**RMH(10)1ST**
**RMH10/01 - 20**

**ROYAL MAIL HOLDINGS plc**
(Company no. 4074919)
**Minutes of the meeting of the Board of Directors held at 100 Victoria Embankment, London, on 27 January 2010**

**Present:**

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| Donald Brydon | Chairman |
| Andrew Carr-Locke | Non-Executive Director |
| Alan Cook | Managing Director, Post Office Ltd |
| Adam Crozier | Group Chief Executive |
| Lord Currie | Non-Executive Director |
| Ian Duncan | Group Finance Director |
| Richard Handover | Non-Executive Director |
| Mark Higson | Managing Director, Royal Mail Letters |
| Paul Murray | Non-Executive Director |
| Les Owen | Non-Executive Director |
| Baroness Prosser | Non-Executive Director |

**In attendance:**

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| Jonathan Evans | Company Secretary |

**Also present:**

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| Rico Back | Chief Executive, GLS |
| Jon Millidge | Acting Group HR Director, for RMH10/11 |
| Mike Devanny | Head of Fleet and Maintenance Services, Royal Mail Letters, for RMH10/12 |
| Robin Dargue | Chief Information Officer, for RMH10/14 |
| Tony Marsh | Acting Group Security Director, for RMH10/15 |

**RMH10/01 LES OWEN**

(a) The Chairman welcomed Les Owen to his first meeting of the Board, having been appointed Non-Executive Director of the Company with effect from 27 January 2010.

**RMH10/02 MINUTES OF PREVIOUS MEETING – RMH(09)12TH**

(a) The Board approved the minutes of the meeting held on 8 December 2009.

**RMH10/03 MATTERS ARISING – RMH(10)01**

(a) The Board noted the status report;

(b) iRed (RMH09/178(c)): several non-executive directors had met Ray Huntzinger, the MD of iRed, to discuss progress and future strategy. The general view of the non-executive directors was that the meetings had been useful in increasing their understanding of the iRed business proposition. The challenge for the business unit was quickly to secure more external customer contracts – a point which had been underlined to Ray Huntzinger as the key issue for the Board.

(d) the Committee had agreed that Jon Millidge would replace Jonathan Evans as Company Secretary on the latter's retirement in June 2010. In the short term Jon Millidge would combine the role with that of acting Group Human Resources Director until a permanent appointment to the HR role was made. Jonathan Evans had agreed to continue as pension fund trustee and in other miscellaneous part-time roles where his experience could be valuable. The Board endorsed these changes which the Committee had agreed on its behalf;

(e) Remuneration Committee: Richard Handover reported that he was in increasingly difficult dialogue with the Shareholder Executive about the 2009/10 annual performance bonus plan for the executive directors. The Committee was beginning to turn its attention to the design of the long-term incentive arrangements to apply from 2010/11, and had engaged Deloittes to help with their considerations.

**RMH10/07** **CHIEF EXECUTIVE'S REPORT**

(a) Innovation: Adam Crozier reported that progress was continuing to be made with Innovation projects following the Board's endorsement in November 2009. He would bring a follow-up report to the March board, and this would include options for the best means of ensuring that projects were implemented, including the possible use of a special purpose vehicle;

(b) Pensions: the CWU had issued a document *Time to Deliver* which set out their proposals for addressing the problems facing the Company from the high level of deficit in the pension fund. The document was well-written albeit with challengeable assumptions, and was based predominantly on moral arguments for Government support. The timing of the its publication was thought to be connected with the current status of the wider negotiations with the Company about Letters transformation, together with the need, for CWU's own internal reasons, to be seen to be pursuing a pensions solution with Government;

(c) Project Q: Adam Crozier reported that Postcomm were about to issue a startement saying that they "were minded" to conclude that a licence breach had occurred. Discussions would take place with the Chairman and David Currie about how best to progress this issue with Postcomm.

**RMH10/08** **HEALTH AND SAFETY REPORT – RMH(10)02**

**ACTION**
**Adam Crozier**

(a) The Board noted the report. The Board asked that future reports showed more performance trends, that the low reported level of compliance in crown offices in Post Office Ltd be verified, and that further consideration be given to using more common measures across the Group. It was agreed that in respect of GLS, safety reports would be made to the GLS Audit Committee in the first instance.

