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POB(98)68

POST OFFICE BOARD
CHIEF EXECUTIVE'S REPORT: NOVEMBER 1998
(September Results)

KEY POINT SUMMARY

1. ROYAL MAIL

- 1.1** Profit in September was £51m. This was £35m above budget, but this includes the £30m profit from the sales of Quadrant and King Edward Building. Income was up £3m on budget due to Royal Mail National and International, whilst expenditure was down £2m on the planned level, despite continuing overspends on mail operations. The full year profit forecast of £496m, has been adjusted back to £478m following further analysis of the balance between risks and opportunities discussed at the September Board and detailed in the October Chief Executive's Report.
- 1.2** Total letter volumes increased by 4.8% over last September, against a budgeted increase of 4.2%. The increase achieved by Royal Mail National was a little disappointing but Royal Mail Streamline reversed recent trends to record a 7.9% increase and International traffic grew 14% against a budget of 7.4%.
- 1.3** September was a mixed month for quality of service. Both Second Class and Priority services achieved their full year target, but First Class performance of 91.6% was significantly down on the previous month. Mailsort performance reflected the focus that it is now receiving, with the 98.9% result for Mailsort 3 being 3.5% above last year's performance.

2. POST OFFICE COUNTERS LTD (POCL)

- 2.1** September's profit was £9.3m compared to a budgeted figure of £0.9m. Income was £0.4m ahead of budget, whilst expenditure was lower than anticipated in both core and development budgets. The full year profit forecast has been increased to £35m from £30m.
- 2.2** The quality of service figures for September showed that 94.9% of customers were served within 5 minutes. This improvement is now only 0.1% below the full year target.

3. PARCELFORCE WORLDWIDE

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- 3.1 Parcelforce Worldwide recorded a loss of £5.3m in September against a budgeted deficit of £4m. Poor International performance meant that income was £0.3m below budget, whilst expenditure was £1m above the planned figure. Current expenditure performance will be covered in Richard Close's presentation to the Board.
- 3.2 Volume was an encouraging 13.5% up on last year, with all major streams except International Standard recording increases in excess of budget. Next Day products grew by 39.4% against last year, driven largely by new customers such as Viking Direct, Pitney Bowes and Neat Ideas.
- 3.3 Only 2 of the 15 streams achieved their full year quality of service targets, although Next Day performance held up reasonably well given the large increases in volume. At the half year, cumulative target performance has been achieved in all 5 Express products, but Standard is 1% below the targeted level.

4. OTHER ISSUES

4.1 Pay

An agreement on pay in Parcelforce Worldwide has been passed unanimously by the CWU Executive. The agreement amounts to an increase of around 2.7% on total pay bill, with a headline increase of 3.005% on basic pay, allowances, overtime and shift premiums. The changes will take effect from 1 September 1998, but will first be agreed by a Special Conference in November which will recommend an individual ballot on the proposals. Residential delivery terms and conditions have also been agreed as part of the deal.

We have received negotiating authority from the DTI for a pay settlement in Royal Mail, of up to 3.5% on rates, within a limit of a 3.2% increase in the static pay bill. Discussions continue with the CWU, with the union appearing to accept our strategy of forging a link between the discussions on pay and productivity.

The CWU pay award for POCL staff was implemented on 1 October 1998, resulting in a 3% increase in the overall pay bill.

4.2 Project Sapphire

Parcelforce Worldwide have issued a non binding letter of intent to purchase Project Sapphire. DTI/Treasury have accepted the principle of

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an approval process which fits the timescale of the project, although they have signalled the difficulty of finding sufficient funds from within the PSBR in this financial year.

The competitive environment is changing rapidly, most notably with Deutsche Post's announcement last week that they have taken a 50% stake in the distribution business of Securicor for £223m. The joint venture will see Securicor carrying Deutsche Post's continental parcels to and from the UK and Ireland and will impact on around £300k of current Parcelforce Worldwide traffic this financial year.

4.3 Horizon

The month long discussions facilitated by Graham Corbett, between ICL, BA and ourselves, came to an end without an agreement being reached. Stephen Byers wrote to ICL expressing his disappointment that unlike BA and POCL, they had not shown a willingness to move their position during the discussions.

Following some subsequent conciliatory noises from ICL, we have been discussing the development of new structural processes/organisational arrangements between the commercial teams of ICL and POCL which would enable ICL to demonstrate additional commercial value in support of their revised business case.

I will update the Board orally on the progress made in these discussions.

4.4 Office of Fair Trading Enquiry

The Office of Fair Trading (OFT) has dismissed the complaint by Paypoint, that POCL had refused to allow potential competitors access to the Post Office network. This was rejected on the grounds that there are a variety of other available sites in both urban and rural areas which would provide alternative suppliers with sufficient access to their target markets. The OFT accepted POCL's explanation that the second element of Paypoint's complaint, namely that a particular Sub-postmaster had attempted to persuade a Common Landlord not to allow a bill payment terminal in a nearby third party premises, was not POCL's policy and that this had been made clear in a circular letter to all Sub-postmasters.

At the same time, the OFT have also dismissed a complaint made by Scottish MPs about POCL preventing Sub-postmasters from selling Scottish Power Cards as part of their non-Post Office business, after POCL had lost their contract with Scottish Power to sell these items. This was rejected on the grounds that no POCL / Sub-postmaster agreement is registerable under the terms of the Restrictive Trade

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Practices Act and that since alternative suppliers have now been sourced in most areas, the number of customers affected is not large enough to warrant an investigation under other competition legislation.

4.5 Pricing

I have agreed Parcelforce Worldwide's proposals to vary 1999 price increases by geographical zone in order to reflect market conditions and cost increases. The largest increases (up to 5%) will be in UK markets, in line with the strategy of achieving an above average price point, whilst a poor customer perception and uncertain economic conditions dictates lower increases in international markets.

Given the desired timing of this increase and the anticipated realignment of business boundaries, we are planning to approach the DTI on these proposals in conjunction with the Royal Mail pricing plans agreed by the September Board, once we have formal confirmation of the External Financing Limit for 1999.

4.6 Lloyds/TSB

Lloyds/TSB have decided to award their internal mail distribution contract to TNT. Parcelforce came second. Having warned the customer that the ITT encompassed some monopoly traffic (up to £5m p.a. of current First Class mail), we are now studying the impact of the new arrangements, although early indications suggest that the deal may have been structured in a way which avoids breaking the monopoly.

4.7 TNT

We have received Court authority to issue a Summons against TNT Mailfast over breaches of our monopoly stemming from the delivery of incoming international mail.

4.8 Television Licencing Contract

The Envision consortium of SSL, Bull and WPP, has been awarded the 7 year contract to collect television licences for the BBC. The new contract runs from 1 April 1999. Winning this contract in the face of intense competition from both EDS and Andersen Consulting is a tremendous achievement for the SSL-led bid team.

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4.9 Crown Office Conversions

Discussions continue with both CMA and CWU, although we are no nearer an agreement on the level of business to be transacted through the directly owned network. We have yet to receive a response from Ian McCartney to the letters from each party setting out our respective positions after the first month of talks.

5. CONCLUSION

The Board is invited to:

- note the November Report
- agree that the following profit/loss forecasts will be released to the DTI:

Royal Mail	£478m
Parcelforce Worldwide	£(12m)
POCL	£ 35m

AJR
NOVEMBER 1998

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