



Shareholder
Executive

HM Government

Post Office Ltd ("POL") Summary

February 2012

RESTRICTED – POLICY & COMMERCIAL

RESTRICTED – POLICY & COMMERCIAL

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Key Objectives and Immediate Priorities

Commercial objectives

- Strengthen POL's Board, in particular through appointment of a new Chair and Non Executive Directors to give increased levels of oversight and challenge.
- Separation of Post Office Ltd and Royal Mail to ensure operational autonomy by 1 April.
- Roll-out of new models – 2,000 Post Office Locals and 4,000 Main Post Offices – over the SR Period.
- Eradicate the losses made by the 373 Crown Offices.
- Achieve significant growth in government services income, through providing the face-to-face services that will still be required to support a 'digital by default' approach to service delivery on behalf of Government.
- Maximise profitable revenues from other areas, especially financial services.

Policy objectives

Key elements of Government policy for the post office network are:

- To ensure no network closure programme and a minimum network of 11,500 branches
- To ensure the network access criteria are met
- To ensure key services are available across the network
- To reduce government subsidy for the network over the long term

Key elements of Government policy for Post Office Ltd are:

- To support delivery of POL's commercial strategy
- To develop options for mutualisation of POL

Immediate Priorities

- Agree strategy to ensure timely state aid approval
- Agree timings and engagement strategy around mutualisation response and next steps
- Agree response to Mark Hoban re Bank of Ireland renegotiation
- Meet POL senior management and key stakeholders
- Engage with OGDs to maintain momentum of POL's Front Office for Government ambitions.

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Executive summary

POL faces declining traditional revenues and highly competitive new markets, while its current branch models are unsustainable

These challenges must be faced as POL undertakes a complex separation from its parent

Successful outcomes may permit subsequent mutualisation of Post Office Ltd

Financial position

- Post Office network of 11,800 outlets depends on Government subsidy of c.£180m pa
- In addition, over the next SR period, the Government has committed £585m to transform the network model to remove fixed costs and improve the customer experience
- Revenue line consists of three core streams: mail c35%, financial services c30%, Government services c20%, – challenge is to grow all three whilst addressing the cost base

Market risks

- Cost levels impact capacity to win key new contracts, especially Government services
- Mail volume decline affects business over the Post Office network
- Low interest rates hit financial services

Focus on developing pipeline of new products

- Digital exception channel for HMG work (face-to-face services for those without computers)
- Identity verification role e.g. passports and licensing
- New financial services products

Developing the network

- New fully variable cost models
- Longer opening hours
- Smaller footprint in store

Separation from Royal Mail

- Need to negotiate contractual terms with RM over distribution of RM products and shared services
- Bolstered Board required to challenge and support executives in separation process and beyond
- Suitable governance arrangements need to be introduced as the companies separate
- Aspiration of a mutual Post Office Ltd once separation and the business transformation envisaged in the current business plan are complete

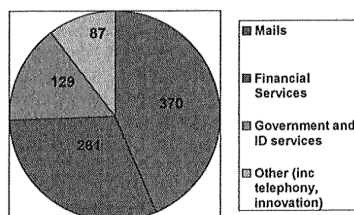
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Business overview

- POL provides mails services, financial services, government services and telephony services across a network of around 11,800 branches.
- There are currently 373 Crown Offices (large, mainly urban, centrally-run post offices) and around 11,500 sub post offices (privately owned by sub-postmasters and franchises). POL directly employs 8,500 staff. POL also runs a cash logistics business.
- POL has four main areas of income – mails, government services, financial services and telephony.

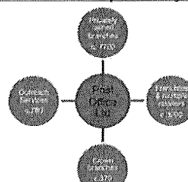
Breakdown of net revenue in 2011 (£m)

Total: £848m excluding network subsidy payment



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Network of branches operated by Post Office Ltd



Existing Ownership Structure



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Business overview

POL is a unique provider of mails, financial and government services across a nationwide network.