**RMH10/09** **FINANCE DIRECTOR'S REPORT – RMH(10)03, AND EXECUTIVE DIRECTORS' MONTHLY REPORTS**

(a) Finance report: the Board noted Ian Duncan's report for period 9. This showed that operating profit before exceptional items in the period was £74million, some £16million favourable to budget. The cumulative position at the end of period 9 was an operating profit before exceptional items of £279million, which was £7million and £24million favourable to budget and prior year respectively. Profit before tax was cumulatively £82million higher than budget driven by £49million lower exceptional costs and £26million lower interest payable. The exceptional items variance was driven by ColleagueShares – the budget assumed maximum payout, while the actuals reflected a lower valuation, partly offset by higher redundancy costs than budgeted in the Letters business;

(b) period 9 itself had been a good month, with the Letters business packet performance better than the previous two months, although volumes had still declined by 2% compared with the prior year. Overall Letters revenues were £107million behind the year-to-date budget;

(c) the Chairman commented on the Engagement Index and the wealth of information that lay behind it derived from the *Have Your Say* process. The Board agreed that it would welcome an in-depth presentation on *Have Your Say* at a future Board meeting;

**ACTION**
**Adam Crozier**

(d) turning to the full-year forecast as at the end of quarter 3, Ian Duncan said that all units were forecasting to achieve or exceed their budgeted operating profit, leading to a Group forecast of £375million, £68million favourable to budget. The Letters business was forecasting to be some £160million below budgeted revenue, but the profit forecast was nevertheless to achieve budget. Indeed the intention of the Letters business was to exceed its operating profit budget by the benefit of an accounting change for surplus staff costs, estimated at £24million;

(e) additional Group outperformance was driven by the release of £33million in respect of the pension charge improvement held centrally and £10million exchange rate benefit in GLS. PBIT was expected to be £181million favourable to budget, reflecting improvement in operating profit and lower ColleagueShare charges for the year, partly offset by additional RML redundancy costs;

(f) Group cash was forecast to improve by £193million from the budget position, largely due to reduced capital expenditure, continued focus on working capital and the flow-through impact of profit, partly offset by higher redundancy costs;

(g) risks to profit performance for the year remained, and included further industrial action, further revenue decline, and potential fines related to the industrial action in 2009. However there were also further potential opportunities, and it was possible that operating profit before exceptional items could reach £400million;

(h) the Board commended management for this improvement in forecast performance, although there were some concerns that the level of profit compared with the previous year and compared with the lower forecast previously given to the Board could give rise to presentational problems amongst some observers;

(i) Business plan refresh update: Ian Duncan updated the Board on the further progress made with refreshing the Group business plan. The key points were:

- overall, despite losing some £3billion of revenue compared with the projections in the Investment Case, the refreshed plan was currently showing the capacity to maintain financial headroom during the plan period;
- whilst the Q3 forecast had downgraded Letters revenue by a further £70million, the refreshed plan would not be amended until March to take account of the likely full-year outturn;
- December inflation and the prospect of future inflationary pressure meant that the plan assumptions, particularly for pay, may be light. Illustrative modelling had been carried out to determine the impact of raising the pay assumption for Letters in 2010/11 from 1.2% to 2.0% and accelerating incentive payments linked to modernisation. Notwithstanding the need to reassess inflation, the final refreshed plan would incorporate any agreement reached with the CWU;
- the pension charge for the following year could be in the order of 20% compared with 17% in the plan. This would degrade profit by some £100million. However there would be no cash impact;

(j) cash headroom had been shown to be tight in the December 2009 refresh despite potential measures to generate cash headroom, including the sale of the investment in Camelot (£70m), and the sale and leaseback on properties (£130m) and further leasing on machines (£100m). The latest estimate at January 2010 showed that the cumulative cash position by September 2011 was some £100million worse than at the December 2009 refresh, with RM Letters bringing forward incentive payments and revising the RPI-based pay deal upwards. Cash risks would continue to be monitored closely as the emerging revenue picture in the Letters business became clearer and as agreement was reached with the CWU. It was intended to begin discussions with the shareholder over covenant waivers and approval for the financing transactions assumed in the plan refresh. In addition, in order to place a further control on cash, a capital rationing process was being implemented by Group Investment Appraisal;

(k) a further update would be provided to the Board in March. It was proposed to share the December 2009 draft business plan refresh with the Pension Plan trustees to allow their advisors PwC to start to form a view on the strength of the employer covenant. It would also be shared with Ernst and Young to allow them to commence their work on assessing the Company's going concern position;

(l) the Board noted the update on the refresh work, and requested that

**ACTION**
**Ian Duncan**

Ian Duncan provide a short briefing note to explain the £3billion revenue shortfall compared with the Investment Case assumption;

