
Implications of the Horizon Agreement

Presentation to the PO Board

19 July 1999



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Purpose:

For the Board to:

- understand the impacts of signing the contract and the alternatives available,
- support and provide guidance to the proposed strategic responses and agree the next steps

Agenda:

1. the POCL context
2. impacts on existing strategies (POCL & Post Office)
3. proposed strategic responses
4. next steps



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Does compulsory ACT require legislation?

1. Context:

Scenarios:

1. Horizon with increasing drift to ACT (50% of current customers retained in year 10)
2. Horizon with heavy promotion by BA of ACT (15% of current customers retained in year 10)
3. Horizon with compulsory ACT from 2003 - 2005 (15% of customers left by 2005/06)
4. Terminate, alternative automation with compulsory ACT as per 3
5. Terminate, no automation, compulsory ACT (as per 3).

This is what the gov. could mean: they are taking on it.

ALL DEPENDS ON BANKS DOING IT!



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1. Context (continued):

POCL's new vision:

Mission: To be the UK's number one choice for the important business of everyday life.

Vision:

- Network Banking: access point for cash (in & out), replacing bank branches,
- Government Gateway: access point for government information and transactions,
- Cash & Distribution: wholesale cash distributor,
- Mails: provider of transactions and advice



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1. Context (continued):

The ICL deal:

• Functionality:

- EPOS, bill payment & bar coded order books for BA
- all other (e.g... Network Bank) at extra cost,
- roll-out complete by March 2001,

• Terms:

- contract finishes March 2005,
- £550 payment for asset,
- operating costs of the order of £80m - £100m p.a.,
- total payments c£1,000m, *in 5yrs more than what we are spending*
- funded by use £480m of "gilts" to fund payments,

• Termination options available:

- system fails acceptance: no cost
- for convenience: sliding scale down from c£600m



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1. Context (continued):

The BA position:

• BA proposals:

- no floor from now
- marginal price for OBCS
- additional obligations/risks put on POCL

• POCL proposal:

- floor to at 2005 (end of current contract)
- OBCS price based on share of total Horizon cost

- £265m NPV gap between positions
- gone to Minister to help unblock negotiation

• BA ACT intentions:

- compulsion or heavy promotion between 2003-05,
- down to the 15% "unbanked" by 2005
- bank contracts in place, systems ready

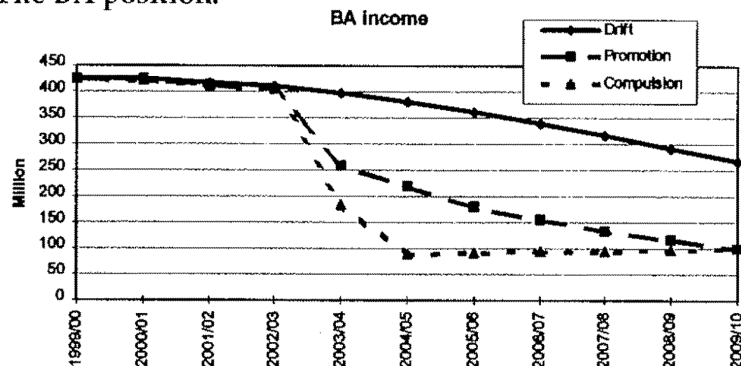


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1. Context (continued):

The BA position:



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1. Context (continued):

Possible Banks' reactions:

- banks would not welcome additional use of current accounts, but Natwest working with BA as a partner,
- these customers are expensive to service and present little added value,
- they are already introducing charges for use of an account (Abbey National will charge £1.50 for use of a non-Abbey ATM),
- However:
 - accepting ACT may be a response to "Financial Exclusion",
 - may be linked to a possible windfall tax on bank profits.

attach a loan sharks



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2. Impacts on existing strategies:

Network Bank

Impacts/issues:

- Banks more likely to want NB deals, (don't want these customers in their branches,
- Automation essential,
- any delay in automation will have a significant impact,
- a need to accelerate deals with banks (3 of big 4 by 2003/4),
- assumes 25% share of bank savings from branch closure,

This is a risky assumption. Not Bank has said yes, understand it but now close

Financials:

- contributes £260m NPV (& £420m terminal value) in Scenario 2,
- significantly worse under Scenarios 4 and 5.

16m accounts at stake



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PO Centers 85% of benefit holders have bank accounts

2. Impacts on existing strategies:

Network Bank (continued):

Threats:

- if Banks paid same as ATM price, year 10 income would fall by c£140m (no. of transactions & cost unaltered),
- earlier deals with banks could make ACT happen earlier,
- banks may be reluctant to be first if they get more benefit customers,
- customer propensity to use other channels (ATM),
- some partners will also be competitors.