In return for the £1.34bn funding from Government for 2011-2015 announced in October 2010, the Government requires Post Office Ltd to ensure that there is a minimum of 11,500 post offices across the country

- POL has a national network larger than that of all the UK banks put together, with 93% of the total UK population (and 99% of those living in towns and cities) living within one mile of a post office.
- Post Offices provide a range of services to customers across the socio-economic spectrum, carry out a critical economic function for many small firms, and often play a significant social role in communities.
- Over 170 different services are available over Post Office counters and all but one is subject to at least a degree of competition.
- The network conforms to the strict access criteria (established in 2007 following a national consultation) which ensure reasonable access to Post Office services regardless of where people live.
- Dependence on access to post office services is particularly acute in rural areas where in return for the £1.34bn funding from Government for 2011-2015 announced in October 2010, the Government requires Post Office Ltd to ensure that there is a minimum of 11,500 post offices across the country re the post office branch is in many cases the only local retail outlet, but branches are also of real importance in deprived urban communities.
- Post Office Ltd is facing increasing competition, especially in the bill payments market, by competitors such as PayPoint. Post Office Ltd also has to compete openly for Government work.

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	Market breakdown
<p>POL operates in three core markets: mails services, government services and financial services.</p> <p>Shareholder Executive HM Government</p>	<p><u>Mails Services</u></p> <ul style="list-style-type: none"> POL is facing the challenge of declining mail volumes, and separation from Royal Mail. A new 10-year distribution agreement with Royal Mail has recently been finalised. POL's product mix in the market will change. As the volume of letters declines they will seek to grow the volume of packages they distribute. To improve the customer experience, POL aims to reduce queue times, extend opening hours, and improve the in-branch experience of customers, focussing on developing 'Post&Go' self service kiosks, solutions for small businesses, online mail support and pre-paid mails.
	<p><u>Government Services – "Front Office for Government"</u></p> <ul style="list-style-type: none"> POL plans to become the physical channel alternative to Government's own direct channels for those customers who cannot interact online and for those services which require a physical touch point, e.g. ID services. POL faces increasing competition from others in this market, and must openly compete to win Government services.
	<p><u>Financial Services</u></p> <ul style="list-style-type: none"> POL aims to deliver a proposition which reflects customer needs and preferred channel choices. For example, they are currently considering a pre-paid debit card and working with DWP on a transactional account providing access to universal credit. This is a highly competitive market in which POL has had some success due to public perception of it as a trusted brand. POL have been particularly successful in foreign exchange services where it is the market leader.
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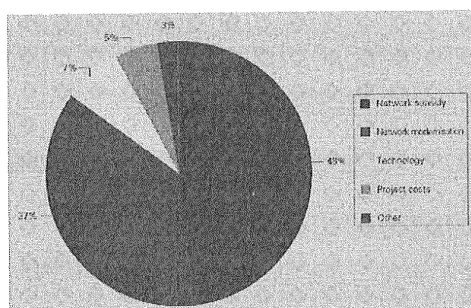
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	Network			
<p>Government subsidises POL (£180m in 2011/12) to maintain a network of at least 11,500 branches. A purely commercial Post Office network would number around 4,000 branches.</p> <p>POL is planning to write to MPs in the coming fortnight, and to launch a national awareness campaign towards the end of February.</p> <p>Shareholder Executive HM Government</p>	<ul style="list-style-type: none"> POL is introducing two new operating models – Locals and Mains - focused on operator flexibility and better customer service (longer opening hours, greater degree of automation, improved offices). They also rebalance cost from fixed to variable. Both models are being extensively piloted and have NFSP support. Consumer Focus has voiced concerns about Locals, but concedes that change is necessary and is working closely with POL during the pilot period to address concerns. 6,000 branches will move to new models by 2015 ("Network Transformation"). This will be a voluntary process. In Nov. 2011, POL and NFSP ran joint events to explain the models to SPMS, and POL has since conducted a survey of SPMS. The results are encouraging, suggesting there will be enough volunteers. POL will be holding further events for SPMS in the coming months. 			
	<table border="1"> <thead> <tr> <th>The Post Office Main operating model:</th><th>The Post Office Local operating model:</th></tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> Around 4,000 by 2015. Particularly suitable for larger post offices (over 800 transactions per week, mainly town centre branches). Up to £45,000 Government investment for those who convert. Longer opening hours via a 'Local' terminal on a retail counter. Fully variable pay, removes fixed pay Pilots in around 20 branches. Offers the full range of Post Office services </td><td> <ul style="list-style-type: none"> Around 2,000 by 2015. Particularly suitable for smaller post offices (up to 800 transactions per week: 1-2 counters). Cost effective solution for operator - integrated with front counter (i.e. retail counter in a convenience store) freeing space and staff. Fully variable pay, removes fixed pay. Pilots in around 150 branches. POL and Consumer Focus research shows model is well received by consumers. New research due in Feb. Longer opening hours, typically 6 hours longer per day. Up to £10k Government investment for those who convert. Offers 95% of services by transaction volume. </td></tr> </tbody> </table> <p>8</p>	The Post Office Main operating model:	The Post Office Local operating model:	<ul style="list-style-type: none"> Around 4,000 by 2015. Particularly suitable for larger post offices (over 800 transactions per week, mainly town centre branches). Up to £45,000 Government investment for those who convert. Longer opening hours via a 'Local' terminal on a retail counter. Fully variable pay, removes fixed pay Pilots in around 20 branches. Offers the full range of Post Office services
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Funding and State Aid