(m) Royal Mail Letters: Mark Higson reported that the bad weather experienced in January had had a marked adverse effect on the number of accidents and on quality of service performance;

(n) work was continuing on the London Project – a rationalisation of operational buildings in London – and a revised proposal with an improved cash-flow would be brought to the Board in due course;

(o) Mark Higson and Ian Duncan thanked the Board for giving its approval in correspondence in December to the acquisition, sale and leaseback of a property in Hemel Hempstead. The deal had been completed in all material respects in line with the Board's remit,

**ACTION**
**Adam Crozier**

(p) the Board went on to discuss the progress with Letters Transformation, and agreed that it would be useful to have prepared a summary of the changes introduced over the previous few years, to demonstrate the scale of change that had been achieved;

(q) Parcelforce Worldwide: Adam Crozier reported that the recent sale of DHL's parcels business represented an opportunity for Parcelforce to acquire new customers – an opportunity that was being pursued vigorously;

(r) GLS: Rico Back reported that trading was continuing to be affected by the recession and, more recently, by the very bad weather on the continent which had impacted markedly on customer behaviour. Nevertheless the full-year forecast remained to achieve the budget target. Setting the budget for the following year was proving a tough challenge as revenue continued to be under great pressure. The big issues to consider would therefore be GLS's pricing strategy, and its progress with turning round the operation in France;

(s) POL: Alan Cook updated the Board on discussions with Government about the future funding of POL. The aim remained to gain Government approval to at least a roll-forward of £150million of Social Network Payment funding in 2011, and to secure this before General Election purdah began. While officials and Ministers in BIS were thought to be supportive of this approach, the Treasury position was currently not in agreement. Intense discussions on this were continuing, and the Board recognised that the absence of a commitment to this minimum level of funding would create a difficulty for going concern considerations at the year-end;

(t) the new version of the Horizon software was currently going live across the POL network. This was a major logistical challenge for POL;

(u) the Board noted the post-investment review on the Network Change Programme. This showed that the programme had succeeded in its key objectives of making up to 2,500 compensated branch closures

(2,432 achieved) and opening 500 outreach services (507 achieved). All the Government access criteria had been met, and 99.4% of customers had either seen no change or were within a mile of an alternative branch following the Network Change Programme. It had delivered the target annual profit improvement of £45million at a cost £17million under budget (delivered £159m: budget £176m), which meant that all the economic targets had been exceeded;

**ACTION Alan Cook**

(v) Alan Cook undertook to provide the Board with information on the size of debt recovered following attacks and burglaries at branches, and when these sums were provided for in the accounts;

**ACTION Alan Cook**

(x) Alan Cook also undertook to provide a briefing note for the Board on the impact on the Group of the UK Payments Council's recent announcement that it was aiming to abolish the use of cheques by 2018.

**RMH10/10** **LEASING OF MAIL AUTOMATION EQUIPMENT - RMH(10)04**

(a) The Board noted Ian Duncan's paper which sought approval to Royal Mail Group Limited signing master lease agreements with Barclays and Royal Bank of Scotland (Lombard) for the leasing of up to £63million of mails automation equipment to be delivered over the following two years. Given current cash forecasts over the coming few years, this would enable relief of some headroom pressure against Government funding facilities at a lower cost than Government borrowing;

**ACTION Ian Duncan**

(b) in considering the proposal, the Board noted that should it become necessary to release some equipment before the end of the lease period, some costs would be incurred. The Board also asked Ian Duncan to consider whether other banks, in particular Australian, may be able to offer better terms;

(c) The Board:

- noted the outline terms of the proposed equipment leases
- noted that a further legal check would be made to confirm RMG's capacity before the finalised lease agreements were signed
- authorised, subject to legal capacity, and delegated authority to Ian Duncan to finalise the arrangements.

**RMH10/11** **INDUSTRIAL RELATIONS UPDATE**

(a) Mark Higson and Jon Millidge updated the Board on the current state of the negotiations with the CWU aimed at reaching agreement on a range of issues to enable the transformation of Royal Mail Letters. Progress was continuing to be made, although there remained some difficult issues to resolve, in particular Saturday working. However there was optimism that a satisfactory settlement would be possible;

(b) the Board noted the update;

(c) the Board went on to discuss the long-running difficulty for the CWU of making a breakthrough on reforming its own internal machinery and culture. It was clear that some innovative form of intervention would be necessary to enable such reform be realised.

