorting frames to ensure a thorough process every day;
- Providing our postmen and women with more Postal Digital Assistants to capture signatures. We now have more than 44,000 of these devices;
- Ensuring that the correct procedures are carried out when using "Something for You" cards and extending our delivery to neighbour trial to reduce the need for redeliveries; and
- Keeping open around 600 enquiry offices up to two hours later on Wednesdays and Saturdays to give customers more flexibility when picking up items.

We also provide detailed annual disclosure on customer complaints to our regulator, which is publicly available.

The Post Office network

Post Office network	2012	2011
Post Offices branches open and trading	**11,818**	11,820
Crown branches	**373**	373
Agency branches	**11,445**	11,447

Network turnover

The vast majority of Post Office branches change hands – when subpostmasters decide to sell their business – without a break in service or closure. This is part of the normal market turnover of businesses in the UK. Around 97 per cent of Post Office branches are operated and owned by local business people who have a contract to offer Post Office Limited services. From April 2011 to March 2012, 950 branches changed hands. The previous year 800 changed hands. These successful transfers bring new energy and focus to our network.

There are cases where branches which are run by independent business people from their own premises close due to circumstances beyond our control. When a branch closes in such circumstances, we communicate the situation to the local community and stakeholders and work with them to restore a sustainable Post Office service when possible. In many cases, we are able to do this.

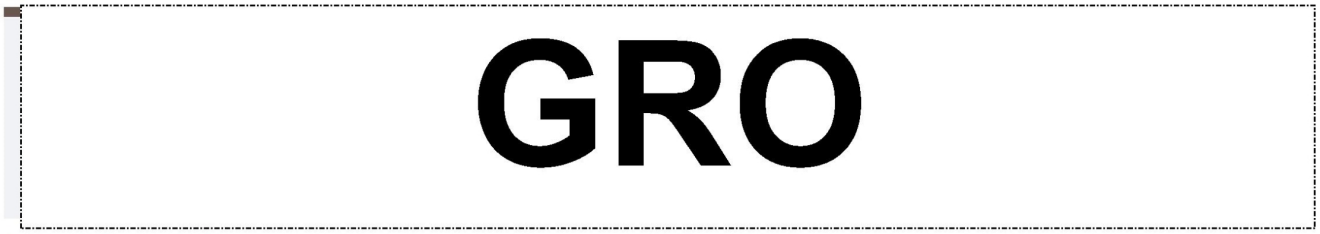
There are cases where this proves to be impossible, even after considerable efforts.

Whenever a Post Office branch is closed, for whatever reason or however briefly it is not included in the numbers we use when reporting network size. Our reported network size is 11,818 at the end of March 2012.



RMG00000342

Our Board of Directors

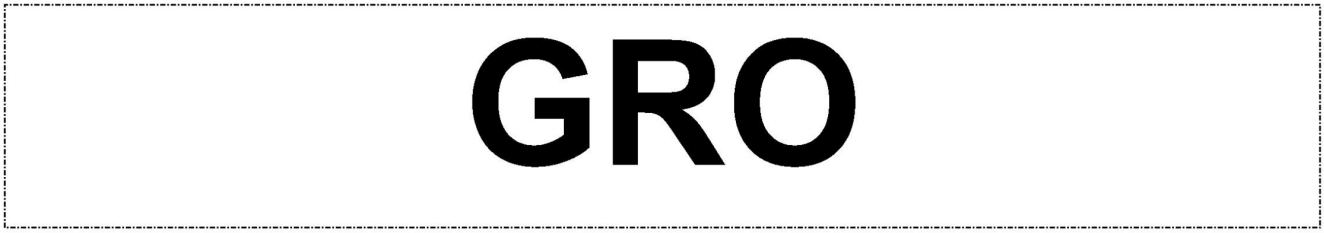


1. Donald Brydon CBE
Chairman

2. Moya Greene
Chief Executive Officer

3. Orna Ni-Chionna
Senior Independent Non Executive Director

4. Matthew Lester
Chief Finance Officer



5. Mark Higson
Managing Director, Operations & Modernisation

6. Paula Vennells
Managing Director, Post Office Limited

7. David Currie
Non Executive Director

8. Nick Horler
Non Executive Director



9. Cath Keers
Non Executive Director

10. Paul Murray
Non Executive Director

11. Les Owen
Non Executive Director

Details of membership of the various Board committees can be found on pages 66-68.

The Group's governance structure was revised after the year end to reflect the separation of Royal Mail Group and Post Office Limited. Please see the Chairman's comments on p8 for more details.

RMG00000342

1. Donald Brydon CBE Chairman, age 67

Appointed to the Board 27 January 2009 as a Director and 26 March 2009 as Chairman.

Skills and experience Donald had a career in finance, during which he ran two of the major global asset management companies owned respectively by Barclays and AXA. He has since chaired FTSE 100 companies, in addition to his experience in the drinks, power, market research and metals industries.

External appointments (current and former) Currently Chairman of Smiths Group. Formerly Chairman of the London Metal Exchange, Amersham plc, Taylor Nelson Sofres plc and the IFS School of Finance and a Director of Allied Domecq plc and Scottish Power plc. He is a past Chairman of EveryChild.

Committee membership Chairman of the Nomination Committee and a member of the Remuneration Committee.

2. Moya Greene Chief Executive Officer, age 57

Appointed to the Board 15 July 2010

Skills and experience Moya became President and Chief Executive Officer of Canada Post Corporation in 2005. In that role, she led a wide-ranging transformation programme to improve quality of service and efficiency across the organisation.

External appointments (current and former) Currently Director of Tim Hortons in Canada. Prior to joining Canada Post, she held senior roles at companies including Bombardier Inc and TD Bank.

Committee membership Chair of the Chief Executive's Committee.

3. Orna Ni-Chionna Senior Independent Non Executive Director, age 56

Appointed to the Board 1 June 2010. Orna was appointed as Senior Independent Non Executive Director on 1 April 2011.

Skills and experience Orna is a former Partner at McKinsey & Company, where she specialised in serving retail and consumer clients.

External appointments (current and former) Currently Senior Independent Director of HMV plc and Chair of Trustees of the Soil Association. Formerly Senior Independent Director of Northern Foods plc and of BUPA and a Non Executive Director of the Bank of Ireland UK Holdings plc and Bristol & West plc.

Committee membership Chair of the Remuneration Committee, member of the Audit & Risk Committee and the Nomination Committee.

4. Matthew Lester Chief Finance Officer, age 48

Appointed to the Board 24 November 2010

Skills and experience Matthew was previously Finance Director of ICAP plc for five years and has held a number of senior finance roles at Diageo plc, including Group Financial Controller.

External appointments (current and former) Matthew is a Non Executive Director of Man Group plc and a main Committee member of the 100 Group of Finance Directors.

Committee membership Member of the Chief Executive's Committee and Chairman of the Pension Committee.

5. Mark Higson Managing Director, Operations and Modernisation, age 56

Appointed to the Board 5 November 2007

Skills and experience Mark was previously divisional Chief Executive and Group Operations Director of BPB plc. He has also held senior positions at Courtaulds plc, HJ Heinz and British Aerospace.

External appointments (current and former) Currently President of the World Class Manufacturing Association (WCMA) and a member of the IPA Advisory Council.

Committee membership Member of the Chief Executive's Committee.

6. Paula Vennells Managing Director, Post Office Limited, age 53

Appointed to the Board 18 October 2010

Skills and experience Paula has worked for Post Office Limited since January 2007 in a number of senior roles, including Managing Director. She was previously Group Commercial Director at Whitbread plc. Before that, she held marketing and strategy & sales director roles with large retailers, including Argos/GUS, Dixons Stores Group and started her career with Unilever.

External appointments (current and former) Currently a Non Executive Director & Trustee for Hymns Ancient and Modern Group. Paula Vennells became CEO of Post Office Limited on 1 April 2012.

Committee membership None.

RMG00000342

Our Board of Directors (continued)

7. David Currie Non Executive Director, age 65

Appointed to the Board 1 January 2009

Skills and experience David was the founding Chairman of Ofcom (2002-April 2009), Deputy Dean of London Business School and Dean of Cass Business School, City University.

External appointments (current and former) Currently Chairman of the International Centre for Financial Regulation and on the Boards of BDO, the Dubai Financial Services Authority, IG Group plc and the Institute for Government.

Committee membership Member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

8. Nick Horler Non Executive Director, age 53

Appointed to the Board 1 April 2010

Skills and experience Nick was previously Chief Executive Officer of Scottish Power and has held senior strategic roles in major companies, both in the UK and abroad.

External appointments (current and former) Currently a Non Executive Director of Secure Electrans Ltd and The Go-Ahead Group plc. Nick is also interim CEO at Alderney Renewable Energy Ltd and also Chairs the Advisory Board for KPMG's Energy and Natural Resources Practice.

Committee membership Member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

9. Cath Keers Non Executive Director, age 47

Appointed to the Board 1 June 2010

Skills and experience Cath was previously Customer Director and Marketing Director of O2 UK and has held various marketing, strategy and business development roles at Next, SKY TV, Avon and Thorn EMI.

External appointments (current and former) Currently a Non Executive Director of Telefónica Europe, Home Retail Group plc and the insurance group LV=.

Committee membership Member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

10. Paul Murray Non Executive Director, age 50

Appointed to the Board 1 August 2009

Skills and experience Paul has been Chairman of the Audit & Risk Committee since August 2009 and is Audit Committee Chairman at Qinetiq plc.

External appointments (current and former) Trustee of Pilotlight. Formerly Senior Independent Director of Taylor Nelson Sofres plc and Group Finance Director of Carlton Communications plc and of LASMO plc.

Committee membership Chairman of the Audit & Risk Committee; member of the Nomination Committee and the Remuneration Committee.

11. Les Owen Non Executive Director, age 63

Appointed to the Board 27 January 2010

Skills and experience Les is a qualified actuary with 35 years' experience in the financial services industry. From 2000 to 2006, he was the Group Chief Executive Officer of AXA Asia Pacific Holdings Limited and responsible for AXA's Asian Life Insurance and Wealth Management operations.

External appointments (current and former) Currently Non Executive Chairman of Jelf Group plc and Non Executive Director of Computershare, CPP Ltd, Just Retirement Ltd and of Discovery Holdings, a South African listed health and life insurer. He was Chief Executive Officer of AXA Sun Life plc and a member of the Global AXA Group Executive Board and was, until 15 March 2012, a Non Executive Director of Post Office Limited.

Committee membership Member of the Audit & Risk Committee, the Nomination Committee, the Pension Committee and the Remuneration Committee.

Directors who left during the year
Richard Handover CBE 30 March 2011
David Smith 13 June 2011

RMG00000342
RMG00000342

Directors' report

The Directors present the Group Annual Report and audited Financial Statements for Royal Mail Holdings plc for the year ended 25 March 2012 (2011 27 March 2011).

Principal activities
The Group provides a nationwide and international distribution service, principally of mails and parcels. The Group also provides access to a wide range of financial and retail services through its network of Post Office branches across the United Kingdom. From 1 April 2012, the principal activities of Post Office Limited no longer form part of Royal Mail Group.

To enable you to assess how the Directors have performed their duty to promote the success of the Company, the Companies Act 2006 requires the Directors to set out in this report a fair review of the business of the Group during the year, the position of the Group at the end of the year and a description of the principal risks and uncertainties facing the Group. Information fulfilling these requirements can be found in the following sections of the Annual Report and Financial Statements and are incorporated by reference.

Index	Page
Review of business and future developments	1-17
Results	83-132
Dividends	130
Board of Directors	60-62
Political and charitable contributions	55-56
Research and development	119
Financial assets and liabilities	103-117
People	25-27
Corporate responsibility	53-56
Disabled employees	26
Going Concern	89

Policy on the payment of suppliers
The policy of the Company and its principal operating subsidiaries is to use their purchasing power fairly. Payment terms are agreed in advance for all major contracts. For lower value transactions, the standard payment terms of the supplier apply. It is the Company's policy to abide with the agreed terms. The Company and its principal operating subsidiaries in the UK have sought to comply with the Department for Business, Innovation and Skills' (BIS) Better Payment Practice Code. Copies of this can be obtained from BIS. As the Company is a non-operating company, the creditor days are zero. The creditor days of the operating subsidiaries are set out in their Annual Report and Financial Statements.

Land & buildings
The net book value of the Group's land and buildings, based upon a historic cost accounting policy and excluding fit-out, is £685 million (2011 £690 million). In the opinion of the Directors, the aggregate market value of the Group's land and buildings exceeds this net book value by £436 million (2011 £480 million).

Qualifying third party indemnity provisions for Directors
A partial qualifying third party indemnity provision (as defined in section 234 of the Companies Act 2006) was and remains in force for the benefit of all the Directors of the Company and former Directors who held office during the year. The indemnity is granted under article 116 of the Company's Articles of Association. The indemnity is partial in that it does not allow the Company to cover the costs of an unsuccessful defence of a third party claim.

Directors and their interests
The Directors of the Company and details of changes during the year are given on pages 60-62. The Secretary of State (BIS) appoints the Chairman; all other Directors are appointed by the Company with the Secretary of State's consent. UK Government is the Company's sole shareholder and, accordingly, the Directors have no interest in shares of the Company.

Audit information
The Directors confirm that, so far as they are aware, there is no relevant audit information of which the auditor is unaware and that each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

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

By Order of the Board

GRO

Jon Millidge
Company Secretary
27 June 2012

Royal Mail Holdings plc
100 Victoria Embankment
LONDON
EC4Y 0HQ

Company number 4074919

RMG00000342

Corporate Governance

GRO

With effect from 1 April 2012, Post Office Limited became a subsidiary of Royal Mail Holdings plc and became a sister company to Royal Mail Group Ltd.

Donald Brydon
Chairman

Chairman's introduction

The Board is collectively responsible for the long-term success of the business. We take decisions only after the necessary level of information has been made available to us and with the necessary consideration of all the relevant facts, including risk. The following statement is intended to explain our governance arrangements in light of the UK Corporate Governance Code (the "Code") principles and provisions and to provide insight into how the Board and management run the business for the benefit of the Shareholder.

I can confirm that we are again compliant with the Code in so far as it is appropriate to a public company with a single shareholder. I am pleased to report that Professor Rob Goffee of the London Business School has undertaken with us the annual review of the performance of the Board. I will be discussing with each Director the outcomes of the annual performance evaluation process and look for continued improvements to the way we function and perform as a Board.

I am pleased to report that our transformation is progressing, with HM Government's recent announcement of a new commercial agreement between Royal Mail Group and Post Office Limited. With effect from 1 April 2012, Post Office Limited became a direct subsidiary of Royal Mail Holdings plc and became a sister company to Royal Mail Group Ltd.

At this point, the members of the Holdings Board, except for Paula Vennells, became Directors of Royal Mail Group Ltd. The Holdings Board is much reduced in size and exists mainly for the consolidation of the accounts. This restructuring was conditional on the coming into force of articles 2-12 of the Postal Services Act 2011 (Transfer of Accrued Pension Rights) Order 2012.

I trust that you will find this Corporate Governance report helpful and informative.

GRO

Donald Brydon
Chairman

The Board has focused on the following matters during the year:

- Safety, including actions to improve performance;
- Operations and modernisation;
- Discussing with Ofcom the new regulatory framework;
- Going Concern and cash management;
- Pensions funding;
- Post Office Limited separation;
- Restructuring plans; and
- Impact of the Bribery Act 2010.

Expected Board focus for the next year:

- Safety;
- Operations and modernisation;
- Growth & innovation;
- Balance sheet restructuring; and
- Pensions funding.

Governance framework

The Board considers that it complied with the full provisions of the Code during the year. This report explains the key features of the governance framework and how it applies the principles of the Code. The location within the Annual Report and Financial Statements of each of the disclosures required in the Directors' Report are either disclosed separately or indexed in the Directors' Report and are therefore incorporated by reference.

The role of the Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance and risk management. At the end of the year, the Board comprised a Chairman, four Executive Directors and six Non Executive Directors. The biographies of each of the Directors, setting out their current roles, commitments and previous experience, are on pages 61-62. The Board met on seven occasions during the course of the year under review.

RMG00000342

The Board has defined those matters that are reserved exclusively for its consideration. These include the approval of strategic plans, financial statements, acquisitions and disposals, major contracts, projects, and capital expenditure. It delegates responsibilities to the Board Committees detailed in this report. For each scheduled meeting of the Board, the Company Secretary, on behalf of the Chairman, collates and circulates the papers, aiming to allow sufficient time for the Directors to review the information provided.

The Board is confident that all its members have the knowledge, talent and experience to perform the functions required of a Director of the business. Executive Directors have rolling 12 month contracts and Non Executive Directors are generally appointed for three-year terms. The Board considers that each of the Non Executive Directors is independent. This means that in the view of the Board, they have no links to the Executive Directors and other managers, and no business or other relationship with the Company that could interfere with their judgement. There is also a clear division of responsibilities between the Chairman and the Chief Executive Officer.

The Chairman of each Committee reports to the Board on matters discussed at Committee meetings and highlights any significant issues requiring Board attention. Reports on the work of the Audit & Risk Committee, Remuneration Committee and Nomination Committee on work during the year are given on pages 66-68. Full terms of reference for these Board Committees can be found on our website www.royalmailgroup.com.

Performance evaluation of the Board
Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis with the support of the Company Secretary. This year's evaluation was conducted with the help of Rob Goffee of the London Business School, using a combination of questionnaires, interviews and a feedback session and was completed during May 2012.

A performance evaluation of the Audit & Risk Committee was conducted by the Chairman of the Committee last year. Other Committees are undertaking a review of their terms of reference.

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

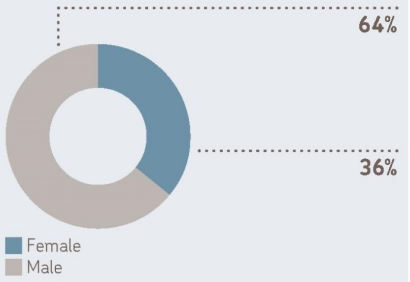
Director appointment and election
All Directors appointed by the Board are required by the Company's Articles of Association to be elected by the Shareholder at the first Annual General Meeting (AGM) after their appointment. All Directors will be standing for annual re-election at this year's AGM. On appointment, the Directors take part in an induction programme, in which they receive information about the Group, the role of the Board and matters reserved for its decision, the role of the principal Board Committees, the Group's Corporate Governance arrangements and the latest financial information about the Group. This is supplemented by visits to key business locations. The Group engages in two-way communication with the Shareholder to discuss information on its strategy, performance and policies. The Board receives feedback on these meetings from the Directors attending them.

Balance is considered a key requirement for the composition of the Board, not only in terms of the Executive and Non Executive Directors, but also with the regard to the mix of skills, experience and knowledge. Biographical details for all the Directors can be found on pages 61-62.

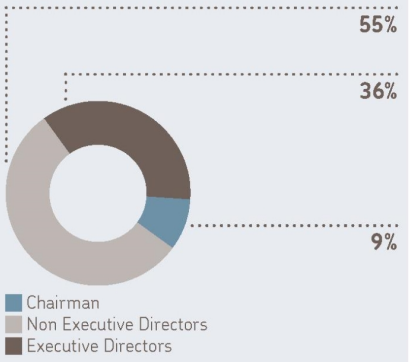
Outside appointments
The Board believes that there are significant benefits to both the Group and the individual from Executive Directors accepting Non Executive Directorships of companies outside of the Group. The Board's policy is normally to limit Executive Directors to one Non Executive Directorship, for which the Director may retain the fees (see the Directors' Remuneration Report on p78 for details).

Board Committees
The following Committees deal with specific aspects of the Group's governance. The details of Committee membership shown are as at 25 March 2012.

Gender balance



Balance of Non Executive and Executive Directors



RMG00000342

Corporate Governance (continued)

Chief Executive's Committee (CEC)	
Chair	Moya Greene
Membership	Stephen Agar (Managing Director, Consumer & Network Access), Rico Back (Chief Executive Officer, GLS), John Duncan (Director, Group Human Resources), Neil Harnby (General Counsel), Mark Higson (Managing Director, Operations and Modernisation), Matthew Lester (Chief Finance Officer), Jon Millidge (Company Secretary), Mike Newnham (Chief Customer Officer), Shane O'Riordain (Director, Group Corporate Affairs), Emily Pang (Chief of Staff), Alex Smith (Director, Business Development and Strategy), and Sue Whalley (Director, Regulation & Government Affairs).
Role	The Committee is responsible for all the key areas of commercial activity within Royal Mail Group. The CEC meets twice a month. The role of the CEC is to manage the overall framework of financial risk and business controls to meet Shareholder, regulatory and legal requirements. The Committee also assigns key accountabilities for business performance.

Audit & Risk Committee	
Chair	Paul Murray
Membership	Non Executive Directors – David Currie, Nick Horler, Cath Keers, Orna Ni-Chionna and Les Owen.
Role	The Committee, which is assisted by the Risk Management Committee, provides a forum for reporting by both internal and external auditors and is responsible for a wide range of matters including: • To oversee the process for managing risks across the business, including review of the Group's corporate risk profile, and ensuring risks are being addressed by the Board, relevant Committees, and management; • To monitor the integrity of the financial statements of the Group; • To review the effectiveness of the Group's internal control system; • To review the effectiveness of the Group's risk management processes; • To monitor and review the effectiveness of the Group's Internal Audit function; • To recommend to the Board, for Shareholder approval, the appointment of the external auditor, and to approve its remuneration and terms of engagement; to monitor and review the external auditor's independence, objectivity and the effectiveness of the audit process; and to develop and implement policy on the engagement of the external auditor to supply non-audit services; and • Where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, to make recommendations to the Board or management on action needed to address the issue.
Work during the year	Key matters the Committee considered during the year include: • Going Concern – consideration of the plan, prospects, and assurances to allow the Board to conclude on the going concern status of Royal Mail; • Modernisation – review of reports and action plans covering progress and reporting on the key initiatives around modernisation of the business; • Business issues – review of issues around Christmas staff resourcing, eBusiness platform, and IT resilience and security, to ensure that issues and implications were well considered, appropriate action was being taken, and learnings were being noted for future application; • Capital restructuring – discussion and review of options and decisions around capital structures; • IT – review of reports and action plans around key exposure and strategic plans in IT; and • Risk management and profile – review of proposed enhancements to the process of managing and monitoring key risks across the Group, and specific review of Royal Mail's Group risk profile.
Chairman's statement	The role and responsibilities of the Audit & Risk Committee have continued to grow and are under increased scrutiny. The Committee will continue to consider best practice reporting to stakeholders as an integral part of its business. We will continue to receive regular reports on risk, compliance and internal controls and expect to work closely with the Remuneration Committee on matters related to compensation. **Paul Murray** Chairman of the Audit & Risk Committee

RMG00000342

Remuneration Committee	
Chair	Orna Ni-Chionna
Membership	Chairman - Donald Brydon, Non Executive Directors - David Currie, Nick Horler, Cath Keers, Paul Murray and Les Owen.
Role	• To determine and recommend for the Board's approval the framework for the remuneration of the senior executives of the Group; • To determine the individual remuneration arrangements for the Chairman, the Executive Directors and the Company Secretary, subject where necessary to the consent of the Secretary of State; and • To agree the targets for any performance-related incentive schemes applicable to senior executives.
Work during the year	Examples of matters the Committee considered during the year include: • Benchmarking executive remuneration; • Long Term Incentive Plan (LTIP) design; and • Executive Director bonus arrangements.
Chair's statement	Remuneration of senior management continues to be in the public eye. The Committee fully acknowledges its responsibilities in this area to ensure that decisions are fully justifiable. The Committee considers the wishes of the Shareholder when making recommendations, and this is illustrated by the consultation with HM Government in respect of the new LTIP. **Orna Ni-Chionna** Chair of the Remuneration Committee

Nomination Committee	
Chair	Donald Brydon
Membership	Non Executive Directors - David Currie, Nick Horler, Cath Keers, Paul Murray and Les Owen.
Role	• To lead a formal, rigorous and transparent process for appointments to the Board of the Company, to the Boards of subsidiaries and to other senior executive positions; • To advise the Board on succession planning for the positions of Chairman, Chief Executive Officer and all other Board appointments; and • To keep under review the balance of Board membership to ensure that it has the required mix of skills, knowledge and experience.
Work during the year	Examples of matters the Committee considered during the year include: • Board structure and composition; • Board evaluation; and • Ongoing Board succession.
Chairman's statement	The Board will continue to review the balance of skills, experience and knowledge that it needs to perform its duties effectively. **Donald Brydon** Chairman of the Nomination Committee

RMG00000342

Corporate Governance (continued)

Pension Committee	
Chair	Matthew Lester
Membership	Jon Millidge (Company Secretary), Neil Harnby (General Counsel) and Les Owen (Non Executive Director).
Role	• To review funding, benefits, scheme structure and strategic developments impacting the Group's occupational pension schemes; and • To represent the Group in discussions with the Trustees of the Group's occupational pension schemes.
Work during the year	Examples of matters the Committee considered during the year include: • Scheme funding; • Investment strategy; • Implications of the Postal Services Act; and • Workplace Pension Reform.
Chairman's statement	The Committee has continued to monitor strategic developments impacting on the Company's pension arrangements and has worked closely with stakeholders in readiness for the transfer of almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP), thus removing its current deficit. **Matthew Lester** Pension Committee Chairman

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

Attendance at Board & Committees

Name	Board	Audit & Risk	Remuneration	Nominations
Total number of meetings	7	5	8	2
Chairman				
Donald Brydon	7/7	–	8/8	2/2
Executive Directors				
Moya Greene	7/7	–	–	–
Mark Higson	7/7	–	–	–
Matthew Lester	7/7	–	–	–
Paula Vennells	7/7	–	–	–
Non Executive Directors:				
David Currie	7/7	4/5	7/8	1/2
Nick Horler	7/7	4/5	8/8	2/2
Cath Keers	6/7	5/5	7/8	2/2
Paul Murray	7/7	5/5	8/8	2/2
Orna Ni-Chionna	7/7	1/5	8/8	2/2
Les Owen	6/7	1/5	7/8	2/2

RMG00000342
RMG00000342

Other Committees

Risk Management Committee

The Risk Management Committee is a sub-Committee of the Audit & Risk Committee and meets to promote and support the establishment, communication and embedding of risk management throughout the business.

Disclosure Committee

The role of the Disclosure Committee is to assist the Executive Directors in fulfilling their responsibility for oversight of the accuracy and timeliness of the disclosures made by the Company in relation to its financial and other reporting. The Committee meets on an ad-hoc basis and is chaired by the Group Chief Executive Officer.

Non-audit services provided by the external auditor

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

Risk management and control overview

The Board believes that effective risk management and a sound control environment are fundamental to the Group.

The system is designed to manage rather than eliminate the risk of failure, as taking on risk is inherent in undertaking the commercial activities of the Group.

