21 May 2015

Royal Mail plc Full Year 2014-15 Results

Management presentation and Q&A transcript
[Amended in places to improve readability only]

Moya Greene – Chief Executive Officer

Good morning, everyone. We're very pleased to be here, and to see you all here, to give you our progress report for 2014-15 and to tell you how we think things are shaping up for 2015-16.

Despite a pretty challenging environment, our outcome for the year is in line with our expectations. We have successfully rolled out in 2014-15 an unprecedented amount of change and innovation across the board. As a result, we have maintained our preeminent place in the UK parcels market. Volumes are up 3%; parcel revenues are up 1%; Group revenue is also up 1%. Our adjusted operating profit of £740 million before transformation costs is also up, relative to last year, and in line with our expectations.

The cost picture is better [UKPIL]; costs are down 1%. Our cash flow, at £453 million, supports our promised progressive dividend at 21p for the full year, which is up 5%.

A few words about the UK parcel market. Overall, the market is still growing at about 4% a year. What has changed is the addressable market; the share of the market that's going to be available to the parcel industry.

With Amazon rolling out its own network, the industry is now facing a period of lower growth, maybe only 1% to 2%. We have had too much capacity in the UK and that continues to put pressure on price.

In addition to Amazon's network, other competitors continue to add capacity. Hermes built a hub in 2014; UK Mail will open a hub in June of this year; DPD, a hub will open in

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September; and Yodel has also increased capacity. And this is coming at a time when customers want more. They want more choice, they want more convenience and these are factors that drive cost.

Many of the technology modernisation and cultural change initiatives that we have introduced in the past three years have now put us in a position to accelerate improvements for our customers.

For example, our acquisition of StoreFeeder. As a result, our e-retailers, in a few clicks on royalmail.com, can see the items they have sold. In the future, no need to enter buyer shipping details, all automated. That will improve in the next year. Our retailers on royalmail.com will be able to manage their inventory systems, their dispatch systems and their billing systems.

Our new returns portal makes us more convenient for buyers and sellers. Parcelforce and GLS are connecting dynamically now, letting people know that the parcel is on its way, letting them choose another place or time for the delivery of the parcel. These networks now offer timed delivery.

With the changes we have introduced, in our core market we can be more flexible today on the parcels that the core network can accommodate. That allows us to participate in the faster growing segments of the online retail market, like clothing.

New online customers like Boohoo have chosen Royal Mail. In March, I was pleased to announce in Shanghai our new Royal Mail shop on Alibaba's Tmall. We're helping great British brands access Chinese consumers.

The drive to improve all aspects of the customer experience at Royal Mail will accelerate in 2015-16. We will be launching a number of new and important initiatives. With new 2D bar codes on more and more of our parcels, we will offer a range of new, more convenient shipping and labeling solutions.

We have settled now on the next generation of handheld devices. We have planned £130 million investment over the next five years. This will add more functionality.

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We already track everything in the Parcelforce and GLS networks and progressively, over the past year, we have greatly increased the share of Royal Mail core network traffic that is tracked. We will step this up in 2015-16. More tracking means more data capture and greater efficiency.

We have started rolling out the automation of parcel sortation in 20 of the busiest mail centers.

All of this has come together to deliver good results in a challenging UK parcels market. Our parcel revenues are up by 1% and volumes are up by 3%.

Revenues have been affected by price pressures, as I mentioned, and this has affected the whole industry. We've seen more import parcels, but that's traffic that has had lower average unit rates. The higher average unit rate traffic in the export sector is also facing more competitive pressure. But we've been very mindful of this and so, with our pricing promotions for consumer and SMEs, this has helped Royal Mail.

We have a very broad customer base, so while large retailers/competitors like Amazon will affect overall market conditions, we are not as exposed as other players in the market.

Our customers strongly incline toward the small retailers and the micro-SMEs. Our products and service improvements have been focused on this segment. For example, we already go to SMEs to deliver mail. For higher volume SMEs, we will offer a collection service at the same time.

Now on letters. I think we've shown, over the years, that we are pretty accurate in forecasting the rate of structural decline in letters. We're not changing our outlook there. We think the structural decline will be in the range of 4% to 6% [per annum].

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Addressed volume decline is at the better end of the range, due to favorable economic conditions. And election revenue in 2014-15 has offset the declines attributable to direct delivery. Marketing mail is up 5%.

Letters are still an important traffic segment, so we continue to invest in mail. We want to add value to reduce rates of decline in the short term.