- BIS's overall CSR spending commitment to POL is £1.34bn. This is broken down as follows:

2011/12	2012/13	2013/14	2014/15
£180m	£410m	£415m	£330m



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- BIS also provides a £1.15bn working capital facility – effectively an overdraft facility – to POL to fund the cash in the network.
- Amounts drawn under this facility enable POL to have sufficient cash in its branches to meet demands for benefits payments or business and personal banking requirements with a high degree of certainty. Consequently "cash-outs" at post offices are extremely rare.
- Government funding for POL – both the subsidy and the loan – requires state aid approval. The 2011/12 funding has been approved and was paid on 1 April 2011. It is imperative we receive approval for the remaining funding before 1 April 2012.
- Discussions with the Commission have hit a late stumbling block around how the Commission applies new rules. Our case is the first to be analysed under them and so is a test case.
- We are submitting separate advice to you and the SoS on our strategy to escalate this issue to ensure a timely resolution.

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Separation from Royal Mail


Work is underway to move POL from its current position – as a subsidiary of RMG – to be come a sister company of RMG under a common, non-trading parent Royal Mail Holdings plc (RMH)

- The restructuring is proposed to coincide with the implementation of the pension solution on 1 April 2012, subject to state aid clearance.
- A new 10-year distribution agreement between Royal Mail and POL, suitable for completely separated businesses, has been agreed.
- On 1 April 2012, POL staff will become formal POL employees (having previously been secondees from Royal Mail) and new group governance arrangements will be put in place.
- We are developing proposals with the companies for the role and constitution of the RMH Board once RMG and POL have moved to sister companies under the RMH holding company at March 2012. Our intention is for RMG and POL to be devolved full operational autonomy, with minimal powers at the RMH level.
- We envisage that the businesses will remain in the same corporate and tax group, but operationally separate, until the earlier of an RMG transaction or a POL mutualisation.
- A new Chair and senior non-executive director have recently been appointed to POL's Board. The Board will be further strengthened by appointment of new NEDs.
- From 1 April 2012, we will ensure that we have direct Shareholder powers over POL (these are currently exercised at RMH level). These will include approval rights over Board appointments and remuneration.
- The company is also deploying a People Engagement plan aimed to ensure that the whole organisation (including agents) is aligned behind the entire strategic plan, including separation.

