Royal Mail Holdings plc

Royal Mail Group results for the first half of 2009/10

Royal Mail Group made a £184 million operating profit in the first half of 2009/10 - up 4% on the £177 million profit in the same period last year. The improved profit is despite a drop in overall Group revenues due to the continuing decline in mail volumes and economic recession which, along with intensifying competition, had an impact on all of the Group's businesses. The Group's resilient financial performance, along with some of the best spring quality of service figures on record, shows that modernisation of the Letters business is working, while the further progress made on tackling costs across the Group has also helped sustain operating profit.

- All four Group businesses – Royal Mail Letters, the Post Office, Parcelforce Worldwide and the European parcels business, GLS – remained in profit despite economic recession and intensifying competition in all our markets.
- Group operating profit increased by £7 million in the six month period despite a £73 million fall in revenues.
- Profits were underpinned by strong progress in our modernisation plan – now around two thirds of the way through with more than £1.3 billion invested to date of the £2 billion we are investing by 2011.
- The fall in revenue was caused by continuing decline in traditional mail volumes in the UK and around the world with UK volumes down by around 8% during the half year due to the effects of recession and the growth in electronic communications. The reduction in revenue was despite a positive contribution from packets and parcels driven by online shopping and fulfilment.
- Despite the resilient profit performance, Group cashflow continues to be negative with an outflow of £434 million during the six months, largely driven by continuing investment and the cost of voluntary redundancies. During the period we also made a cash payment of more than £300m into the pension fund. The pension fund deficit is currently being revalued with the historic deficit widely expected to be at least £10 billion compared with £3.4 billion at the last valuation three years ago.
- People costs in the half year were £170 million lower than the same period last year, again helped by our ongoing modernisation and efficiency gains. About 5,000 people left the company, mainly in the Letters business, bringing the total number to have left the Group since spring 2002 to around 60,000 through voluntary redundancy or natural turnover.
- Post Office Limited increased its profits despite the ongoing decline in Government business conducted through the network. Profits were buoyed by tough cost control and by the growth in new Post Office services.
- For part of the half year, industrial action by the Communication Workers Union - focussed mainly in London - disrupted services for some customers. However strikes have now been halted through an agreement reached at the TUC while we continue to talk to the CWU about the future.

The key figures:

	External Revenue		**Operating Profit***	
Business Unit	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Royal Mail Letters	**3,210**	3,265	**48**	46
General Logistics Systems	**718**	715	**45**	59
Parcelforce Worldwide	**191**	184	**7**	4
Post Office Limited	**426**	461	**41**	28
Other businesses	**30**	23	**43**	40
Group	**4,575**	4,648	**184**	177

*All references to operating profit are before exceptional items

Royal Mail Letters saw letter volumes fall by around 8% year on year. However a combination of cost reduction driven by modernisation and changes in our price and product mix helped operating profit increase slightly to £48 million from £46 million in the same period last year despite a £55 million fall in Letters revenue year on year.

A combination of new and upgraded sorting machines in mail centres means more than 80% of the mail is now automatically sorted down to the level of the postman or woman's walk and is delivering cost benefits while changes in working practices – including everyone working all the hours for which they are paid, working flexibly and using the new equipment we're investing in - have also helped drive efficiency and offset the effects of volume decline. As a result of increased efficiency there was a further reduction in the number of people working for Royal Mail during the half year with 5,000 people leaving the business.

The transformation of Royal Mail remains on track with an investment of more than £1.3 billion to date of the £2 billion investment we are making in the Letters business by 2011. Since the spring of this year:

- We have commenced the national roll out of walk sequencing machines and 55 of the machines – which sort mail down to the exact route followed by the delivery postmen and women - are now in place. Over the next two years, we will be installing sequencers at the rate of three to six a week with the aim of having more than 500 in use by the end of 2011. This will see around 75% of letters "walk sequenced" by that time.

- Six more Large Flat sorters, which sort larger items of mail such as catalogues and magazines, have also been installed in recent months and we now operate 25 of these machines. In addition to all our new and upgraded sorting machines a further six of the latest generation of "intelligent" Letter Sorting Machines have been installed in recent months, bringing the total of these state-of-the-art machines to ten in the UK. These iLSMs sort mail faster and more efficiently than the existing Integrated Mail Processors in our mail centres. We are on track to have 16 iLSMs in place by the end of the financial year.