For example, our Mailmark initiative, launched less than a year ago, already covers 17% of business, publishing and marketing mail. Customers get cheaper rates, better visibility; Royal Mail gets better revenue protection.

Our Keep Me Posted campaign; it's something that resonates with consumers. Customers want the choice of receiving their statements in a printed version.

Our survey, the Private Life of Mail, has proven the value of mail. Almost 70% of people say they open envelops with promotions that come in the mail.

Our mailmen campaign has had benefits for the entire market. Let me show you a clip of that campaign.

[Video clip]

These are some of the leading lights in UK advertising, and that's what they think about the power of mail.

A few words now about the regulatory situation. We have a very professional regulator in Ofcom and we continue to engage with Ofcom, advocating for a fair, balanced and forward-looking framework to support the universal service.

Ofcom has a number of reviews underway now, and we're at an important phase. We hope that Ofcom will have something to say on where their thinking is by the end of our fiscal year.

GLS is our parcel company in Europe, and it is a strong performer. We're seeing revenue growth in all markets.

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Their position in Italy is particularly strong today, fueled by market share gains and acquisitions. I think it's fair to say that we expect growth to slow there in the future.

The France turnaround is a little ahead of plan, which is good. Losses have been greatly reduced year-on-year, and we will break even next year [2016-17].

Germany, an important market for GLS, has just introduced new minimum wage protections for subcontractors. We agree with this initiative and we have a number of measures underway to mitigate the cost impact of that. That said, the legislation will affect GLS profitability, going forward.

Over the past five years or so, our [modernisation] efforts have ensured Royal Mail has avoided about £0.5 billion in costs per annum. Our cost performance in UKPIL is good. Underlying costs are down 1%. We have pulled all of the short-term levers that we talked to you about pre-privatisation.

Productivity, we're very proud, is smack in the middle of our range, 2.5% improvement. Our management reorganisation has delivered more than we thought in cost savings last year, about £42 million, and per annum this will equate to £80 million. Our logistics review continues and has already resulted in considerable savings. We are using less fuel, renting fewer vehicles.

Most importantly, what Matthew and I have been doing over the past few years is now showing that we are starting to instill a cost cutting culture in Royal Mail. That has delivered very strong performance in the non-people area of our costs. It's down by about 4%. This broad range of effort has delivered the efficiencies to which we are very committed.

We have now built the environment that allows us, with greater speed, to do more. Much stronger levels of employee engagement; the kind of engagement with our people that helps everybody be aligned and understand what kind of environment we are facing; our ground-breaking Agenda for Growth agreement with the CWU.

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All of this has come together so that we are all aligned on the need for change and change faster. We can offer new services now much faster than we could even two years ago. We have opened our networks on weekends. Our networks are opened later; you can induct traffic with us up to midnight. We have Sunday deliveries inside the M25 area.

These initiatives, which are very big changes in our operation, from the time we conceived of them until the time we put them in motion - six weeks.

We are increasing our first-time delivery rate. We are doing things now that reduced the complaints from our customers very significantly. By standardising how we do things across the whole operation, not only can we reduce costs, we can satisfy more of our customers more often, and our scores tell us it is working.

We are now targeting flat or better [UKPIL] costs in 2015-16.

At the end of the day, it is our focus on our customers that is the differentiator of the brand, Royal Mail. We are trusted, and we are trusted for high quality delivery. Quality is always important, but more so in the challenging environment we are in. We delivered one of the highest quality service at Christmas time on record for Royal Mail.

We will continue to innovate, give customers more choice, more convenient services, and this has driven our net promoter scores a full 7 points up year-on-year.

I'm now going to turn things over to Matthew, who will let the numbers tell the story in greater detail.

Matthew Lester – Chief Finance Officer

Thank you, Moya. Good morning, everybody. So starting with the financial summary; revenues grew by 1% to just over £9.4 billion, and operating profit before transformation costs comes out at £740 million. After transformation costs, operating profit of £595 million represents a margin of 6.3%.

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It's important here to understand why we've moved to the basis of stripping out the difference between the cash and the IAS 19 pension cost. You can see its impact on margins in the box on the right-hand side.

As I've just said, on an adjusted basis, the margins are 6.3%, and on a reported basis they would have been 4.9%. And that gap is set to widen further; hence the need for us to actually move to this basis.