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Mutualisation	
<p>The PSA 2011 allows for POL to remain either in state ownership or to be transferred to a mutual.</p> <p>A public consultation, launched in Sept 2011 closed in December.</p> <p>Government has committed to publishing a response in the Spring, setting out the path towards mutualisation.</p> <p> Shareholder Executive HM Government</p>	<ul style="list-style-type: none"> A Government-commissioned report by Co-operatives UK on mutualisation options was published in May. It examined how best to transfer POL from Government ownership into a mutual run for the public benefit. We launched a public consultation, <i>Building a Mutual Post Office</i>, in September, to explore a suitable model for mutualisation. It asked questions about the purpose of the Post Office, the optimal membership and governance of a Post Office mutual, and whether mutual ownership would be respondents' preferred model. The consultation closed on 12 December 2011 and we have been analysing the forty responses elicited. In brief: <ul style="list-style-type: none"> Most were tentatively positive about the proposal. Over a quarter of respondents affirmed mutual ownership would be their preferred model. Only four expressed outright opposition (including the CWU and Unite). Consensus formed around a mixed membership model (comprising 'producers' e.g. staff and subpostmasters and 'consumers' e.g. customers) and with members represented through a representative body. Concerns recurred about commercial sustainability of the Post Office, the continued provision of branch services and access to them, and the need to successfully transform the network before ownership can be transferred. Post Office Ltd's private response highlighted access to finance, business leadership and cultural change as areas requiring particular consideration before a move to mutual ownership. Government has committed to publishing a response to the consultation in the spring, setting out the path towards mutualisation. We have made clear the transition will take a number of years and depend on the return to financial sustainability, but it is also important to keep up momentum. We will approach you shortly for a DECISION on the optimal timing of Government's response, next steps and milestones towards mutualisation. <p>11</p>

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Appendices	
<p><u>General</u></p> <ul style="list-style-type: none"> Major risks and opportunities POL team Shareholder Executive team Key stakeholders: Government Key stakeholders: External <p><u>Financial appendices</u></p> <ul style="list-style-type: none"> Performance vs Budget Profit & loss forecasts Net Revenue breakdown forecasts Cost breakdown forecasts Cashflow forecasts <p> Shareholder Executive HM Government</p>	

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Major risks and opportunities


RISK	MAGNITUDE (based on current revenue)	MITIGATION
State aid application for payments for 2012/15 and ongoing operation of working capital facility is unsuccessful.	£1.115m (SGElis and network subsidy) £1,150m (loan)	High level official engagement with senior officials at the European Commission. Ministerial engagement if required.
New Government services and innovation revenues fail to feed through sufficiently during the life of the next strategic plan (to 2014/15) leading to greater POL demand for Government subsidy.	£100m pa for IPS and DVLA	POL has recruited a specialist HMG services team. ShEx is working closely with OGDs to communicate post office policy and encourage strategic engagement with POL on a without-prejudice basis.
Introduction of new network models is perceived as involving closures or a reduction of service	Reputational – though delay leads to financial risk	POL plans further communications (to SPMS, MPs and publicly) in February – ShEx is engaging closely on this.
Strategy to bring 373 Crown Offices to break-even by 2015 is unsuccessful	Current losses are c£60m pa	Engaging closely with POL in the development of its strategy in this area, particularly around pay and new revenues.
OPPORTUNITY	MAGNITUDE (based on current revenue)	STEPS BEING TAKEN
Development of transactional account capable of supporting Universal Credit payments.	Current POCA revenues are c£100m pa	POL is working on this with Bank of Ireland and engaging closely with DWP.
Renegotiation of current financial services joint venture with Bank of Ireland.	Up to £38mpa by 2016/17	New package negotiated involving much better commercial terms but a 3 year extension (from 2020 to 2023). HMT has not objected though we need to respond to Mark Hoban's letter.


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Board and management of POL

The Board of POL is being strengthened to support separation from RMG.