- We are making a £120 million investment in new equipment for our delivery postmen and women to ensure their workload is fair and reasonable - around 2,400 electric powered trolleys and 24,000 lightweight trolleys to take the weight off our people's backs, 11,500 new vehicles and a further 9,000 handheld mail tracking devices on top of the 27,000 already in use.

Through our modernisation we aim to provide our customers with even better and more consistent quality of service while keeping our prices as low as possible and continuing to support the one-price-goes anywhere Universal Service.

Traditional volumes continue to fall in the UK and around the world as electronic communications continues its inexorable growth: for example the Dutch postal operator TNT has said that volumes in the Netherlands will fall by 7-9% in 2010 while in some countries such as the US the decline is as steep as 13%. In the UK, rival postal operators also continue to have an increasingly significant impact on Royal Mail. In the half year, rivals handled just over three billion letters – around one in three of the total of 8.2 billion delivered by Royal Mail in the first six months of the financial year - and although these competitors rely on Royal Mail to deliver over the "final mile" to customers on their behalf, we lose money in doing so. Around 60% of bulk business mail is now handled by our competitors.

It is too early to assess the impact of the CWU's recent strike action but we are grateful to all those postmen and women who chose to continue working through the strikes and for the huge efforts made by our managers to help keep the mail moving. Their support, along with our greater levels of automation in the business, and the use of fully vetted temporary workers, helped deal more quickly than in the past with mail that was delayed by CWU strikes. However the strikes caused disruption for some customers, to whom we apologise wholeheartedly. Across the whole of the company, all of our people are now fully engaged in delivering a great Christmas for our customers.

We are pleased that Roger Poole, former Assistant General Secretary of Unison and former Chairman of the Northern Ireland Parades Commission, has agreed to support our talks with the union. We are also very grateful to Brendan Barber, General Secretary of the TUC, for his help in reaching our recent agreement with the CWU to provide a strike-free Christmas.

Parcelforce Worldwide continues to enjoy positive financial performance - with profits almost doubling to £7 million from the £4 million result at the previous half year - in the highly competitive express parcels sector where margins are traditionally slim. The business saw strong export growth as UK companies take advantage of the weak pound to seek out new market opportunities. As a result, it launched in the summer a new suite of international products to give its customers an even greater range of services to meet their global delivery needs. Quality of service remains among the best in the industry.

GLS, our European parcels business, saw a fall in operating profits during the period, largely due to the effects of recession in its main markets. GLS is one of Europe's leading delivery companies, operating in 36 European states and handling one million parcels every working day. GLS also has global reach through contractual agreement with other international operators.

Post Office Limited's half year profit rose by almost 50%, primarily as a result of cost saving measures and despite a fall in revenues of £35 million in the six months compared to the same period a year earlier. There was a further fall in traditional Government business, including an increase in the number of drivers renewing their vehicle tax licences online rather than over the counter but the Post Office has continued to expand its Financial Services portfolio with a wider range of mortgages on offer and also the launch of a business insurance policy open to 95% of the UK's small firms.

The Post Office is one of the fastest growing providers of Financial Services with 2.1 million customers. Our rollout of free-to-use cash machines continues with 1,950 now installed in our branches - making it one of the UK's biggest cash machine networks - we are issuing 3,700 credit cards a week and 600,000 consumers now carry one in their wallets and purses, £8 billion has been invested in Post Office savings products, and 780,000 customers insure their homes or cars with the Post Office.

We are in active dialogue with the Government to explore the opportunities to win business around the rollout of ID services. We are investing in 750 of our busiest branches with the installation of some of the world's most sophisticated identity verification technology and we believe we are well placed to secure additional revenue that would help support the entire network.

The branch network remains at the heart of communities nationwide with 11,500 branches, along with 500 Outreach services, serving 23 million customers who make 34 million weekly visits for 63 million transactions each week. The Horizon computer system which links the network handles 750 transactions a second at the busiest times.

The Royal Mail Pension Plan, which last financial year consumed more than £800 million in cash, remains a daunting challenge to fund. The triennial actuarial valuation has not yet been completed but the pension plan deficit is widely expected to increase from its £3.4 billion deficit three years ago to at least £10 billion and we are exploring with the trustees ways of addressing this legacy deficit.