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group in accordance with the guidance detailed by the Turnbull Committee as part of the "the Combined Code", including financial, operational, compliance risks and risks to reputation. The process incorporates both a top-down element (which collates executive management/Board view of key risks) and a bottom-up element (which collates the views of the business units and functions on risks in their area). Taken together, these two perspectives are combined to form the Group Risk Profile.

The process has been in place throughout the year and up to the date of approval of these financial statements.

The responsibility for joint ventures and associates rests, on the whole, with the senior management of those operations. The Group monitors its investments and exerts influence through Board representations.

Risk environment

In the main, the principal risks facing the Group have not changed.

The Group has classified its principal risks into five main categories – changes in customer preferences; economic environment; preparing for attracting external capital; business modernisation and risks inherent in the postal industry. An analysis of the risks, their impacts, and mitigating actions is given on pages 50-52.

Risk framework

The Group wide risk management framework includes risk governance, risk identification, measurement and management, and risk reporting.

The Group's approach to control is based on the underlying principle of line management accountability for internal control and for risk management. The Group recognises and uses the principle of the "Three Lines of Defence", that is:

a) Primary controls over the risks to the business are located in the day to day operation;

b) These are supported by internal monitoring and oversight; and

c) Independent assessments by Internal Audit and others provide the third line.

The process for risk identification and management consists of formal identification by management at each level of the Group of the key risks to achieving their business objectives and the controls in place to manage them. The likelihood and potential impact of each risk is evaluated. Risk management action plans are monitored at executive level to ensure key risks are being mitigated.

The views of top management and units/functions are collated and brought together, in the Group risk profile, to form a comprehensive view of key risks in the organisation.

The process also includes an annual certification by management that the internal controls are such that they provide reasonable assurance that the risks are appropriately identified, evaluated and managed.

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

Risk governance and the Board

The Board has delegated responsibility for specific review of risk and control processes to the Audit & Risk Committee (ARC), and the ARC in turn has set up a sub-Committee, the Risk Management Committee (RMC), to help discharge its duties. The key responsibilities for risk and control among the Board, ARC, and RMC are set out in this section of this report.

Royal Mail Group's attitude to risk

The Group operates in an industry where elements are in structural decline, and where margins have been narrow. Allied to this, the historic position included a restricting regulatory regime, historic under-investment in infrastructure, an unaffordable historic pension obligation, pricing which did not reflect the value of the product, and an unsupportable cost base.

This backdrop was clearly outside the Board's risk tolerance, so a number of key initiatives were established and executed over the past year to build a viable and sustainable business. Accordingly, the strategy agreed by the Board in this context is appropriate but challenging.

RMG00000342

Corporate Governance (continued)

To help assure success of the programme, the business has refined the number of key initiatives, has clarified accountabilities and specified key milestones, and is focusing on performance against the critical elements of the strategy, including significant management focus to ensure key elements remain on track.

Risk management policy

The risk management policy has been refreshed in the year and communicated to business units and functions. The policy includes minimum mandatory standards for risk management in the business.

Internal control

The Group operates a system of internal control, including operational, financial, and compliance controls, and risk management systems, to control the day-to-day operations of the Group's activities. In terms of the "Three Lines of Defence" model, the key processes and controls include:

First line

- Management: the Group has an established management organisation, with structure, reporting lines, accountabilities and delegated authorities.
- Key policies and documentation:
  - Royal Mail's activities are mandated by the Postal Services Act 2011 and are further bound by regulatory requirements which cover service standards, complaint handling, integrity of mail, access to postal facilities, accounting separation and process for postal services.
  - The Group's Code of Business Standards sets the principles of professionalism and integrity for our people.
- Standard policies exist within each function:
  - Standard daily and monthly management accounting and payroll processes through centralised shared services for the UK businesses.
  - A budget prepared, reviewed and set once a year, providing clarity on the short-term strategies for each part of the Group. This, along with the delegated authorities, resets the levels of delegated spend in each area on an annual basis.
  - Performance management reviews include production of weekly indicators and a pyramid of monthly balanced scorecards from frontline operations to Holdings Board level, which underpin quarterly reviews and the interim and year end results.
  - Five to ten year business plans are collated on a regular basis and submitted to both the Shareholder and the regulator as part of formal external processes such as regulatory framework reviews and State Aid applications. This provides regular opportunity for executive management and the Board to reappraise and confirm long-term strategies and objectives for the Group.

Second line

- Regular rolling reviews and audits are carried out within the operations, covering key operational areas including quality of service, corporate security, health and safety, and fleet.
- A self assessment is conducted of key financial and non-financial processes across all parts of the UK businesses, including commercial and operations, and within each key function.
- Annual sign-off by Finance Directors provides a formal confirmation, including proper preparation of financial results, compliance with Group accounting policies, compliance to statutory reporting standards and tax accounting arrangements, disclosure of post balance sheet events and related party transactions, and maintenance of an appropriate system of internal control, including disclosure of material weaknesses and confirmation of remedial action plans.

RMG00000342

Third line

- Specific and targeted Internal Audit work programme. The effectiveness of the internal control system is reviewed regularly by Internal Audit & Risk Management (IA&RM), the Group's independent Internal Audit function. IA&RM reports to the ARC and provides assurance to executive management and the Board on the effectiveness of the internal control system.

  Internal Audit reports include an action plan where issues have been identified, and progress against action plans is regularly tracked and reported.

  IA&RM establishes and agrees with the ARC an annual plan of assignments and activities based on discussions with the Board and management, and also taking into account known issues in the business and the postal industry.

- External audit and other reviews.

  External audits and reviews take place during the year to provide management, the Board and the regulator with assurance on specific matters, including:

  - The external auditor performs a statutory year end audit.
  - The external auditor performs an audit of the regulatory accounts.
  - The externally measured end to end quality of service is audited by an independent accounting firm (appointed by Ofcom).

Statement by the independent Non Executive Directors

A number of structured processes exist throughout the business to support good governance. All the Non Executive Directors are members of the principle Board Committees: Audit & Risk, Nomination and Remuneration, which gives each of them insight into a cross-section of important issues and informs Board discussions.

The Independent Non Executive Directors are satisfied that the Company's Corporate Governance and Internal controls have been effective throughout the financial year ended 25 March 2012.

GRO

Orna Ni-Chionna
Senior Independent Non Executive Director

RMG00000342

Directors' remuneration report

This report explains the approach adopted by the Remuneration Committee when setting the remuneration of the Company's Executive Directors and certain other senior executives. It has been prepared taking due account of the Directors' Remuneration Report Regulations, in so far as Royal Mail Group as a non-listed company can comply with them. In line with these Regulations, the parts of the report relating to Directors' emoluments with respect to 2011-12 (including short-term incentive plan payments for 2011-12 and pension provision) have been audited.

Chairman's overview

This year has been one of significant achievement for Royal Mail Group. The Company is delivering one of the largest transformations ever undertaken in the UK, from a financial, operational and regulatory perspective. Particular highlights include the following:

- We are cash positive[1] at the Group level for the first time in four years;
- UKPIL, our core UK business, has returned to operating profit after modernisation costs[2];
- Royal Mail no longer has going concern issues;
- We have embedded our new business strategy, clearly demonstrating our path to put the Group on a sound financial footing;
- Through Ofcom's new regulatory framework, we have won the potential to earn an appropriate commercial return on our products and services; and
- Prior to the year end, the Government and the Company achieved European Commission authorisation for the transfer of almost all the pension liabilities and pension assets of the Royal Mail Pension Plan to the Government, thus cancelling an annual deficit payment of just under £300 million.

The Committee recognises that executive reward is a sensitive issue for society at large. We understand that all stakeholders in the Royal Mail expect executive remuneration levels to be set appropriately. The Committee determines remuneration levels carefully and the Secretary of State for the Department for Business, Innovation and Skills (BIS) approves any significant changes to the remuneration arrangements of Royal Mail's Directors, including the approach and targets relating to the short-term and long-term incentive plans.

For the second consecutive year, the Committee has not awarded salary increases for any of Royal Mail's Directors with the only exception being Paula Vennells, who joined the Board in October 2010 and was awarded an increase in April 2011.

In relation to bonus payments, there is a clear alignment between payments awarded and achievement against clearly stated performance targets. For 2011-12 the Committee is satisfied that there has been a strong link between reward under our Short Term Incentive Plan (STIP) and performance assessed against the twelve KPIs closely linked to our strategic objectives, which form the basis for the STIP. A similar approach is expected to be adopted in 2012-13, and this is currently being discussed with the Secretary of State for the Department for Business, Innovation and Skills.

As disclosed in last year's Remuneration Report, the Company has been in discussions with the Secretary of State for the Department of Business, Innovation and Skills to agree a new Long Term Incentive Plan (LTIP). This standard element of an executive package provides a long-term focus on growth in value alongside the more operational-based STIP, but the previous LTIP contained some cumbersome and complex elements. The new LTIP is simpler than the previous plan and the Committee believes that it aligns Directors' interests with the long-term interests of our Shareholder and wider stakeholders.

On behalf of the Committee I commend this report to all stakeholders in Royal Mail Group.

GRO

Orna Ni-Chionna
Chair of the Remuneration Committee

[1] Free cash inflow.

[2] Before other exceptional items.

RMG00000342

Executive pay at Royal Mail
The Company's objectives on Directors' remuneration are that:

- The overall remuneration package should be sufficiently competitive to attract and retain executives with the commercial experience to run a large, complex business in a highly challenging context;
- A significant proportion of the remuneration package should be dependent on performance – both short and long-term; and
- Incentives should be designed so that they align the interests of senior executives, customers and the Shareholder.

The Committee regularly reviews the remuneration package offered to its key executives with the aim of ensuring that the package is reasonable in the circumstances and that it follows accepted best practice. In considering any changes to salary, it takes into account any proposed changes to the remuneration of all employees.

Advice to the Remuneration Committee
The Committee obtains information and advice from inside and outside the Group. It takes advice from independent professional organisations that are best able to assist it on the particular topic under discussion.

During 2011-12, the Committee conducted a competitive tender for the position of independent adviser to the Remuneration Committee, culminating in the appointment of Aon Hewitt Limited (trading under the name New Bridge Street). No other services were provided to the Company by Aon Hewitt Limited during the year in question.

Internal support is provided by the Group Human Resources Director and the Company Secretary. Other advice and information has been provided by specialists from the Human Resources and Finance functions. This ensures that the Committee is kept fully abreast of pay and conditions in the workforce as a whole.

During the year Towers Watson Limited provided the Company with advice on pensions and actuarial matters.

The main components of remuneration
The table below summarises the main elements of the remuneration packages of the Executive Directors:

Element of Pay	Purpose	Summary of how it operates
Base salary	Help recruit and retain executives of a sufficiently high calibre Reflect individual's experience, performance and role within the Group	Paid monthly in cash Reviewed annually (but not necessarily increased annually) against appropriate benchmarks and reflecting the Committee's policy (described below)
Pension	Provide appropriate levels of retirement benefits	Mix of defined benefit and defined contribution pensions and unfunded pension guarantees
Other benefits	Provide an appropriate, cost effective benefits package through leveraging the Company's size and scale	Company car and health insurance, or the cash equivalent of any benefits not taken
Short-term incentives	Drive and reward annual performance against financial and non-financial targets, as outlined in the Corporate Scorecard (see p74).	Payable in cash annually, based on performance against a broad range of targets relating to financial performance, people, service levels, other strategic objectives and personal goals
Long-term incentives	Drive and reward delivery of sustained long-term financial performance measured against operating profit and Return on Total Assets (ROTA) targets	Payable in cash, normally three years after initial award, subject to continued employment and performance against interdependent financial targets in the third year

All Directors are paid into personal bank accounts through the PAYE scheme.
Further details of each of the above elements of pay are set out on the following pages.

RMG00000342

Directors' remuneration report (continued)

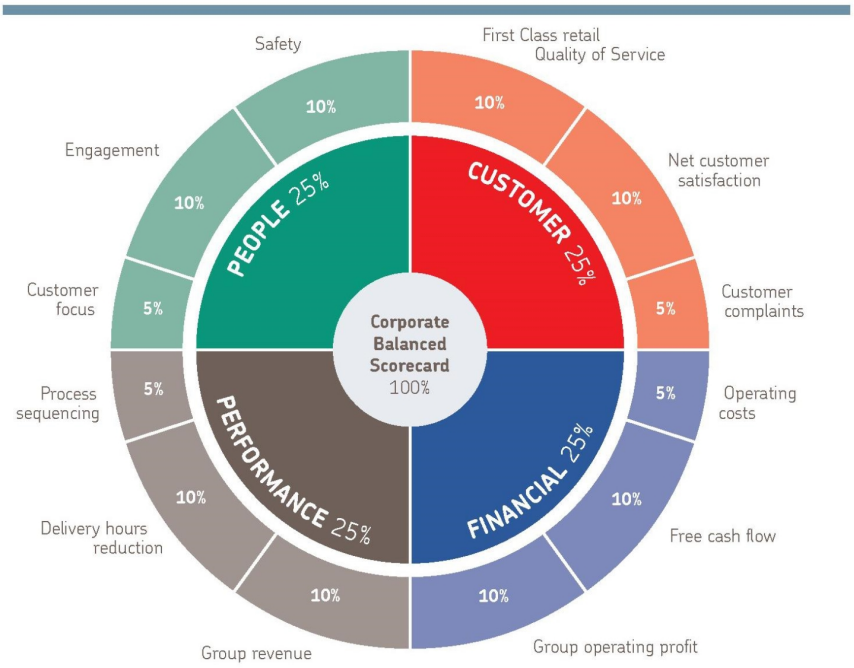
Base salaries
As stated above, the Committee's underlying policy regarding senior executive base salaries is to set salaries at levels that are enough to recruit and retain executives of proven ability to manage a very large and complex company which faces many challenges. The Secretary of State's (Department for Business, Innovation and Skills) consent is required for all significant changes to Directors' remuneration, including base salary increases.

During 2011-12 the Committee conducted a comprehensive review of the remuneration packages of the entire senior leadership population, comparing them to remuneration in comparable companies. This exercise was undertaken by AON Hewitt. Appropriate comparator companies were chosen from the utilities, consumer services, industrial and telecommunications industries. The companies forming this group were chosen due to their sharing of certain characteristics including, but not limited to (i) size and complexity, (ii) regulation, (iii) asset intensity and (iv) large infrastructure management. One of the findings of this review was that the base salaries of the Executive Directors were below median, with the Chief Executive Officer's salary in the lower quartile range.

Notwithstanding this, no salary increases were made to the Executive Directors' salaries during 2011-12, except for an increase to Paula Vennells' salary from £225,000 to £250,000 from 1 April 2011.

Pensions
A summary of the pension provision of the Executive Directors can be found on pages 79-80.

Other benefits
Benefits include the provision of a company car and health insurance, or the cash equivalent of any benefits not taken. The Chief Executive Officer is eligible for two return flights to Canada each year and financial advice. Relocation expenses are paid where applicable and are explained in the notes to the table on p77.



Short Term Incentive Plan (STIP)
In 2011-12, the target STIP potential for the Chief Executive Officer and for the Group Finance Director was 60 per cent of base salary, each with a maximum opportunity of 100 per cent of salary. In the case of the other executive Directors the figures were 48 per cent and 80 per cent respectively. In each case, 80 per cent of the STIP was dependent on the achievement of corporate targets, with the remaining 20 per cent dependent on the achievement of specific personal targets. The benchmarking exercise undertaken showed that these levels of opportunity were below typical market levels.

A blend of targets determined the extent to which STIPs could be earned in 2011-12. The Committee reviewed the measures and targets to ensure that they were appropriate and consistent with challenging levels of performance. The chart above illustrates the Corporate Balanced Scorecard[3] which contains a summary of the corporate metrics used. In addition to these metrics, a minimum level of operating profit must also be achieved before an Executive Director becomes eligible for a payment. The Corporate Balanced Scorecard (above) is used to determine STIP awards for all Royal Mail's managers.

[3] The targets relating to Paula Vennells relate to the performance of Post Office Limited, with the above weightings marginally different.

RMG00000342

Most of the targets were exceeded in each quadrant of the Corporate Balanced Scorecard (People, Customer, Performance, Financial) with the People quadrant achieving the highest score. Financial performance was also significantly above the target level. In "Performance" the score was lower, primarily due to the lower than planned implementation of delivery revisions. There was some variation in performance against "Customer measures" and overall the Customer quadrant score came in at just below the target level. All of the measures have been independently validated.

The total Short Term Incentive Plan payments awarded to the Executive Directors for performance in 2011-12 were as follows:

Moya Greene – 74.5 per cent of salary;

Matthew Lester – 74.8 per cent of salary;

Mark Higson – 63.8 per cent of salary; and

Paula Vennells – 69.1 per cent of salary.

The above payments reflect the achievement of very strong performance against most of the measures and targets in the STIP. The Executive Directors' annual bonus for 2012-13 will be structured in broadly the same manner as described above.

Executive Directors also participate in the legacy share scheme on the same terms as all other eligible employees. This is explained in the "Basis of preparation and significant accounting policies" on p136. It is anticipated that these awards will have no material value.

Long Term Incentive Plan (LTIP)

During 2011-12, the Committee put in place a new Royal Mail Group LTIP. The LTIP is a conditional award, defined as a percentage of salary, which vests (pays out) based on performance in the third year after the award is made, provided that financial performance targets are met. As noted above, the Secretary of State for the Department for Business, Innovation and Skills approved both the design of the LTIP and the grants made under the plan to the Executive Directors.

When designing the new LTIP, the Committee took account of a number of factors, including:

Factor	LTIP design approach
Policy	The LTIP must reflect the general approach the Committee takes to framing executive remuneration at the Company, as summarised on p73
Link with strategy	The LTIP targets support the achievement of the Company's key strategic objectives. The Company's senior leadership drive this performance and the LTIP forms part of their competitive reward arrangements
Award levels	Appropriate, but not excessive, levels of potential rewards should be available, but only in return for delivery of strong levels of performance against stretching targets
Risk	Excessive operational risk-taking should be neither encouraged nor rewarded
Compliance	The LTIP should take due account of best and market practice, while being tailored to the Company's specific circumstances and challenges
Clawback	Discretion for the Committee to "clawback" the value of any cash amount received if it transpires that an award had been paid on the basis of misstated results because of wilful wrongdoing by employees

The main features of the new LTIP are as follows:

- It is intended that regular annual awards will be made each year. The first awards were made in 2011-12;
- Awards take the form of a right to receive a cash amount, normally three years after grant, subject to continued employment and the satisfaction of performance conditions. The recent benchmarking exercise undertaken by the Committee showed that the award level to the Executive Directors of 70 per cent of salary (1.4 x this amount at a stretch level of performance) was well below market norms;
- The performance conditions applying to the awards made in 2011-12 were based on both operating profit and Return on Total Assets ("ROTA") targets, further details of which are set out below; and
- The Remuneration Committee has the discretion to "clawback" the (after tax) value of any cash amount received if it transpires that an award had been paid on the basis of misstated results because of wilful wrongdoing by employees. This restriction lapses after five years from the vesting date.

The previous LTIP ran from 2007 to 2010 inclusive. It had been the Committee's intention to make a grant under a new plan in the 2010-11 financial year which would have measured performance over the three year period up to 2012-13. A number of senior executives were given a commitment that such a grant would be made in that year. However, no such grant was made in view of a number of pressing challenges facing the business during that time.

To take this into account, the Committee granted two awards in 2011-12 under the new LTIP to the majority of participants (including the Executive Directors). The first award was made in lieu of the award that should have been granted in 2010 and measures performance over the three year period from April 2010 to March 2013. However, to provide an additional long-term focus, the Executive Directors' awards do not actually vest until the end of the 2013-14 financial year i.e. March 2014.

The second award constituted the 2011 award, thereby measuring performance over the three year period from April 2011 to March 2014.

RMG00000342

Directors' remuneration report (continued)

As mentioned on previous page, the performance conditions applying to the initial awards granted under the new LTIP in 2011-12 are based on both operating profit and ROTA. The primary measure is operating profit, with the indicative payout under this measure then subject to a downward-only adjuster based on ROTA targets. Therefore, for awards to pay out in full both the operating profit and ROTA targets must be met in full. ROTA was chosen as the secondary measure as it covers the need to make a sufficient return both on any new investments and on the existing asset base. The impact of the performance conditions on the awards made to the Executive Directors in 2011-12 is set out below. The Executive Directors' two awards were 70 per cent of salary each, with a multiplier of up to 1.4 applying dependent on the level of performance achieved as outlined in the tables below:

Operating profit performance in third year after award	% award vesting
Less than 70% of target	0%
70% to 80% of target	0% to 80% vesting (straight-line sliding scale) i.e. 0% to 56% of salary
80% to 100% of target	80% to 100% vesting (straight-line sliding scale) i.e. 56% to 70% of salary
100% to 120% of target	100% to 140% vesting (straight-line sliding scale) i.e. 70% to 98% of salary
More than 120% of target	140% vesting i.e. maximum 98% of salary

In addition, an award only vests under the operating profit performance condition if ROTA is at least equal to 75 per cent of plan. If this is the case then the award vests as follows:

- If ROTA is between 75 per cent of plan and 90 per cent of plan there is a 50 per cent reduction the level of vesting achieved under the operating profit performance condition; and
- If ROTA is greater than 90 per cent of plan there is no reduction in vesting.

Following the separation of Post Office Limited, the LTIP awards in respect of Paula Vennells will be subject to a different performance condition, which will better reflect the strategic goals of Post Office Limited.

The Committee intends to grant awards under the new LTIP in 2012-13. These awards are intended to be structured in broadly the same manner as described above.

RMG00000342

Directors' emoluments in respect of 2011-12

The following table summarises the remuneration of Board members in respect of 2011-12:

	Annual salary/fees £000	Salary/fees paid in year £000	Short Term Incentive Plan £000	Benefits £000	Amount in lieu of defined benefit pension £000	**2012 £000**	2011 £000
Chairman							
Donald Brydon	200	200	–	–	–	**200**	200
Executive							
Moya Greene[4]	498	498	371	38	200	**1,107**	778*
Mark Higson	428	428	273	15	171	**887**	686
Matthew Lester[5]	428	428	320	15	171	**934**	265*
Paula Vennells[6]	250	250	173	10	30	**463**	147
Non Executive							
David Currie	40	40	–	–	–	**40**	40
Nick Horler	40	40	–	–	–	**40**	37
Cath Keers	40	40	–	–	–	**40**	31
Paul Murray	50	50	–	–	–	**50**	51
Orna Ni-Chionna	60	60	–	–	–	**60**	31
Les Owen[7]	40	40	–	–	–	**40**	37
Former Directors							
Adam Crozier[8]	633	–	–	–	–	**–**	7
Ian Duncan[9]	325	–	–	–	–	**–**	87
Richard Handover[10]	65	–	–	–	–	**–**	63
Baroness Prosser[11]	50	–	–	–	–	**–**	32
David Smith[12]	250	50	–	3	6	**59**	363
Total 2012		2,124	1,137	81	578	**3,920**	–
Total 2011		1,870	371	183	431	**–**	2,855

* The 2011 amounts for Moya Greene and Matthew Lester are part-year figures as they joined during the year 2010-11.

The figures in the table represent the qualifying emoluments earned and receivable by anyone who has served as a Director at any time during the financial year, whenever paid. Such emoluments are normally paid in the same financial year, with the exception of the annual performance-related bonus, which is paid in the year following that in which it is earned.

[4] Details of Moya Greene's pension arrangements are given on p79-80. The Chief Executive Officer is eligible for two return flights to Canada each year, relocation expenses and financial advice.

[5] Matthew Lester joined the Board on 24 November 2010.

[6] Paula Vennells joined the Board on 18 October 2010.

[7] Les Owen was also a member of the Post Office Limited Board for the full year and was also paid £13,000 in respect of his membership of the Post Office Limited Board for the period 22 September 2011 to 31 March 2012.

[8] Adam Crozier left the Board on 31 March 2010.

[9] Ian Duncan left the Board on 15 June 2010.

[10] Richard Handover left the Board on 30 March 2011.

[11] Baroness Prosser left the Board on 31 October 2010.

[12] David Smith left the Board on 13 June 2011.

RMG00000342

Directors' remuneration report (continued)

Executive Directors' outside appointments

The annual fees received by the Executive Directors as at 25 March 2012 in respect of their Non Executive Directorships are shown in the table opposite.

	Directorship	2012 £000	2011 £000
Moya Greene	Tim Hortons	**16**[13]	22[13]
Matthew Lester	Man Group plc	**79**	–

Contracts

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

The rolling service contracts and letters of appointment of the Directors (as shown in the table opposite) include the following terms as at 25 March 2012.

	Date of contract	Expiry date of current employment contract	Unexpired term (months)
Chairman			
Donald Brydon[14]	26 March 2009	25 March 2012	–
Executive Directors			
Moya Greene	15 July 2010	–	12
Mark Higson	5 November 2007	–	12
Matthew Lester	24 November 2010	–	12
Paula Vennells	16 November 2010	–	12

The Non Executive Directors have service contracts but do not have employment contracts. The service contract dates for the Non Executive Directors who have served during the year are shown in the table opposite.

	Date of contract	Expiry date of current service contract	Unexpired term (months)
Non Executive Directors			
David Currie	1 January 2012	31 December 2014	33
Nick Horler	1 April 2010	31 March 2013	12
Cath Keers	1 June 2010	31 May 2013	14
Paul Murray[15]	1 August 2009	31 July 2012	4
Orna Ni-Chionna	1 June 2010	31 May 2013	14
Les Owen	27 January 2010	26 January 2013	10

The Company is committed to the service contracts for the remaining term of appointments, subject to annual review and notice, for Non Executive Directors, including the Chairman.

[13] Sterling equivalent of payments received in the year.

[14] Donald Brydon was reappointed on 26 March 2012 for a further three year term to 25 March 2015.

[15] Paul Murray was reappointed on 24 May 2012 for a further three year term to 31 July 2015.

RMG00000342

Non Executive Directors
The fees paid to the Chairman are approved by the Secretary of State for the Department for Business, Innovation and Skills. Fees for the Non Executive Directors are determined by the executive Directors and are submitted to the Secretary of State for approval. Independent market surveys are consulted in determining them, with due account also taken of time commitment and responsibilities.

Pensions
The Group has a liability to pay pensions in respect of Directors' services and, for some Executive Directors, makes contributions to pension schemes for this purpose. The Company pays a cash supplement to Directors whose contributions to the Company scheme are restricted by the scheme-specific earnings cap. The Company continues to apply the scheme-specific earnings cap, indexed by inflation each year, as a constraint on the amount of salary that is pensionable through the Company scheme.

The Royal Mail Senior Executives Pension Plan (RMSEPP) is closed to new members. Existing members accrue service on a career average basis on the basis of a retirement age of 65. Current Executive Directors who are members of the plan are subject to a cap on pensionable earnings which for 2011-12 was £129,600.

