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ROYAL MAIL HOLDINGS plc BOARD

POST OFFICE LTD – MANAGING DIRECTORS REPORT – PERIOD 4 (July 2010)

1. Profit Target

Operating Profit in the month was £4.9m against a budgeted profit of £3.7m resulting in a favourable variance of £1.2m. Year to date shows a £9.0m profit against a planned profit of £1.6m giving an overall £7.4m favourable position. The current month's favourable variance has resulted from £1.4m higher net income, savings of £0.5m on staff and £1.1m on non-staff partly offset by adverse variances of £1.1m on Agents and £0.7m on Interbusiness.

Total net income in the month was £1.4m favourable to budget, mainly as a result of lower cost of sales on Telephony and Government Services, and some budget timing issues.

Year to date the Profit was £12.9m lower than prior year driven by lower external income of £23.0m (predominantly POCA and Financial Services), but was partly offset by favourable people & non-people costs.

2. Cashflow

Cumulative cashflow is an outflow of £96m against the budget of £123m giving a favourable variance of £27m. The main elements of this variance are client balances which are £45m favourable offset by total Network cash which is £37m adverse. Working capital is £17m favourable and capex is £10m adverse.

July is a self-assessment month which drives cash up on account of £220m cheques on hand and this explains the Cash variance which will reverse in P5. Cash remains strongly favourable on an underlying basis. Client balances have been largely in line with budget to now but July however includes an element of under-settling with A&L which produces a
c. £30m favourable variance and will reverse going forwards. There is also a favourable variance of £13m on Growth Bonds. Bond issue 12 ceased on 31 July and issue 13 launches mid-August meaning this source of funds continues into Period 5.

The working capital variance stems from Debtors with £7m arising from the timing of the DWP's monthly invoice settlement and a further £7m from the A&L income accrual being lower than budget. In creditors there is an ongoing favourable variance from DWP receipts relating to POCA migration and regulatory income to be amortised over this and future years; however this is currently offset by an adverse variance from savings stamps where the actual balance decline is more rapid than budgeted. Finally capex is adverse on account of the AEI equipment which is largely matched by an equivalent finance lease creditor meaning the real cash effect is negligible.

3. Application, Enrolment & Identity (AEI) Services Update

The programme continues to deliver the roll-out to 750 branches by 9th Nov to provide the driver licence renewal service on behalf of the DVLA. The last milestone of 375 branches live by 10th Aug is on track. Recently, the AEI Programme Team was awarded the annual CIO Gold Award for 'delivery excellence'.

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4. Horizon Online Rollout Update

Rollout continues to go well with the daily success rate consistently in excess of 90%. As at 28th July, there are now 5,583 branches live on Horizon Online, and over

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15,500 counters (around 55% of the live estate). 11,404 Branch Routers have been installed and this activity is now complete, with the exception of 50 VSAT branches. Last week, Horizon Online handled more than 50% of all debit card transactions and settled 1.5 million customer sessions.

A team of Network and Property, surplus colleagues and subpostmasters have successfully undertaken cash audits and provided in branch training, preparation and overnight operational support in 7000 plus branches to enable migration to Horizon online. The team are on track to complete the remaining 4000 by the end of August.

Financially the programme remains significantly ahead of the Business Case due to higher than planned benefits and a number of financial savings which have been made. The programme status is Amber until formally re-baselined, however migrations are scheduled to complete to the revised time line of September.

5. System & Channel Availability

Horizon – Branch availability in July was 99.81% exceeding a stretch target of 99.60% and significantly above the contracted target of 99.45%. This is due to a reduction in Online Service issues during the month.

ATM – ATM availability performance was 95.54% in July, slightly down on last month (95.65%) but achieving the overall SLA of 95.50%, though was adverse against the issued budget of 96%.

Website – Availability has remained stable at 99.96% in July from 99.96% in June. Despite a 20 minute unscheduled outage across the web platform on 30th July due to a database lock issue, web availability throughout the rest of July was exceptional.

Call Centre – grade of service (GOS) achieved the target at 80%, with most contact centres meeting this target. The exceptions include telephony that has seen poor performance on their customer service (75%) and NBSC was affected by the Horizon On Line role out resulting in a fall to GOS 52%. However card account remains very strong with a GOS of 85%.

6. Network Related Updates

Sales

At the end of week 18, Crowns stand at 95%, WH Smith at 97% and Agency at 96% of Focus Product Income, giving overall Network performance of 96%. Standard Product performance is close to budget. Overall, gross income is adverse.

National Federation of Sub Postmasters (NFSP)

The collaboration workshop with NFSP was held on 9 July, attended by senior members of respective teams. A productive and worthwhile series of sessions explored very openly ways in which we could work together more effectively both in the short term BAU and long term strategically. POL has committed to sharing more information with the NFSP (who have now signed confidentiality agreements), as well as seeking NFSP involvement and input into strategic developments. The precise nature of this is yet to be defined but overall there are positive signs that effective collaboration may be possible, albeit NFSP's ultimate posi0tion will be heavily influenced by funding decisions.

Camelot Bill Payment

The National Lottery Commission (NLC) announced on 16 July that it would not allow Camelot to undertake ancillary services on its terminals, on the basis of potential EU/competition law risks. This has been positioned as provisional allowing

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any party until September to seek clarification against any of the issues raised. POL will continue to explore options around its bill payment services and the potential for provision outside the network with other providers.

7. **Pay Negotiations**
At the time of writing, the revised mandate is being reviewed by Moya and Jon, however, the proposal is as follows:

Supply Chain: The current offer of 2.7% averaged across all grades and a lump sum of £220 + the £600 colleagues shares was rejected by the CWU in June and Andy Furey was due to seek a mandate to ballot to reject this offer 2 weeks ago. This would inevitably have led to an industrial action ballot putting at risk both the external cash collection contracts and the supply of cash to the Post Office Network.

Our current mandate is for 2.9% and a £250 lump sum. But we know that formally offering this would not have been sufficient to prevent a ballot. Further talks in the last 2 weeks have got us to a position where we believe we can gain agreement on pay and cooperation with our cost saving target in return for the following:

- Pay 2.9% averaged over all grades but no headline rates higher than 3%.
- £250 lump sum.
- 1 hour off the working week for crew grades and Swindon only.

Admin Staff: Talks have only just recommenced in this area following the offer of zero made in May. We are confident we will be able to settle within our existing mandate of 2%. The cost of 2% is £245k.
In POL this area has low numbers of employees they are unlikely to strike as the organisational impact of their short term action would be limited.

Crown Employees: This is the area where we are most likely to reach an impasse. We have been talking to the union about the need to have a realistic plan to turn round the current £40m+ loss pa. We are meeting the union w/c 23rd August with some transformation proposals

8. **Organisation Design Review**
The “as is” picture has now been identified and agreed. We have also agreed a set of core principles that the design team are now taking into phase two. The key principles for design are:

- A fitter organisation that does not duplicate activities or roles
- A flexible organisation that runs cost effective change and can flex to meet market demands
- Improved accountability that speeds up decision making
- Central focus on functions essential to our future strategy -customer needs, income generation and channel development
- All of which is underpinned by change in how we lead and work together in the organisation.

Our aim is to design a core model that will flex as we need it to which means that overall there will be fewer roles than in our current structure.

9. **“New Future”**
We are making good progress towards presenting the initial business plan to Government on 23 August and the Holdings Board on 1 September, in preparation for agreement of the funding envelope, in time for the Government’s Spending Review which completes on 20 October.

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David Smith
September 2010