

In Strictest Confidence

POB(99)55

POST OFFICE BOARD
CHIEF EXECUTIVE'S REPORT : September 1999
(July 1999 Results)

KEY POINT SUMMARY

1. ROYAL MAIL

- 1.1 The profit result for July of £34m was £6m down on budget driven by the income result which was £17m below budget as a result of lower volumes in letter services across all the business units. RM National income was on budget but due to an additional £10m of Ancillary income from the European Commission, Welsh & Scottish Elections offsetting the £10m below budget performance of Letter Services. RM Streamline income was £13m below budget and International income was £5m below budget. Expenditure was £9m below budget with mails operational expenditure representing £5m of this, predominantly due to volume related savings. Cumulative profit is now £15m behind budget.
- 1.2 RM National traffic volume for July was down 0.8% driven by a decline in First Class of 2.4% which was partially offset by Second Class growth of 1.2%. RM Streamline growth was 7% below budget at 9.1% due to reduced volumes of Mailsort 2 & 3. RM International showed a decline of 2.8% against a budgeted growth of 3.8% with all sectors performing worse than budget especially Inward Terminal Dues which was 18% down on last year.
- 1.3 Quality of Service in July for First Class was 91.7% which brings the year to date performance up to 90%. The Second Class result was up on last month to 98.7% and remains cumulatively above the full year target of 98.5%. There are month on month improvements in virtually all streams and gains in most of the key Customer Sorted streams.

2. POST OFFICE COUNTERS LTD (POCL)

- 2.1 POCL made a profit of £5.4m for July, but some £1.1m below the budgeted target of £6.5m and this trend is expected to continue in August. Monthly revenue was £7.8m below budget and, correspondingly, expenditure was £6m below budget due to underspends in both Regional and Central cost centres. Cumulative profit is now £7.4m ahead of budget.
- 2.2 All services under-performed this month's revenue targets with Licence Fees being particularly low as a result of a revised agreement with Forbuoys.
- 2.3 The Quality of Service result stood at 94.2% against a target of 95%, a 1% improvement on the previous month's performance. Branch Offices improved by 3.6% and Modified/Franchise Offices by 2.3% on last month even with the

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further extension of the Graduated Vehicle Excise and the continuing emergency passport extension work.

3. PARCELFORCE WORLDWIDE

- 3.1 July's financial result, including Special Delivery, was a profit of £0.3m, £3m worse than budget. Special Delivery had another strong month producing an additional £1.1m profit above budget (£3.1m cumulative). The underlying Parcels performance though was £4.1m below budget comprising £3.1m income shortfall and £1m expenditure overrun. Cumulative profit for Parcels, including Special Delivery, is now £6.1m behind budget.
- 3.2 Parcel volumes are down against both the UK (-4.9%) and International (-1.3%) markets. Within the sectors, however, Customised Solutions (+3%), Rest of World (+1%) and Small Business (+2.5%) were all up. The largest shortfalls were in the Home Shopping (-10%) and Business to Business sectors. Standard volumes are down by 18% due to the loss of 4 contracts and PF24 down by 28%. PF10 is of particular concern with 15 of the top 25 customers showing a marked decline in year on year revenues. The International shortfall is mainly price reflecting the continued tough trading conditions, and last month's Euro 48's strong performance has reversed.
- 3.3 July's Quality of Service improved markedly on last month with four targets being achieved: PF12, Standard Day 2 and International Outward EMS & Standard; nevertheless performance behind last year's when 12 targets were achieved.

4. OVERVIEW OF PERFORMANCE

All three business failed to meet their profit targets for the month: POCL for the first time this year. Both Parcelforce Worldwide and Royal Mail continue to experience performance problems. Parcelforce Worldwide's revenue is still below target compounded by staff costs above budget despite reduced volumes. This cost overrun is being vigorously addressed. Quality of Service has improved but still remains poor compared to last year. Royal Mail continues to have significant revenue shortfalls but a good set of recovery actions are in place with risk seemingly more balanced for the year through the failure of the Way Forward ballot (see para. 5.5). Quality of Service has continued to improve with the First Class cumulative figure now reaching 90%. Continued improvement in both business and service performance is being vigorously pursued by both businesses.

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5. OTHER ISSUES

COMMERCIAL DEVELOPMENTS

5.1 National Lottery

The Lottery launch, following the announcement of our joint bid with Camelot on the 6th August, has been regarded favourably both within the press and with our employees and managers. As a consequence of joining, Camelot require a member of The Post Office Board to join their board. The Chairman and I have agreed that this should be Jerry Cope, with his 'alternative' being Dick Wheelhouse who heads up the Lottery project. This is in line with the other four company shareholders.

5.2 UK Passport Agency

Agreement has been reached on the charge for the emergency passport extensions. An invoice of £2m (excluding VAT) has been sent which covers the period of 7th July to 1st September. The passport emergency extension service has been extended by one month to the 2nd October at a proposed unit price of £5.

5.3 Distribution of freebeeb.com CD

The BBC are offering a free ISP service called freebeeb.com which will be available as a CD from post offices for the period 4th - 30th October. This first contract of its kind is worth only £0.1m but is one of several such ISP distribution contracts under discussion.

INTERNATIONAL STRATEGY

5.4 Acquisitions

British Post Office

In line with the strategy and authority agreed by the Board in May, we expect to finalise over the next week or so a deal to purchase the Williams Group, the General Parcel partner in Ireland. The price is around £9m including a delayed payment of nearly £2m, depending on results. We are also in preliminary discussions with An Post to whom we might sell on a share of the Williams Group, as part of a general alliance.