Details of RMSEPP are set out in note 9 to the financial statements. The Plan is a funded, HMRC-registered defined benefit occupational pension scheme. It provides for a pension on a final salary basis for service up to 31 March 2008 and for subsequent service on a career average basis. The pension is payable from normal retirement age (currently age 65) and is subject to the maximum pensionable service and the scheme-specific earnings cap. Pensions in payment are increased annually in line with inflation, subject in some cases to a cap of five per cent. Pensions are also payable to dependants on the death of the member and a lump sum is payable if death in service occurs.

For senior executives whose membership of the Plan (RMSEPP) is restricted by the earnings cap (£129,600 for 2011-12), pension provision is made by a combination of the Company scheme and a cash pension supplement or its equivalent. David Smith and Paula Vennells received a cash supplement of 25 per cent of base pay above the earnings cap. Mark Higson and Matthew Lester are not members of the Plan and receive a cash supplement of 40 per cent of base pay.

For the Chief Executive Officer, the Company makes a contribution to a UK HMRC approved pension plan and promises to pay her after leaving the Company a sum that accumulates monthly during employment as if it were invested in Government securities.

The following table is designed to indicate the increase in the value of Directors' accrued benefits during the period. The transfer value is calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes Directors' contributions.

	Age at Year end	Accumulated accrued benefit at 27 March 2011 £	Accrued benefit at 25 March 2012 or date of leaving if earlier £	Increase in accrued benefits during the period (net of inflation) £	Transfer value of increase before inflation less Directors' contributions £
Executive Directors					
David Smith[16]	47	23,608	25,223	1,615	20,317
Paula Vennells	53	11,448	14,721	2,701	35,049

The following table is designed to assess the change in transfer values during the year, taking into account movement in investment market conditions:

	Age at Year end	Transfer value at 27 March 2011 or at date of appointment to Board if later £	Plus transfers-in received £	Sub total £	Transfer value at 25 March 2012 £	Movement in the period less Directors' contributions £
Executive Directors						
David Smith[17]	47	347,627	-	347,627	450,282	101,311
Paula Vennells	53	194,384	-	194,384	283,759	81,599

[16] David Smith left the Board on 13 June 2011 and his employment with Royal Mail Group ceased on 3 December 2011; his increase in accrued benefits, net of inflation as a former Director, were £1,498.

[17] David Smith left the Board on 13 June 2011 and his employment with Royal Mail Group ceased on 3 December 2011; his increase in transfer value, less contributions as a former Director, were £16,687.

RMG00000342

Directors' remuneration report (continued)

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

Moya Greene has been provided with a contribution of £20,000 to an HMRC approved defined contribution pension plan in respect of service during the 2011-12 financial year. Additionally, contributions of £60,000 were made into the Royal Mail Defined Contribution Plan during 2011-12. During 2011-12 the Company accrued an additional amount of £120,000 towards Moya's unfunded promise to be paid upon cessation of her employment. The cumulative value of this unfunded promise was £261,222 at the end of 2011-12, based on the value of the amounts accrued having been invested in UK 5-year gilts. These arrangements provide the Chief Executive Officer with pension arrangements valued at 40 per cent of salary, in line with the other Executive Directors.

Tony McCarthy, a former Director, is in receipt of an annual payment of £45,094 as a result of an unfunded unapproved pension promise made to him when he joined the Company in 2003.

GRO

Orna Ni-Chionna
Remuneration Committee Chair
27 June 2012

RMG00000342

Our financial statements

Consolidated income statement[1]	83
Consolidated statement of comprehensive income[1]	84
Consolidated statement of cash flows[1]	85
Consolidated balance sheet[2]	86
Consolidated statement of changes in equity[1]	87
Core notes to the financial statements	**88**
1. Authorisation of financial statements and statement of compliance with IFRS	89
2. Going concern and funding	89
3. Events after the reporting period	90
4. Segment information	90
5. People information	92
6. Operating exceptional items	93
7. Cash flow information	94
8. Provisions	95
9. Employee benefits – pensions	96
Other notes – financial assets, financial liabilities and hedging programmes	**102**
10. Financial assets and liabilities – introduction, summary and management of financial risk	103
11. Pension escrow investments	105
12. Cash and cash equivalents	106
13. Loans and borrowings	106
14. Financial liabilities net and gross maturity analysis	108
15 Financial assets and liabilities – additional analysis	110
16. Hedging programmes	115
Other notes – income statement	**118**
17. Other operating costs	119
18. Income tax	120
19. Net finance costs	122

[1] For the year ended 25 March 2012 and 27 March 2011

[2] At 25 March 2012 and 27 March 2011

RMG00000342

Our financial statements (continued)

Other notes – balance sheet	**123**
20. Property, plant and equipment	**124**
21. Goodwill	**125**
22. Intangible assets	**126**
23. Investments in joint venture and associates	**127**
24. Current trade and other receivables	**128**
25. Current trade and other payables	**129**
26. Issued share capital and reserves	**129**
27. Commitments	**130**
28. Related party information	**131**
Basis of preparation and significant accounting policies	**133**
Group five-year summary (Unaudited)	**143**
Directors' and Auditor responsibilities in relation to the Group financial statements	**145**
Royal Mail Holdings plc – parent Company financial statements	**148**
Pro-forma 2011-12 financial statements for Royal Mail Group excluding Post Office Limited (Unaudited)	**155**

RMG00000342

Consolidated income statement

for the year ended 25 March 2012 and 27 March 2011

	Notes	2012 £m	2011 £m
Continuing operations			
Turnover		**9,352**	9,006
Network Subsidy Payment for Post Office Limited		**180**	150
Revenue		**9,532**	9,156
People costs	5	**(5,657)**	(5,717)
Distribution and conveyance costs		**(1,758)**	(1,619)
Other operating costs	17	**(1,707)**	(1,602)
Share of post tax profit from joint venture and associates	23	**32**	28
Operating profit before exceptional items		**442**	246
Modernisation costs – operating exceptional items	6	**(231)**	(207)
Operating profit after modernisation costs before other operating exceptional items		**211**	39
Other operating exceptional items	6	**(93)**	(88)
Operating profit/(loss)		**118**	(49)
Profit on disposal of property, plant and equipment		**157**	65
Profit on disposal of businesses		**26**	44
Profit before financing and taxation		**301**	60
Finance costs	19	**(118)**	(114)
Finance income	19	**54**	69
Net pension interest	9(e)	**26**	(167)
Profit/(loss) before taxation		**263**	(152)
Taxation charge	18	**(10)**	(106)
Profit/(loss) for the financial year from continuing operations		**253**	(258)
Profit/(loss) attributable to:			
Equity holder of the parent company		**252**	(259)
Non-controlling interest		**1**	1

RMG00000342

Consolidated statement of comprehensive income

for the year ended 25 March 2012 and 27 March 2011

	Notes	2012 £m	2011 £m
Profit/(loss) for the financial year from continuing operations		**253**	(258)
Other comprehensive income/(expense) for the period		**1,585**	3,432
Translation differences on foreign currency net investments		(47)	(11)
Actuarial gains on defined benefit schemes	9	1,544	3,424
(Losses)/gains on cash flow hedges deferred into equity	16	(4)	24
Gains on cash flow hedges released from equity to income	16	(15)	(7)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	16	(3)	(3)
Gains on financial assets deferred into equity	11	133	20
Gains on financial assets released from equity to income		–	(6)
Taxation on items taken directly to equity	18	(23)	(9)
Total comprehensive income for the period		**1,838**	3,174
Total comprehensive income for the period attributable to:			
Equity holder of the parent company		**1,846**	3,173
Non-controlling interest		**(8)**	1

RMG00000342

Consolidated statement of cash flows

for the year ended 25 March 2012 and 27 March 2011

	Notes	2012 £m	2011 £m
Cash flow from operating activities			
Operating profit before exceptional items		**442**	246
Adjustment for:			
Pension operating costs	9	**419**	458
Depreciation and amortisation	17	**302**	286
Share of post tax profit from joint venture and associates	23	**(32)**	(28)
EBITDA before pension costs		**1,131**	962
Working capital movements:		–	(49)
(Increase)/decrease in receivables		(156)	14
Increase/(decrease) in payables		110	(44)
Decrease/(increase) in client receivables		20	(9)
Increase in client payables		18	1
Net increase in derivative assets		(6)	(12)
Increase in non-exceptional provisions		14	1
Pension operating costs paid		**(428)**	(741)
Cash payments in respect of operating exceptional items	7	**(342)**	(272)
Modernisation:			
Legacy share scheme/Business Transformation		(70)	(102)
Redundancy		(137)	(121)
Redundancy related pension costs		(39)	(30)
One-off projects		(55)	(8)
Other		(4)	(6)
Non-modernisation		(37)	(5)
Cash inflow/(outflow) from operations		**361**	(100)
Income tax paid		**(23)**	(22)
Net cash inflow/(outflow) from operating activities		**338**	(122)
Cash flows from investing activities			
Dividends received from joint venture and associates	23	**42**	39
Finance income received		**53**	69
Proceeds from sale of property, plant and equipment		**205**	164
Proceeds from disposal of businesses		**37**	73
Purchase of property, plant and equipment (including modernisation investment in UKPIL)		**(306)**	(292)
Acquisition of businesses		**(2)**	(2)
Purchase of intangible assets (software)		**(59)**	(82)
Payment of deferred consideration in respect of prior years' acquisitions		**(1)**	–
Net (purchase)/sale of financial assets investments (non-current)		**(45)**	42
Net purchase of financial assets investments (current)		**(30)**	–
Net cash (outflow)/inflow from investing activities		**(106)**	11
Net cash inflow/(outflow) before financing activities		**232**	(111)
Cash flows from financing activities			
Finance costs paid		**(73)**	(60)
Payment of capital element of obligations under finance lease contracts		**(52)**	(65)
Cash received on sale and leasebacks		**88**	115
New loans		**2**	332
Repayment of borrowings		**(1)**	(42)
Net cash (outflow)/inflow from financing activities		**(36)**	280
Net increase in cash and cash equivalents		**196**	169
Effect of exchange rates on cash and cash equivalents		**(4)**	(2)
Cash and cash equivalents at the beginning of the period		**1,101**	934
Cash and cash equivalents at the end of the period	12	**1,293**	1,101

RMG00000342

Consolidated balance sheet

at 25 March 2012 and 27 March 2011

	Notes	2012 £m	2011 £m
Non-current assets			
Property, plant and equipment	20	**1,825**	1,832
Leasehold land payment		**3**	3
Goodwill	21	**189**	197
Intangible assets (mainly software)	22	**135**	126
Investments in joint venture and associates	23	**92**	105
Financial assets – pension escrow investments	10/11	**1,383**	1,161
– bank deposits	10/15	**–**	44
– derivatives	10/15	**2**	6
Deferred tax assets	18	**9**	8
		3,638	3,482
Non-current assets held for sale		**4**	4
Current assets			
Inventories		**38**	38
Trade and other receivables	24	**1,251**	1,135
Income tax receivable		**2**	–
Financial assets – derivatives	10/15	**9**	36
– short-term deposits	10/15	**31**	1
Cash and cash equivalents	10/12	**1,293**	1,101
		2,624	2,311
Total assets		**6,266**	5,797
Current liabilities			
Trade and other payables	25	**(2,085)**	(1,961)
Financial liabilities – interest bearing loans and borrowings	10/15	**(377)**	(375)
– obligations under finance leases	10/15	**(90)**	(65)
– derivatives	10/15	**(4)**	(3)
Income tax payable		**(9)**	(6)
Provisions	8	**(138)**	(181)
		(2,703)	(2,591)
Non-current liabilities			
Financial liabilities – interest bearing loans and borrowings	10/15	**(1,522)**	(1,478)
– obligations under finance leases	10/15	**(237)**	(193)
– derivatives	10/15	**(1)**	–
Provisions	8	**(93)**	(97)
Retirement benefit obligation – pension deficit	9	**(2,922)**	(4,501)
Other payables		**(39)**	(34)
Deferred tax liabilities	18	**(18)**	(10)
		(4,832)	(6,313)
Total liabilities		**(7,535)**	(8,904)
Net liabilities		**(1,269)**	(3,107)
Equity			
Share capital	26	**–**	–
Share premium		**430**	430
Retained earnings		**(1,998)**	(3,803)
Reserves		**299**	258
Equity attributable to equity holder of parent company		**(1,269)**	(3,115)
Non-controlling interest		**–**	8
Total equity		**(1,269)**	(3,107)

The financial statements on pages 83 to 132 were approved by the Board of Directors on 27 June 2012 and signed on its behalf by:

GRO
Donald Brydon

GRO
Alice Perkins

RMG00000342

Consolidated statement of changes in equity

for the year ended 25 March 2012 and 27 March 2011

	Share premium £m	Retained earnings £m	Financial Assets Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Non-controlling interest £m	Total equity £m
At 28 March 2011	**430**	**(3,803)**	**64**	**125**	**22**	**47**	**(3,115)**	**8**	**(3,107)**
Profit for the period	–	252	–	–	–	–	252	1	253
Other comprehensive income/(expense) for the period	–	1,544	102	(47)	(14)	–	1,585	–	1,585
Translation differences on foreign currency net investments	–	–	–	(47)	–	–	(47)	–	(47)
Actuarial gains on defined benefit schemes	–	1,544	–	–	–	–	1,544	–	1,544
Losses on cash flow hedges deferred into equity	–	–	–	–	(4)	–	(4)	–	(4)
Gains on cash flow hedges released from equity to income	–	–	–	–	(15)	–	(15)	–	(15)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	–	–	–	–	(3)	–	(3)	–	(3)
Gains on financial assets deferred into equity	–	–	133	–	–	–	133	–	133
Taxation on items taken directly to equity	–	–	(31)	–	8	–	(23)	–	(23)
Dividend from non-controlling interest	–	9	–	–	–	–	9	(9)	–
Total comprehensive income/(expense) for the period	–	**1,805**	**102**	**(47)**	**(14)**	–	**1,846**	**(8)**	**1,838**
At 25 March 2012	**430**	**(1,998)**	**166**	**78**	**8**	**47**	**(1,269)**	–	**(1,269)**

	Share premium £m	Retained earnings £m	Financial Assets Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Non-controlling interest £m	Total equity £m
At 29 March 2010	430	(6,968)	55	136	12	47	(6,288)	7	(6,281)
(Loss)/profit for the period	–	(259)	–	–	–	–	(259)	1	(258)
Other comprehensive income/(expense) for the period	–	3,424	9	(11)	10	–	3,432	–	3,432
Translation differences on foreign currency net investments	–	–	–	(11)	–	–	(11)	–	(11)
Actuarial gains on defined benefit schemes	–	3,424	–	–	–	–	3,424	–	3,424
Gains on cash flow hedges deferred into equity	–	–	–	–	24	–	24	–	24
Gains on cash flow hedges released from equity to income	–	–	–	–	(7)	–	(7)	–	(7)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	–	–	–	–	(3)	–	(3)	–	(3)
Gains on financial assets deferred into equity	–	–	20	–	–	–	20	–	20
Gains on financial assets released from equity to income	–	–	(6)	–	–	–	(6)	–	(6)
Taxation on items taken directly to equity	–	–	(5)	–	(4)	–	(9)	–	(9)
Total comprehensive income/(expense) for the period	–	3,165	9	(11)	10	–	3,173	1	3,174
At 27 March 2011	430	(3,803)	64	125	22	47	(3,115)	8	(3,107)

A description of the nature and application of the reserves in the above tables is included in note 26.

RMG00000342

Core notes to the financial statements

In simple terms:

The notes in this section are considered by the Board to be particularly important to a reader of the financial statements and show:

- that we have followed all relevant International Financial Reporting Standards (IFRSs) in preparing these financial statements (note 1)
- why the Directors have concluded that the Group is a going concern (note 2)
- certain notable events that occurred after the financial year end, but which did not affect the financial position or performance of the Group up to 25 March 2012 (note 3). These events do however have a significant impact on the future of the Group
- an analysis of the financial results of our main business segments, UKPIL, GLS and POL (note 4)
- information about the number of people we employ in all parts of the Group and the costs of their employment (note 5)
- an analysis of the non-recurring or restructuring costs ('exceptional items') that have been disclosed separately (due to their size or incidence) to allow a more meaningful analysis of underlying operational performance (note 6)
- an analysis of the cash spent on exceptional items and a reconciliation of free cash flow – a key indicator used by management to assess performance – to the statutory cash flow that we have to disclose under IFRS (note 7)
- a summary of the provisions that have been made in the accounts, including for modernisation costs (note 8)
- details of the Group's pension schemes, including an analysis of the costs to the Group of providing the schemes, assumptions used to determine the pension liabilities, expected rates of return on the pension assets, and a summary of the key movements in the pension accounting deficit (note 9)

1. Authorisation of financial statements and statement of compliance with IFRSs	89
2. Going concern and funding	89
3. Events after the reporting period	90
4. Segment information	90
5. People information	92
6. Operating exceptional items	93
7. Cash flow information	94
8. Provisions	95
9. Employee benefits – pensions	96

RMG00000342
RMG00000342

Notes to the Consolidated financial statements

Introduction

In preparing these financial statements, the Group continues to consider recent guidance issued by the Financial Reporting Council ('FRC'). The FRC outlined principles in its "Louder than Words" and "Cutting clutter" discussion papers to make corporate reporting clearer and less complex.

Based on our views, as well as the key areas of focus from our stakeholders, Royal Mail Group has separated the notes to the financial statements into two sections: "Core" and "Other" in order to assist the users of the financial statements. While the financial statements need to be considered as a whole, "Core" notes to the financial statements represent those that we regard to be of most importance to a user of the financial statements. All remaining notes are included in the "Other" category.

1. Authorisation of financial statements and statement of compliance with IFRSs

The Group's financial statements for the year ended 25 March 2012 were authorised for issue by the Board on 27 June 2012 and the balance sheet was signed on behalf of the Directors (as at 25 March 2012) by Donald Brydon and Alice Perkins.

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and as they apply to the financial statements of the Group for the year ended 25 March 2012. The principal accounting policies adopted by the Group are set out on p137.

2. Going concern and funding

Royal Mail Group Ltd

At March 2011 and September 2011 the year end and interim accounts respectively contained a specific note on going concern, highlighting that the Directors continued to rely on either the granting of State Aid by the European Commission to the Government to take on almost all of the historical pension liabilities and pension assets of the main pension scheme, Royal Mail Pension Plan (RMPP), or that if State Aid was not granted, the Government would continue to provide alternative financing arrangements which would allow Royal Mail Group Ltd ('the company') to pay its liabilities as they fell due.

In light of:

- the post balance sheet event with respect to pensions described below;
- the return to profitability of the UKPIL businesses highlighted on page 40;
- the return to cash generation at both the Group (page 40) and company level;
- the recent price increases in April 2012; and
- a formal review by Directors of cash headroom forecasts, including a 'pessimistic but realistic' downside scenario, which confirmed there is sufficient cash headroom so the company can meet its liabilities as they fall due

the Directors have concluded that the company is a going concern and that it is appropriate to prepare the financial statements on this basis.

Post Office Limited

Post Office Limited had net liabilities as at 25 March 2012 but has operated at a profit before exceptional items during 2011-12 for the fourth year running.

On 24 March 2010 a funding agreement was agreed that provided up to £180m for compensation for losses sustained in parts of the network in 2011-12 as well as providing access to the working capital facility of £1.15bn to 31 March 2012. These arrangements received State Aid approval on 21 March 2011.

A further funding agreement with Government was announced on 27 October 2010 which provided for:

- Funding of £410m for 2012-13
- Funding of £415m for 2013-14
- Funding of £330m for 2014-15
- Extension of the existing working capital facility of £1.15bn up to 31 March 2016

State Aid approval for the funding for 2012-13 to 2014-15 was received on 28 March 2012 and it was also recognised that the working capital facility was no longer deemed State Aid.

This investment will enable Post Office Limited to modernise the branch network and the continuation of the Network Subsidy Payment recognises the major social value that Post Offices provide to communities. New main and local branches are currently being piloted across the UK and these pilots will help inform the future roll-out plans. Customers will benefit from a much better retail experience including extended opening hours. This programme is designed to make the Post Office network more self-sustaining and, over time, less dependent on direct subsidy. This programme will not involve branch closures.

The Directors are satisfied that the plans in place and the substantial investment secured will enable Post Office Limited to modernise and to secure its future but note that the scale of change required is significant so not without risk.

The Directors recognise that significant progress has been made in preparing for the coming years of investment in modernisation, and after careful consideration, continue to believe that Post Office Limited will be able to meet its liabilities as they fall due in the foreseeable future. Accordingly, on that basis, the Directors consider that it is appropriate that these financial statements have been prepared on a going concern basis.

RMG00000342

Notes to the Consolidated financial statements (continued)

3. Events after the reporting period

On 1 April 2012 – after the granting of State Aid by the European Commission to the Government on 21 March 2012 – almost all of the pension liabilities and pension assets of the main pension scheme, RMPP, built up until 31 March 2012, were transferred to HM Government. On this date the RMPP was also sectionalised, with Royal Mail Group Ltd and Post Office Limited each responsible for their own sections in future. This arrangement left the RMPP fully funded on an actuarial basis in respect of historic liabilities at that date.

Royal Mail Holdings plc continues to hold £1.2bn of investments which were previously held in pension escrow and which will not be transferred to Royal Mail Group Ltd or Post Office Limited. The £149m of investments which were previously held in pension escrow in Royal Mail Group Ltd were made available to that company on 1 April 2012.

At the end of March 2013, certain unused tax losses deriving from past pension contributions will be extinguished in accordance with regulations made under the Postal Services Act 2011.

On 1 April 2012 Post Office Limited became a directly owned subsidiary of Royal Mail Holdings plc. At that date the majority of Royal Mail Holdings plc Directors became Directors of Royal Mail Group Ltd. Alice Perkins and Donald Brydon are the only Directors of Royal Mail Holdings plc at 1 April 2012.

4. Segment information

The Group reports its segments in the way it internally manages its business as follows:

25 March 2012

	UK operations				Other European operations	
	UK Parcels, International & Letters £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	Total £m
External revenue	7,164	801	5[1]	7,970	1,562	9,532
Revenue between segments	25	359	129	513	–	513
Total segment revenue	7,189	1,160	134	8,483	1,562	10,045
Operating profit before exceptional items	252	61	1	314	128	442
Modernisation costs – operating exceptional items	(229)	(2)	–	(231)	–	(231)
Operating profit after modernisation costs before other operating exceptional items	23	59	1	83	128	211
Other exceptional items	114	(35)	10	89	1	90
Profit before financing and taxation	137	24	11	172	129	301

[1] The 'Other' segments' external revenue comprises £4m (2011 £37m) relating to the provision of facilities management services by Romec Limited and £1m (2011 £1m) for building engineering services provided by NDC 2000 Limited.

Finance costs of £118m (2011 £114m), finance income of £54m (2011 £69m) and net pensions interest of £26m (2011 £167m) when adjusting the profit before financing and taxation of £301m (2011 £60m) reconciles to the Group profit before taxation of £263m (2011 £152m loss).

Page 31 describes the activities of the major business segments.

RMG00000342

Notes to the Consolidated financial statements

4. Segment information (continued)

27 March 2011

	UK operations				Other European operations	
	UK Parcels, International & Letters £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	Total £m
External revenue	6,857	776	38	7,671	1,485	9,156
Revenue between segments	28	345	142	515	–	515
Total segment revenue	6,885	1,121	180	8,186	1,485	9,671
Operating profit before exceptional items	72	36	20	128	118	246
Modernisation costs – operating exceptional items	(192)	(15)	–	(207)	–	(207)
Operating (loss)/profit after modernisation costs before other operating exceptional items	(120)	21	20	(79)	118	39
Other exceptional items	12	(35)	44	21	–	21
(Loss)/profit before financing and taxation	(108)	(14)	64	(58)	118	60

The following amounts are included within operating profit before exceptional items:

25 March 2012

	UK operations				Other European operations	
	UK Parcels, International & Letters £m	**Post Office Limited £m**	**Other £m**	**Total £m**	**General Logistics Systems £m**	**Total £m**
Depreciation	**241**	–	–	**241**	**28**	**269**
Amortisation of intangible assets (mainly software)	**29**	–	–	**29**	**4**	**33**
Share of post tax (loss)/profit from joint venture and associates	**(2)**	**31**	**3**	**32**	–	**32**

27 March 2011

	UK operations				Other European operations	
	UK Parcels, International & Letters £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	Total £m
Depreciation	223	–	–	223	27	250
Amortisation of intangible assets (mainly software)	29	–	–	29	7	36
Share of post tax (loss)/profit from joint venture and associates	(1)	25	4	28	–	28

RMG00000342

Notes to the Consolidated financial statements (continued)

5. People information

People costs:

	2012 £m	2011 £m
Wages and salaries	**4,361**	4,398
Pensions	**419**	458
Social security	**304**	304
Subpostmasters	**483**	475
Temporary resource	**90**	82
Total	**5,657**	5,717

People numbers:

The number of people employed, calculated on a headcount basis, were:

	Period end employees		Average employees	
	2012	2011	**2012**	2011
UK Parcels, International & Letters (UKPIL)	**151,156**	155,181	**152,514**	157,317
Post Office Limited	**7,798**	7,782	**7,734**	8,066
UK wholly owned subsidiaries	**158,954**	162,963	**160,248**	165,383
UK partially owned subsidiaries	**3,926**	4,254	**3,972**	4,244
General Logistics Systems	**13,362**	13,167	**13,103**	13,120
Group total	**176,242**	180,384	**177,323**	182,747

Further details about 'Our people' are included on page 25.

The number of subpostmasters employed at the period end were:

	2012	2011
Total	**8,125**	8,283

The number of subpostmasters employed is not included in the period end and average employees numbers above.

Directors' emoluments:

	2012 £000	2011 £000
Directors' emoluments	**3,920**	2,855
Amounts earned under Long-Term Incentive Plans	**-**	–
Number of Directors accruing benefits under defined benefit schemes	**2**	2

The Directors' Remuneration Report discloses full details of Directors' emoluments and can be found on pages 72 to 80.

RMG00000342

6. Operating exceptional items

The results for the year include a number of non-recurring or restructuring costs which fall outside of the Group's normal trading activity. These are items which, in management's judgement, need to be disclosed to provide greater visibility of the underlying results of the business.

An analysis of the exceptional items included within the income statement is as follows:

	2012		2011	
	£m	£m	£m	£m
Modernisation costs				
Legacy share scheme – notional shares	–		109	
– dividend	–		1	
– Business Transformation	**(60)**		(41)	
		(60)		69
Modernisation bonus – frontline costs		**(30)**		–
Restructuring costs – redundancy costs charged through provisions	**(78)**		(237)	
– other costs charged through provisions	**(3)**		(19)	
	(81)		(256)	
Restructuring costs – project and excess travel costs incurred	**(60)**		(8)	
		(141)		(264)
Impairment of property, plant and equipment		–		(12)
Total modernisation costs		**(231)**		(207)
Non-modernisation costs				
Charged through provisions-potential industrial diseases claims	**(10)**		(30)	
Impairments	**(43)**		(43)	
State Aid and Postal Services Bill	**(24)**		(15)	
Other exceptional items	**(16)**		–	
		(93)		(88)
Total operating exceptional items		**(324)**		(295)

The £60m charge (2011 £41m) mainly represents payments linked to the achievement of key modernisation milestones as part of the pay deal with the Communication Workers Union.