- Current MD, since October 2010, is Paula Vennells (formerly Network Director since 2007).
- Executive team has been strengthened in last two years but with significant changes. A new Financial Director, Chris Day (former Group Financial Controller, BBC), new Financial Services Director, Nick Kennett (former MD, epay) and a new HR Director, Pauline Holroyd (former HR director, RAC) have recently started.
- Additionally, POL has a Commercial Director (Martin Moran, leading on new Government Services), a Network & Sales Director (Kevin Gilliland, leading on Network Transformation), a COO (Mike Young, leading on separation from RMG) and a Legal & Compliance Director (Susan Crichton, leading on state aid).
- Separation from Royal Mail requires an independent voice for POL within the Royal Mail group governance structure:
 - A new Chair of POL, Alice Perkins, has been appointed with a strong public sector background.
 - A new non-executive Director, Neil McCausland, has been appointed with a strong retail background that will complement the chair's public sector background.
 - We are in the process of recruiting further NEDs to POL and the appropriate Board committees (e.g. audit, risk and compliance, remuneration) are being established.
- Corporate governance
 - Chairman's proposals would assist in making POL combined code compliant on separation.
- Shareholder levers
 - We are in the process of agreeing new Articles of Association for POL for 1 April (i.e. when it becomes as sister company to Royal Mail). These will ensure the relationship with BIS is direct, rather than through RMH as it is now, giving us greater clarity around issues such as remuneration.
 - From 1 April, A ShEx representative (Susannah Storey) will sit on the POL Board.

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ShEx team works very closely with the Post Office.	ShEx team
	<ul style="list-style-type: none"> • 1 x Director – Susannah Storey provides overview as head of RMPS Team * • 1 x Executive Director – Will Gibson heads up the POL team, with oversight of all major policy issues • 3 x Assistant Directors - Mike Whitehead and Jane Hoy as well as one vacancy currently being advertised <ul style="list-style-type: none"> – Mike Whitehead leads on network issues, as well as stakeholder relations and correspondence – Jane Hoy leads on all issues connected with POL's Government and Financial Services strategy – New recruit will lead on all issues connected with mutualisation, state aid and POL's financial performance • 2 x further team members – Peter Batten and Katie Wake <ul style="list-style-type: none"> – Peter Batten leads on POL's relationship with Local Government and works on network and correspondence issues – Katie Wake leads on mutualisation and works on state aid and financial issues. • Besides pure shareholder issues, ShEx plays a supportive role for POL's directors, providing a voice within Government (a major customer) and guidance on political issues. • Good relationships with the business and the management team at all levels. • ShEx has been supported by advice from the following external advisers: <ul style="list-style-type: none"> – Freshfields – legal advice in relation to separation, funding arrangements and state aid – Deloitte – commercial due diligence of the business strategy and advice on tax and separation issues – UBS – advice on separation issues
<p> Shareholder Executive HM Government</p> <p>* Susannah is shortly going on maternity leave and Roger Lowe will replace her as head of RM and Post Office team in ShEx.</p>	
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Key Government stakeholders				
Stakeholder	Stakeholder interest	Assessment of relationship	Key current issues	Strategy to obtain support/ overcome barriers
HMT	<ul style="list-style-type: none"> • HMG shareholding • HMG lending to business • Accounting and budget impact of business performance • Long term risk of subsidy 	<ul style="list-style-type: none"> • Strong ShEx working relationship with key HMT team 	<ul style="list-style-type: none"> • Discussions ongoing re mutualisation and will need to work closely with HMT on progression of proposals 	<ul style="list-style-type: none"> • Maintained close dialogue and sharing of strategy
Cabinet Office	<ul style="list-style-type: none"> • POL procurement strategy and role in providing transactions to support online services. 	<ul style="list-style-type: none"> • Good working relations – merit in expanding and renewing post CO reorganisations. 	<ul style="list-style-type: none"> • POL's position in providing face-to-face transactions in light of digital delivery and OPS White paper. 	<ul style="list-style-type: none"> • Continue to identify and target key contacts, coordinating with POL where required.
DWP	<ul style="list-style-type: none"> • Contracts with POL for payment of benefits 	<ul style="list-style-type: none"> • Good working relations, although recent restructuring at official level 	<ul style="list-style-type: none"> • POL's role in delivering Universal Credit, the impact of UC on POCA. 	<ul style="list-style-type: none"> • Maintain close dialogue and coordinate with POL where required.
DTT (DVLA)	<ul style="list-style-type: none"> • Contracts with POL for provision of services 	<ul style="list-style-type: none"> • Strong working relationships 	<ul style="list-style-type: none"> • DVLA plans to procure a wider range of face-to-face services shortly – crucial to POL's GS strategy. 	<ul style="list-style-type: none"> • Maintain close dialogue and appropriate procedures during procurement process.
Home Office (IPS, UKBA)	<ul style="list-style-type: none"> • Contracts with POL for provision of 'check and send' passport applications 	<ul style="list-style-type: none"> • Some relationships in place – could be strengthened 	<ul style="list-style-type: none"> • UKBA procurement outstanding. • Direction on data collection for online passports unclear - key projected revenues for POL. 	<ul style="list-style-type: none"> • Attempt to expand contacts with key senior officials, coordinating with POL where required.
<p> Shareholder Executive HM Government</p>				
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Key External stakeholders