Opportunities:

- providing a service to the unbanked,
- additional customers from anti-ACT campaign



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2. Impacts on existing strategies:

Government Gateway:

Impacts/issues:

- pace at which joined-up Govt. becomes a reality,
- price at which Govt. is prepared to pay for services,
- smartcard the key to delivery of services,
- competitors ahead in technology and card based services,
- high investment costs & need for alternative channels,

Financials:

- contributes £8m NPV (& £192m terminal value) in Scenario 2,
- worse under Scenarios 4 and 5.

*NZ does this
or half the POs
closed.*

look at Modernising Gov. white paper.



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2. Impacts on existing strategies:

Government Gateway (continued):

Threats:

- success of Network Bank in retaining customers,
- smartcards released by supermarkets and banks,
- alternative channels not owned by PO:

Gateway	% of business volumes by channel			
	Counter	Kiosk	Internet	Call centre
By year 5:	59	12	5	24
By year 10:	37	18	10	35

Opportunities:

- ACT drift makes POCL de-facto channel for C2DE,
- influencing Govt. through McCartney working group.



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*Get to show that the implications of
this are that up to 8000 POs might go!*

2. Impacts on existing strategies:

Cash & distribution:

Impacts/issues:

- in partnership with Girobank - profit and losses shared,
- benefit from Network Banking & supply to banks,
- pace of fall in cash requirements & being left with surplus cash,

Financials:

- contributes £90m NPV (& £45m terminal value) in Scenario 2.

Threats:

- cash consumption in the market falls significantly due to ACT,
- partnership profit falls and Girobank give notice.

Opportunities:

- build on cash sourcing banks as they take over benefit work.



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2. Impacts on existing strategies:

Other POCL business:

• Bill payment:

- 40% of benefit customers are POCL bill payers responsible for 70% of bill payment volume
- research suggests 41% of these customers will migrate to other methods,
- price sensitive market,
- Paypoint has 7,300 outlets, Camelot has 40,000.

34,000 outlets - technically capable of doing bills

• Other:

- impacts is expected to be marginal if the network is managed down and the brand image protected,
- maintaining product profitability a risk - risk of cross subsidy



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2. Impacts on existing strategies:

Network of post offices:

• **Key variables:**

- % loss of PO business to lead to unviable office (>20%),
- extent of customer migration to remaining network,
- loss of confidence in market for buying/selling offices,
- amount of compensation offered

26 wthrs salary offered now only by custom notice. (6 wthrs notice)

• **Network impact:**

Year 10:	Scenario:				
	1	2	3	4	5
Size:	16,600	12,900	10,700	9,100	0
Reach (within 1 mile):	94%	93%	91%	87%	0
Force Majeure:	2,000	3,700	5,400	7,000	n/a
Managed:	0	2,000	2,500	2,500	n/a



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2. Impacts on existing strategies:

Network of post offices (continued):

- without reduced levels of compensation, managed network closure is marginal,
- closure has additional adverse impact on revenue,
- will be difficult to prevent force majeure,
- any force majeure reactions need to be managed,
- Agents have c£1,300m invested in the network. This is damaged by the fall in business.



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2. Impacts on existing strategies:

Network of post offices (continued):

Responses:

- managed decline ensures better remaining reach, but could be expensive,
- agree lower compensation package,
- need to manage force majeure
- develop alternative PO channels,

- subsidy:
 - direct payment to Agents equivalent to AOP (or higher) to reduce force majeure,
 - separate "non-commercial" offices which then sells services to PONU at commercial rate & Govt subsidises the difference,
 - accessibility fee on charges to clients, and giving Govt., utilities etc. nation-wide accessibility obligations.

We are obliged to look at subsidies business plans & now add some evaluation of the impact of this.

like NZ might do 3000 for ourselves + say the other 15000 done by gov.



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2. Impacts on existing strategies:

Royal Mail:

Impacts/issues (Scenario 2):

- footfall & closure impact on revenue: }
 • cost of alternative channels: } c£60m p.a.
 • cost of advice service: }

- "share" of direct cost of Horizon:
 - peaks: c£54m
 - steady state: c£32m

- total costs:
 - peaks: c£100m
 - steady state: c£90m

- impacts worse in scenarios where:
 - higher closures,
 - RM has higher share of remaining volume.



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2. Impacts on existing strategies:

Royal Mail (continued):

Responses:

- Scope of size of response required (if achievable):
 - reducing investment plans by up to one third,
 - increasing productivity by 2-3% on top of existing 18%,
 - additional 2.5% new traffic (Plans already > GDPL).