A one-off modernisation bonus of £30m (2011 £nil) has been charged in 2011-12 to reflect the progress on frontline efficiency.

Of the £141m (2011 £264m) restructuring costs, £78m (2011 £237m) relates to provisions for redundancy costs in UKPIL and Post Office Limited and £3m (2011 £19m) mainly onerous property lease costs. The remaining £60m (2011 £8m) principally relates to excess travel expenses and one-off project costs in support of the modernisation of the business.

Impairments of £43m (2011 £43m) relate to: Post Office Limited comprising £19m (2011 £29m) property, plant and equipment and £17m (2011 £11m) intangible assets; UKPIL comprising £1m (2011 £nil) property, plant and equipment and £3m (2011 £nil) software assets; and £3m (2011 £2m) in relation to an associate company carrying value.

Exceptional costs of £24m (2011 £15m) were charged in the year for specific costs relating to the Postal Services Bill, the State Aid process and the transfer of the Royal Mail Pension Plan (RMPP) pension liabilities and pension assets to HM Government on 1 April 2012.

Other exceptional items of £16m (2011 £nil) largely relate to Romec Limited transformation costs.

RMG00000342

Notes to the Consolidated financial statements (continued)

7. Cash flow information

Cash flows relating to operating exceptional items

The net cash outflows relating to operating exceptional items charged to the income statement in the current and prior years are as follows:

	2012 £m	2011 £m
Current year modernisation costs	**129**	88
Prior year modernisation costs	**176**	179
Current year non-modernisation costs	**27**	5
Prior year non-modernisation costs	**10**	–
Total	**342**	272

The £129m (2011 £88m) modernisation cash outflows relating to the current year comprise £22m (2011 £55m) redundancy payments, £52m (2011 £25m) Business Transformation payments and £55m (2011 £8m) project and excess travel costs. The £176m (2011 £179m) modernisation cash flows in respect of the prior year comprise £97m (2011 £66m) redundancy payments, £2m (2011 £77m) legacy share scheme payments, £39m (2011 £30m) redundancy related pension payments, £18m (2011 £nil), redundancy creditor payments £16m (2011 £nil) Business Transformation payments and £4m (2011 £6m) other costs.

Free cash flow

Free cash flow in Royal Mail Group is defined as the net cash inflow/(outflow) before financing activities (except finance costs paid), less the net cash purchase/sale of financial asset investments (current and non-current).

Free cash flow is not a measure defined under IFRS but is a key indicator used by management to assess performance.

A reconciliation of 'net cash inflow/(outflow) before financing activities' in the consolidated statement of cash flows to Free cash inflow/(outflow) is shown below.

	2012 £m	2011 £m
Net cash inflow/(outflow) before financing activities	**232**	(111)
Finance costs paid	**(73)**	(60)
Add back: Net purchase/(sale) of financial asset investments (non-current)	**45**	(42)
Net purchase of financial asset investments (current)	**30**	–
Free cash inflow/(outflow)	**234**	(213)

RMG00000342

8. Provisions

	Exceptional			
	Modernisation £m	Non-modernisation £m	Other £m	Total £m
At 27 March 2011	**193**	**30**	**55**	**278**
Arising during the year:				
– charged in operating exceptional items	**90**	**19**	–	**109**
– charged in other operating costs	–	–	**33**	**33**
Unused amounts reversed	**(9)**	**(2)**	**(5)**	**(16)**
Utilised in the year	**(156)**	**(6)**	**(14)**	**(176)**
Discount rate adjustment	**1**	**2**	–	**3**
At 25 March 2012	**119**	**43**	**69**	**231**
Disclosed as:				
Current at 25 March 2012	**76**	**7**	**55**	**138**
Non-current at 25 March 2012	**43**	**36**	**14**	**93**
	119	**43**	**69**	**231**
Current at 27 March 2011	140	3	38	181
Non-current at 27 March 2011	53	27	17	97
	193	30	55	278

Exceptional modernisation

Modernisation exceptional provisions of £119m (2011 £193m) principally comprise redundancy schemes of £87m (2011 £159m). A further £32m (2011 £32m) relates to onerous property and commercial contracts associated with restructuring. Current modernisation provisions of £76m are expected to be utilised in 2012-13 with the remainder expected to be utilised within two to three years, except for onerous property provisions of £2m likely to be utilised within three to five years and a further £4m expected to be utilised over a period greater than five years.

Exceptional non-modernisation

Non-modernisation exceptional provisions of £43m (2011 £30m) primarily relate to potential industrial diseases claims of £39m (2011 £30m), of which £3m is expected to be utilised in 2012-13.

Other

Other provisions of £69m (2011 £55m) include those recognised for the expected liabilities arising from property exits in the normal course of business. These principally comprise onerous lease obligations and decommissioning costs. In addition, further provision amounts arise from estimated exposures resulting from legal claims incurred in the normal course of business and mainly obligations under onerous commercial IT contracts. The majority of the 'Other' provision amounts are expected to be utilised in 2012-13, with the remainder within two to three years, except £2m onerous property contracts expected to be utilised within three to five years, and a further £6m expected to be utilised over a period greater than five years.

RMG00000342

Notes to the Consolidated financial statements (continued)

9. Employee benefits – pensions

On 1 April 2012, after the reporting period end date, almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP) were transferred to HM Government.

The disclosures in this note relate to the year ending 25 March 2012 and show how the value of the assets and liabilities have been calculated at the balance sheet date.

The Group operates pension plans as detailed below.

Plan	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executives' Pension Plan (RMSEPP)	UK senior executives	Defined benefit
Royal Mail Defined Contribution Plan (RMDCP)	UK employees	Defined contribution
Various other small-scale plans operated by overseas subsidiaries	Overseas subsidiary employees	Defined contribution

Defined Contribution

A charge for the defined contribution plans of £12m (2011 £10m) was recognised in operating profit before exceptional items within the income statement. The Company contributions to these plans was £12m (2011 £10m). A new defined contribution plan (RMDCP) was launched in April 2009. Recruits joining from 31 March 2008 are able to begin paying contributions to the new plan after they have worked for the Company for a year.

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. RMPP includes sections A, B, and C, each with different terms and conditions:

- Section A is for members (or beneficiaries of members) who joined before 1 December 1971;
- Section B is for members (or beneficiaries of members) who joined on or after 1 December 1971 and before 1 April 1987 or to members of Section A who chose to receive Section B benefits;
- Section C is for members (or beneficiaries of members) who joined on or after 1 April 1987 and before 1 April 2008.

A series of changes to RMPP and RMSEPP began to take effect on 1 April 2008. The changes encompass:

- the Plans closed to new members from 31 March 2008;
- all pensions and benefits earned before 1 April 2008 are still linked to final salary at the time of retirement;
- from 1 April 2008, defined benefits building up for employee members of the Plans are earned on a career salary basis;
- employees can continue to take their pension on reaching 60 but the normal retirement age will increase to 65 for benefits earned from 1 April 2010; and
- from 1 April 2010 it is possible to draw pension earned before the change to normal retirement age from 55, and continue working while still contributing to the Pension Plan until the maximum level of benefits has been reached.

Payment of £408m (2011 £432m) was made during the year in respect of regular future service contributions, with £405m (2011 £428m) relating to RMPP. The regular future service contributions charge for RMPP, expressed as a percentage of pensionable pay, remained at 17.1% (2011 17.1%), effective from April 2010. This rate is not expected to change materially during 2012-13. For RMSEPP, these contributions remained at 35.9% (2011 35.9%) effective from April 2010.

Payment of £8m (2011 £299m) was made during the year to fund the deficit in the plans, with £nil (2011 £292m) relating to RMPP. Deficit recovery payments were agreed for RMPP over the 38 years from the date of the latest full actuarial valuation at March 2009. Following the State Aid clearance granted on 21 March 2012 and the subsequent transfer of almost all of the pension liabilities and pension assets to HM Government on 1 April 2012, no RMPP deficit payment was made during the year. For RMSEPP, deficit recovery payments will be £11m per annum less regular future service contributions, from 1 April 2010 to 31 January 2024.

A current liability of £5m (2011 £12m) has been recognised for payments to the pension plans relating to redundancy. During the year, payments of £39m (2011 £30m) relating to redundancy were made.

A liability of £1m (2011 £1m) has been recognised for future payment of pension benefits to a past Director (see page 80 of the Directors' Remuneration Report).

RMG00000342

9. Employee benefits – pensions (continued)

The following disclosures relate to the gains/losses and deficit recognised in the financial statements of the Group for the defined benefit plans RMPP and RMSEPP:

a) Major long-term assumptions – RMPP and RMSEPP

The size of the pension deficit, which is large in the context of the Group and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the deficit and overall income statement charge. The major assumptions were:

	At 25 March 2012 % pa	At 27 March 2011 % pa
Inflation assumption (RPI)	**3.3**	3.5
Inflation assumption (CPI)	**2.3**	2.8
Discount rate	**5.1**	5.5
Rate of increase in salaries*	**RPI + 1%**	RPI + 1%
Rate of increase for deferred pensions – RMSEPP members transferred from Section A or B of RMPP	**RPI**	RPI
Rate of increase for deferred pensions – all other members	**CPI**	CPI
Rate of pension increases – RMPP Sections A/B	**CPI**	CPI
Rate of pension increases – RMPP Section C	**RPI**	RPI
Rate of pension increases – RMSEPP all members	**RPI**	RPI
Expected average rate of return on assets	**5.9**	6.5

* The rate of increase in salaries for 2012-13 reflects the Business Transformation 2010 and Beyond agreement. From 2013-14 the rate of increase in salaries assumption is RPI + 1%.

In June 2010, the Government announced that it was intending to change the inflation measure used to determine statutory minimum indexation in deferment and in payment from RPI to CPI from April 2011. Where relevant, the inflation assumption has changed from RPI to CPI.

The above assumptions relate to both defined benefit plans, with the exception of the expected average rate of return on assets which is computed for the combined assets of the plans. The expected average rate of return on assets is a weighted average of the long-term expected rate of return of each principal asset class (see section b).

RMG00000342

Notes to the Consolidated financial statements (continued)

9. Employee benefits – pensions (continued)

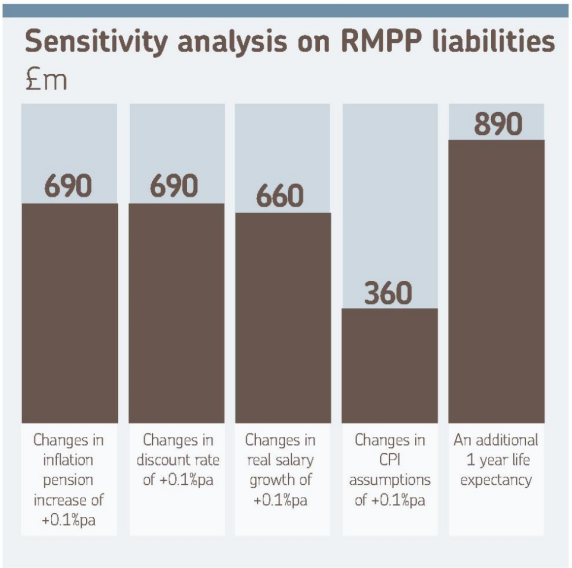
Mortality

The mortality assumptions for the larger plan are based on the latest Self Administered Pension Scheme (SAPS) mortality tables with appropriate scaling factors (106% for male pensioners and 101% for female pensioners). For future improvements the assumptions allow for 'medium cohort' projections with a 1.25% floor. These are detailed below:

Average expected life expectancy from age 60:

	2012	2011
For a current 60 year old male RMPP member	**26 years**	26 years
For a current 60 year old female RMPP member	**29 years**	29 years
For a current 40 year old male RMPP member	**29 years**	29 years
For a current 40 year old female RMPP member	**32 years**	32 years

The following table shows the potential impact on the RMPP liabilities and pension deficit of changes in key assumptions:



b) Plans' assets and expected rates of return and deficit calculation – RMPP and RMSEPP

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

	Market value		Long-term expected rate of return	
	2012 £m	2011 £m	2012 % pa	2011 % pa
Equities	**3,385**	4,268	**7.7**	8.2
Bonds	**25,356**	21,291	**5.7**	6.2
Property	**1,417**	1,590	**6.8**	6.5
Cash/other	**333**	418	**3.4**	4.2
Derivatives	**254**	118	**5.7**	6.2
Fair value of plans' assets	**30,745**	27,685		
Present value of plans' liabilities	**(33,667)**	(32,186)		
Deficit in plans	**(2,922)**	(4,501)		

Ninety nine percent of the above assets are held by RMPP.

Included within the pension assets are £12.5bn of HM Government bonds.

RMG00000342

9. Employee benefits – pensions (continued)

The expected average rate of return is computed at each balance sheet date based on the market values and long-term rate of return of each principal asset class as at that date. The rate shown for bonds and derivatives is the combined expected rate of return for bonds/debt instruments.

There is no element of the present value of plans' liabilities on the previous page that arises from plans that are wholly unfunded.

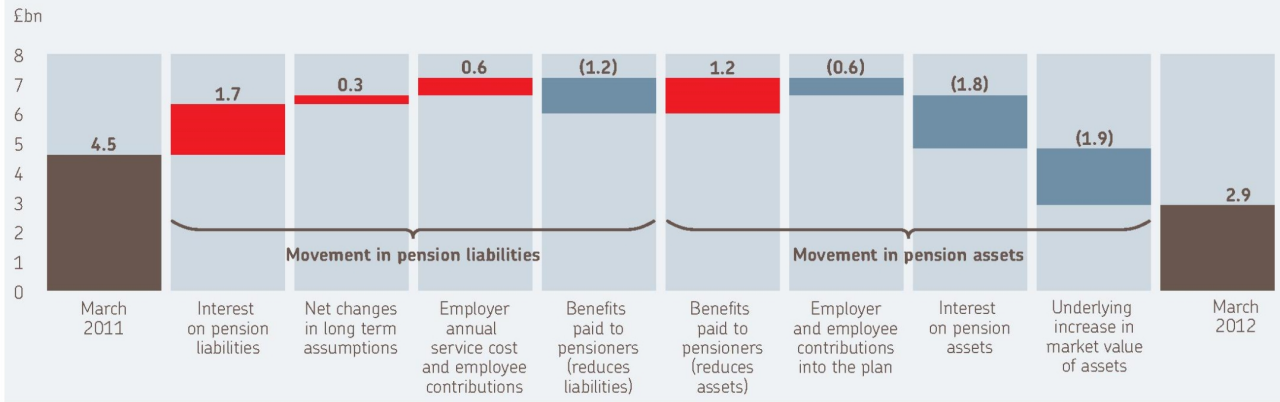
The RMPP Trustee has elected to use equity futures and interest rate and inflation rate swaps ("derivatives") to deliver the investment strategy whilst managing risk as described below. These derivatives are recorded at market value within the table on the previous page and are commonly used by pension funds. The equity futures retain the effective economic exposure to equity prices whilst de-risking the Plan by allowing cash which was previously held in equities to be transferred into bonds. The equity futures generate exposure to equity type assets totalling £10.5bn (March 2011 £11.7bn). The interest rate and inflation rate swaps are used to hedge the exposure to movements in interest rates and inflation (which are key long-term assumptions used to estimate future pension liabilities) and the economic exposure of these swaps in total is £30.5bn (March 2011 £31.0bn).

The investment strategy of the RMPP Trustee aims to safeguard the assets of the Plan and to provide, together with contributions, the financial resource from which benefits are paid. Investment is inevitably exposed to risks. The investment risks inherent in the investment markets are partially mitigated by pursuing a widely diversified approach across asset classes and investment managers. The Plan uses derivatives (such as swaps and futures) to reduce risks whilst maintaining expected investment returns. The Plan Trustee recognises that there is a natural conflict between improving the potential for positive return and limiting the potential for poor return. The Trustee has specified objectives for the investment policy that balance these requirements. More details of the RMPP investment strategy, principles and objectives is available in the RMPP Report and Financial Statements 2010-11 at http://www.royalmailpensionplan.co.uk/56/rmpp-report-and-accounts.

c) Movement in plans' assets, liabilities and deficit – RMPP and RMSEPP

The pensions accounting deficit has moved in the year as follows:

Accounting Pension Deficit Movement



RMG00000342

Notes to the Consolidated financial statements (continued)

9. Employee benefits – pensions (continued)

The movements in the pension liabilities include:

1. Interest on the brought forward pension liabilities using the March 2011 discount rate - this is mainly due to the unwinding of the discount factor of 5.5% on the brought forward liability of £32bn (approximately 5.5% x £32.2bn equates to c£1.7bn higher liability).
2. The changes in long-term assumptions which comprise a higher liability as the discount factor has reduced from 5.5% to 5.1%, offset by lower future pension payments due to RPI and CPI reducing. In line with the relevant accounting standard IAS 19, an AA corporate bond rate has been used to discount plan liabilities.
3. The annual ongoing pension cost of £0.4bn charged to the income statement 'people costs' line at a 17.1% rate. Employee contributions increase the total to £0.6bn. Note this offsets the £0.6bn ongoing company and employee contributions below.
4. Benefits paid to members of £1.2bn which reduce the liability although this is offset by an equal and opposite reduction in pension assets as shown in item 5.

Items that impact the pension assets include:

5. Benefits to members which are funded from assets, so therefore a reduction to assets, see item 4.
6. Ongoing company contributions to the main plan, RMPP, included in cash flow at a 17.1% rate, together with employee contributions, offsetting item 3.
7. The expected rate of return on pension assets based on the March 2011 6.5% blended asset return assumption (6.5% x £28bn assets equates to £1.8bn higher asset).
8. The additional increase in market value of pension assets, which is mainly driven by the holding in bonds.
9. The combination of 7 and 8 comprises the overall return on assets of £3.7bn and this is the main reason why the accounting deficit has decreased.

IAS 19 requires a reconciliation of opening to closing assets and liabilities. This is shown below and is consistent with the chart on page 99.

Changes in the fair value of the plans' assets are analysed as follows:

	2012 £m	2011 £m
Plans' assets at beginning of period	**27,685**	25,814
Company contributions paid	**455**	761
Employee contributions paid	**144**	152
Movement in Company contributions accrued	**(8)**	6
Finance income (expected rate of return)	**1,775**	1,714
Actuarial gains (additional increase in market values)	**1,869**	470
Benefits paid to members	**(1,175)**	(1,232)
Plans' assets at end of period	**30,745**	27,685

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	2012 £m	2011 £m
Plans' liabilities at beginning of period	**(32,186)**	(33,855)
Current service cost	**(407)**	(448)
Employee contributions	**(144)**	(152)
Curtailment costs*	**(31)**	(36)
Finance cost	**(1,749)**	(1,881)
Actuarial (losses)/gains (recognised in statement of comprehensive income)	**(325)**	2,954
Benefits paid	**1,175**	1,232
Plans' liabilities at end of period	**(33,667)**	(32,186)

* The curtailment costs in the income statement are recognised on a consistent basis with the associated compensation costs. Estimates of both are included, for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy during the accounting period. Such payments may occur in an accounting period subsequent to the recognition of costs in the income statement.

RMG00000342

9. Employee benefits – pensions (continued)

d) History of experience gains and losses – RMPP and RMSEPP

The cumulative amount of actuarial gains and losses recognised since transition to IFRSs at 29 March 2004 in the statement of comprehensive income is a £462m gain (2011 £1,082m loss).

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of assets	**30,745**	27,685	25,814	20,071	23,923
Present value of liabilities	**(33,667)**	(32,186)	(33,855)	(26,847)	(26,846)
Deficit in plans	**(2,922)**	(4,501)	(8,041)	(6,776)	(2,923)

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Experience adjustment on assets	**1,869**	470	4,469	(5,481)	(1,327)
Experience adjustment on liabilities	**(5)**	(8)	673	(10)	(169)

This disclosure is in accordance with IAS 19.

e) Recognised charges – RMPP and RMSEPP

A disaggregation of the amounts recognised in the income statement and statement of comprehensive income is as follows:

	2012 £m	2011 £m
Analysis of amounts recognised in the income statement:		
Analysis of amounts charged to operating profit before exceptional items:		
– Current service cost	**407**	448
Total charge to operating profit before exceptional items	**407**	448
Analysis of amounts charged to operating exceptional items:		
– Loss due to curtailments (within provision for restructuring charge – note 8)	**15**	47
Total charge to operating profit	**422**	495
Analysis of amounts charged/(credited) to financing:		
– Interest on plans' liabilities	**1,749**	1,881
– Expected return on plans' assets	**(1,775)**	(1,714)
Total net (credit)/charge to financing	**(26)**	167
Net charge to income statement before deduction for tax	**396**	662
Analysis of amounts recognised in the statement of comprehensive income:		
– Actual return on plans' assets	**3,644**	2,184
– Less: expected return on plans' assets	**(1,775)**	(1,714)
Actuarial gains on assets (all experience adjustments)	**1,869**	470
– Experience adjustments on liabilities	**(5)**	(8)
– Effects of changes in actuarial assumption on liabilities	**(320)**	2,962
Actuarial (losses)/gains on liabilities	**(325)**	2,954
Total actuarial gains recognised in the statement of comprehensive income before deduction for tax	**1,544**	3,424

RMG00000342

Other notes – financial assets, financial liabilities and hedging programmes

In simple terms:

The notes in this section explain how the Group is financed by providing:

- a summary of financial assets (e.g. cash, investments and deposits) and liabilities (e.g. loans and finance lease obligations) and how the various risks associated with these assets and liabilities are managed (note 10)
- an analysis of the pension escrow investments balance at 25 March 2012, established as security for the Pension Trustee in support of the pension deficit recovery period (note 11)
- a summary of the cash and cash equivalents balances held, including balances held in the Post Office network (note 12)
- details of loans and borrowings, including interest rates, additional loan facilities available and any security provided against the loans (note 13)
- a summary of the maturity values/timescales for the loans, finance lease obligations and derivative liabilities (note 14)
- an analysis of the Sterling carrying values of the financial assets and liabilities held in various foreign currencies, along with details of interest rates, interest rate risk and maturity timescales (note 15)
- information regarding the various hedging programmes in place to mitigate volatility in commodity prices and foreign currency exchange rates (note 16)

10. Financial assets and liabilities – introduction, summary and management of financial risk	103
11. Pension escrow investments	105
12. Cash and cash equivalents	106
13. Loans and borrowings	106
14. Financial liabilities net and gross maturity analysis	108
15. Financial assets and liabilities – additional analysis	110
16. Hedging programmes	115

RMG00000342

10. Financial assets and liabilities – introduction, summary and management of financial risk

The Group's financial assets and liabilities are shown in the table below. Subsequent notes provide more detailed disclosures.

	2012			2011		
	Non-current £m	**Current £m**	**Total £m**	Non-current £m	Current £m	Total £m
Pension escrow investments	**1,383**	–	**1,383**	1,161	–	1,161
Cash and cash equivalents	–	**1,293**	**1,293**	–	1,101	1,101
Other bank and local authority deposits	–	**31**	**31**	44	1	45
Derivative assets	**2**	**9**	**11**	6	36	42
Total financial assets	**1,385**	**1,333**	**2,718**	1,211	1,138	2,349
BIS loans to Post Office Limited	–	**(377)**	**(377)**	–	(375)	(375)
BIS loans to Royal Mail Group Ltd	**(1,522)**	–	**(1,522)**	(1,477)	–	(1,477)
Miscellaneous loans in subsidiaries	–	–	–	(1)	–	(1)
Total loans and borrowings	**(1,522)**	**(377)**	**(1,899)**	(1,478)	(375)	(1,853)
Finance leases obligations	**(237)**	**(90)**	**(327)**	(193)	(65)	(258)
Derivative liabilities	**(1)**	**(4)**	**(5)**	–	(3)	(3)
Total financial liabilities	**(1,760)**	**(471)**	**(2,231)**	(1,671)	(443)	(2,114)

Financial assets and liabilities – financial risk management objectives and policies

The Group's principal financial assets and liabilities, comprise short-term deposits, money market liquidity investments, Government gilt edged securities, loans, finance leases and cash. The main purposes of these financial instruments are to raise finance and manage the liquidity needs of the business operations. The Group has various other financial instruments such as trade receivables and trade payables, which arise directly from operations and are not disclosed further in this section.

The Group enters into derivative transactions, which create derivative assets and liabilities, principally commodity price swaps and forward currency contracts. The purpose is to manage the commodity and currency risks arising from the Group's operations.

It is, and has been throughout the year under review, the Group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial assets and liabilities are interest rate risk, liquidity risk, foreign currency risk, commodity price and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The Group's exposure to market risk for changes in interest rates relates to the Group's loans and borrowings and interest bearing financial assets. The BIS loans to Royal Mail Group Ltd of £1,522m (2011 £1,477m) are a mix of £600m (2011 £600m) variable rate and £922m (2011 £877m) fixed interest rate with a combined average maturity date of 2017 (2011 average maturity date of 2017). The BIS loans to Post Office Limited of £377m (2011 £375m) are at short-dated fixed interest rates with average maturity 1 day (2011 average maturity 1 day). The total interest bearing financial assets of the Group (excluding the non-current investments) of £549m (2011 £397m) are at short-dated fixed or variable interest rates with average maturity 16 days (2011 average maturity 5 days). These short-dated financial instruments are maturity managed to obtain the best value out of the interest yield curve.

The Group's policy is to manage its net interest expense using an appropriate mix of fixed and variable rate financial instruments. No external hedging of interest rate risk is undertaken.

Foreign currency risk

The Group is exposed to foreign currency risk due to: trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in UKPIL; the balances held to operate the Bureau de Change services within Post Office Limited; and various purchase contracts denominated in foreign currency, all in UKPIL. These risks are mitigated by hedging programmes managed by Group Treasury. Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts. Hedging will not normally be considered for exposures of less than £1m and hedging is normally confined to 80% of the forecast exposure where forecast cash flows are highly probable.

RMG00000342

Notes to the Consolidated financial statements (continued)

10. Financial assets and liabilities – introduction, summary and management of financial risk (continued)

The Group's obligation to settle with overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprised of US dollar (US$), Japanese Yen, Sterling and Euro. Group Treasury operates a rolling 18-month hedge programme, which is subsequently reviewed on a quarterly basis. An external SDR hedge was put in place during 2010-11.

For the Bureau de Change business, balances of major currency holdings are hedged along with minor currencies showing a closely correlated movement.

The Group's obligations to settle conveyance charges in UKPIL in US$ has been hedged to April 2013.