Stakeholder	Stakeholder interest	Assessment of relationship	Key current issues	Strategy to obtain support/ overcome barriers
NFSP	<ul style="list-style-type: none"> Network Transformation Front Office for Government Mutualisation SubPostmaster pay 	<ul style="list-style-type: none"> Close and constructive. NFSP supported the Postal Services Act, and have voiced support for Network Transformation and mutualisation. 	<ul style="list-style-type: none"> Ensuring new Gov't services contracts are won. Seeking representation on the POL Board. 	<ul style="list-style-type: none"> Maintain dialogue at official and Ministerial level to ensure continued support. Encourage growing engagement with POL in advance of mutualisation.
CWU/Unite	<ul style="list-style-type: none"> Mutualisation Network Transformation Front Office for Government 	<ul style="list-style-type: none"> Constructive dialogue about mutualisation despite unions' scepticism given POL's current financial insolvency. 	<ul style="list-style-type: none"> Concerns about separation from RMG and network transformation – view that Locals offer decreased service. 	<ul style="list-style-type: none"> Continue to engage and involve as the Mutualisation agenda progresses. Careful comms around Network Transformation.
Consumer Focus	<ul style="list-style-type: none"> Network Transformation Front Office for Government 	<ul style="list-style-type: none"> Improving following a slew of negative (and skewed) media pieces about the Local model. 	<ul style="list-style-type: none"> Consumer Focus are compiling fresh research about the Local model, due for publication in March, and new research about Front Office for April. Concern about the suitability of the existing Code of Practice for NT. 	<ul style="list-style-type: none"> Rapprochement with officials to continue, with a research briefing meeting scheduled for Feb. Encourage POL to engage to explain the Local model, and to work on a MoU re the Code of Practice.
Competitors	<ul style="list-style-type: none"> State Aid Front Office for Government 	<ul style="list-style-type: none"> Healthy engagement. 	<ul style="list-style-type: none"> PayPoint are sceptical of SGEI rationale for bill payments. 	<ul style="list-style-type: none"> Maintain dialogue at official level and keep PayPoint's presence as a bill payment provider, relative to POL, under review.
European Commission	<ul style="list-style-type: none"> State Aid 	<ul style="list-style-type: none"> Good and open. 	<ul style="list-style-type: none"> Securing Commission approval for funding 2012-2015. 	<ul style="list-style-type: none"> Ensure swift responses to remaining Cion queries.

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Operating performance: budget

Year ended	2009A		2010A		2011A		2012F
	Budget	Actual	Budget	Actual	Budget	Actual	Forecast
Commercial							
EBIT pre exceptionals (£m)	32.0	41.3	62.3	72.6	30.0	35.6	36.3
Net income (£m)	1135.8	1140.3	1082.4	1051.8	1021.0	997.8	1025.3
Agents pay to income ratio (%)	88.1	88.6	85.0	87.4	95.0	93.6	95.5
Crown staff cost to income ratio (%)	132.2	193.7	125.0	142.2	132.0	135.5	123.0
Crown losses	63.8	74.3	52.6	58.2	39.2	50.7	51.4
Policy – Access Criteria							
National 1 mile (%)	90	93.3	90	93.2	90	93.1	90
National 3 mile (%)	99	99.7	99	99.7	99	99.7	99
Urban deprived 1 mile (%)	99	99.8	99	99.8	99	99.8	99
Urban 1 mile (%)	95	99.1	95	99.1	95	99.1	95
Rural 3 miles (%)	95	99.2	95	99.2	95	99.2	95
Post Code District (number not meeting criteria)	0	6	0	0	0	0	0

- POL consistently exceeds the Access Criteria which have been in place since 2007.
- Crown Staff Costs are predicted to continue to decrease this year, whilst agents pay to income ratio will increase.
- POL has consistently outperformed its EBIT target, driven by cost savings rather than revenue upside.

