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POB(99)2

POST OFFICE BOARD
CHIEF EXECUTIVE'S REPORT : JANUARY 1999
(November Results)

KEY POINT SUMMARY

1. ROYAL MAIL

- 1.1** November's profit was £32m, which was £33m below budget. Income was down £14m on budget due largely to performance in Royal Mail National, whilst there were continuing overspends on mail operations. Encouragingly, mails manpower and overtime have fallen for the second consecutive month and it is obviously important that this trend continues for the rest of the year. Richard Dykes will update the Board on the further measures that are being taken.
- 1.2** Traffic in Royal Mail National declined by 3.9% compared to the same month last year, with First Class down 1.9% and Second Class down 6.1% due to the trend towards later postings at Christmas. Streamline volume was up 7% against a budgeted increase of 8.3% whilst International traffic growth of 13.4% was 3.8% above the budgeted level.
- 1.3** First Class quality was 91.1%, the same as November 1997, whilst Second Class performance of 98.7% was 0.4% ahead of the previous year. Robust contingency arrangements ensured that this was achieved despite the impact of industrial action and flooding in the Midlands and South West. All Streamline products showed year on year improvements, with Mailsort 3 exceeding its full year target of 98.5% delivery within 7 days.

2. POST OFFICE COUNTERS LTD (POCL)

- 2.1** Profit in November was £5.2m compared to a budget of £5.9m. Both income and expenditure were down 2% on budget.
- 2.2** Quality of service in the 3 months to November hit its full year target of 95% of customers being served within 5 minutes.

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3. PARCELFORCE WORLDWIDE

- 3.1 November's loss of £2m was £5.5m worse than budget and brings the cumulative loss to £21m. Income was 6% below budget and 1% below last year, whilst expenditure was 8% above budget, with overspends in both staff and non staff areas. The full year forecast remains a loss of £20m, although there are further risks around this and a key issue will be the planned reduction of between 2,000-2,500 staff after Christmas.
- 3.2 Total volume fell by 1.7%, 3.8% below budget. The strong performances by PF48 and International Express were not sufficient to compensate for disappointing results from other services.
- 3.3 November was an excellent month for quality of service, with nearly every product stream showing a year on year improvement. All the key domestic Next Day services beat their full year targets.

4. OVERVIEW OF PERFORMANCE

- 4.1 Results in both Royal Mail and Parcelforce Worldwide continue to be disappointing. The next 4 months will be tough ones and much will depend upon how successful we have been during the Christmas period.
- 4.2 I have agreed with Richard Dykes that we will take every step to try and hit the key targets in Royal Mail, which should then give us a reasonable chance of meeting the EFL. With our demands for extra borrowing for Sapphire, the proposed White Paper and the run up to regulation, it is important that we do not miss targets at this time and present the Treasury with the opportunity to go back on any of the earlier agreements with the DTI.

5. OTHER ISSUES

5.1 Project Sapphire

We intend to announce the purchase of Sapphire on Monday 11 January 1999 with a simultaneous press briefing in London and Frankfurt. As discussed at the December Board, this will give us a strong presence in the German parcels market and access to a pan European network serving 22 other destinations.

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International consolidation has continued with La Poste's purchase of Denkhaus and Deutsche Post's acquisition of the distribution business of Danzas for a reported £640 m.

5.2 Department of Trade and Industry

Stephen Byers, previously Chief Secretary to the Treasury, has been appointed Secretary of State for Trade and Industry following the resignation of Peter Mandelson.

5.3 Horizon

The ministerial re-shuffle which involved the key players at both the Treasury and DTI meant that we did not get the anticipated pre-Christmas, Government decision on the future of Horizon.

A way forward which would allow the programme to continue was proposed by Stephen Byers, in his role as Chief Secretary to the Treasury and supported by DTI ministers. This was based on an agreement reached during December between POCL and ICL, covering the acceptance process and revised commercial proposals in which POCL offered some concessions in return for a reduced level of financial risk around the programme. The DSS has submitted a counter proposal, which essentially returns to the theme of continuing with the Horizon infrastructure whilst dropping the benefit card and introducing early, compulsory ACT in return for some form of compensation to ICL for the development cost of the card. DSS have not yet agreed the revised acceptance process.

Our current understanding is that ministers are now aiming to meet in the week commencing 11 January and are under pressure to agree a way forward which will avoid the need for arbitration by No 10.

5.4 Christmas 1998

Operational statistics for the Christmas period suggest that on a like for like basis, traffic in Royal Mail grew by 3.5% compared to the previous year. This figure climbs to 3.8% once pre-sorted traffic is excluded from the analysis. Traffic in Parcelforce showed an overall decline of around 4 %, with 13% growth in Next Day traffic unable to compensate for the declines in Standard and PF48.

It is too early to tell how these figures will translate into financial performance for the month of December.

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5.5 Project Beotys

By the end of January, Parcelforce Worldwide hope to reach "Heads of Agreement" with a leading mail order company on a proposal which will result in Parcelforce contracting for the distribution and delivery of all their Home Shopping items and involve the transfer of their courier operation to Parcelforce. This will deliver base volumes of 24m items, traffic which is forecast to grow by 60% over 5 years. If concluded, the deal will provide Parcelforce with the kind of "best in class" courier operation which is essential to maintain cost competitiveness in the Large Mail Order market, remove a key competitor and provide significant opportunities for synergy with other major Home Shopping customers.

5.6 Pricing

The proposed price increases in Royal Mail and Parcelforce Worldwide are due to be submitted to Post Office Users National Council (POUNC) on Thursday 14 January, with a view to being implemented on Monday 26 April.

5.7 Pay and Productivity

An individual ballot of CWU members has endorsed the Pay and Residential Delivery agreement in Parcelforce Worldwide by a majority of approximately 3:1.

Royal Mail have agreed a new productivity deal with the CWU which has now been endorsed by the Union's executive. This is predominantly a gainshare scheme under which any savings from productivity improvements, including savings from absorbing traffic growth will be shared with employees in the form of a bonus. The scheme contains quality and customer satisfaction gateways which will ensure that productivity improvements are not achieved at the expense of customer service and that we reward and incentivise improvements in quality and customer satisfaction. The CWU intend to put the deal to the membership as part of a combined ballot with the new pay settlement. The ballot will close on 10 February 1999.

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5.8 Select Committee

The Post Office was questioned by the Trade and Industry Select Committee along with the Minister of State, Ian McCartney and representatives from POUNC, DHL, the Direct Marketing Association (DMA) and our trade unions. We welcomed the Government's announcement on the future of The Post Office and covered issues including regulation, liberalisation, international expansion and crown office conversions.

6. CONCLUSION

The Board is invited to:

- note the January Report
- agree that the following profit/loss forecasts, which remain unchanged from the previous month, will be released to the DTI:

Royal Mail	£478m	- no change
Parcelforce Worldwide	£(20m)	- no change
POCL	£ 35m	- no change

AJR
JANUARY 1999

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