The Group has two hedge programmes covering obligations to settle Euro invoices on automation projects in UKPIL.

The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries mainly GLS. However, it does hedge the transactional exposure created by inter-company loans with these subsidiaries.

Commodity price risk

The Group is exposed to fuel price risk arising from operating one of the largest vehicle fleets in Europe, which consumes over 130 million litres of fuel per year, and a jet fuel price risk arising from the purchasing of air freight services. The Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy uses over-the-counter derivative products (in both US$ commodity price and US$/Sterling exchange rate) to manage these exposures, mainly on a combined basis.

In addition, the Group is exposed to the commodity price risk of purchasing electricity and gas. The Group's risk management strategy aims to reduce uncertainty created by the movements in the electricity and gas markets. These exposures are managed by locking into fixed rate price contracts with suppliers and using over-the-counter derivative products to manage these exposures.

Credit risk

Royal Mail considers that a fair and equitable credit policy is in operation for all its account customers. The level of credit granted is based on a customer's risk profile assessed by an independent credit referencing agent. The credit policy is applied rigidly within the regulated products area so as to ensure that Royal Mail is not in breach of compliance legislation. Assessment of credit for the non-regulated products is based on commercial factors, which are commensurate with the Group's appetite for risk.

Royal Mail has a dedicated credit management team, which sets and monitors credit limits, and takes corrective action as and when appropriate. The level of bad debt incurred for the whole Group is 0.4% (2011 0.1%) of turnover.

With respect to credit risk arising from other financial assets of the Group, which comprise cash, cash equivalent investments, available for sale financial assets, held to maturity financial assets, held for trading financial assets, loans and receivables financial assets and certain derivative instruments, the Group invests/trades only with high-quality financial institutions. The Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Liquidity risk

The Group's primary objective is to ensure that the Group has sufficient funds available to meet its financial obligations as they fall due. This is achieved by aligning short-term investments and borrowing facilities with forecast cash flows. Typical short-term investments include money market funds, time deposits with approved counterparties, UK Government gilts and Treasury bills. Borrowing facilities are regularly reviewed to ensure continuity of funding.

The unused facilities for Royal Mail Group Ltd of £300m expire in 2014 (2011 £300m expiring in 2014). The unused facility for Post Office Limited of £773m expires in 2016 (2011 £775m expiring in 2012). Additionally, the Group has £200m (2011 £200m) of uncommitted lines of credit which are reviewed annually.

Capital management

Royal Mail Holdings plc is a public limited company whose shares are not traded and the Group regards its capital as share capital, share premium, retained earnings and debt provided by the UK Government. The sole shareholder and the provider of the majority of debt to the Group is the UK Government. The management of capital is closely linked to the Group's relationship with its shareholder. The Group maintains its liquidity requirements by the management of its internal funds and by the drawing down of equity and debt from its shareholder as well as drawing on limited external debt facilities. The Group's debt to equity ratio is determined by its shareholder.

Sensitivity

As a result of the mix of fixed and variable rate financial instruments and the currency and commodity hedge programmes in place, the Group has no material exposure to operating profit risk from interest rate, exchange rate or commodity prices (2011 £nil).

RMG00000342

11. Pension escrow investments

The pension escrow investments were established to provide security to the Royal Mail Pension Plan (RMPP) Trustee in support of a 38 year deficit recovery period as agreed with the Trustee in 2009 as part of the last triennial valuation.

At 25 March 2012, Royal Mail Holdings plc had £1,234m (2011 £1,074m) of financial assets in the pension escrow and Royal Mail Group Ltd had £149m (2011 £87m) of financial assets plus mortgages on certain Group properties over which charges have been registered.

At the balance sheet date the pension escrow investments comprised cash, treasury bills, index-linked gilt edged securities and conventional gilt edged securities with varying effective interest rates. These are analysed in the table below:

	2012		2011	
	Average effective interest rate %	**£m**	Average effective interest rate %	£m
Fixed rate				
Cash at bank	**0.4**	**1**	0.4	3
Treasury bills	**0.4**	**257**	0.5	242
Gilt edged securities (index-linked)	**4.3**	**835**	4.7	707
Gilt edged securities (conventional)	**4.8**	**141**	4.8	122
Held in Royal Mail Holdings plc (page 149)		**1,234**		1,074
Treasury bills	**0.4**	**45**	–	–
Gilt edged securities (index-linked)	**4.3**	**79**	4.7	66
Gilt edged securities (conventional)	**4.8**	**25**	4.8	21
Held in Royal Mail Group Ltd		**149**		87
Group Total		**1,383**		1,161

Treasury bills, index-linked gilt edged securities and conventional gilt edged securities are classified as available for sale financial instruments on the basis that they are quoted investments that are not held for trading and may be disposed of prior to maturity. The investments are initially recognised at fair value, being the purchase price. After initial recognition, interest is included in the reported profit/(loss) for the year, using the effective interest rate method and the assets are measured at fair value with gains and losses being recognised in the Financial Assets Reserve until the investment is derecognised.

The increase in the pension escrow investments of £222m (2011 decrease of £28m) consists of £45m (2011 £54m) interest on the investments plus £133m (2011 £20m) movement in fair value deferred into the Financial Assets Reserve, plus £44m paid into escrow on the disposal of one of the Group's properties previously held under mortgage in escrow (2011 less £102m released from escrow, substituted by mortgages on certain Group properties).

As from 1 April 2012, following the transfer of almost all of the RMPP pension liabilities and pension assets to HM Government, Royal Mail Holdings plc continues to hold £1.2bn of investments which were previously held in pension escrow and which will not be transferred to Royal Mail Group Ltd or Post Office Limited. The £149m of investments which were previously held in pension escrow in Royal Mail Group Ltd were made available to that company on this date.

RMG00000342

Notes to the Consolidated financial statements (continued)

12. Cash and cash equivalents

Cash and cash equivalents include cash in Post Office Limited's 11,818 branches and other cash equivalent investments as shown below:

	2012 £m	2011 £m
Cash in the Post Office Limited network	**759**	704
Cash at bank and in hand	**171**	100
Total cash at bank in hand or in the Post Office Limited network	**930**	804
Cash equivalent investments: Short-term bank and local authority deposits and money market fund investments	**363**	297
Total cash and cash equivalents	**1,293**	1,101

Cash and cash equivalents comprise amounts held physically in cash, bank balances available on demand and deposits for three months or less, dependent on the immediate cash requirements of the Group. Where interest is earned, this is either at floating or short-term fixed rates based upon bank deposit rates. The fair value of cash and cash equivalent investments is not materially different from the carrying value of £1,293m (2011 £1,101m).

13. Loans and borrowings

Below is a summary of loans and borrowings at the year end, the average interest rate, facility availability and security granted.

	Loans and borrowings £m	Further committed facility £m	Total facility £m	Average interest rate of loan drawn down %	2012 Average maturity date of loan drawn down year
BIS loans to Royal Mail Group Ltd	**1,522**	**300**	**1,822**	**6.1**	**2017**
BIS loans to Post Office Limited	**377**	**773**	**1,150**	**0.8**	**2012**
Total	**1,899**	**1,073**	**2,972**		

	Loans and borrowings £m	Further committed facility £m	Total facility £m	Average interest rate of loan drawn down %	2011 Average maturity date of loan drawn down year
BIS loans to Royal Mail Group Ltd	1,477	300	1,777	6.3	2017
BIS loans to Post Office Limited	375	775	1,150	0.8	2011
Committed facilities	1,852	1,075	2,927		
Miscellaneous loans and borrowings in subsidiaries	1	–	1	4.5	2012
Total	1,853	1,075	2,928		

The undrawn committed facilities, in respect of which all conditions precedent had been met at the balance sheet date, expire as follows:

	2012 £m	2011 £m
Expiring in one year or less	**–**	–
Expiring in more than one year, but not more than two years	**300**	775
Expiring in more than two years	**773**	300
Total	**1,073**	1,075

RMG00000342

13. Loans and borrowings (continued)

The following securities apply to the Group's committed facilities:

	2012 Facility £m	Facility end date	2011 Facility £m	Facility end date	Security
Royal Mail Group Ltd senior debt facility	**900**	**2014**	900	2014	Fixed charges over Royal Mail Holdings plc's shares in Royal Mail Group Ltd and Royal Mail Group Ltd's shares in Royal Mail Estates Limited. Floating charges over all assets of Royal Mail Holdings plc, Royal Mail Group Ltd and Royal Mail Estates Limited excluding certain Group properties over which mortgages are held as security to the Royal Mail Pension Plan
Royal Mail Group Ltd shareholder loan facility	**422**	*	377	*	None
Royal Mail Group Ltd other drawn down loans	**500**	**2021-2025**	500	2021-2025	Fixed charges over any Royal Mail Group Ltd loans to General Logistics Systems B.V., any Royal Mail Group Ltd loans to subsidiaries of General Logistics Systems B.V. and Royal Mail Investments Limited's shares in General Logistics Systems B.V. Floating charge over non-regulated assets of Royal Mail Group Ltd
	1,822		1,777		
Post Office Limited facility	**1,150**	**2016**	1,150	2012	Floating charge over all assets of Post Office Limited and a negative pledge** over cash and near cash items
Total	**2,972**		2,927		

* Loan facilities are repayable on the later of March 2016 and the release of the pension escrow investment.

** The negative pledge is an agreement not to grant security over these assets or to set up a vehicle that has the same effect.

The Royal Mail Group Ltd shareholder loan increased by £45m (2011 £40m) as a result of accrued interest added to the loan balance.

The Post Office Limited facility of £1,150m is currently restricted to funding the cash and near cash items held within the Post Office Limited network.

The BIS loans to Post Office Limited under the facility are short dated on a programme of liquidity management and mature on average 1 day after the year end (2011 1 day). On maturity it is expected that further loans will be drawn down under this facility, which expires in 2016.

The security in place in the previous year was as disclosed above – with the exception of the £60m (2011 £102m) mortgages over certain Group properties which were established in March 2011.

The BIS loans to Royal Mail Group Ltd and Post Office Limited become repayable immediately on the occurrence of an event of default under the loan agreements. These events of default include non-payment, insolvency and breach of covenant relating to interest and total indebtedness. It is not anticipated that the Group is at risk of breaching any of these obligations.

RMG00000342

Notes to the Consolidated financial statements (continued)

14. Financial liabilities net and gross maturity analysis

Below is a summary of when all the financial liabilities fall due.

	Loans and borrowings £m	Finance leases £m	Derivative liabilities £m	2012 Total £m
Amounts falling due in:				
One year or less or on demand (current)	**377**	**90**	**4**	**471**
More than one year (non-current)	**1,522**	**237**	**1**	**1,760**
More than one year but not more than two years	600	55	1	656
More than two years but not more than five years	–	145	–	145
More than five years	922	37	–	959
Total	**1,899**	**327**	**5**	**2,231**

	Loans and borrowings £m	Finance leases £m	Derivative liabilities £m	2011 Total £m
Amounts falling due in:				
One year or less or on demand (current)	375	65	3	443
More than one year (non-current)	1,478	193	–	1,671
More than one year but not more than two years	–	50	–	50
More than two years but not more than five years	601	109	–	710
More than five years	877	34	–	911
Total	1,853	258	3	2,114

Obligations under finance leases are either unsecured or secured on the leased assets. These are repayable in variable and fixed amounts over their maturity periods. The average interest rate is 4% (2011 5%). The average maturity date is more than five years (2011 more than five years).

RMG00000342

14. Financial liabilities net and gross maturity analysis (continued)

The tables below set out the gross (undiscounted) contractual cash flows of the Group's financial liabilities. For overdrafts, loans and finance lease contracts, these cash flows represent the undiscounted total amounts payable including interest. For derivatives which are settled gross, these cash flows represent the undiscounted gross payment due and do not reflect the accompanying inflow. For derivatives which are settled net, these cash flows represent the undiscounted forecast outflow.

						2012
	Gross loans and borrowings commitments £m	Gross finance lease instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	**423**	**102**	**525**	**316**	**3**	**844**
More than one year (non-current)	**2,081**	**351**	**2,432**	**3**	**1**	**2,436**
More than one year but not more than two years	646	63	709	3	1	713
More than two years but not more than five years	88	157	245	–	–	245
More than five years	1,347	131	1,478	–	–	1,478
Total	**2,504**	**453**	**2,957**	**319**	**4**	**3,280**

						2011
	Gross loans and borrowings commitments £m	Gross finance lease instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	424	76	500	379	2	881
More than one year (non-current)	2,144	308	2,452	3	–	2,455
More than one year but not more than two years	51	58	109	3	–	112
More than two years but not more than five years	717	119	836	–	–	836
More than five years	1,376	131	1,507	–	–	1,507
Total	2,568	384	2,952	382	2	3,336

RMG00000342

Notes to the Consolidated financial statements (continued)

15. Financial assets and liabilities – additional analysis

The following tables show the currency, classification, maturity and effective interest rate of the Group's financial assets and liabilities.

Carrying amounts and fair values

Trade receivables, payables, prepayments, accruals and client payables have been omitted from this analysis on the basis that carrying value is a reasonable approximation for fair value. Pension scheme assets and liabilities are also excluded. Fair values have been calculated using current market prices (forward exchange rates/commodity prices) and discounted using appropriate discount rates. There are no material differences between the fair value (transaction price) of all financial instruments at initial recognition and the fair value calculated using these valuation techniques. The fair value of the BIS loans to Royal Mail Group Ltd (non-current) is £1,698m at 25 March 2012 (2011 £1,563m). The fair value of 'obligations under finance leases' is £338m (2011 £262m). For all other financial instruments fair value is equal to the carrying amount.

RMG00000342

15. Financial assets and liabilities – additional analysis (continued)

The tables below also set out the carrying amount of the currency of the Group's financial instruments:

	Level	Classification	2012 Total £m	2011 Total £m
Financial assets				
Cash at bank, in hand or in Post Office Limited network			**930**	804
Cash equivalent investments			**363**	297
– Money market funds		Loans and receivables	314	142
– Short-term deposits – local government		Loans and receivables	–	29
– Short-term deposits – bank		Loans and receivables	49	126
Cash and cash equivalents			**1,293**	1,101
Financial assets – investments (current)			**31**	1
– Short-term deposits – Government/local government		Loans and receivables	1	1
– Short-term deposits – Bank		Loans and receivables	30	-
Financial assets –investments (non-current) – Bank deposits		Loans and receivables	**-**	44
Financial assets – pension escrow investments (non-current)	1		**1,383**	1,161
– Cash at bank			1	3
– Treasury bills	1	Available for sale	302	242
– Gilt edged securities (conventional)	1	Available for sale	166	143
– Gilt edged securities (index linked)	1	Available for sale	914	773
Derivative assets – current	2		**9**	36
– non-current	2		**2**	6
Total financial assets			**2,718**	2,349
Financial liabilities				
Financial liabilities – loans and borrowings (current)			**(377)**	(375)
– BIS loans to Post Office Limited		Amortised cost	**(377)**	(375)
Obligations under finance leases (current)		Amortised cost	**(90)**	(65)
Financial liabilities – loans and borrowings (non-current)			**(1,522)**	(1,478)
– BIS loans to Royal Mail Group Ltd		Amortised cost	(1,522)	(1,477)
– Miscellaneous loans in subsidiaries (non-current)		Amortised cost	–	(1)
Obligations under finance leases (non-current)		Amortised cost	**(237)**	(193)
Derivative liabilities – current	2		**(4)**	(3)
Derivative liabilities – non-current	2		**(1)**	–
Total financial liabilities			**(2,231)**	(2,114)
Net total financial assets			**487**	235

RMG00000342

Notes to the Consolidated financial statements (continued)

15. Financial assets and liabilities – additional analysis (continued)

There are no financial assets or liabilities designated at fair value through the income statement on initial recognition.

The criteria for codification of 'Level' in the table on the previous page is described in the accounting policy 'Fair value measurement of financial instruments' on page 139.

The financial assets – investments (non-current) – bank deposits of £nil (2011 £44m) and £nil (2011 £1m) of the cash equivalent investments are pledged as collateral to a counterparty bank which has provided a letter of credit in support of a lease payable obligation. These investments are held in US$.

Derivative assets £9m current, £2m non-current (2011 £36m current, £6m non-current) and liabilities £4m current, £1m non-current (2011 £3m current, £nil non-current) are valued at fair value. Effective changes in the fair value of derivatives, which are part of a designated cash flow hedge under IAS 39, are deferred into equity. All other changes in derivative fair value are taken straight to the income statement.

None of the financial assets listed in the table on the previous page are either past due or considered to be impaired.

The net total financial assets are held in various different currencies as summarised in the table below. The majority of these financial assets are held within cash at bank, in hand or in the Post Office Limited network.

	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Net total financial assets 2012	**275**	**22**	**146**	**44**	**487**
Net total financial assets 2011	14	82	110	29	235

Interest rate risk

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

The tables below set out the carrying amount by maturity of the Group's financial instruments that are exposed to interest rate risk. The pension escrow investments mature between 1 day and 44 years but have been disclosed as maturing in greater than 5 years as the investments have been provided as security to the Royal Mail Pension Plan in support of the 38 year deficit recovery period from March 2009 (see note 3 for further information regarding these investments). The floating rate BIS loans to Royal Mail Group Ltd mature in 2014 and interest rates on these loans are set for periods between 7 days and 6 months as selected by the Group.

RMG00000342

15. Financial assets and liabilities – additional analysis (continued)

Financial year ended 25 March 2012

	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Cash at bank	4.2	28	–	–	–	28
Cash equivalent investments:						
- Short-term deposits - bank	0.7	30	–	–	–	30
Financial assets – investments (current)						
- Short-term deposits – Government/local government	7.7	1	–	–	–	1
- Short-term deposits - Bank	2.4	30	–	–	–	30
Financial assets – pension escrow investments (non-current)						
- Gilt edged securities (conventional)	4.8	–	–	–	166	166
BIS loans to Post Office Limited	0.8	(377)	–	–	–	(377)
BIS loans to Royal Mail Group Ltd	8.7	–	–	–	(922)	(922)
Obligations under finance leases	3.9	(90)	(55)	(145)	(37)	(327)
Total		(378)	(55)	(145)	(793)	(1,371)
Floating rate						
Cash at bank	0.5	127	–	–	–	127
Cash equivalent investments:						
- Money market funds	0.8	314	–	–	–	314
- Short-term deposits – bank	0.8	19	–	–	–	19
Financial assets – pension escrow investments (non-current)						
- Cash at bank	0.4	–	–	–	1	1
- Treasury bills	0.4	–	–	–	302	302
- Gilt edged securities (index linked)	4.3	–	–	–	914	914
BIS loans to Royal Mail Group Ltd	2.2	–	(600)	–	–	(600)
Total		460	(600)	-	1,217	1,077
Non-interest bearing						
Cash at bank, in hand or in Post Office Limited network		775	–	–	–	775
Derivative assets		9	2	–	–	11
Derivative liabilities		(4)	(1)	–	–	(5)
Total		780	1	–	–	781
Net total financial assets/(liabilities)		862	(654)	(145)	424	487

RMG00000342

Notes to the Consolidated financial statements (continued)

15. Financial assets and liabilities – additional analysis (continued)

Financial year ended 27 March 2011

	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Cash at bank	3.9	12	–	–	–	12
Cash equivalent investments:						
- Short-term deposits local government	0.6	29	–	–	–	29
- Short-term deposits - bank	0.8	92	–	–	–	92
Financial assets – investments (current)						
- Short-term deposits – Government/local government	7.7	1	–	–	–	1
Financial assets – investments (non-current)						
- Bank deposits	0.4	–	5	24	15	44
Financial assets – pension escrow investments (non-current)						
- Gilt edged securities (conventional)	4.8	–	–	–	143	143
BIS loans to Post Office Limited	0.8	(375)	–	–	–	(375)
BIS loans to Royal Mail Group Ltd	8.4	–	–	–	(877)	(877)
Obligations under finance leases	4.6	(65)	(50)	(109)	(34)	(258)
Miscellaneous loans in subsidiaries	4.5	–	–	(1)	–	(1)
Total		(306)	(45)	(86)	(753)	(1,190)
Floating rate						
Cash at bank	0.8	87	–	–	–	87
Cash equivalent investments:						
- Money market funds	0.7	142	–	–	–	142
- Short-term deposits – bank	0.8	34	–	–	–	34
Financial assets – pension escrow investments (non-current)						
- Cash at bank	0.4	–	–	–	3	3
- Treasury bills	0.5	–	–	–	242	242
- Gilt edged securities (index linked)	4.7	–	–	–	773	773
BIS loans to Royal Mail Group Ltd	3.0	–	–	(600)	–	(600)
		263	–	(600)	1,018	681
Non-interest bearing						
Cash at bank, in hand or in Post Office Limited network		705	–	–	–	705
Derivative assets		36	6	–	–	42
Derivative liabilities		(3)	–	–	–	(3)
Total		738	6	–	–	744
Net total financial assets/(liabilities)		695	(39)	(686)	265	235

RMG00000342

Notes to the Consolidated financial statements (continued)

16. Hedging programmes

The purpose of the Group's hedging programmes is to mitigate volatility in commodity prices and foreign exchange rates. As explained in note 10, interest rate risk is managed using an appropriate mix of fixed and variable rate financial instruments. There are no significant concentrations of credit risk. Accounting rules require the Company to choose whether to designate cash flow hedge programmes or not (subject to various tests). The impact of not designating a cash flow hedge programme is that all gains or losses on the derivatives in the programme have to be taken immediately to the income statement and cannot be deferred into equity. The Group had the following designated cash flow hedge programmes during the current and previous year:

Hedging Activities

i) The diesel fuel hedge programme uses forward commodity price swaps in US$ or Sterling and forward currency purchase contracts to hedge the exposure arising from commodity price and US$/Sterling exchange rates for forecast diesel fuel purchases.

ii) The air conveyance hedge programme uses US$ forward currency purchase contracts to hedge the exposure arising from US$/Sterling exchange rates for forecast air conveyance purchases.

iii) Three capital programmes use Euro forward currency purchase contracts to hedge the exposure arising from Sterling/Euro exchange rates for contracted capital expenditure on automation projects.

iv) The electricity hedge programme uses forward commodity price swaps to hedge the exposure arising from electricity prices.

v) The gas hedge programme uses forward commodity price swaps to hedge the exposure arising from gas prices.

In addition, minor changes were made to the jet fuel hedge programme to allow it to be designated as a cash flow hedge prospectively from December 2011. The programme uses forward commodity price swaps and forward currency purchase contracts to hedge the exposure arising from commodity price and US$/Sterling exchange rates for forecast jet fuel usage.

The Group had undesignated cash flow hedge programmes for the Post Office Limited Bureau de Change balances, the UKPIL overseas postal operator liabilities and the transactional exposure created by inter-company loans with GLS. The derivative balances of these programmes are not material.

Commodity price hedging

The Group's normal operating activities result in the consumption of fuel (both diesel and jet), electricity and gas. The prices of these commodities can be volatile so the Group enters into price swap contracts to lock future purchases (at an agreed volume) into a known price. For diesel and jet these price swaps are sometimes entered into on the US$ price for the commodity (based upon available market prices), in which case the Group uses forward foreign currency contracts to lock into a combined sterling price for the commodity. The following table shows the commodity, risk and the percentage of the expected consumption hedged.

RMG00000342

Notes to the Consolidated financial statements (continued)

16. Hedging programmes (continued)

Commodity	Risk	Expected consumption hedged 2012 March Year ending 2013	March Year ending 2014	March Year ending 2015
Diesel fuel	**US$ price and $/£ exchange rate movements**	**91%**	**51%**	**9%**
Jet fuel	**US$ price and $/£ exchange rate movements**	**90%**	**66%**	**–**
Electricity	**£ price movement**	**83%**	**85%**	**20%**
Gas	**£ price movement**	**78%**	**80%**	**9%**

		Expected consumption hedged 2011 March Year ending 2012	March Year ending 2013	March Year ending 2014
Diesel fuel	US$ price and $/£ exchange rate movements	90%	29%	–
Jet fuel	US$ price and $/£ exchange rate movements	90%	30%	–
Electricity	£ price movement	76%	26%	–
Gas	£ price movement	88%	40%	–

Foreign currency hedging for non-commodity items

As highlighted in note 10, the Group, where possible, nets exposure to foreign currency internally. This is possible because Post Office Limited holds foreign currency cash balances, whilst UK Parcels, International & Letters (UKPIL) have net liabilities with respect to amounts owed to foreign postal administrations, because the UK is a net exporter of mail to the rest of the world. The remaining net exposure is hedged with external forward foreign currency contracts. The foreign currency cash balances, the foreign postal administration liabilities and the derivatives are all revalued to current market prices at the balance sheet dates, meaning that no net gains or losses arise in the income statement.

UKPIL's obligations on automation projects are fully hedged, under the capital hedge programmes, for the remainder of the projects (expected to be complete during 2012) using forward foreign currency contracts to fix the cost of the currency required to pay the supplier.

The hedge programme covering the UKPIL conveyance costs uses forward foreign currency contracts to fix the cost of the currency required to pay air freight. The contracts in place at the year end covered 90% of the exposure for the year ending March 2013 (2011 90% of the exposure for the year ending March 2012).

Derivative values

At any point in time, the derivative in these cash flow hedge programmes are either 'in the money' which means the hedged rates are better than current market rates or 'out of the money' which means the hedged rates are worse than current market rates. The gains ('in the money') and losses ('out of the money') as at the balance sheet date are deferred into equity (where the hedge is effective) and an associated financial asset or financial liability is created in the balance sheet. The financial asset/liability is released when the derivative matures. The amounts deferred into equity are released when the hedged transaction occurs. The following tables show the derivative contracts entered into at 25 March 2012 and 27 March 2011 and the associated derivative assets and liabilities.