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Operating performance: P&L

Year ended	2010A	2011A	2012B	2013F	2014F	2015F	2016F	2017F	CAGR 2010-17
Net Revenue exc NSP (£m)	902	848	872	899	923	966	1,025	1,084	+2.7%
growth (%)		-6.0%	2.9%	3.1%	2.7%	4.7%	6.1%	5.8%	
NSP (£m)	150	150	180	210	200	160	130	80	-8.6%
Net Revenue inc NSP (£m)	1,052	998	1,052	1,109	1,123	1,126	1,155	1,164	+1.6%
growth (%)		-5.1%	5.4%	5.4%	1.3%	0.3%	2.6%	0.8%	
Operating profit (£m)	73	36	30	84	102	99	130	137	+9.5%
Operating margin (%)	6.9%	3.6%	2.9%	7.6%	9.1%	8.8%	11.3%	11.8%	

- Net Revenue here is what POL defines as Net Income (gross income after cost of sales).
- Key growth expected in Government services revenues expected to begin in 2012/13 and increase thereafter, as POL expected to fulfil its ambition to act as the Front Office of Government (see next slide).
- Expectation of continuing increase in innovation revenues post 2012 as POL seeks to develop new products to counter the decline in traditional services. These innovation forecasts are aspirational (such as benefits payments).
- Mails revenue predicted to remain fairly steady after 2012, as letters revenues drop and revenue from parcels increases.
- Anticipated growth in financial services revenue in light of development of new products in this area (e.g. Children's ISA, Internet Saver), and income from new contract with RBS.

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Operating performance: net revenue breakdown

Year ended £m	2010A	2011A	2012B	2013F	2014F	2015F	2016F	2017F	CAGR 2010-17
Mails									
Revenue	370	370	331	337	336	338	340	346	-0.9%
growth (%)		0.1%	-10.6%	1.8%	-0.3%	0.6%	0.6%	1.8%	
Financial Services									
Revenue	272	281	305	303	301	292	294	290	+0.9%
growth (%)		-3.7%	16.7%	-0.7%	-0.7%	-3.0%	0.7%	-1.4%	
Government & ID Services									
Revenue	167	129	138	143	157	197	240	284	+7.9%
growth (%)		-22.8%	7.2%	3.6%	9.8%	25.5%	21.8%	18.3%	
Other (inc telephony & innovation)									
Revenue	94	87	99	117	128	139	151	164	+8.3%
growth (%)		-8.8%	13.4%	18.2%	9.4%	8.6%	8.6%	8.6%	
Total net revenue (exc NSP)	902	848	872	899	923	966	1,025	1,084	+2.7%
growth (%)		-6.0%	3.0%	3.1%	2.4%	4.6%	6.1%	5.8%	

- **Mails:** Contract negotiation with Royal Mail and POL's ability to harness growth in parcels are main drivers of static growth forecast.
- **Financial services:** The company is coming under greater pressure in the bill payments market with competitors such as PayPoint. Forecast increase in 2012 reflects renegotiation of Bank of Ireland contract and macro-economic assumptions.
- **Government and ID services:** POL's network of AEI kits makes them a good competitor to win key government services contracts, particularly in identity verification. However this revenue is volatile as it is largely dependent on POL winning key contracts with UKBA, IPS and DVLA.
- **Other (inc. telephony & innovation):** Projected new revenues are largely unidentified and more work needs to be done here.