Competitors

Deutsche Post, through its subsidiary Danzas, finally won its battle with the Swedish Post Office, Posten, for control of ASG following a court ruling. Danzas now has 78.6% of issued ASG equity and 59.3% of all votes.

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FDX Global, sister company to Federal Express, has acquired the specialist Caribbean air freight forwarding business arm of GeoLogistics, GeoLogistics Air Services.

INTERNAL DEVELOPMENTS5.5 Way Forward Agreement

The ballot of CWU members which closed on 1st September resulted in the Way Forward Agreement not being accepted, with 55.5% voting 'No' in a high turnout of 64%. This was despite the unanimous endorsement by the CWU Executive. This will be discussed at the Board.

5.6 National Minimum Wage - Subpostmasters

A test case on the application of the National Minimum Wage was heard at an Employment Tribunal on the 27th August. Clarification has been requested by the tribunal Chairperson and a decision is expected in early October. The case depends on the definition of the word 'worker' and whether it applies to subpostmasters. Previously, the status of a subpostmaster, as an independent agent who has a commercial contract with POCL for the provision of services, has been thoroughly tested in case law.

5.7 Birmingham Mail Centre

The previous negative impact on Quality of Service caused by the new mail centre in Birmingham has now been remedied following implementation of a recovery plan. Birmingham Mail Centre is now clearing mails to workplan and mail diversions have ceased.

The new mail centre at Chester has been implemented with no operational problems.

5.8 Re-branding SSL

Following a branding review, Subscription Services Ltd or Customer Management Business Unit (under SCS) will be re-branded Post Office Customer Management Ltd.

5.9 Horizon - ICL Pathway

The Acceptance Board for Horizon met on the 18th August and concluded that while a great deal of progress had been demonstrated there were still a number of issues needing further work before it could pass the system acceptance test. As a result of this, the national roll-out programme could not commence. The resolution of the problems are being undertaken through facilitated workshops which commenced on the 25th August and will run to

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the 17th September. Contractually, the system must fully pass the acceptance test by 15th November at the latest.

As a consequence, it may not now be possible to write-off £550m at the half year if system acceptance occurs in November.

5.10 Group Managing Directors - Unit Accountability Changes

As there has been no success in finding an external candidate for the position of Group Managing Director, International Services, it has been decided that the position would be filled by Jerry Cope, alongside his Group Centre accountabilities, supported internally at Managing Director level. John Modd has been appointed. This has necessitated freeing Jerry of some other units leaving a new allocation as below:

Richard Dykes	Business & Consumer Markets Media Markets Post Office New Enterprises (Electronic Services) Service Delivery Cash & Distribution Post Office Services Group
Stuart Sweetman	Network Banking Post Office Customer Management Stamps & Collectibles Post Office Network
Kevin Williams	Corporate Clients Logistics & Contract Distribution Packages & Express Sales & Customer Support
Jerry Cope	International Services European Parcels

5.11 Post Office Strategic Plan Presentation to Government

The Post Office's Strategic Plan was presented to Government on Monday 6th September by the Chairman and Jerry Cope. Along with Alan Johnson MP and the DTI, representatives from the Treasury and No.10 Policy Unit were present. The presentation was well received and we have been promised a definitive response from Government in the next 6 weeks.

5.12 Universal Postal Union Congress - Beijing

I attended a week of this Congress which, under the auspices of the UN, meets every 5 years to bring together every postal nation in the world - some 128 countries. Around 2000 people attended.

Whilst the Congress itself has all the problems of a UN meeting, I had a wide range of bi-lateral meetings with my opposite numbers from amongst others

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USA, Japan, Argentina, Switzerland and Ireland. I will bring the Board up to date orally on some of the issues emerging.

6. CONCLUSION

The Board is invited to:

- note the September Report
- note the following businesses' full year pre-tax profit/(loss) forecasts:

	<u>Profit/(Loss) (before SCS costs)</u>		
	<u>Budget</u>	<u>June Forecast</u>	<u>July Forecast</u>
Royal Mail	£ 441m	£ 441m	£ 441m
Parcelforce Worldwide			
• without RM Special Delivery	(£ 14m)	(£ 14m)	(£ 14m)
• with RM Special Delivery	£ 16m	£ 16m	£ 16m
POCL	£ 22m	£ 22m	£ 22m
SSL	£ 0m	(£ 3m)	£ 0m
POSG	(£ 4m)	(£ 4m)	(£ 3m)
POPH	£ 33m	£ 33m	£ 33m
Group Centre	£ 64m	£ 67m	£ 59m
Group Profit Before Tax	£572m	£572m	£568m

- note the following comment on businesses' full year profit/(loss) forecasts:

Parcelforce Worldwide - Current indication would suggest an outturn of £6m profit is most likely (budgeted £16m).

It is suggested to wait at least 2 months (half year) before proposing a change in the report to the DTI thus reducing the possibility of a second reported change.

- agree that the following full year post-tax profit forecast can be released to the DTI:

Post Office Group Post-Tax Profit (1999/00) of £ 368m.

	<u>Full Year Outturn Profit</u>		
	<u>Budget</u>	<u>Last Forecast</u>	<u>Latest Forecast</u>
Post Office Group	£ 368m	£ 368m	£ 368m

AJR
September 1999