The future for Royal Mail holds major challenges and the outlook remains uncertain as mail volumes continue to fall in the UK and around the world and as low interest rates affect sales of financial services through the Post Office. But we also see great opportunities for the business, its people and its customers if we continue to modernise, become more efficient and develop a leadership position in the intensely competitive packets and parcels business – the real engine for future growth – both in the UK and overseas. We believe that within five years parcels and packets will be providing a very significant proportion of our revenues and profits - and will underpin our ability to continue to provide the all-important Universal Service across the UK every working day.

Change is difficult for everyone but Royal Mail has no alternative but to change and modernise if it is to compete in today's highly competitive communications market and keep on delivering the postal service on which so many depend. We have come a very long way since seven years ago when the company was losing more than £1m every working day and failing quality targets to the position today where all four businesses within the Group are profitable and – setting aside the impact of the recent strikes - quality targets are being met. Our modernisation is working – delivering greater efficiency and better quality – and we are now within clear sight of our aim of completing our £2 billion transformation plan. We know that with our people behind us, we can and will achieve that goal.

Adam Crozier
Chief Executive
10 December 2009

Financial Highlights

- Group external revenue has fallen year on year by £73m, £140m when excluding the impact of foreign exchange in GLS. This reflects the continued impact of recessionary pressures and structural change in the market
- Group operating profit before exceptionals has increased by £7m to £184m, driven by targeted cost savings
- All four Group businesses continue to be profitable, as they were last year for the first time in two decades
- Despite falling volumes, Royal Mail Letters continues to generate an operating profit as investment in modernisation has enabled cost efficiencies to mitigate revenue decline
- Operating profit in GLS has fallen year on year by £14m despite cost reduction measures, as these have not been sufficient to fully mitigate the impact of the adverse economic climate on revenue
- Parcelforce Worldwide's operating profit has grown by £3m in a highly competitive market through continued focus on quality and cost
- Post Office Limited have delivered a 46% improvement in operating profit, now at £41m, as reduced Government and Financial Services income has been outweighed by delivery of transformation programme benefits and other cost savings
- Group net cash outflow after financing and investing activities of £138m, is driven by the continued heavy investment in the modernisation of our operations and our significant pension fund obligation

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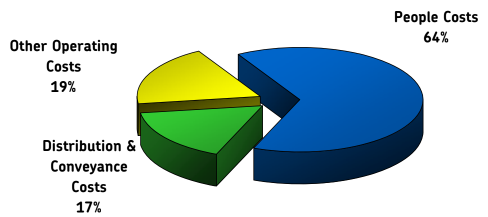
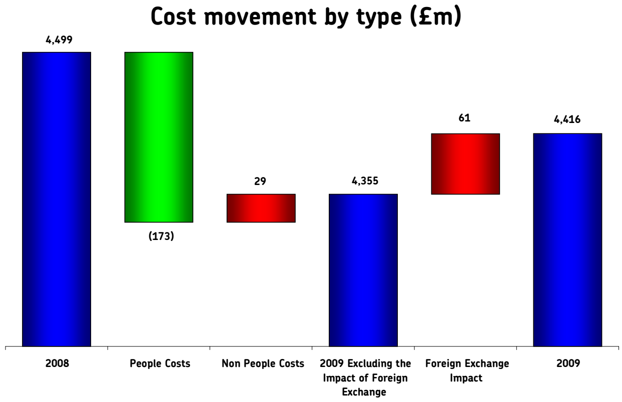
Due to the timing of Easter bank holidays, 2009/10 has approximately two less working days compared to the same half year period in 2008/09.

Costs by type (%)



Cost movement by type (£m)



Royal Mail Letters

Royal Mail Letters operating profit has increased by £2m to £48m. Falling revenue has been offset by cost savings reflecting the increasing pace of modernisation of working methods and investment in new equipment, enabling a 6% reduction in gross hours.

External revenue has fallen year on year by £55m to £3,210m reflecting current economic conditions (GDP decline), growth in e-substitution and increasing competition from alternative advertising media. Addressed inland volume decline has accelerated from 4% at the last half year, to over 8% this year (7% if working day adjusted), with recent months experiencing declines of up to 10%. Although, this fall has been partially offset by price rises, customers are also switching to lower priced products and migrating to Downstream Access, which dilutes our revenues.