Earnings per share of 42.8p demonstrate the improved operating and financial efficiency of the business. Free cash flow is £453 million, and so you can see our net debt reduced materially. As Moya said, we're proposing a dividend increase of 5%, and that means a full annual dividend of 21p.

Just touching a bit more on the underlying piece here. All of the percentages and margin changes are shown on an underlying basis. This is similar to what we've done previously, and most of the items you will have seen before, but it's worthwhile just running through.

One of the items we need to adjust for is the VAT credit that we saw in the first half of the previous fiscal year. We had one less working day this fiscal year just ended; we have another one less in the current year. Foreign exchange reduced profits by about £7 million and, at current rates, we would expect it to also reduce the profits again this year by another £8 million.

One new item here is we've increased the comparator for the one-off bonus that we paid last fiscal year as part of the wage negotiations that completed just after privatisation.

So getting into the results in a bit more detail, starting with UKPIL. Revenues were flat, but operating costs were 1 percentage point lower. As a result, operating profit before transformation costs increased by an underlying 5% to £615 million. Transformation costs were lower, such that operating profit after transformation costs was £470 million.

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As you can see on the right-hand side, we've actually adjusted some of the items here for the impact, as I said, of the management reorganisation. That was material in terms of the year-on-year change in the transformation, which reduced substantially. As a result, we say that the underlying increase in our operating profit margin to 6.1% was an improvement of 20 basis points.

In terms of revenue, Moya's discussed most of the commercial drivers. But in terms of numbers, volumes increased in UK parcels by 3%; that was driven mainly by the increase in imports which have lower average unit revenues. And as a result, we saw a negative price and mix shift of 2%, so overall revenues increased by 1%.

In terms of letters, the decline in revenues was only 1%. This was principally due to the fact that volumes came in at the better end of our 4% to 6% decline as a result of the economy being stronger year-on-year.

We were able to offset a lot of this decline with price, elections and other benefits. And also, you can see a very good performance from marketing mail which, as Moya said was up 5%. So overall, the letter decline was only 1% in revenues.

Moving onto people costs in the UK. People costs were up 1% on an underlying basis. Moya's talked about the productivity improvements and the management reorganisation, which contributed £42 million year-on-year. This was offset by the pre-agreed pay award of 3% and the costs of elections, Parcelforce expansion driving a very substantial increase in volumes, and the IT expansion which we have been talking about since we were privatised.

I'm expecting the management reorganisation program now to deliver £80 million worth of annual benefits.

Looking at non-people costs, I'm pleased to say another very strong performance here, with an underlying decline in costs of 4%. Distribution and conveyance costs were down 5%; that was driven by lower terminal dues and improved fleet management.

Infrastructure costs came down by 4%. This was a very good performance from the newly reorganised property team. And other costs are down 1%. I think that really just reflects the cost-conscious culture which Moya was referring to a moment ago.

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In terms of transformation costs, as I've already said, they were down substantially year-on-year because we did not have the charge for the management reorganisation provision in this year, whereas we did in 2013-14. And so we're really at a more normal level of the ongoing redundancy charge which I would expect going forward.

Accordingly, we're continuing with our guidance of between £120 million and £140 million a year of transformation costs, in a similar proportion to that which you've seen for the last fiscal year.

As Moya said, GLS has performed very well, with Euro revenues up 7% to €2.1 billion, operating profit increased to €146 million, a margin of 7%. But as I said, that was at an average exchange rate of €1.27 to £1.

Post year end, we sold in Germany DPD SL, a franchise that GLS ran. That has a negative impact in terms of revenues of £96 million, but actually had a minimal profit impact.

GLS revenues were very much driven by volumes, as you can see on the right-hand side of this slide, with volumes actually increasing by 8%. In Germany, revenues were up 3% and this remains our largest market by revenue. In France, we saw a 7% increase in revenues, driven from volumes from both existing and new customers.

Moya has referred to Italy. We saw 16% growth in revenues this year, despite the problems in that economy. We continue to expect a strong performance, but not at that sort of level, in the current fiscal year. But importantly for us, we saw revenue growth across all the developed and emerging European markets.

The cost picture is what you'd expect for this much more variable cost business model, with costs growing pretty much in line with volumes. People costs were up 8%; 2 percentage points of which is accounted for by acquisitions, and the remainder on a net basis pretty much grew in line with the volume, as I've just said.

So moving down the P&L, you can see that interest costs reduced this year. That came very much as a result of the refinancing that we did at the time of the flotation. And the improved operating results, and this lower interest, means that we've seen a significant increase in EPS you can see at the bottom of the table.