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2. Impacts on existing strategies:

Royal Mail (continued):

- recovery as part of the USO:
 - additional cost of the monopoly,
 - "allowable" in price regulation,
 - 2p/2p price increase on stamps,
 - >4p/4p price increase to cover losses in POCL,
 - doesn't protect network,
 - raises issues of open v hidden subsidy.
 - reaction of regulator unknown
- with Horizon costs ringfenced, impact could still reach £60m p.a.



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2. Impacts on existing strategies:

Parcelforce Worldwide:

Impacts/issues (Scenario 2):

- footfall & closure impact on revenue: }
- cost of alternative channels: } c£20m p.a.
- cost of advice service: }

- "share" of direct cost of Horizon:
 - peaks: c£5m
 - steady state: c£2m

- total costs:
 - peaks: c£22m
 - steady state: c£22m

- impacts worse in scenarios where:
 - higher closures.



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2. Impacts on existing strategies:

Parcelforce Worldwide:

Responses:

- expand access options (supermarkets, garage etc.),
- switch SMEs to telephone ordering & collection,
- alternative channels may be cheaper,
- with Horizon costs ringfenced, impact could still reach £20m p.a



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Election Date will dictate the style of our warnings on ACT

2. Impacts on existing strategies:

Other Group impacts:

- lost interest on £480m of investments used to pay ICL (c£70m over four years,
- capital allowances (c£165m).



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2. Impacts on existing strategies:

Financial impacts:

Scenario	Impact on POCL				Impact on PO			
	5 yr NPV	10 yr NPV	Terminal Value	Total	5 yr NPV	10 yr NPV	Terminal Value	Total
Bus. Plan	43	226	614	840	n/a	n/a	n/a	n/a
1	-189	-161	211	50	-134	-115	189	74
2	-278	-487	-161	-648	-319	-672	-448	-1120
3	-443	-674	-207	-881	-483	-856	-493	-1349
4	-1011	-1310	-277	-1587	-1097	-1537	-564	-2101
5	-654	-1050	-755	-1805	-776	-1380	-1327	-2707

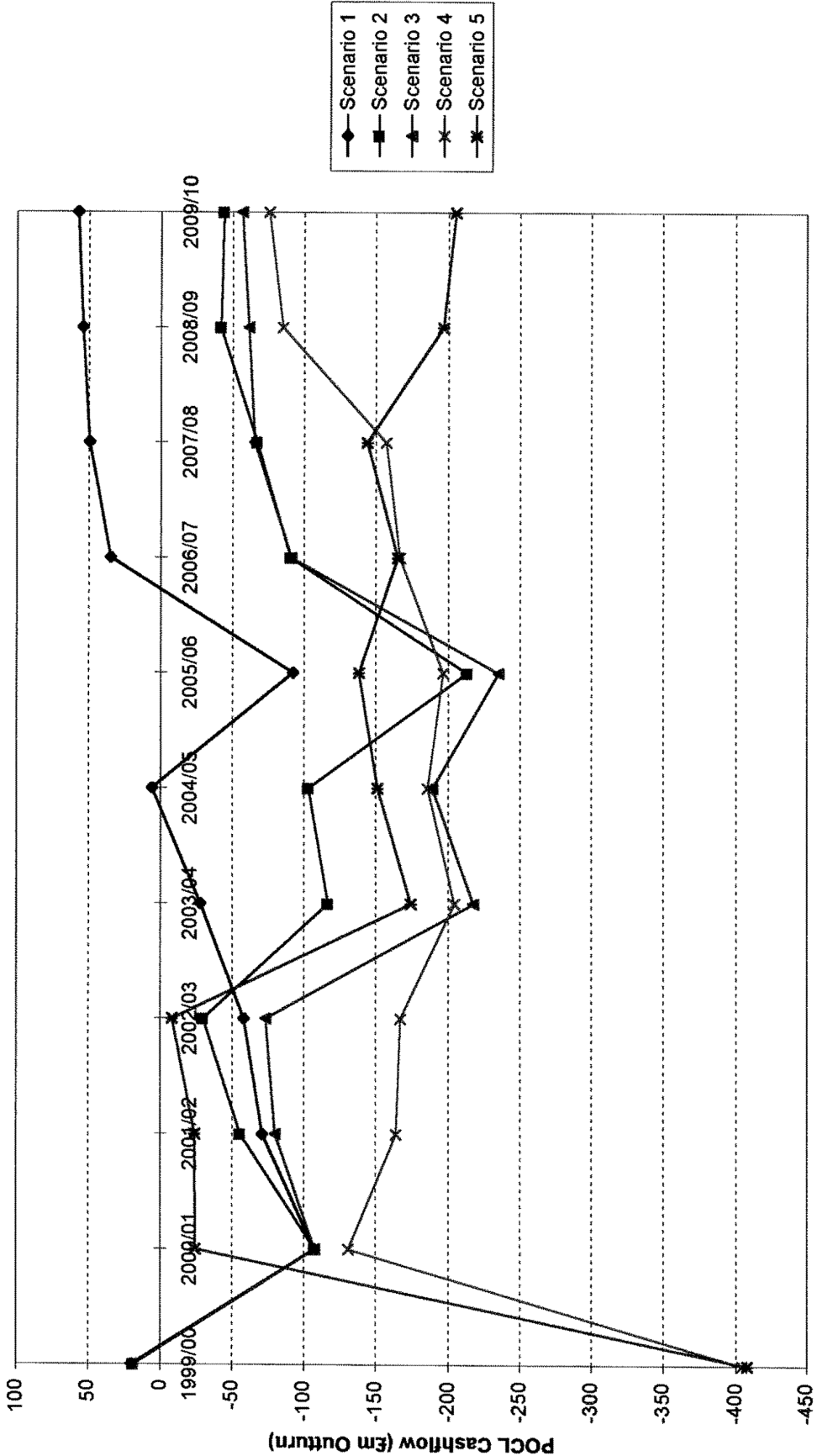
- from a POCL and PO point of view signing is least bad, but all options have a negative NPV