RMG00000342

16. Hedging programmes (continued)

	Commodity/ currency	Nominal amount	Maturity date	Average contracted commodity price/ exchange rate	Derivative asset non-current fair value £m	Derivative asset current fair value £m	Derivative liability non-current fair value £m	Derivative liability current fair value £m
2012								
Diesel fuel	**Diesel fuel**	**191k tonnes**	**Apr 12 – Oct 14**	**US$963/tonne**	**1**	**7**	**–**	**–**
Diesel fuel	**US$**	**$184m**	**Apr 12 – Oct 14**	**US$1.58/£**	**–**	**1**	**–**	**(1)**
Diesel fuel	**Diesel fuel**	**32m litres**	**May 13 – Jul 14**	**£0.5/litre**	**1**	**–**	**–**	**–**
Jet fuel	**Jet fuel**	**29k tonnes**	**Apr 12 – Sep 13**	**US$1,017/tonne**	**–**	**1**	**–**	**–**
Jet fuel	**Jet fuel**	**$29m**	**Apr 12 – Sep 13**	**US$1.58/£**	**–**	**–**	**–**	**–**
Air conveyance	**US$**	**$28m**	**Mar 12 – Apr 13**	**US$1.60/£**	**–**	**–**	**–**	**–**
Capital programmes	**Euro**	**€21m**	**Mar 12 – Jun 12**	**£0.84/€**	**–**	**–**	**–**	**–**
Electricity	**Electricity**	**695k MWH**	**Apr 12 – Oct 14**	**£55/MWH**	**–**	**–**	**(1)**	**(2)**
Gas	**Gas**	**40m therms**	**Apr 12 – Oct 14**	**£0.70/therm**	**–**	**–**	**–**	**–**
Cash flow hedges					**2**	**9**	**(1)**	**(3)**
Other derivatives					**–**	**–**	**–**	**(1)**
Total					**2**	**9**	**(1)**	**(4)**

	Commodity/ currency	Nominal amount	Maturity date	Average contracted commodity price/ exchange rate	Derivative asset non-current fair value £m	Derivative asset current fair value £m	Derivative liability non-current fair value £m	Derivative liability current fair value £m
2011								
Diesel fuel	Diesel fuel	148k tonnes	Apr 11 – Jan 13	US$795/tonne	4	17	–	–
Diesel fuel	US$	$118m	Apr 11 – Jan 13	US$1.57/£	–	–	–	(1)
Air conveyance	US$	$25m	Mar 11 – Apr 12	US$1.63/£	–	–	–	–
Capital programmes	Euro	€67m	Mar 11 – Apr 12	£0.85/€	–	2	–	–
Electricity	Electricity	378k MWH	Apr 11 – Jan 13	£46/MWH	1	3	–	–
Gas	Gas	24m therms	Apr 11 – Apr 13	£0.56/therm	–	3	–	–
Cash flow hedges					5	25	–	(1)
Other derivatives					1	11	–	(2)
Total					6	36	–	(3)

Other derivatives represent hedges by the Group of other foreign exchange and commodity price exposures, which are not designated under IAS 39 (including the hedge of the Bureau de Change currency holdings within Post Office Limited, the hedge of the trading balance with overseas postal operators and the hedge of inter-company loans with overseas subsidiaries).

Due to timing differences between the maturity of the derivative and the hedged transaction, there can be differences between derivative balances (shown above) and the balance on the Hedging Reserve.

RMG00000342

Other notes – income statement

In simple terms:

The notes in this section explain other costs incurred by the Group in relation to:

- other operating costs (e.g. pensions, depreciation and amortisation and operating lease charges) (note 17)
- income tax charges (and related deferred tax assets/liabilities) (note 18)
- finance income from investments and finance costs on loans and finance lease obligations (note 19)

17. Other operating costs	119
18. Income tax	120
19. Net finance costs	122

RMG00000342

17. Other operating costs

Operating profit before exceptional items is stated after charging the following other operating costs:

	2012 £m	2011 £m
Pensions charge (note 9)	**419**	458
Depreciation and amortisation		
Depreciation of property, plant and equipment (note 20)	**269**	250
Amortisation of intangible assets (mainly software – note 22)	**33**	36
Total	**302**	286
Operating lease charges on property, plant and equipment	**237**	241
Costs of inventories expensed	**178**	160

Research and development expenditure during the year amounted to £nil (2011 £nil).

The following costs are relevant in understanding the extent of the Group's regulatory costs and statutory audit costs:

Regulatory body costs		
Postcomm	**6**	10
Ofcom	**2**	–
Consumer Focus	**3**	3
Total	**11**	13

Auditor's fees	2012 £000	2011 £000
Audit of statutory financial statements	**597**	597
Other fees to auditor:		
Statutory audits for subsidiaries	**1,706**	1,398
Other services (including regulatory audits)	**669**	471
Taxation services	**78**	55
Total	**3,050**	2,521

The Group paid £267,000 additional amounts in 2012 in respect of the 2011 audit (£nil in 2011 in respect of 2010 audit).

RMG00000342

Notes to the Consolidated financial statements (continued)

18. Income tax

The major components of the income tax charge for the years ended 25 March 2012 and 27 March 2011 are:

	2012 £m	2011 £m
Tax charged in the income statement		
Current income tax:		
Current UK income tax credit	**(43)**	(16)
Foreign tax	**36**	35
Adjustments in respect of UK current income tax of previous years	**–**	(1)
Adjustments in respect of foreign current income tax of previous years	**2**	–
	(5)	18
Deferred income tax:		
Relating to origination and reversal of temporary differences	**15**	88
Income tax charge reported in the income statement	**10**	106
Tax charged to equity		
Income tax related to items charged or credited directly to equity:		
Deferred income tax charge related to actuarial movements in the pension deficit	**–**	–
Deferred income tax (credit)/charge related to movements in hedging reserve	**(8)**	4
Current income tax charge for fair value adjustments on financial assets investments	**31**	5
Income tax charge reported in equity	**23**	9
Total taxation charge		
Current income tax charge	**26**	23
Deferred income tax charge	**7**	92
Total income tax charge reported	**33**	115

A reconciliation between the tax charges and the product of accounting profit/(loss) multiplied by the UK rate of Corporation Tax for the years ended 25 March 2012 and 27 March 2011 is as follows:

	2012 £m	2011 £m
Profit/(loss) before taxation	**263**	(152)
At UK standard rate of Corporation Tax of 26% (2011 28%)	**68**	(43)
Overseas current tax rates	**(1)**	(3)
Tax under/(over) provided in prior years	**2**	(1)
Non-taxable income	**(8)**	(12)
Non-deductible expenses	**15**	15
Associates'/joint venture profit after tax charge included in Group pre-tax profit	**(7)**	(8)
Net (decrease)/increase in tax charge resulting from derecognition/(recognition) of deferred tax assets	**(15)**	192
Profit from asset disposals eligible for relief	**(48)**	(28)
Other	**4**	(6)
Tax charge in the income statement	**10**	106
Effective income tax rate	**4%**	–

RMG00000342

18. Income tax (continued)

Deferred tax relates to the following:

	Balance sheet		Income statement	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Liabilities				
Accelerated capital allowances	**(1)**	(1)	–	–
Goodwill qualifying for tax allowances	**(17)**	(9)	**(8)**	(5)
Gross deferred tax liabilities	**(18)**	(10)		
Assets				
Deferred capital allowances	–	9	**(9)**	8
Provisions and other	**4**	1	**3**	(29)
Pensions temporary differences	–	–	–	(2)
Losses available for offset against future taxable income	**5**	6	**(1)**	(62)
Hedging derivatives temporary differences	–	(8)	–	2
Gross deferred tax assets	**9**	8		
Net deferred tax liability	**(9)**	(2)		
Consolidated income statement			**(15)**	(88)

The Group has unrecognised deferred tax assets of £1,512m (2011 £2,017m), comprising £684m (2011 £1,218m) relating to the retirement benefit obligation, £481m (2011 £452m) relating mainly to fixed asset timing differences, and £347m (2011 £347m) relating to tax losses in subsidiaries that are available to offset against future taxable profits. The Group has capital losses carried forward, the tax effect of which is £4m (2011 £15m) and temporary differences related to capital losses of £80m (2011 £91m). The Group has rolled over capital gains of £62m (2011 £61m); no tax liability would be expected to crystallise should the assets into which the gains have been rolled be sold at their residual value, as it is anticipated that a capital loss would arise.

Finance Act 2011 reduced the main rate of corporation tax to 25% with effect from 1 April 2012. The effect of this change on unrecognised deferred tax is included in these accounts. In March 2012 the Chancellor of the Exchequer announced that the main rate of corporation tax will be 24% for the year commencing 1 April 2012 and that there will be successive annual one percentage point reductions until the rate reaches 22% with effect from 1 April 2014. However, in accordance with accounting standards the effect of these rate reductions on deferred tax balances has not been reflected in these accounts due to the relevant legislation not having been substantively enacted at the balance sheet date. A reduction to 22% would, based on losses and temporary differences at 25 March 2012, reduce the Group's unrecognised deferred tax assets by £178m.

At 25 March 2012, there was no recognised or unrecognised deferred income tax liability (2011 £nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, associates or joint venture, as the Group has no liability to additional taxation should such amounts be remitted due to the availability of exemptions and other reliefs.

RMG00000342

19. Net finance costs

The following analysis excludes net pension interest.

	2012 £m	2011 £m
Unwinding of discount relating to legacy share scheme	–	7
Interest payable on financial liabilities carried at amortised cost	**118**	107
Finance costs	**118**	114
Interest received on available for sale financial assets	**(45)**	(60)
Interest received on loans and receivables financial assets	**(9)**	(9)
Finance income	**(54)**	(69)
Net finance costs (excluding net pensions interest)	**64**	45

The finance costs of £118m (2011 £114m) include £16m (2011 £13m) in respect of finance charges payable under finance lease contracts.

The finance income of £54m (2011 £69m) includes gains of £nil (2011 £6m) on available for sale financial assets which were released from equity and recognised in the income statement for the year.

RMG00000342

Other notes – balance sheet

In simple terms:

The notes in this section provide additional information regarding certain assets and liabilities shown in the balance sheet, most notably:

- property, automation equipment and vehicles, which are recorded at their historic cost (what we paid for them) less: accumulated depreciation (reflecting their usage within the business over their useful life - from 3 to 50 years); and impairments relating to under-performance of assets in their objective of generating economic benefits (note 20)
- goodwill, primarily relating to our overseas subsidiary, GLS (note 21)
- intangible assets, mainly software, which are recorded in much the same way as our physical assets such as property and vehicles, but with shorter useful lives over which they are amortised (1 to 6 years) (note 22)
- investments in joint venture and associates, which represent the Group's share of the net assets of these entities (note 23)
- amounts owed to and from related parties, which have been identified to include the Royal Mail Pension Plan (RMPP) and the Group's joint venture and associate companies, and payments to key management personnel (note 28). Details of the Group's principal subsidiaries, associates and joint venture are also provided

20. Property, plant and equipment	124
21. Goodwill	125
22. Intangible assets (mainly software)	126
23. Investment in joint venture and associates	127
24. Current trade and other receivables	128
25. Current trade and other payables	129
26. Issued share capital and reserves	129
27. Commitments	130
28. Related party information	131

RMG00000342

20. Property, plant and equipment

	Land and buildings						
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
Cost							
At 28 March 2011	1,592	277	693	1,182	472	1,008	5,224
Exchange rate movements	(16)	(1)	–	(8)	(3)	(5)	(33)
Reclassification	(32)	–	32	–	–	–	–
Additions	132	2	30	114	29	40	347
Disposals	(58)	(1)	(8)	(60)	(16)	(6)	(149)
Reclassification to non-current assets held for sale	(20)	(1)	–	–	–	–	(21)
At 25 March 2012	1,598	276	747	1,228	482	1,037	5,368
Depreciation and impairment							
At 28 March 2011	863	169	470	722	258	910	3,392
Exchange rate movements	(4)	(1)	–	(5)	(2)	(4)	(16)
Reclassification	(9)	–	9	–	–	–	–
Depreciation (note 17)	47	6	45	82	54	35	269
Impairment (note 6)	4	–	1	–	1	14	20
Disposals	(16)	(1)	(8)	(60)	(15)	(6)	(106)
Reclassification to non-current assets held for sale	(16)	–	–	–	–	–	(16)
At 25 March 2012	869	173	517	739	296	949	3,543
Net book value							
At 25 March 2012	729	103	230	489	186	88	1,825
At 28 March 2011	729	108	223	460	214	98	1,832

Depreciation rates are disclosed within accounting policies (page 137). No depreciation is provided on freehold land, which represents £202m (2011 £190m) of the total cost of properties. The net book value of the Group's property, plant and equipment held under finance leases amounts to £320m (2011 £262m) comprising £137m (2011 £152m) vehicles, £154m (2011 £88m) plant and machinery and £29m (2011 £22m) land and buildings. The net book value of the Group's property, plant and equipment includes £173m (2011 £150m) in respect of assets in the course of construction. The net book value of the Group's land and buildings includes £389m (2011 £383m) in respect of building fit-out.

The £347m (2011 £291m) additions include borrowing costs capitalised in relation to specific qualifying assets of £2m (2011 £nil).

Last year, on 24 March 2011 an agreement was implemented to substitute £102m pension escrow financial investments with mortgages against certain property assets. Subsequently, during the year, one of the properties, Rathbone Place, was sold and the mortgage against that property was replaced with cash in the pension escrow. The carrying value of the remaining property assets of £17m as at 25 March 2012 is included within the £729m freehold land and buildings total above. The fair value of these property assets, based on a residual cash flow analysis*, exceeds their carrying value by £77m. During April 2012, after almost all of the pension liabilities and pension assets of the Company's main pension plan, RMPP, were transferred to HM Government, these mortgages, pledged as security to the RMPP Trustee, were released.

* A residual cash flow analysis determines a price that could be paid for the property given the expected 'as if complete' value of the proposed development and the total cost of the proposed development, allowing for market level profit margins and having due regard to the known characteristics of the property and the inherent risk involved in its development.

RMG00000342

20. Property, plant and equipment (continued)

	Land and buildings						
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
Cost							
At 29 March 2010	1,719	267	601	1,143	460	964	5,154
Exchange rate movements	(5)	–	–	(2)	(1)	(1)	(9)
Reclassification	(75)	(4)	79	(2)	3	(1)	–
Additions	74	19	17	85	44	52	291
Disposals	(109)	(5)	(4)	(42)	(34)	(6)	(200)
Reclassification to non-current assets held for sale	(12)	–	–	–	–	–	(12)
At 27 March 2011	1,592	277	693	1,182	472	1,008	5,224
Depreciation and impairment							
At 29 March 2010	891	166	387	682	233	860	3,219
Exchange rate movements	(1)	–	–	(2)	–	(1)	(4)
Reclassification	(40)	(3)	42	–	1	–	–
Depreciation (note 17)	44	7	38	74	53	34	250
Impairment (note 6)	–	–	7	10	1	23	41
Disposals	(21)	(1)	(4)	(42)	(30)	(6)	(104)
Reclassification to non-current assets held for sale	(10)	–	–	–	–	–	(10)
At 27 March 2011	863	169	470	722	258	910	3,392
Net book value							
At 27 March 2011	729	108	223	460	214	98	1,832
At 29 March 2010	828	101	214	461	227	104	1,935

21. Goodwill

	2012 £m	2011 £m
Cost		
At 28 March 2011 and 29 March 2010	**628**	636
Exchange rate movements	**(32)**	(11)
Acquisition of businesses	**3**	3
At 25 March 2012 and 27 March 2011	**599**	628
Impairment		
At 28 March 2011 and 29 March 2010	**431**	439
Exchange rate movements	**(21)**	(8)
At 25 March 2012 and 27 March 2011	**410**	431
Net book value		
At 25 March 2012 and 27 March 2011	**189**	197
At 28 March 2011 and 29 March 2010	**197**	197

RMG00000342

Notes to the Consolidated financial statements (continued)

21. Goodwill (continued)

The carrying value of goodwill arising on business combinations of £189m (2011 £197m) at the balance sheet date, includes £187m (2011 £195m) relating to the General Logistics Systems (GLS) business segment. In line with the Group's accounting policy (see page 136), this goodwill has been reviewed for impairment. An impairment loss is recognised for the amount by which the carrying value of an asset or cash generating unit exceeds the recoverable amount. The recoverable amount is the higher of net realisable value and value in use. The carrying value of GLS, excluding interest bearing and tax related assets and liabilities, is £446m (2011 £450m) at 25 March 2012 and the operating profit before exceptional items is £128m (2011 £118m) for the year (note 4). The carrying value of GLS represents a multiple of 3.5 (2011 3.8) on operating profit before exceptional items. The net realisable value of GLS, for the purposes of the impairment review (i.e. the 'fair value less costs to sell'), has been assessed with reference to earnings multiples for quoted entities in a similar sector. On this basis, the net realisable value has been assessed to be in excess of the carrying value. The earnings multiples referenced would need to reduce by more than 40% to reduce the net realisable value to below the carrying value.

22. Intangible assets

	2012				2011			
	Master franchise licences £m	Customer listings £m	Software £m	Total £m	Master franchise licences £m	Customer listings £m	Software £m	Total £m
Cost								
At 28 March 2011 and 29 March 2010	**24**	**29**	**382**	**435**	24	27	325	376
Additions	**–**	**–**	**60**	**60**	–	–	73	73
Disposals	**–**	**–**	**(10)**	**(10)**	–	–	(16)	(16)
Acquisition of businesses	**–**	**2**	**–**	**2**	–	2	–	2
Exchange rate movements	**(1)**	**(1)**	**(1)**	**(3)**	–	–	–	–
At 25 March 2012 and 27 March 2011	**23**	**30**	**431**	**484**	24	29	382	435
Amortisation and impairment								
At 28 March 2011 and 29 March 2010	**24**	**25**	**260**	**309**	22	22	233	277
Impairment (note 6)	**–**	**–**	**20**	**20**	–	–	12	12
Amortisation (note 17)	**–**	**2**	**31**	**33**	2	3	31	36
Disposals	**–**	**–**	**(10)**	**(10)**	–	–	(16)	(16)
Exchange rate movements	**(1)**	**(1)**	**(1)**	**(3)**	–	–	–	–
At 25 March 2012 and 27 March 2011	**23**	**26**	**300**	**349**	24	25	260	309
Net book value								
At 25 March 2012 and 27 March 2011	**–**	**4**	**131**	**135**	–	4	122	126
At 28 March 2011 and 29 March 2010	**–**	**4**	**122**	**126**	2	5	92	99

The intangible assets above, none of which have been internally generated, have finite lives and are being written down on a straight-line basis.

RMG00000342

23. Investments in joint venture and associates

Joint venture

During 2011–12 (and 2010–11), the Group's only joint venture investment was a 50% interest in First Rate Exchange Services Holdings Limited, whose principal activity is the provision of Bureau de Change services in Post Office Limited.

Associates

Details of the Group's 2011–12 and 2010–11 associate investments are provided on page 132. The reporting dates for these investments is 31 March 2012 except for Quadrant Catering Limited (30 September 2011) and G3 Worldwide Mail N.V. (Spring) (31 December 2011). Estimates of the profits of Quadrant Catering Limited and G3 Worldwide Mail N.V. (Spring), from their reporting date to 25 March 2012 (and 27 March 2011 for the prior year), have been included to ensure that the reported share of profits of associates aligns with the Group's financial year. There are no significant restrictions on the ability of associates to transfer funds to the Group in the form of cash dividends, repayment of loans or advances.

	At 28 March 2011 £m	Share of post tax pre dividend profit £m	Impairment £m	Disposal £m	Dividend £m	At 25 March 2012 £m
Joint venture						
Share of net assets	**72**	**32**	–	–	**(38)**	**66**
Goodwill	**1**	–	–	–	–	**1**
Net investments	**73**	**32**	–	–	**(38)**	**67**
Associates						
Share of net assets	**32**	–	**(3)**	–	**(4)**	**25**
Total net investments in joint venture/associates	**105**	**32**	**(3)**	–	**(42)**	**92**

The £3m (2011 £2m) impairment relates to G3 Worldwide Mail N.V. (Spring).

	At 29 March 2010 £m	Share of post tax pre dividend profit £m	Impairment £m	Disposal £m	Dividend £m	At 27 March 2011 £m
Joint venture						
Share of net assets	74	28	–	–	(30)	72
Goodwill	1	–	–	–	–	1
Net investments	75	28	–	–	(30)	73
Associates						
Share of net assets	61	–	–	(20)	(9)	32
Goodwill	11	–	(2)	(9)	–	–
Net investments	72	–	(2)	(29)	(9)	32
Total net investments in joint venture/associates	147	28	(2)	(29)	(39)	105

RMG00000342

Notes to the Consolidated financial statements (continued)

23. Investments in joint venture and associates (continued)

	2012			2011		
	Joint venture £m	Associates £m	Total £m	Joint venture £m	Associates £m	Total £m
Share of assets and liabilities:						
Current assets	**179**	**49**	**228**	150	49	199
Non-current assets	**3**	**18**	**21**	2	21	23
Share of gross assets	**182**	**67**	**249**	152	70	222
Current liabilities	**(116)**	**(42)**	**(158)**	(80)	(37)	(117)
Non-current liabilities	**–**	**–**	**–**	–	(1)	(1)
Share of gross liabilities	**(116)**	**(42)**	**(158)**	(80)	(38)	(118)
Share of net assets	**66**	**25**	**91**	72	32	104
Share of revenue and profit:						
Revenue	**75**	**116**	**191**	74	380	454
Profit after tax	**32**	**–**	**32**	28	–	28

24. Current trade and other receivables

	2012 £m	2011 £m
Trade receivables	**799**	853
Prepayments and accrued income	**313**	124
	1,112	977
Client receivables in the Post Office Limited network	**138**	158
Finance income	**1**	–
Total	**1,251**	1,135

Refer to note 25 for an explanation of Post Office Limited network balances.

Movements in the provision for bad and doubtful debts were as follows:

	2012 £m	2011 £m
At 28 March 2011 and 29 March 2010	**26**	32
Foreign exchange rate adjustment	**–**	–
Receivables provided for during the year	**28**	11
Release of provision	**(4)**	(6)
Utilisation of provision	**(10)**	(11)
At 25 March 2012 and 27 March 2011	**40**	26

RMG00000342

24. Current trade and other receivables (continued)

The amount of trade receivables that were past due but not impaired are as follows:

	2012 £m	2011 £m
Past due not more than one month	**63**	64
Past due more than one month and not more than two months	**15**	14
Past due more than two months	**34**	29
Total past due but not impaired	**112**	107
Provided for or not yet overdue	**727**	772
Provision for bad and doubtful debts	**(40)**	(26)
Total	**799**	853

25. Current trade and other payables

	2012 £m	2011 £m
Trade payables and accruals	**1,247**	1,179
Advance customer payments (for stamps held, not yet used by customers)	**342**	307
Social security	**98**	95
	1,687	1,581
Client payables in the Post Office Limited network	**332**	314
Capital repayments	**57**	50
Other	**9**	16
Total	**2,085**	1,961

The Group, through Post Office Limited, receives and disburses cash on behalf of Government agencies and other clients to customers through its Post Office branch network. Amounts owed to/from these parties are disclosed separately as client payables (as above) and receivables (see note 24). The level of cash held and the related payables can vary significantly at each balance sheet date.

Capital payables represent liabilities outstanding in relation to the acquisition of property, plant and equipment and intangible assets.

26. Issued share capital and reserves

Authorised share capital

	2012 £	2011 £
Ordinary shares of £1 each	**100,000**	100,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	**1**	1
Total	**100,001**	100,001

Issued and called up share capital

	2012 £	2011 £
Ordinary shares of £1 each	**50,005**	50,005
Special Rights Redeemable Preference Share (Special Share) of £1 each	**1**	1
Total	**50,006**	50,006

RMG00000342

Notes to the Consolidated financial statements (continued)

26. Issued share capital and reserves (continued)

The Special Share can be redeemed at any time by its holder (the Secretary of State for Business, Innovation and Skills), subject to such redemption being compliant with the Companies Act 2006. The Company cannot redeem the Special Share without the prior consent of its holder. No premium is payable on redemption.

On distribution in a winding up of the Company, the holder of the Special Share is entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member. The Special Share does not carry any rights to vote.

Under section 63(7) of the Postal Services Act 2000, for the purposes of the Companies Act 2006, certain shares issued shall be treated as if their nominal value had been fully paid up.

Under sections 72 and 74 of the Postal Services Act 2000, the Secretary of State for Business, Innovation and Skills may issue directions to the Company which, depending on the direction issued, could result in the recognition of a distribution.

Reserves identified in the consolidated statement of changes in equity

Financial Assets Reserve

The Financial Assets Reserve is used to record fair value changes on available for sale financial assets.

Foreign Currency Translation Reserve

The Foreign Currency Translation Reserve is used to record the gains and losses arising from 29 March 2004 on translation of assets and liabilities of subsidiaries denominated in currencies other than the reporting currency.

Hedging Reserve

The Hedging Reserve is used to record gains and losses arising from cash flow hedges since 28 March 2005.

Other Reserves

Other Reserves of £47m (2011 £47m) comprise £2m (2011 £2m) relating to First Rate Exchange Services Holdings Limited, a joint venture entity, and £45m (2011 £45m) recognised on the formation of Midasgrange Limited, an associate company. The transaction to establish Midasgrange Limited, involved the Bank of Ireland investing £100m in exchange for a 50% shareholding.

Dividends

The Directors do not recommend a dividend (2011 £nil dividend).

27. Commitments

Operating lease commitments

The Group is committed to the following future minimum lease payments under non-cancellable operating leases as at 25 March 2012 and 27 March 2011:

	Land and buildings		Vehicles and equipment		IT equipment		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Within one year	**148**	146	**11**	11	**29**	36	**188**	193
Between one and five years	**458**	456	**18**	13	**16**	19	**492**	488
Beyond five years	**578**	521	**–**	–	**3**	–	**581**	521
Total	**1,184**	1,123	**29**	24	**48**	55	**1,261**	1,202

Existing leases for UK land and buildings have an average term of 13 years and any new leases entered into generally have a 15-year term with a 10-year break clause or a 10-year or 20-year term without a break. Existing land and buildings leased overseas by the GLS subsidiary have an average lease term of 9 years. Vehicle leases generally have a term of between 1 and 7 years, depending on the asset class, with the average term being 4 years – the existing leases have an average term remaining of 2 years. The majority of the IT commitments relate to a 10-year contract, part of which ceases in 14 months and part of which ceases in 6 years.

RMG00000342

27. Commitments (continued)

Finance lease commitments

	2012		2011	
	Minimum lease payments £m	**Present value of minimum lease payments £m**	Minimum lease payments £m	Present value of minimum lease payments £m
Within one year	**102**	**90**	76	65
Between one and five years	**220**	**200**	177	158
Beyond five years	**131**	**37**	131	35
Total minimum lease payments	**453**	**327**	384	258
Less amounts representing finance charges	**(126)**	**–**	(126)	–
Present value of minimum lease payments	**327**	**327**	258	258

The Group has finance lease contracts for vehicles, land and buildings and plant and equipment. The leases have no terms of renewal, purchase options or escalation clauses and there are no restrictions concerning dividends, borrowings or additional leases. Vehicle leases have a term of between 1 and 7 years, depending on the class of vehicle, with the average term being 4 years. Property leases have a term of between 1 and 107 years with the average term being 46 years. The term of the plant and equipment leases range from 5 to 8 years with the average being 5 years.

Capital commitments

The Group has commitments of £97m at 25 March 2012 (27 March 2011 £159m), which are contracted for but not provided for in the financial statements.