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The tax rate is 24%, 1% lower than [at the half year], which reflects the lower UK corporation tax predominantly.

Specific items. I will go back one more time to the pension, cash and IAS difference; £129 million different in 2014-15; £58 million difference in the previous fiscal year. Very importantly, we know now that the rate will increase to 29.8% in respect of the defined benefits scheme under IAS 19.

This is equivalent to a further increase of £125 million in this non-cash item, again demonstrating why it was necessary to make this presentational change.

The remainder of the items in terms of the specific items you'll be familiar with and they're listed on the right-hand side. One item I will call out is the provision for the French Competition Authority investigation, which we've increased to £46 million. This increase is due to the level of fines that we have seen subsequent to our announcement in October for this particular item.

In terms of the profit on disposal, obviously the main item there is Paddington at £106 million. The profit on sale of DPD SL is yet to be reflected, or will be reflected in the current year's results, and that will be a Euro profit of €40 million. But as I said, it will be treated as a specific item.

So on to the most important part, the cash. EBITDA of just over £1 billion this period, but for me the most important line here is about halfway down, the in-year trading cash flow, £311 million, an increase from £257 million the year before. That is despite the fact that we increased investment to £658 million, and I'll talk a bit more on the detail on that in the next slide.

In terms of the benefit to the free cash flow from the London property portfolio, that was a net £100 million, reflecting the property proceeds from Paddington, net of investments that we've made in other sites, such that overall free cash flow was, as I said, £453 million.

In terms of that investment, you can see that, as we said this time last year, we thought that we would spend, over the two fiscal years ended March 2015, £1.2 billion, and that came in almost exactly.

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You can see that, in terms of the transformation opex in the year, voluntary redundancy cost £96 million in terms of the management reorganisation provision, and the ongoing cost was about £62 million, project costs of £61 million. That is what we've spent in the last fiscal year.

As you can see, because we don't have the [management reorganisation] voluntary redundancy cost next year, we're not expecting, going forward, that level of expenditure because the management reorganisation provision will not be there.

But we will be expecting cash outflow in respect of other voluntary redundancy. Hence, that charge of £120 million to £140 million, similar to the transformation charge that we've got in the P&L.

Replacement capex of between £250 million and £300 million, which we've previously talked about. And then what I call the net growth capex of between £160 million and £180 million, very much behind IT, parcels and GLS.

In terms of debt, a pretty simple movement there where the free cash flow was somewhat offset by the dividend expenditure, such that we end up with £275 million worth of debt. It's been a very busy year for our treasury team.

Not only did we issue the Eurobond back in July, but we also renegotiated our bank facilities, that they are now all of a revolving nature. As a result, we're expecting to see lower net interest, and we are saying that the actual interest rate is likely to come out around about 3% of gross debt. We've shown the composition of net debt in the bottom right-hand side.

In terms of pensions, on the left-hand side we've shown the movement on an accounting basis. But I have to be frank, it's the actuarial basis which drives the decisions, and the surplus has increased on this basis as well to £1.8 billion.

The drivers of that increase in surplus are very similar to what we've discussed at the half-year; namely, that as part of our commitment to keep the scheme open until March 2018, the trustee is hedging liabilities in advance of them actually being incurred.

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So you have a bit of a timing difference where we're seeing the benefit of that hedging program in terms of assets appearing in the surplus, but the actual liabilities are not there yet. So the impact of that, when you distil it down, is that the surplus has got £700 million which will automatically unwind as those liabilities are recognised.

In addition, it's important to remember that, as part of the agreement with the Trustees, we continue to make cash contributions of £400 million to the defined benefit scheme, versus an actuarial cost estimated at £700 million back in March 2012; again, another reason why the surplus will automatically come down, over time.

Accordingly, we expect neither a material surplus nor a deficit by March 2018, the time which we have committed to keep the pension scheme open until.

Lastly, moving to property, you may have noticed we sold Paddington for a bit of money. Secondly, we are marketing Nine Elms actively at the moment. And in terms of Mount Pleasant, we continue to go through the pleasures of the planning process. We now understand that there may be a judicial review of the London Authority's decision.

It's important to recognise in particular that at Mount Pleasant, in order to provide for the ongoing operations that will be necessary on that site, we will need to invest substantially in that site. As a result, the Paddington proceeds will need to be reinvested in those sites in order that we can actually optimise their sales value when we come to sell them. Moya.