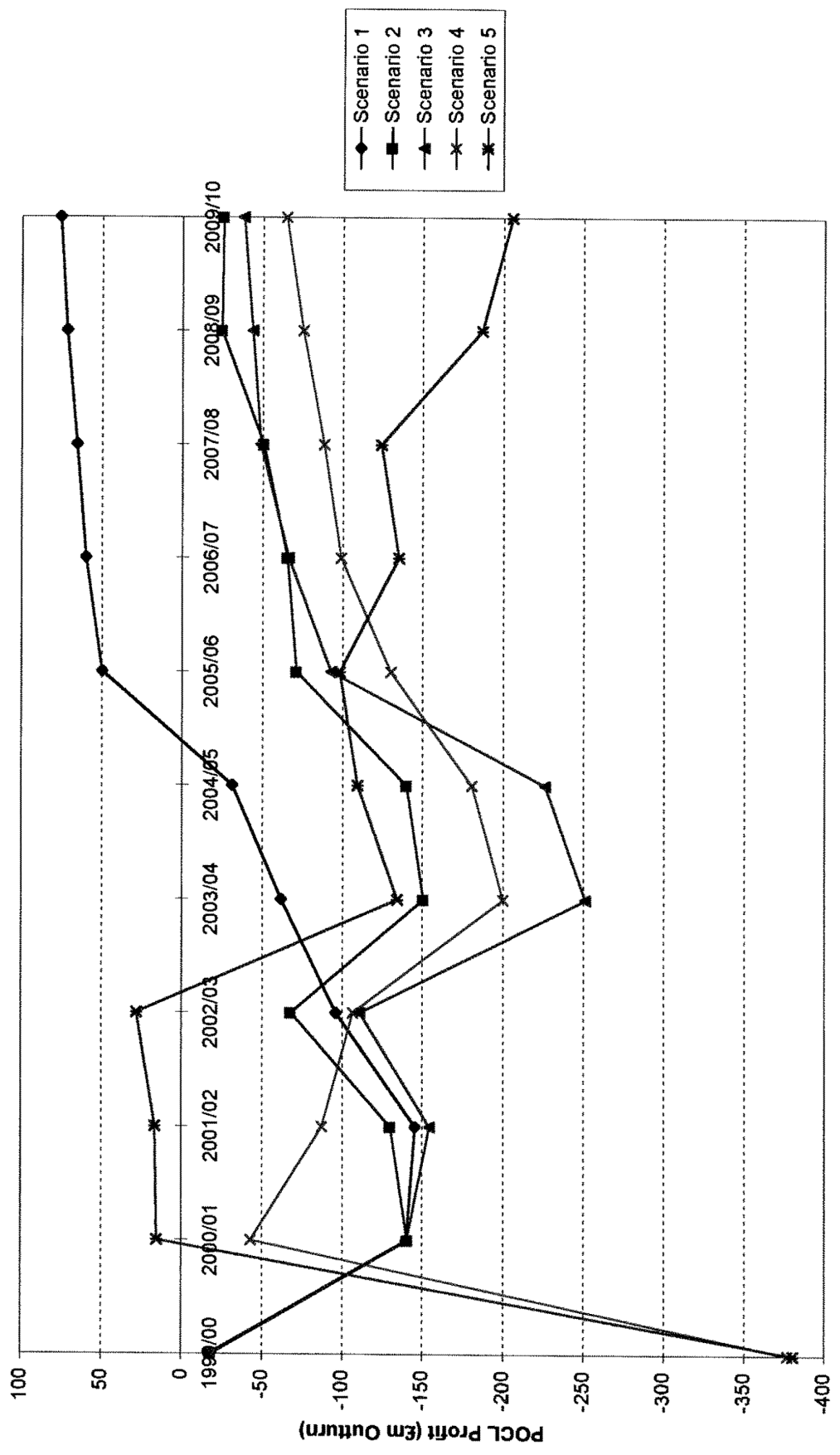
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Impact of Horizon on POCL Cashflow by Scenario