28. Related party information

Related party transactions

During the year the Group entered into transactions with related parties. The transactions were in the ordinary course of business and included administration and investment services recharged to the Group's pension plan by Royal Mail Pension Trustees Limited. The material transactions entered into, and the balances outstanding at the financial year end were as follows:

	Counter-party business segment	**Sales/recharges to related party**		**Purchases/ recharges from related party**		**Amounts owed from related party including outstanding loans**		**Amounts owed to related party including outstanding loans**	
		2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Royal Mail Pension Plan (RMPP)	Other	**9**	9	**–**	–	**–**	–	**–**	–
Quadrant Catering Limited	UKPIL/ Post Office Limited	**–**	–	**35**	34	**–**	–	**3**	3
Camelot Group plc	Post Office Limited	**–**	10	**–**	–	**–**	–	**–**	–
G3 Worldwide Mail N.V. (Spring)	UKPIL	**–**	–	**6**	6	**4**	3	**–**	1
Midasgrange Limited	Post Office Limited	**41**	30	**1**	3	**12**	10	**1**	–
First Rate Exchange Services Holdings Limited	Post Office Limited	**31**	30	**128**	132	**5**	9	**8**	1

With the exception of the investment in Camelot Group plc, disposed of in 2010-11, and the Royal Mail Pension Plan, the companies listed above are either a joint venture or associate of the Group.

The sales to and purchases from related parties are made at normal market prices. Balances outstanding at the year end are unsecured, interest free and settlement is made by cash.

The Group trades with numerous Government bodies on an arm's length basis. Transactions with these entities are not disclosed owing to the significant volume of transactions that are conducted.

RMG00000342

Notes to the Consolidated financial statements (continued)

28. Related party information (continued)

Key management compensation

	2012 £000	2011 £000
Short-term employee benefits	**3,920**	2,855
Post-employment benefits	**183**	43
Other long-term benefits	**–**	–
Total compensation earned by key management	**4,103**	2,898

Key management comprises Executive and Non Executive Directors of the Royal Mail Holdings plc Board at 25 March 2012.

HM Government is the Company's sole shareholder and accordingly the Directors have no interest in the shares of the Company.

The ultimate parent (the Company) and principal subsidiaries

Royal Mail Holdings plc is the ultimate parent company of the Group. The consolidated financial statements include the financial results of Royal Mail Holdings plc and the principal subsidiaries listed below:

Company	Principal activities	Country of incorporation	% equity interest 2012	% equity interest 2011
Royal Mail Group Ltd	Mails and parcels services	United Kingdom	**100**	100
Post Office Limited	Counter, retail and financial services	United Kingdom	**100**	100
Royal Mail Investments Limited	Holding company	United Kingdom	**100**	100
General Logistics Systems B.V.	Parcel services	Netherlands	**100**	100
Royal Mail Estates Limited	Property holdings	United Kingdom	**100**	100
Romec Limited	Facilities management	United Kingdom	**51**	51

During the year Romec Limited disposed of its 99% shareholding in Romec Services Limited.

The legal structure of the Group is shown on p3.

Joint venture

The Group's 50% interest in First Rate Exchange Services Holdings Limited, a company incorporated in the United Kingdom, is held by Post Office Limited. The company's principal activity is the provision of Bureau de Change services.

Associates

The following companies are the principal associates of the Group:

Company	Principal activities	Country of incorporation	% ownership 2012	% ownership 2011
Quadrant Catering Limited	Catering services	United Kingdom	**51**	51
G3 Worldwide Mail N.V. (Spring)	Mail services	Netherlands	**32.45**	32.45
Midasgrange Limited	Financial services	United Kingdom	**50**	50

The majority of Board membership and voting power in Quadrant Catering Limited is held by the Group's business partner, hence it is not a subsidiary.

Management control lies with the Bank of Ireland business partner in the operation of the Midasgrange Limited company and therefore the company is not a joint venture.

The investment in Quadrant Catering Limited is held by Royal Mail Group Ltd, the investment in G3 Worldwide Mail N.V. (Spring) is held by Royal Mail Investments Limited and the investment in Midasgrange Limited is held by Post Office Limited.

RMG00000342
RMG00000342

Basis of preparation and significant accounting policies

In simple terms:

This section includes mandatory disclosures to explain:

- the financial statements have been prepared in accordance with the Companies Act 2006 and relevant International Financial Reporting Standards (IFRS)
- assets and liabilities are stated at historic cost, with only a few exceptions for items valued at fair value (amount at which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction)
- the policy for intra-group transactions eliminated on consolidation and the consolidation of wholly owned and part-owned subsidiaries, including how the latter are impacted by the relevant entity's remaining minority shareholding (i.e. non-controlling interest)
- significant accounting policies relevant to the Group, including new or revised policies and their financial impact
- accounting areas which require management to make judgements, estimates and assumptions (e.g. deferred tax)

RMG00000342

Basis of preparation and significant accounting policies

The Group comprises Royal Mail Holdings plc (the Company) – which is wholly owned by HM Government – and its subsidiaries. The Company is incorporated in the United Kingdom and the financial statements are produced in accordance with the Companies Act 2006 (the Act) and applicable IFRSs. The UK is the Group's country of domicile.

The Group consolidated financial statements are presented in Sterling and all values are rounded to the nearest £m except where otherwise indicated. These consolidated financial statements have been prepared on a historic cost basis, except for pension assets, derivative financial instruments and available for sale financial assets, which have been measured at fair value.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings. The financial statements of the major subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-group balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Transfer prices between business segments are set on a basis of charges reached through negotiation with the respective businesses.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which control is no longer held by the Group. Where the Group ceases to hold control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group held control.

Non-controlling interest represents the portion of profit/loss, gains/losses and net assets relating to subsidiaries that are not attributable to members of the Company. The non-controlling interest balance is presented within equity in the consolidated balance sheet, separately from parent shareholder's equity.

Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The following amended accounting standard, adopted by the Group with effect from 28 March 2011, will have no material impact on the financial position or performance of the Group.

IAS 24 Related Party Disclosures

This revised standard provides an exemption from disclosure requirements for transactions between entities controlled, jointly controlled or significantly influenced by the same government and between such entities and the government itself, unless they are individually or collectively significant. The standard also amends the definition of a related party to remove some inconsistencies.

Improvements to IFRSs

In May 2010 the IASB issued its third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following relevant 2010 amendments resulted in changes to accounting policies, but they will have no material impact on the financial position or performance of the Group.

IFRS 3 Business Combinations: The measurement options for non-controlling interests resulting from a business combination have been limited. Further, acquisition related costs are required to be expensed and not included in the purchase price and contingent consideration should be recognised at fair value on the acquisition date.

IFRS 7 Financial Instruments: Disclosures: The amendment includes multiple clarifications related to the disclosure of financial instruments.

IAS 27 Consolidated and Separate Financial Statements: Any future partial disposal of an equity interest in a subsidiary that does not result in a loss of control will be accounted for as an equity transaction and will have no impact on goodwill, nor will it give rise to any gain or loss. Where there is loss of control of a subsidiary, any retained interest will have to be remeasured to fair value, which will impact the gain or loss recognised on disposal.

IAS 34 Interim Financial Statements: The amendment requires additional disclosure around significant changes to financial instruments and contingent liabilities/assets.

RMG00000342

Basis of preparation and significant accounting policies (continued)

Key sources of estimation, uncertainty and accounting judgements

The preparation of the Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

The key sources of uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year relate to the measurement of deferred tax and provisions.

Deferred tax

Assessment of the deferred tax asset requires an estimation of future profitability. Such estimation is inherently uncertain in a market subject to various competitive pressures. Should estimates of future profitability change in future years, the amount of deferred tax recognised will also change accordingly. The carrying values of the deferred tax assets and liabilities are included within note 18.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Due to the nature of provisions, a significant part of their determination is based upon estimates and/or judgements concerning the future.

Restructuring provisions, including for redundancy and property costs, are derived based upon the most recent business plan for direct expenditure where plans are sufficiently detailed and appropriate communication to those affected has been undertaken. This includes the expected number of employees impacted, rate of compensation per employee, rental costs and expected period of properties remaining vacant and dilapidation costs.

The industrial diseases claims provision is based on the best information available as at the year end, including independent expert advice.

Investments in joint venture and associates

The Group's investments in its joint venture and associates are accounted for under the equity method of accounting. Under the equity method, the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the joint venture/associates, less any impairment in value. The income statement reflects the Group's share of post tax profits from the joint venture/associates.

Any goodwill arising on acquisition of an associate, representing the excess of the cost of the investment compared to the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired, is included in the carrying amount and not amortised.

Revenue

Revenue reported in the income statement is net of value added tax and comprises Turnover and the Network Subsidy Payment. Turnover principally relates to the rendering of services as follows:

UK Parcels, International & Letters

Account revenue is derived from specific contracts and recognised when the delivery of an item is complete. Prepaid revenue mainly relating to stamp and meter income is recognised when the sale is made, adjusted to reflect a value of stamp and meter credits held but not used by the customer.

General Logistics Systems

Revenue is derived from specific contracts and is recognised at the time of delivery.

Post Office Limited

Revenue is recognised at the time that Government, financial, mails and telephony services are provided.

The Network Subsidy Payment is Government grant revenue recognised to match the related costs of providing the network of public post offices that the Secretary of State for Business, Innovation and Skills considers appropriate and which would otherwise not be provided.

Distribution and conveyance

Distribution and conveyance costs relate to non-people costs incurred in transporting and delivering mail. These include conveyance by rail, road, sea and air, together with costs incurred by international mail carriers and Parcelforce Worldwide delivery operators and GLS. These costs are disclosed separately on the face of the income statement.

RMG00000342

Basis of preparation and significant accounting policies (continued)

Operating exceptional items
Operating exceptional items are items of income and expenditure arising from the operations of the business which, due to the nature of the events giving rise to them, require separate presentation on the face of the income statement to allow a better understanding of financial performance in the year, in comparison to prior years.

Legacy share scheme
This scheme (originally termed 'ColleagueShare') introduced in 2007-08, is a five-year scheme spanning the accounting years from April 2007 to March 2012 and comprises both a 'share' plan and a related stakeholder dividend throughout the life of the scheme.

The costs of the scheme are included in the income statement as an exceptional item throughout the life of the scheme and corresponding liabilities are included within payables or provisions as appropriate.

Operating profit
Operating profit is the profit arising from the normal, recurring operations of the business and after charging operating exceptional items defined above. It excludes the non-operating exceptional items for profit or loss on disposal of businesses and profit or loss on disposal of property, plant and equipment. These items are not part of the normal recurring operations of the business but are material, so are presented separately on the face of the income statement to allow a better understanding of financial performance in the year, in comparison to prior years.

Goodwill
Business combinations on or after 29 March 2004 are accounted for under IFRS 3 Business Combinations using the purchase method. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition is recognised in the balance sheet as goodwill and is not amortised.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill arising from business combinations is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use. For the purpose of such impairment reviews, goodwill is allocated to the relevant cash generating units.

Goodwill arising on the acquisition of equity accounted entities is included in the cost of those entities and therefore not reported in the balance sheet as goodwill.

Intangible assets
Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition. Intangible assets acquired separately or development costs that meet the criteria to be capitalised are initially recognised at cost and are assessed to have either a finite or indefinite useful life. Those with a finite life are amortised over their useful life and those with an indefinite life are reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the income statement on a straight-line basis as follows:

Customer listings	1 to 4 years
Software	1 to 6 years

RMG00000342

Basis of preparation and significant accounting policies (continued)

Property, plant and equipment
Property, plant and equipment is recognised at cost, including directly attributable costs in bringing the asset into working condition for its intended use. Depreciation of property, plant and equipment is provided on a straight-line basis by reference to net book value and to the remaining useful economic lives of assets and their estimated residual values. The useful lives and residual values are reviewed annually and adjustments, where applicable, are made on a prospective basis. The lives assigned to major categories of property, plant and equipment are:

Land and buildings:	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	3-15 years
Motor vehicles and trailers	2-12 years
Fixtures and equipment	2-15 years

Non-current assets held for sale
Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Impairment reviews
Unless otherwise disclosed in these accounting policies, assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Group assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Leases
Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group, are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and capital element of the lease liability to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expense over the lease term on a straight-line basis.

A leasehold land payment is an upfront payment to acquire a long-term leasehold interest in land. This payment is stated at cost and is amortised on a straight-line basis over the period of the lease.

Trade receivables
Trade receivables are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Financial instruments
Financial assets within the scope of *IAS 39 Financial Instruments: Recognition and Measurement* are classified as; financial assets at fair value through the income statement (held for trading); held to maturity investments, loans and receivables or available for sale financial assets as appropriate. Financial liabilities within the scope of IAS 39 are classified as either financial liabilities at fair value through the income statement or financial liabilities measured at amortised cost.

The Group determines the classification of its financial instruments at initial recognition and re-evaluates this designation at each financial year end. When financial instruments are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial instruments not at 'fair value through the income statement', any directly attributable transactional costs.

The subsequent measurement of financial instruments depends on their classification as follows:

RMG00000342

Basis of preparation and significant accounting policies (continued)

Loans and receivables
Non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, do not qualify as trading assets and have not been designated as either 'fair value through the income statement' or available for sale, are carried at amortised cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available for sale financial assets
'Available for sale financial assets' are non-derivative financial assets that are designated as such or are not classified in any of the three preceding categories. After initial recognition, interest is taken to the income statement using the effective interest rate method and the assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised, or until the investment is deemed to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

Financial liabilities at fair value through the income statement (held for trading)
Derivatives liabilities are classified as held for trading unless they are designated as hedging instruments. They are carried in the balance sheet at fair value with gains or losses recognised in the income statement.

Financial liabilities measured at amortised cost
All non-derivative financial liabilities are classified as financial liabilities measured at amortised cost. Non-derivative financial liabilities are initially recognised at the fair value of the consideration received, less directly attributable issue costs. After initial recognition, non-derivative financial liabilities are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits (cash equivalents) with an original maturity date of three months or less. In addition, the Group uses Money Market funds as a readily available source of cash, and these funds are also categorised as cash equivalents.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank overdrafts.

Cash equivalents are classified as loans and receivables financial instruments.

Financial assets – pension escrow investments
Financial assets – pension escrow investments comprise cash at bank, conventional gilt edged securities, index-linked gilt edged securities and Treasury bills.

Conventional gilt edged securities, index-linked gilt edged securities and Treasury bills are classified as available for sale financial instruments on the basis that they are quoted investments that are not held for trading and may be disposed of prior to maturity.

Financial assets – other investments
Financial assets – other investments comprise short-term deposits (other investments) with Government, local government or banks with an original maturity of three months or more. Short-term deposits are classified as loans and receivables financial instruments.

Financial liabilities – interest-bearing loans and borrowings
All loans and borrowings are classified as financial liabilities measured at amortised cost.

Financial liabilities – obligations under finance leases
All obligations under finance leases are classified as financial liabilities measured at amortised cost.

RMG00000342

Basis of preparation and significant accounting policies (continued)

Derivative financial instruments

The Group uses derivative instruments such as foreign currency contracts in order to manage the risk profile of any underlying risk exposure of the Group, in line with the Group's treasury management policies. Such derivative financial instruments are initially stated at fair value.

For the purpose of hedge accounting, hedges are classified as cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction.

In relation to cash flow hedges to hedge the foreign exchange or commodity price risk of firm commitments that meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to relate to an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or non-financial liability, then at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit/loss, for example when the hedged transaction actually occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement in the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the year.

Fair value measurement of financial instruments

The fair value of quoted investments (including conventional gilt edged securities, index-linked gilt edged securities and Treasury bills) is determined by reference to bid prices at the close of business on the balance sheet date. Hence the conventional gilt edged securities, index-linked gilt edged securities and Treasury bills are within Level 1 of the fair value hierarchy as defined within IFRS 7.

Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models. Specifically, in the absence of quoted market prices, derivatives are valued by using quoted forward prices for the underlying commodity/currency and discounted using quoted interest rates (both as at the close of business on the balance sheet date). Hence derivative assets and liabilities are within Level 2 of the fair value hierarchy as defined within IFRS 7.

For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date.

Income tax and deferred tax

The charge for current taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using rates that have been enacted or substantively enacted at the balance sheet date.

RMG00000342

Basis of preparation and significant accounting policies (continued)

Deferred income tax assets and liabilities are recognised for all taxable and deductible temporary differences and unused tax assets and losses except:

- initial recognition of goodwill;
- the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit and loss;
- taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future; and
- deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which they can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and increased or reduced to the extent that it is probable that sufficient taxable profit will be available to allow them to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates (and tax laws) that have been substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

Current and deferred tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity, otherwise it is recognised in the income statement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate.

Pensions and other post-retirement benefits

The pension assets for the defined benefit plans are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet. Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and, with appropriate updates and accounting adjustments at each balance sheet date, form the basis of the deficit disclosed. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme.

For defined benefit schemes, the amounts charged to operating profit are the current service costs and any gains and losses arising from settlements, curtailments and past service costs. The net difference between the interest costs and the expected return on plan assets is recognised as net pension interest in the income statement. Actuarial gains and losses are recognised immediately in the statement of comprehensive income. Any deferred tax movement associated with the actuarial gains and losses is also recognised in the statement of comprehensive income.

For defined contribution plans, the Group's contributions are charged to operating profit within people costs in the period to which the contributions relate. Overseas subsidiaries make separate arrangements for the provision of pensions and other post-retirement benefits.

Foreign currencies

The functional and presentational currency of Royal Mail Holdings plc is Sterling (£). The functional currency of the overseas subsidiaries in Europe is mainly the Euro (€).

The assets and liabilities of foreign operations are translated at the rate of exchange ruling at the balance sheet date. The trading results of foreign operations are translated at the average rates of exchange for the reporting period, being a reasonable approximation to the actual transaction rate. The exchange rate differences arising on the translation, since the date of transition to IFRSs, are taken directly to the Foreign Currency Translation Reserve in equity.

RMG00000342

Basis of preparation and significant accounting policies (continued)

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Currently hedge accounting is not claimed for any monetary assets and liabilities. All differences are therefore taken to the income statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment occurs, at which time they are recognised in profit or loss.

Non-monetary items that are measured in terms of historic cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value is determined.

Contingent liabilities

Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote.

Government grants

Government grants of a revenue nature are credited to the income statement and are shown separately to the expenditure to which they relate.

Government grants relating to assets are recognised as deferred income that is amortised over the useful life of the relevant assets.

Segment information

The Group's operating segments are organised and managed separately according to the nature of the products and services provided, with each segment representing a business unit that offers different products and serves largely different markets. Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit/loss.

There is no aggregation of operating segments. The operating units that make up the four operating segments are detailed on page 90.

The operating segments comprise operations in both the UK and other parts of Europe, the latter being relevant to the GLS business segment. The UK operations include the remaining two operating segments plus the 'Other' segments.

Segment revenues have been attributed to the respective countries based on the location of the customer.

Transfer prices between the segments are set on a basis of charges reached through negotiation with the respective business units that form part of the segments.

There are no differences in the measurement of the respective segments' profit/loss and the consolidated financial statements prepared under IFRSs.

Accounting standards issued but not yet applied

The International Accounting Standards Board (IASB) has issued accounting standards relevant to the Group with an effective date for accounting periods beginning after the commencement date of the period to which these financial statements relate. The Group has considered the impact of these below:

International Accounting Standards (IAS/IFRSs)		Effective date
IAS 1	Financial Statements Presentation (Amendment)	1 July 2012
IAS 19	Employee Benefits (Amendment)	1 January 2013
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013

RMG00000342

Basis of preparation and significant accounting policies (continued)

IAS 1 Financial Statements Presentation (Amendment)
In June 2011, the IASB issued amendments to IAS 1 Financial Statement Presentation, which are intended to improve and align the presentation of items of other comprehensive income (OCI). This amendment affects presentation only and therefore has no impact on the Group's financial position or performance. The amendment becomes effective for the Group on 1 April 2013.

IAS 19 Employee Benefits (Amendment)
In June 2011, the IASB issued amendments to IAS 19 Employee Benefits, which may result in changes to the net pension cost and may require additional disclosures relating to pension assets. The impact of this amendment on the Group, effective from 1 April 2013, is currently being assessed.

IFRS 9 Financial Instruments: Classification and Measurement
IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets as defined in IAS 39. In subsequent phases, the IASB will address classification and measurement of financial liabilities, hedge accounting and derecognition. The completion of this project is expected in 2011. The adoption of the first phase of IFRS 9, mandatory for the Group commencing 1 April 2013, will have an effect on the classification and measurement of the Group's financial assets. The Group will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 10 Consolidated Financial Statements
IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. The standard will be adopted with a commencement date of 1 April 2013 and is not expected to have a significant impact on the financial position or performance of the Group.

IFRS 11 Joint Arrangements
IFRS 11 replaces *IAS 31 Interests in Joint Ventures* and provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities. The standard will be adopted with a commencement date of 1 April 2013 and is not expected to have a significant impact on the financial position or performance of the Group.

IFRS 12 Disclosures of Interests in Other Entities
IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms on interests in other entities, including subsidiaries, joint arrangements and unconsolidated structured entities. A number of new disclosures are required. One of the most significant changes introduced by IFRS 12 is that an entity is now required to disclose the judgements made to determine whether it controls another entity. The standard will be adopted with a commencement date of 1 April 2013 and is not expected to have a significant impact on the financial position or performance of the Group.

IFRS 13 Fair Value Measurement
IFRS 13 establishes a single framework for measuring fair value where that is required by other standards. The standard applies to both financial and non-financial items measured at fair value. The standard will be adopted with a commencement date of 1 April 2013 and is not expected to have a significant impact on the financial position or performance of the Group.

RMG00000342
RMG00000342

Group five-year summary (Unaudited)

In simple terms:

This section includes:

- a five-year history of key financial information (i.e. income statement, cash flow statement and balance sheet) which is unaudited. A summary of the number of employees at the end of each of the last five years has also been included. The remainder of the audited financial statements focus on 2011-12 and the comparative year 2010-11.

RMG00000342

Group five-year summary (Unaudited)

Income statement	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
	Financial year ending March				
Turnover	**9,352**	9,006	9,199	9,410	9,238
Network Subsidy Payment for Post Office Limited	**180**	150	150	150	150
Revenue	**9,532**	9,156	9,349	9,560	9,388
Operating profit before exceptional items	**442**	246	404	321	162
Operating exceptional items – modernisation costs	**(231)**	(207)	(224)	(199)	(644)
Operating profit/(loss) after modernisation costs before other operating exceptional items	**211**	39	180	122	(482)
Operating exceptional items – other	**(93)**	(88)	(67)	50	203
Non-operating exceptional items	**183**	109	5	11	58
Profit/(loss) before financing and taxation	**301**	60	118	183	(221)
Finance income and costs, including net pension interest	**(38)**	(212)	(380)	(134)	144
Profit/(loss) before tax	**263**	(152)	(262)	49	(77)
Taxation	**(10)**	(106)	(58)	(278)	212
Profit/(loss) after tax	**253**	(258)	(320)	(229)	135

Free cash flow[#]	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
EBITDA before pension costs	**1,131**	962	1,082	1,027	1,052
Working capital	**–**	(49)	(83)	(80)	140
Pension payments	**(467)**	(771)	(867)	(873)	(870)
Modernisation investment in UKPIL	**(429)**	(377)	(325)	(427)	(149)
Other exceptional items	**(59)**	(31)	(59)	(162)	(74)
Other capital expenditure	**(183)**	(210)	(321)	(317)	(274)
Other (dividends, tax, interest)	**(1)**	26	14	(18)	28
Government grant	**–**	–	–	152	313
Cash (outflow)/inflow before disposal of assets	**(8)**	(450)	(559)	(698)	166
Disposal of assets	**242**	237	14	20	71
Free cash inflow/(outflow)	**234**	(213)	(545)	(678)	237

[#] A definition of Free cash flow is provided on page 94.

Balance sheet	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Net operating assets and investments in joint venture and associates	**1,177**	1,160	1,190	942	389
Net debt (cash/cash equivalents less: loans/borrowings and finance lease obligations)	**(902)**	(965)	(720)	(80)	604
Other net (liabilities)/assets	**(5)**	38	101	152	619
Net assets before pension deficit and pension escrow investments	**270**	233	571	1,014	1,612
Pension deficit	**(2,922)**	(4,501)	(8,041)	(6,776)	(2,923)
Pension escrow investments	**1,383**	1,161	1,189	1,106	1,070
Net liabilities	**(1,269)**	(3,107)	(6,281)	(4,656)	(241)

People numbers – period end employees	2012	2011	2010	2009	2008
UK Parcels, International & Letters	**151,156**	155,181	160,291	167,396	172,113
Post Office Limited	**7,798**	7,782	8,209	8,760	9,163
UK wholly owned subsidiaries	**158,954**	162,963	168,500	176,156	181,276
UK partially owned subsidiaries	**3,926**	4,254	4,217	4,438	4,313
General Logistics Systems	**13,362**	13,167	12,885	13,059	13,135
Group total	**176,242**	180,384	185,602	193,653	198,724

RMG00000342
RMG00000342

Directors' and Auditor responsibilities in relation to the Group financial statements

In simple terms:

This section includes two mandatory statements signed by:

- the Royal Mail Holdings plc Directors to confirm that they have followed all applicable law and regulations in preparing the Directors' Report and financial statements
- the external auditor, Ernst & Young, to confirm that they have audited the financial statements and expressed an opinion on these statements in accordance with applicable law and International Standards on Auditing (UK and Ireland)

Statement of Directors' responsibilities in relation to the consolidated financial statements	146
Independent Auditor's Report to the members of Royal Mail Holdings plc	147

RMG00000342

Statement of Directors' responsibilities in relation to the Group financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained by the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

GRO

Donald Brydon **Alice Perkins**

RMG00000342

Independent Auditor's Report to the members of Royal Mail Holdings plc

We have audited the Group financial statements of Royal Mail Holdings plc for the year ended 25 March 2012 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of changes in equity, the Consolidated balance sheet, the Consolidated statement of cash flows and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 146 the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 25 March 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Royal Mail Holdings plc for the year ended 25 March 2012.

Ernst & Young LLP

Richard Wilson (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
London
27 June 2012

RMG00000342

Royal Mail Holdings plc – parent Company financial statements 2011-12

In simple terms:

This section includes mandatory financial statements for Royal Mail Holdings plc, the Group's holding ('top') company, (the Company) which is a non-trading entity. Key points to note are:

- the Company's financial statements are prepared under UK Generally Accepted Accounting Practice (UK GAAP), different to the Group consolidated financial statements presented in preceding sections which are prepared under IFRS. In common with many other large organisations, the Group still prepares its separate legal entity (or 'solus') accounts under UK GAAP.
- the Company has investments which at 25 March 2012 were held as security in support of the Group's pension deficit recovery period. On 1 April 2012 these investments were released from escrow.
- in addition to Royal Mail Group Ltd, Post Office Limited became a direct subsidiary investment of the Company on 1 April 2012.