General Logistics Systems

External revenue has increased by £3m to £718m, but operating profit has fallen by £14m to £45m. Whilst revenue performance improved due to the strengthening of the Euro, on an underlying basis it has fallen by 8%. Both prices and volumes are lower year on year as a result of the recessionary conditions and the challenging trading environment.

Cost reduction measures have been implemented but these have not been sufficient to fully mitigate the impact of revenue decline on operating profit.

Parcelforce Worldwide

External revenue is £7m higher than last year, increasing to £191m. The increase has been driven by income and volume growth in both Contract and Retail channels. This growth, which has been underpinned by a continued focus on first time delivery and quality of service, is a strong performance in a very competitive market sector.

Operating profit has increased from £4m to £7m. This profit increase reflects both revenue growth and cost efficiencies, partially offset by higher year on year energy and fuel rates.

Post Office Limited

External revenue has fallen by £35m from last year, to £426m. This is largely attributable to a fall in Government and Financial Services income, which has been partially offset by growth in HomePhone products. The economic environment, low interest rates and the weakening of Sterling have all had adverse impacts on revenue streams.

POL's operating profit performance of £41m is an improvement of £13m year on year. This is driven by a reduction in both people and non people costs, including programme benefits of transformation in line with expectations, revision of supplier contracts and other cost saving initiatives deployed across the business.

Other businesses

The £7m increase in external revenue from other businesses to £30m, is principally driven by Romec. Romec has seen an increase in sales activity which has enabled new contracts to be secured.

The £43m operating profit from other businesses is largely attributable to Royal Mail Estates Limited (RMEsL), which leases a portfolio of property interests to the Group. The operating profit improvement of £3m is driven by RMEsL.

Pensions

Accounting Pension Deficit £m (27 September & 29 March)	**2009 Sept**	2009 March
Pension deficit (balance sheet)	**7,968**	6,776

The accounting pension deficit has increased during the half year from £6,776m in March 2009 to £7,968m. The increase in the deficit of £1,192m mainly relates to an actuarial loss of £1,078m, driven by increased liabilities partially offset by higher than expected asset values, due to changes in market conditions.

Pension Payments: Group Contributions	**2009 £m**	2008 £m
Regular pension contributions	**270**	279
Funding of pension deficit	**7**	2
Payments relating to redundancy	**28**	19
Prepayment in 2007/08 of 2008/09 regular pension contributions	**-**	(50)
Net cash payments	**305**	250

Regular pension contributions reduced by £9m year on year to £270m, mainly as a result of reduced pay costs. The rate of employer contributions to the Royal Mail Pension Plan has remained at 20.0% and the regular rate of employee contributions remains unchanged at 6.0%.

Payments to fund the deficit throughout the year 2008/09 amounted to £290m and they will continue at an average of over £260m per annum for the 14 years from 31 March 2009. There have been no employee deficit contributions.

Cash Flow

	2009 £m	2008 £m
Net cash outflow before specific financing and investing activities:	**(434)**	(520)
Exceptional government grant	**-**	152
Network Support Payment	**150**	150
Net new borrowings	**197**	81
Finance lease agreements	**9**	19
Net movement in financial asset investments	**(60)**	(31)
Total net cash outflow	**(138)**	(149)

During the period, the Group's cash and cash equivalents decreased by £138m (2008 £149m). However, this was after net new borrowings of £197m (2008 £81m) driven by further drawdown of Government loans to invest in modernisation and receipt of the Network Support Payment (NSP) for the full year of £150m (2008 £150m). Half of the NSP has been recognised in operating profit. There was no cash receipt from Government this year to compensate Post Office Limited for providing 'services of general economic interest' (2008 £152m).

Before these items, the Group's cash flow was an outflow of £434m (2008 £520m). This is driven by £193m capital expenditure on modernisation of our operations (2008 £218m), payments for voluntary redundancies of £102m (2008 £149m), and £79m of ColleagueShare payments to all qualifying employees (2008 £156m). These, and other outflows including working capital totalling £284m (2008 £189m), were higher than the cash inflow from operating profit before interest, tax, depreciation, amortisation and NSP of £224m (2008 £192m).

Cautionary statement

Where this trading update contains forward looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with appropriate caution due to the inherent uncertainties underlying any such forward looking information.

Registered Office & Corporate Website

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