RESTRICTED – POLICY & COMMERCIAL

Operating performance: cost analysis

Year ended	2010A	2011A	2012F	2013F	2014F	2015F	2016F	2017F	CAGR 2010-17
Net Revenue inc NSP (£m)	1,052	998	1,052	1,109	1,123	1,126	1,155	1,164	1.6%
Agency pay (£m)	(480)	(475)	(479)	(493)	(525)	(580)	(564)	(577)	2.7%
(% of revenue)	45.7%	47.6%	45.4%	44.5%	46.7%	49.7%	48.6%	49.6%	
Fixed agency pay (£m)	(148)	(149)	(154)	(139)	(120)	(90)	(52)	(10.2)	-31.8%
(% of revenue)	14.1%	14.9%	14.6%	12.5%	10.7%	8.0%	4.5%	0.8%	
Variable agency pay (£m)	(333)	(326)	(325)	(354)	(406)	(471)	(513)	(566)	7.9%
(% of revenue)	31.7%	32.7%	30.9%	31.9%	36.1%	41.8%	44.4%	48.6%	
Staff costs (£m)	(286)	(253)	(252)	(224)	(194)	(169)	(161)	(154)	-7.5%
(% of revenue)	25.2%	25.3%	24.0%	20.2%	17.3%	15.0%	13.9%	13.2%	
Central & supporting (£m)	(234)	(245)	(291)	(303)	(289)	(276)	(267)	(254)	1.2%
(% of revenue)	22.2%	24.5%	27.7%	27.3%	25.7%	24.5%	23.1%	21.8%	
Other costs (£m)	1	10	0	(6)	(12)	(22)	(32)	(42)	-283.5%
(% of revenue)	(0.1%)	(1.0%)	0.0%	0.5%	1.2%	2.0%	2.9%	3.6%	
Operating profit (£m)	73	36	30	84	102	99	130	137	9.5%

Key Cost Reduction Drivers include:

- Delivering the changes to Crown Offices will reduce staff costs by ~£60m per annum.
- Reducing the cost of central and supporting staff through ongoing organisational development and management and through the introduction of more Single Person Vehicles in supply chain will reduce staff costs by ~£20m.
- Delivering the new agents contracts will remove fixed pay by ~£110m (while agents retain much of their income as variable pay, critically, it is then dependent on revenue levels).

RESTRICTED – POLICY & COMMERCIAL

Operating performance: cash flow

Year ended £m	2010A	2011A	2012B	2013B	2014B	2015B	2016B	2017B	CAGR 2010-17
Operating profit	73	36	30	84	102	99	130	137	9.5%
Movement in working capital	(33)	21	(12)	(107)	54	13	4	10	
Capital expenditure	(88)	(37)	(30)	(114)	(126)	(125)	(53)	(50)	
Reserves, provisions & exceptionals	(51)	(17)	(33)	(201)	(181)	(137)	(85)	(75)	
Other cash movements	(58)	(5)	25	0	0	0	0	0	
Operating cash flow	(165)	(2)	(28)	(338)	(152)	(151)	(5)	23	-176.1%
Colleague shares/incentives	(7)	(7)	(3)	(13)	(13)	(13)	(13)	(13)	
Undistributed JV profit & pension creditor etc	(28)	0	(17)	8	(21)	(19)	(17)	(14)	
FCF before interest and tax	(188)	(9)	(40)	(343)	(188)	(183)	(34)	(4)	-42.3%
Interest	15	(7)	(11)	(12)	(15)	(16)	(17)	(18)	
Tax	0	0	13	0	0	0	0	0	
Free cash flow	(173)	(16)	(37)	(355)	(201)	(199)	(51)	(22)	-25.5%
Other Government funding	0	0	0	200	215	170	80	80	
FCF after funding	(173)	(16)	(37)	(155)	14	(29)	29	58	-186.6%

- Reserves, provisions & exceptionals increase substantially to £201m in 2013 due to compensation for agents leaving the business or remaining on acceptance of revised (variable) contract terms.
- Undistributed JV profit and pension creditor cash flow is forecast as positive in 2013 only thanks to a special dividend from FRES, its foreign currency exchange services.
- Expected tax entry of £13m in 2012 due to sale of tax losses.
- Funding for modernisation of the network begins in 2012/13 resulting in increase in capital expenditure.
- Risks for cash-flow include the State Aid notification process for the network subsidy.