Parent Company balance sheet at 25 March 2012 and 27 March 2011	149
Notes to the parent Company financial statements	150
Statement of Directors' responsibilities in relation to the parent Company financial statements	153
Independent Auditor's Report to the members of the parent Company, Royal Mail Holdings plc	154

RMG00000342

Parent Company financial statements

The majority of the Annual Report and Financial Statements relates to the Royal Mail Holdings plc Group consolidated accounts, which comprise the aggregation of all the Group's trading entities (subsidiaries, joint venture and associated undertakings). This mandatory section reports the individual balance sheet of the top holding company, Royal Mail Holdings plc (the Company). For the duration of 2011-12 the Company had one direct subsidiary investment, a 100% holding in Royal Mail Group Ltd and held a majority of the pension escrow investments at the balance sheet date, which are summarised in note 5. On 1 April 2012, after the balance sheet date, the Group's 100% investment in the Post Office Limited subsidiary was transferred from under the ownership of Royal Mail Group Ltd to the Company at £nil value, being its cost less cumulative impairment. Also, on this date, the Directors of the Company except for Paula Vennells, Chief Executive Officer of Post Office Limited and Donald Brydon (Chairman), became Directors of Royal Mail Group Ltd. Alice Perkins was also appointed to the Royal Mail Holdings plc Board on 1 April 2012.

Parent Company balance sheet at 25 March 2012 and 27 March 2011

	Notes	2012 £m	2011 £m
Fixed assets			
Investments in subsidiaries	4	**–**	–
Investments in pension escrow	5	**1,234**	1,074
Total net assets		**1,234**	1,074
Capital and reserves			
Share capital	8	**–**	–
Share premium	9	**430**	430
Reserves	9	**144**	56
Profit and loss account	9	**660**	588
Shareholder's funds		**1,234**	1,074

The financial statements on pages 149 to 152 were approved by the Board of Directors on 27 June 2012 and signed on its behalf by:

GRO

Donald Brydon **Alice Perkins**

RMG00000342

Notes to the parent Company financial statements

1. Parent Company accounting policies

The following accounting policies apply:

Financial year
The financial year ends on the last Sunday in March and, accordingly, these financial statements are made up to the year ended 25 March 2012 (2011 year ended 27 March).

Basis of preparation
The financial statements of the parent Company, Royal Mail Holdings plc (the Company) were authorised for issue by the Board on 27 June 2012.

The financial statements on pages 149 to 152 have been prepared in accordance with applicable UK Accounting Standards and law, including the requirements of the Companies Act 2006. Unless otherwise stated in the accounting policies below, the financial statements have been prepared under the historic cost accounting convention.

In making an assessment on the Company's ability to continue as a going concern, the Directors have considered the respective going concern assessments made by the Directors of the Royal Mail Group Ltd and Post Office Limited subsidiary companies (see note 2 on page 89). In reviewing these assessments, the Directors have also taken account of the fact that the Company acts as guarantor for the Royal Mail Group Ltd £900m senior debt facility and £500m other loans facility (see notes 13 and 15 of the Group financial statements for further details). After careful consideration of all available information, the Directors are of the view that it is appropriate that these financial statements have been prepared on a going concern basis.

The Company has not presented its own profit and loss account, as permitted by section 408 of the Companies Act 2006. However, the results of the Company for the year are disclosed in notes 6 and 9 to the financial statements.

The Company has taken advantage of paragraph 2D of *FRS 29 (IFRS 7) Financial Instruments: Disclosures* and has not disclosed information required by that standard, as the Group's consolidated financial statements in which the Company is included, provide equivalent disclosures for the Group under IFRS 7.

No new UK Accounting Standards, which affect the presentation of these financial statements, have been issued.

Impairment reviews
Unless otherwise disclosed in these accounting policies, fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Company assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the profit and loss account for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Investments in subsidiaries
Investments in subsidiaries within the Company's financial statements are stated at cost less any accumulated impairment losses. The opening and closing carrying value relates solely to the Company's investment in Royal Mail Group Ltd, a 100% subsidiary of the Company.

Investments in pension escrow
Investments in pension escrow are financial assets within the scope of *FRS 26 Financial Instruments: Recognition and Measurement*.

The investments are a combination of short-term deposits and long-term investments which mature between 1 day and 44 years but have been included within fixed assets as the investments have been provided as security to the Royal Mail Pension Plan Trustee in support of the 38 year deficit recovery in 2009 as part of the last formal triennial valuation.

The investments comprise bank balances, Treasury bills and gilt edged securities.

Treasury bills, index-linked gilt edged securities and conventional gilt edged securities are classified as available for sale financial instruments on the basis that they are quoted investments that are not held for trading and may be disposed of prior to maturity. The investments are initially recognised at fair value, being the purchase price. After initial recognition, interest is included in the reported profit/(loss) for the year, using the effective interest rate method and the assets are measured at fair value with gains or losses being recognised in the Financial Assets Reserve until the investment is derecognised.

Contingent liabilities
Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote.

2. Directors' emoluments

The Directors of the Company are not paid fees by the Company for their services as Directors of the Company. The Directors of the Company are paid fees by other companies of the Group. These emoluments are disclosed in the Group financial statements.

3. Auditor's remuneration

The auditor of the Company is not paid fees by the Company. The auditor of the Company is paid fees by the other companies of the Group. This remuneration is disclosed in the Group financial statements (note 17).

RMG00000342

4. Investments in subsidiaries

	Cost £m	Impairment £m	2012 £m	2011 £m
At 28 March 2011 and 29 March 2010	4,160	(4,160)	–	3,784
Impairment charge	–	–	–	(3,784)
At 25 March 2012 and 27 March 2011	**4,160**	**(4,160)**	**–**	**–**

In 2010-11, in accordance with FRS 11 'Impairment of Fixed Assets and Goodwill', the carrying value of the Company's investment in Royal Mail Group Ltd was compared to its recoverable amount, represented by its value in use to the Company. The value in use was derived from discounted cash flow projections from its formally approved strategic plan using the Company's pre-tax Weighted Average Cost of Capital (WACC). The comparison of the carrying value of the Company's investment in Royal Mail Group Ltd to its recoverable amount resulted in an impairment charge of £3,784m. The main driver for this zero valuation was the continuing impact of the large pension deficit.

At 25 March 2012, the impairment of the Company's investment in Royal Mail Group Ltd remains. Whilst the pension deficit in the RMPP was removed on 1 April 2012, the cash flows of Royal Mail Group Ltd, before one-off disposal proceeds, remain negative and it has yet to establish a track record of sustainable free cash flow generation.

On 1 April 2012, after the balance sheet date, Post Office Limited became an additional direct subsidiary of the Company (note 11 refers).

5. Investments in pension escrow

	2012 Average effective rate %	2012 £m	2011 Average effective rate %	2011 £m
Cash at bank	**0.4**	**1**	0.4	3
Treasury bills	**0.4**	**257**	0.5	242
Gilt edged securities (index linked)	**4.3**	**835**	4.7	707
Gilt edged securities (conventional)	**4.8**	**141**	4.8	122
Total		**1,234**		1,074

These pension escrow investments are discussed further in the Group financial statements (note 11).

6. Profit and loss account

The Company is a non-trading company. The profit for the period relates to income from the investments in pension escrow of £41m (2011 £46m) and a tax credit of £31m (2011 £5m credit). The investment in Royal Mail Group Ltd was impaired by £3,784m in 2011.

7. Taxation

A tax charge of £31m (2011 £5m charge) has been taken to the Financial Assets Reserve, reflecting the tax liability on the fair value changes on available for sale financial assets. A tax credit of £31m (2011 £5m credit) has been taken to the profit and loss account, reflecting the sheltering of that tax liability by losses of other Group companies.

8. Share capital

Details of the share capital are disclosed in the Group financial statements (note 26).

RMG00000342

9. Shareholder's funds

	Share premium £m	Profit and loss account £m	Financial Assets Reserve £m	2012 Total £m	2011 Total £m
At 28 March 2011 and 29 March 2010	430	588	56	1,074	4,795
Profit/(loss) for the year	–	72	–	72	(3,733)
Taxation on items taken directly to reserves	–	–	(31)	(31)	(5)
Gains on financial asset investments	–	–	119	119	17
At 25 March 2012 and 27 March 2011	430	660	144	1,234	1,074

Financial Assets Reserve
The Financial Assets Reserve is used to record fair value changes on available for sale financial assets.

10. Charges

Details of charges registered over the assets of the Company are contained in the Group financial statements (notes 13 and 15).

11. Post balance sheet events

On 1 April 2012 Post Office Limited became a directly owned subsidiary of Royal Mail Holdings plc, having previously been a directly owned subsidiary of Royal Mail Group Ltd. At that date the majority of Royal Mail Holdings plc Directors became Directors of Royal Mail Group Ltd. Alice Perkins and Donald Brydon are the only Directors of Royal Mail Holdings plc at 1 April 2012.

Royal Mail Holdings plc continues to hold £1.2bn of investments, which were previously held in pension escrow up to 1 April 2012, and which will not be transferred to Royal Mail Group Ltd or Post Office Limited.

RMG00000342
RMG00000342

Statement of Directors' responsibilities in relation to the parent Company financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are not required under UK law to prepare a Remuneration Committee Report but, in accordance with the principles of good corporate governance, as outlined in the Combined Code, have chosen to do so. This Report has been prepared by the Remuneration Committee as if the Company was required to comply with both Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 of the United Kingdom and relevant Listing Rules of the Financial Services Authority and has been approved by the Board. The only exception is that a performance graph has not been included, since the Company is not quoted.

GRO

Donald Brydon Alice Perkins

RMG00000342
RMG00000342

Independent Auditor's Report to the members of the parent Company, Royal Mail Holdings plc

We have audited the parent Company financial statements of Royal Mail Holdings plc for the year ended 25 March 2012 which comprise balance sheet and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 153, the Directors are responsible for the preparation of the parent Company financial statements and for being satisfied that they give a true and fair view. The Directors are also responsible for the preparation of the Directors' Remuneration Report, which they have chosen to prepare as if the Company was required to comply with relevant requirements of both the UK Companies Act 2006 (and Regulations thereunder) and the Listing Rules of the Financial Services Authority. The only exception is that a performance graph has not been included, since the Company is not quoted. Our responsibility is to audit and express an opinion on the parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. In addition, the Company has also instructed us to review whether the section of the Directors' Remuneration Report that has been described as audited has been properly prepared in accordance with the basis of the preparation described therein.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 25 March 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of Royal Mail Holdings plc for the year ended 25 March 2012.

Ernst & Young LLP

Richard Wilson (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
London
27 June 2012

RMG00000342
RMG00000342

Pro-forma 2011-12 financial statements for Royal Mail Group excluding Post Office Limited (unaudited)

In simple terms:

- In view of the possibility of Post Office Limited formally separating from the remainder of the Group at a future date, this section provides an indication of how the Group's consolidated primary financial statements would look if Post Office Limited was not part of the Group. These statements are not mandatory and have not been audited.

Introduction	156
Royal Mail Group excluding Post Office Limited five-year summary (unaudited)	156
Summary of financial results (unaudited)	157
Consolidated income statement [1] (unaudited)	158
Consolidated balance sheet [2] (unaudited)	159
Consolidated statement of cash flows [1] (unaudited)	160

1 For the year ended 25 March 2012 and 27 March 2011

2 At 25 March 2012 and 27 March 2011

RMG00000342

Royal Mail Group excluding Post Office Limited

Introduction

These pro-forma 2011-12 financial statements for Royal Mail Group excluding Post Office Limited ('RMG ex POL') are unaudited and have been included for indicative purposes only, on the basis that Post Office Limited is expected to be formally separated from the rest of the Group at a future date.

Royal Mail Group excluding Post Office Limited five-year summary (unaudited)

Income statement	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
External revenue	**8,731**	8,380	8,511	8,652	8,477
Inter-company revenue from Post Office Limited	**33**	35	36	43	44
Revenue	**8,764**	8,415	8,547	8,695	8,521
Operating profit before exceptional items	**381**	210	332	280	196
Operating exceptional items – modernisation costs	**(229)**	(192)	(185)	(179)	(362)
Operating profit/(loss) after modernisation costs before other operating exceptional items	**152**	18	147	101	(166)
Operating exceptional items - other	**(57)**	(48)	(180)	(26)	(10)
Operating profit/(loss)	**95**	(30)	(33)	75	(176)
Non-operating exceptional items	**182**	104	186	3	53
Profit/(loss) before financing and taxation	**277**	74	153	78	(123)
Net finance (costs)/income including net pensions interest	**(34)**	(192)	(352)	(120)	155
Profit/(loss) before tax	**243**	(118)	(199)	(42)	32
Taxation (charge)/credit	**(20)**	(118)	(77)	(297)	184
Profit/(loss) after tax	**223**	(236)	(276)	(339)	216

Free cash flow#	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
EBITDA before pension costs	**1,076**	925	1,011	991	1,081
Working capital	**(19)**	(58)	31	63	(76)
Pension payments	**(440)**	(724)	(811)	(809)	(801)
Modernisation investment in UKPIL	**(429)**	(377)	(325)	(427)	(149)
Other exceptional items	**(37)**	(7)	(8)	–	–
Other capital expenditure	**(150)**	(176)	(234)	(237)	(183)
Other (dividends, tax, interest)	**(46)**	(13)	(29)	(68)	(11)
Cash outflow before disposal of assets	**(45)**	(430)	(365)	(487)	(139)
Disposal of assets	**240**	230	10	11	65
Free cash inflow/(outflow)	**195**	(200)	(355)	(476)	(74)

A definition of Free cash flow is given on page 161.

Balance sheet	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Net operating assets and investments in associates	**1,444**	1,416	1,438	1,335	1, 074
Net debt (cash/cash equivalents less: loans/borrowings and finance lease obligations)	**(1,335)**	(1,359)	(1,135)	(685)	(201)
Other net (liabilities)/assets	**(5)**	38	100	149	619
Net assets before pension deficit and pension escrow investments	**104**	95	403	799	1,492
Pension deficit	**(2,716)**	(4,185)	(7,477)	(6,301)	(2,718)
Pension escrow investments	**1,383**	1,161	1,189	1,106	1,070
Net liabilities	**(1,229)**	(2,929)	(5,885)	(4,396)	(156)

RMG00000342

Royal Mail Group excluding Post Office Limited Summary of financial results (unaudited)

Profit and loss summary

	2012 £m	2011 £m
External revenue	**8,764**	8,415
Operating costs	**(8,384)**	(8,208)
Modernisation costs	**(229)**	(192)
Share of profits from associates	**1**	3
Operating profit after modernisation costs	**152**	18
Other net exceptional items	**125**	56
Profit before financing and taxation	**277**	74
Net finance costs and net pension interest	**(34)**	(192)
Taxation charge	**(20)**	(118)
Profit/(loss) for the financial year	**223**	(236)

- external revenue increased by £349m, from £8,415m in 2011 to £8,764m in 2012 as the impact of price increases more than offset core traditional volumes decline in UKPIL;
- operating costs increases are lower than inflation and comprise a reduction in people costs, offset by expected increases in non-people costs;
- modernisation costs in 2011 included a £101m credit relating to the legacy share scheme. Underlying costs have reduced mainly due to lower redundancy costs;
- other net exceptional items of £125m mainly comprise profit on disposal of property of £156m;
- net finance costs of £34m have reduced by £158m, mainly due to a non-cash pension interest credit in 2012, driven by changes in long-term pension assumptions; and
- taxation charge of £20m mainly relates to GLS profits, compared with 2011 which included £79m relating to the write-down of UK deferred tax assets.

Free cash flow summary

	2012 £m	2011 £m
EBITDA before pension costs	**1,076**	925
Working capital	**(19)**	(58)
Ongoing/other pension payments*	**(440)**	(453)
Pension deficit payments for RMPP	**–**	(272)
Modernisation investment in UKPIL	**(429)**	(377)
Other capital expenditure and other exceptional costs	**(187)**	(182)
Other (dividends, tax, interest)	**(46)**	(13)
Cash outflow before disposal of assets	**(45)**	(430)
Disposal of property and non-core businesses	**240**	230
Free cash inflow/(outflow)	**195**	(200)

* Includes pension payments relating to redundancy of £36m (2011 £29m), of which £36m (2011 £29m) relates to modernisation.

- EBITDA before pension costs of £1,076m is £151m higher than last year due to improved trading performance;
- RMG ex POL is no longer required to make pension deficit payments into the main pension scheme (2011 £272m payment). Significant ongoing/other pension cash costs of £440m remain;
- modernisation investment continues, but focus now changing from processing units to delivery and collections; and
- before property and business disposals RMG ex POL consumed cash, but at a lower level than last year.

Balance sheet summary

	2012 £m	2011 £m
Net operating assets and investments in associates	**1,444**	1,416
Net debt (cash/loans/finance leases)	**(1,335)**	(1,359)
Other net liabilities (taxation, derivatives)	**(5)**	38
Net assets before pension deficit and pension escrow investments	**104**	95
Pension deficit	**(2,716)**	(4,185)
Pension escrow investments:		
in Royal Mail Holdings plc	**1,234**	1,074
in Royal Mail Group Ltd	**149**	87
Net liabilities	**(1,229)**	(2,929)

- net debt has decreased by £24m mainly due to cash generation, partly offset by an increase in finance leased assets and non cash interest;
- the accounting pension deficit decreased from £4.2bn in 2011 to £2.7bn in 2012, mainly due to a net £4bn improvement in the market value of pension assets – primarily investments in bonds;
- pension escrow investments increased by £222m, mainly as a result of increased gilt investment values and interest accrued;
- on 1 April 2012 almost all of the pension liabilities and pension assets of the RMPP, built up until 31 March 2012, were transferred to HM Government. This arrangement left the RMPP fully funded on an actuarial basis in respect of historic liabilities at that date;
- after the balance sheet date, £149m of pension escrow investments held by Royal Mail Group Ltd were made available to that company; and
- Royal Mail Holdings plc continues to hold £1.2bn of investments which previously were held in pension escrow and which will not be transferred to Royal Mail Group Ltd or Post Office Limited.

RMG00000342

Royal Mail Group excluding Post Office Limited Consolidated income statement

for the year ended 25 March 2012 and 27 March 2011 (unaudited)

	2012 £m	2011 £m
Continuing operations		
Revenue	**8,764**	8,415
People costs	**(4,920)**	(4,986)
Distribution and conveyance costs	**(1,755)**	(1,616)
Other operating costs	**(1,709)**	(1,606)
Share of post tax profit from associates	**1**	3
Operating profit before exceptional items	**381**	210
Modernisation costs – operating exceptional items	**(229)**	(192)
Operating profit after modernisation costs before other operating exceptional items	**152**	18
Other operating exceptional items	**(57)**	(48)
Operating profit/(loss)	**95**	(30)
Profit on disposal of property, plant and equipment	**156**	60
Profit on disposal of businesses	**26**	44
Profit before financing and taxation	**277**	74
Finance costs	**(111)**	(106)
Finance income	**53**	69
Net pension interest	**24**	(155)
Profit/(loss) before taxation	**243**	(118)
Taxation charge	**(20)**	(118)
Profit/(loss) for the financial year from continuing operations	**223**	(236)
Profit/(loss) attributable to:		
Equity holder of the parent company	**222**	(237)
Non-controlling interest	**1**	1

RMG00000342

Royal Mail Group excluding Post Office Limited Consolidated balance sheet

at 25 March 2012 and 27 March 2011 (unaudited)

	2012 £m	2011 £m
Non-current assets		
Property, plant and equipment	**1,814**	1,820
Leasehold land payment	**3**	3
Goodwill	**189**	197
Intangible assets (mainly software)	**135**	126
Investments in associates	**3**	9
Financial assets – pension escrow investments	**1,383**	1,161
– bank deposits	**–**	44
– derivatives	**2**	6
Deferred tax assets	**9**	8
	3,538	3,374
Non-current assets held for sale	**4**	4
Current assets		
Inventories	**32**	33
Trade and other receivables	**1,036**	906
Financial assets – derivatives	**9**	36
– short-term deposits	**31**	1
Cash and cash equivalents	**473**	319
	1,581	1,295
Total assets	**5,123**	4,673
Current liabilities		
Trade and other payables	**(1,512)**	(1,394)
Financial liabilities – obligations under finance leases	**(86)**	(61)
– derivatives	**(4)**	(3)
Income tax payable	**(9)**	(6)
Provisions	**(132)**	(167)
	(1,743)	(1,631)
Non-current liabilities		
Financial liabilities – interest bearing loans and borrowings	**(1,522)**	(1,478)
– obligations under finance leases	**(231)**	(184)
– derivatives	**(1)**	–
Provisions	**(85)**	(85)
Retirement benefit obligation – pension deficit	**(2,716)**	(4,185)
Other payables	**(36)**	(29)
Deferred tax liabilities	**(18)**	(10)
	(4,609)	(5,971)
Total liabilities	**(6,352)**	(7,602)
Net liabilities	**(1,229)**	(2,929)
Equity		
Share capital	**–**	–
Share premium	**430**	430
Retained earnings	**(1,913)**	(3,580)
Reserves	**254**	213
Equity attributable to equity holder of parent company	**(1,229)**	(2,937)
Non-controlling interest	**–**	8
Total equity	**(1,229)**	(2,929)

RMG00000342

Royal Mail Group excluding Post Office Limited Consolidated statement of cash flows

for the year ended 25 March 2012 and 27 March 2011 (unaudited)

	2012 £m	2011 £m
Cash flow from operating activities		
Operating profit before exceptional items	**381**	210
Adjustment for:		
Pension operating costs	**395**	432
Depreciation and amortisation	**301**	286
Share of post tax profit from associates	**(1)**	(3)
EBITDA before pension costs	**1,076**	925
Working capital movements:	**(19)**	(58)
Decrease/(increase) in inventories	1	(1)
Increase in receivables	(148)	(21)
Increase/(decrease) in payables	116	(25)
Net increase in derivative assets	(6)	(12)
Increase in non-exceptional provisions	18	1
Pension operating costs paid	**(404)**	(695)
Cash payments in respect of operating exceptional items	**(317)**	(247)
Modernisation:		
Legacy share scheme/Business Transformation	(60)	(95)
Redundancy	(129)	(109)
Redundancy related pension costs	(36)	(29)
One-off projects	(55)	(8)
Other	–	(1)
Non-modernisation	(37)	(5)
Cash inflow/(outflow) from operations	**336**	(75)
Income tax paid	**(35)**	(36)
Net cash inflow/(outflow) from operating activities	**301**	(111)
Cash flows from investing activities		
Dividends received from associates	**4**	9
Finance income received	**53**	68
Proceeds from sale of property, plant and equipment	**203**	157
Proceeds from disposal of businesses	**37**	73
Purchase of property, plant and equipment (including modernisation investment in UKPIL)	**(287)**	(270)
Acquisition of businesses	**(2)**	(2)
Purchase of intangible assets (software)	**(45)**	(70)
Payment of deferred consideration in respect of prior years' acquisitions	**(1)**	–
Net (purchase)/sale of financial assets investments (non-current)	**(45)**	42
Net purchase of financial assets investments (current)	**(30)**	–
Net cash (outflow)/inflow from investing activities	**(113)**	7
Net cash inflow/(outflow) before financing activities	**188**	(104)
Cash flows from financing activities		
Finance costs paid	**(68)**	(54)
Payment of capital element of obligations under finance lease contracts	**(49)**	(62)
Cash received on sale and leasebacks	**88**	115
New loans	–	300
Repayment of borrowings	**(1)**	(42)
Net cash (outflow)/inflow from financing activities	**(30)**	257
Net increase in cash and cash equivalents	**158**	153
Effect of exchange rates on cash and cash equivalents	**(4)**	(2)
Cash and cash equivalents at the beginning of the period	**319**	168
Cash and cash equivalents at the end of the period	**473**	319

RMG00000342

Royal Mail Group excluding Post Office Limited Consolidated statement of cash flows

for the year ended 25 March 2012 and 27 March 2011 (unaudited) (continued)

Free cash flow

Free cash flow in RMG ex POL is defined as the net cash inflow/(outflow) before financing activities (except finance costs paid), less the net cash purchase/sale of financial asset investments (current and non-current).

Free cash flow is not a measure defined under IFRS but is a key indicator used by management to assess performance.

A reconciliation of 'net cash inflow/(outflow) before financing activities' in the RMG ex POL consolidated statement of cash flows to Free cash inflow/(outflow) is shown below.

	2012 £m	2011 £m
Net cash inflow/(outflow) before financing activities	**188**	(104)
Net purchase/(sale) of financial asset investments (non-current)	**45**	(42)
Net purchase of financial asset investments (current)	**30**	–
Finance costs paid	**(68)**	(54)
Free cash inflow/(outflow)	**195**	(200)

RMG00000342

Forward looking statements

This document contains statements concerning the Group's business, financial condition, results of operations and certain of the Group's plans, objectives, assumptions, projections, expectations or beliefs with respect to these items.

The Company cautions that any forward looking statements in this document may and often do vary from actual results and the differences between these statements and actual results can be material. Accordingly, readers are cautioned not to place undue reliance on forward looking statements. The Company undertakes no obligation to release publicly the result of any revisions to these forward looking statements that may be made to reflect events or circumstances after the date of this document, including, without limitation, changes in the Group's strategy, or to reflect the occurrence of unanticipated events.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Such forward looking statements should, therefore, be considered in light of various important factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements. These factors include, among other things: the impact of competitive products and pricing; the occurrence of major operational problems; the loss of major customers; limitations imposed by the Group's indebtedness; undertakings and guarantees relating to pension funds; contingent liabilities; risks of litigation and risks associated with the Group's overseas operations.

RMG00000342

Corporate information

Registered Office and Group Head Office
Royal Mail Holdings plc
100 Victoria Embankment
LONDON
EC4Y 0HQ
Telephone: 020 7250 2888
Registered No: 4074919

Royal Mail, the Cruciform, the colour red, Parcelforce Worldwide and the Parcelforce Worldwide logo are registered trademarks of Royal Mail Group Ltd. Post Office and the Post Office symbol are registered trademarks of Post Office Limited. Group Annual Report and Financial Statements 2012 © Royal Mail Group Ltd 2012. All Rights Reserved.

Corporate website
Additional corporate and other information can be accessed on the following website www.royalmailgroup.com. Information made available on the website is not intended to be, and should not be regarded as being, part of the Financial Statements.

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

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

Actuary
Towers Watson Limited
Watson House
London Road
REIGATE
Surrey
RH2 9PQ

Regulator (Ofcom)
Riverside House
2a Southwark Bridge Road
LONDON
SE1 9HA

Consumer body
Consumer Focus
Fleetbank House
Salisbury Square
LONDON
EC4Y 8JX

RMG00000342

RMG00000342

Royal Mail, the cruciform, the colour red, the Parcelforce Worldwide logo and all words or logos marked with the ® symbol are registered trade marks, and all words or logos marked with the ™ symbol are trade marks, of Royal Mail Group Limited. The GLS arrow logo is the registered trade mark of General Logistics Systems Germany GmbH & Co. OHG. The Post Office logo is the registered trade mark of Post Office Limited. Annual Report 2011-12 © Royal Mail Group Limited 2012. All rights reserved.