Impact of Horizon on POCL Profit by Scenario



* Take the biggest possible hit as soon as possible so that the losses are quickly associated with the government's decision, not ours.
* However, as it is the regulator, we ought to take it later in order to win softer regulation. BUT it's hard to run a business in loss!

2. Impacts on existing strategies:

Financial impacts: Summary:

- Horizon adds £90m of operating costs & £100m of depreciation without adding any new business,
- in all scenarios POCL will be making significant losses from c£18m in 1999-00, to well in excess of c£100m thereafter,
- Group benefits are only achieved in year 1 with the use of tax relief,
- adverse impacts begin to hit RM & PFWW from year two onwards,
- without subsidy or guarantee the network will decline and POCL will become bankrupt in all scenarios except ACT drift.



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3. Proposed strategic responses:

Key areas for discussion and guidance:

- ACT timing and pace,
- network size and channel cost,
- commercial responses,
- RM & PFWW,
- regulation and targetry,



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As the complete distributor company, this is bad for POCL, but we might accept the situation, & look at the opportunities for the rest of the business.

3. Proposed strategic responses (continued):

- ACT timing and pace:
 - delays to ACT improve overall position:
 - reduced force majeure,
 - less footfall loss.
 - Communications plan:
 - campaign to slow down ACT,
 - for Govt. to prevent further loss of PO's business,
 - possible need for additional funding.



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3. Proposed strategic responses (continued):

- network size:
 - with loss of benefits business current size untenable,
 - 3,000 - 7,000 force majeure closures possible,
 - review network requirements of the future and develop strategy for managing decline,
 - agree new compensation payments for closure,
 - reduce the cost of the network,
 - seek alternative channels to maintain nation-wide access,
 - identify commercial v social network.

NB: White paper unclear on the ultimate size of network

We might be looking at 10,500



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3. Proposed strategic responses (continued):

• commercial responses:

- push ahead with Network Bank and Cash & Distribution (but need investment),
- PO to review channel strategy across the business,

• RM & PFWW:

- review of channel strategies in conjunction with PO wide review,

• Regulation and targetry:

- examine the network subsidy options,
- ring fence rest of PO from direct impact of Horizon, — *BAF.*
- link nation-wide network to RM USO (?),
- costs an allowable cost of the monopoly (?),



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?

Technical criteria 25 pages - any 'severes' - 20 + 1 highly severe (training)

4. Next steps:

- agree signing of ICL contract,
- agree accounting, funding and tax strategy,
- input work, views and guidance into Post Office Management Model process,
- sponsor further work on:
 - stopping or delaying ACT,
 - reducing the ongoing cost of Horizon,
 - reviewing channel strategy (new channels, smaller network),
 - ring fencing Horizon costs,
 - Government subsidy of the network.

They will all be solved 18 August.



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*agree deal with BA
Veltor Co Bgars.*

- * Hamza - do we sign it
- * ACT up to 2003 (perhaps going outside internal PR people) Have a ... slightly outside system - use Bell etc to do the stuff a step away.
- * Really look at the office network. And how do we get it down to the right level. - Commercial ones, subsidised ones etc.

GOT TO GET FACTS ON THE STREET.

Nike is wary - does it work? what about the finances of ICL/Fujitsu.

- software in 3000 300 offices & another 5 1/2 000
- milestones properly supervised.

- 1) Don't let them off the VAT issue. (with Byers letter)
- 2) And what about the Melantney group getting it done!
- 3) Pol. status (An under-sec. of state & not a Trustee/State Policy unit. - New Rowlen. - Alan Johnson.

Training package reform:-
House - ICL on system help-desk.

What's wrong
is it self-fight tutoring.

ICL post-sign off
- they are repairing their help-line

System contract at 19,000 Post Offices.