**RMH10/12** **VEHICLES PLAN 2010/11 – RMH(10)06**

(a) The Board noted Mark Higson's paper, which sought approval for the proposed vehicle plan for 2010/11, requiring £36.9million to replace 1,875 vehicles (5.1% of the fleet) in 2010/11. This figure was for 'business as usual' replacements and did not include Delivery Methods acquisitions in 2010/11 (5,986 vehicles, incurring capital expenditure of £49.5million) which had been separately authorised;

(b) the Board:

- approved the 2010/11 Vehicles Replacement Plan as set out in the paper
- noted that the Group Investment Committee would exercise ring-fenced authority for certain categories (totalling £19.5million) with draw-down subject to agreement between the relevant Business Unit and the Group Finance Director.

**RMH10/13** **POST OFFICE LTD NEGOTIATING MANDATE – RMH(10)05**

(a) The Board noted Alan Cook's paper, which set out for the Board's endorsement the proposed approach to negotiating a changed relationship with the Bank of Ireland (BoI);

(b) the aspiration was to achieve a change in the business model, specifically to improve the contribution that POL received and the level of control that POL had over its personal Financial Services business, moving POL more in the direction of being a distributor of Financial Services products. In order to deliver this aspiration, POL had identified three levers which would significantly improve POL's profit by some £15-25million a year by 2015/16, with significant additional upside. The three levers were:

- to manage insurance directly within POL, ensuring that the value flowing to POL properly reflected the contributions it made, delivering an additional £10-13million;
- to improve commissions and margins on some savings and lending products provided by BoI so that POL captured at least £3-8million additional value. This would require BoI's commission payments to move towards industry benchmarks over time, perhaps with volume discounts creating further upside for POL as book values reached pre-agreed levels;
- to dissolve POFS (the JV between POL and BoI) and integrate its key functions into POL to simplify the model, improve transparency and set up a more efficient partnership. Removing duplication of roles and support functions (some 20 people, representing a third of POFS' non-salesforce headcount),

alongside administrative and operational IT systems savings and premises synergies from moving staff to POL's building could realise £2-4million for POL;

(c) Adam Crozier reported that he and Alan Cook had recently held a meeting with the Chief Executive of BoI, at which the need from POL's perspective for a renegotiation of the relationship had been clearly signalled;

(d) after further discussion, the Board endorsed the proposed negotiating aims and approach. The Board appointed a sub-committee, comprising Les Owen, Andrew Carr-Locke and Paul Murray, to act as a steering group for the negotiations between Board meetings.

**RMH10/14** **E-BUSINESS TRANSFORMATION – RMH(10)07**

(a) The Board noted Robin Dargue's paper which sought approval to spend £24.9million to help transform the eBusiness capability of the Group. It was intended to contract with a systems integration and business transformation partner to put in place new web technology and an operating model that would enable the delivery of the business units' strategic plans, migrate and improve the current web functionality delivering a customer-centric strategy and improving accessibility, enable strategic applications that could not be delivered by the current technology platform, safeguard existing web presence as software moves out of extended support and reduce both the operating costs of the current web platform by 20% and future project development costs by 35%;

(b) the Board noted in discussion that the proposed new platform would represent a leapfrogging of the competition in terms of web technology: however its success commercially would depend on the quality of the products being sold over it;

(c) the Board approved the proposal to contract with a systems integration and business transformation partner to implement a new eBusiness technology platform and operating model as set out in the paper, at a total project cost of £24.9million.

**RMH10/15** **ANNUAL SECURITY REPORT – RMH(10)08**

(a) The Board noted Tony Marsh's report and his presentation to the Board, which highlighted the key security issues facing the Group and the measures being taken to address them.

**RMH10/16** **GOING CONCERN UPDATE – RMH(10)09**

(a) The Board noted Ian Duncan's paper to the Audit and Risk Committee. The Board further noted that the Audit and Risk Committee had fully considered and approved the paper at its January meeting, at which Ernst and Young had given its support to the proposed process for monitoring going concern;

(b) the Board also endorsed the proposed approach.

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**RMH10/17** **CORPORATE FINANCE REPORT – RMH(10)10**

(a) The Board noted the report.

**RMH10/18** **REGULATION REPORT – RMH(10)11**

(a) The Board noted the report.

**RMH10/19** **COMPANY SECRETARY'S REPORT – RMH(10)12**

(a) The Board noted the report.

**RMH10/20** **CLOSE**

(a) In the absence of any further business, the Chairman closed the meeting. The next meeting of the Board was scheduled for 24 March 2010, at 100 Victoria Embankment, London.

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