

## COMMERCIAL - IN STRICTEST CONFIDENCE

Counters Major Projects Expenditure Committee  
(COMPEC)

NOTES OF MEETING

Friday, 26 April 1996, Room 424, Drury House, London  
and Monday 29 April 1996, Room 419 Drury House, London

Present:	COMPEC Tim Brown Richard Dykes Danny McDonough Roger Tabor (chair)  David Taylor	Also Attending Bob Peaple (Friday only) } project Paul Rich (Friday only) } controllers Dick Wheelhouse (Monday only) Representatives from Charterhouse (item 2 - Friday only)
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**1 Introduction**

- 1.1 Roger Tabor welcomed members of Charterhouse.
- 1.2 He outlined the purpose of the meeting; to agree the business case for BA/POCL and to discuss issues and approach to be adopted at the forthcoming meetings with MaPEC and the Board.
- 1.3 The submission sought MaPEC authority for POCL, in conjunction with the Benefits Agency (BA), to proceed to the contract award stage of the counter automation project. The project includes the full automation of all counter positions in all post offices and the new card-based benefit encashment service.

**2 Valuation of POCL**

- 2.1 The meeting heard a presentation from Charterhouse Bank, commissioned to assess POCL's likely future market valuation, with and without the automation platform proposed in the business case.
- 2.2 The approach used was from a market perspective or as if POCL were about to be floated. An analysis of quantitative and qualitative issues was delivered, against a background of Counters existing mission statement. Key issues likely to influence the market, were outlined, in particular:
- recognised strengths and weaknesses
  - financial record
  - cost projections
  - likely market perception of prospects for growth on existing and potential new business
  - market comparator analysis

## COMMERCIAL - IN STRICTEST CONFIDENCE

- 2.3 Different methodologies gave different values and the presentation reached its conclusion on the basis of the whole exercise. Charterhouse's estimate of the value of POCL, assuming automation, lay in the range £285m to £310m, although pessimistic and optimistic sensitivities extended this range by some £120m at either end. Without automation the derating of this assessment by the market would reduce the value of POCL by £265m-£350m, effectively indicating that the hypothetical flotation could only be viable with automation and related growth prospects in place.
- 2.4 The Committee noted that the Charterhouse conclusions supported the assumption on the base case that not proceeding with Automation would seriously worsen POCL's future business viability.
- 2.5 Members asked Charterhouse to explain how the various value reduction assumptions (which gave rise to the difference in value between the automated and non-automated environment) related to net present value details in the business case. The business case NPV did not reflect market value increases, only changes in cash flows. Charterhouse undertook to take this away for consideration.

### 3 Business Case

- 3.1 COMPEC reviewed the business case and supporting information and noted that:
- In line with business practices, options were compared using NPVs discounted at 12%. As the proposal did not involve upfront investment by POCL but created changes in the income streams and running costs of the business, the effect on P&L projections would be of at least equivalent importance.
  - The highest NPV would come from a hypothetical public procurement option, but this was not feasible because the Benefits Agency would not agree to it and their parallel involvement was crucial. Furthermore it was unclear whether the capital outlay of £140m could be afforded by the Post Office. The whole project had been constructed on the presumption that it would be done under the Private Finance Initiative - a Government requirement - and the decision would be made on that basis.
  - Of the PFI options, which were feasible, the most attractive option was the supplier 'Dick'. 'Dick' had the best NPV but also accepted greater accountability for fraud and associated risks. Although that option was technically less secure than 'Tom', it was commercially the only acceptable one on the evidence before the Committee. The business case figures were based on 'Dick'. It was likely that the failure of 'Tom' and 'Harry' to accept any fraud risk and to put the onus of proof on to the Post Office, would rule them out from being acceptable PFIs. 'Tom' might be classed as a finance lease, requiring some £380m to be created in POCL's balance sheet.

## COMMERCIAL - IN STRICTEST CONFIDENCE

- The positive NPVs in the business case depended on the avoidance of unacceptable losses of business opportunities and price erosion deriving respectively from marketing opportunities opened up by automation, and the associated long term agreement with BA, which included pricing principles and some protection against volume losses. In incremental terms, the use of automation would add to operating costs, because subpostmasters were not paid for back-office time which automation would save, and cash accounting savings were not proper to this case, because they also required the TIP project to release them. In the same vein, manpower savings were not fundamental to the case. It was crucial therefore that the base case was fair and reasonable and to that end Coopers and Lybrand had been commissioned to validate the details and had expressed themselves content that the assumptions were reasonable and consistent.
- While POCLs latest Business Plan had already factored in the main assumptions about automation costs and benefits, a deterioration from those profit projections of up to £12m in a single year was implied by the project, following a receipt of tenders, with supplier prices above earlier indicative levels.
- The numbers in the paper had been expressed net of the outstanding SSA (Northern Ireland) negotiations (which, if successful represented an income upside)
- The paper recognised various 'risks' relating to costs outside the contracts implied under each option. The risks had been attributed values within the case and did not differentiate between options, except that the (infeasible) non-PFI option's financial advantage was severely eroded by taking fraud risk otherwise left to the suppliers.
- The non-financial value factors indicated that all three suppliers exceeded the acceptable hurdle.

## 3.2 On the basis that:

- the project had a positive NPV of £65m ('Dick') relative to the base case
- the project would not worsen Business Plan projections outside manageable bounds (maximum single year effect £12m)
- the project would secure strategic value and create net worth for POCL
- automation was a key enabler for new business development in the Business Plan
- POCL would be transformed into an automated business at the end of the contract period without significant investment outlay
- the associated long term contract with the Benefits Agency would help POCL to secure the nation-wide network of post offices and de-risk a substantial element of the Business Plan
- project management and fraud risks would be substantially transferred to the supplier

COMMERCIAL - IN STRICTEST CONFIDENCE

- only a PFI option would be acceptable to Government and the Benefits Agency

COMPEC agreed to recommend to MaPEC and the Board that POCL should go ahead to award a contract, provided the final financial evaluation remains broadly consistent with the costs and risks identified in the paper and noted that subject to final decisions by the joint Project Steering Committee, 'Dick' was the best option.

- 4 There was no other business and a meeting review was not conducted on this occasion.