Moya Greene – Chief Executive Officer

Overall, we're very pleased with our performance. Our focus on costs will continue. In the long term, our value drivers remain our overall financial objectives in the immediate term. As I mentioned, this is a challenging environment and it certainly shows on the top-line pressures that we faced.

That means we must, and we will, really bear down on costs. I think many of the steps that we've taken over the past two to three years enable us now to move faster and broader across a number of fronts with respect to costs. I think we will be flat, maybe if we have a little bit wind at our back a little better than flat, next year.

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So you will see us roll out a lot more innovation in 2015, building on the platforms that we have built with our employees, with our unions, with our technology backbone.

I think it's probably time for your questions.

Matthew Lester – Chief Finance Officer

Can you just make sure that you put your name and firm ahead of the question, please?

Matija Gergolet – Goldman Sachs

Two questions from me. The first one, well, it was on the news that one of the competitors in the end-to-end competition is stopping the end-to-end delivery, and if you could tell us, from the Royal Mail perspective, what is happening. Are you already seeing an increase in volumes? And perhaps also give us some idea of the potential impact on an annualised basis.

And then the second question would be, I understand later this year you - or perhaps you already started negotiations with the unions for wages - just how are they going? And also specifically, I think in your press release there is a mention that from next year there is a £75 million increase in national insurance contributions. Is that being taken into account in the negotiations with the unions? Thank you.

Moya Greene – Chief Executive Officer

Well, Matthew will talk a little bit about direct delivery and the impact on our volumes. Just one little word from me. I think what it shows, though, is that delivery is hard, and delivery is very hard when you're in a declining market, when the traffic is declining by 4% to 6% a year.

With respect to negotiations with our unions, you're correct, in 2016 we will commence a negotiation with our unions, but we have ongoing talks now. I think one of the improvements that has occurred as a result of the Agenda for Growth is that we're having discussions with our unions all the time. And that has helped us become more aligned on what the Company has to do to retain its preeminent position, particularly on the challenging parcels side of the business.

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I'm not going to talk about the details of any of these discussions or negotiations. I think it's improper to negotiate in public and we don't need to. All I'm saying is that the conversation is now a continuous conversation at Royal Mail, and at all levels in Royal Mail.

Matthew Lester – Chief Finance Officer

In terms of Whistl, we disclosed that the impact last year up to March 2015 was £20 million worth of lost revenue, so obviously, that's the piece that will reverse year-on-year. And we called out there's a risk of up to £200 million, but we've put that out to 2019-20, I think it was, Catherine, so I don't know what people put in their models for that.

So obviously, you would unwind that just for that particular impact. It remains to be seen whether or not other competitors emerge, or how the regulator reacts in different ways.

Angus Tweedie – Bank of America Merrill Lynch

Two questions, please. On the cost side, I think you've said that you've had a £15 million benefit from fuel decreasing. You've upped your management reorganisation targets by £30 million, and still you're saying costs may be flat to down.

You've also done a good job on the headcount reductions. Are you being conservative there, or is there some sort of underlying inflation that you've noticed through the year?

And, secondly, on working capital, there was this benefit from the timing of payroll payments for monthly paid staff. Will that continue, or should we expect working capital to be negative, going forward, on the back of the deferral of stamps unwinding?

Moya Greene – Chief Executive Officer

Let me talk a little bit about the costs, going forward. On the back of these platforms that I spoke about, I think we're in a position to run more cost reduction initiatives and run them at a faster pace. And so we now have - I think what it demonstrates, though, is that those levers that we talked to you about pre-privatisation that we could pull if things changed in the environment, we can.

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So we've got a lot on board. I'm not going to change the guidance. I'm going to say flat but, as I said, if we get a little bit of wind at our back - I'm not going to say that we're being conservative either because there are things that come up in the run of the year that you have to absorb, if government changes policy, for example.

I think you mentioned, or our colleague from Goldman Sachs mentioned National Insurance charges. When you get a workforce the size of ours, that can be a significant item that you have to find other ways to address.

So let's stick with we're confident that costs will be flat and, as I say, if we have a bit of wind at our back, we're going to run hard to try to bring it in better than that.

Matthew Lester – Chief Finance Officer

The bit you haven't got is the 2.8% that we're increasing wage rates by. So that's the big offset that you have to take into account with your analysis.

In terms of working capital, no, once you have the time to get into the detail of the press release you'll see that that timing difference sticks, I think, for another four years.

Damian Brewer – RBC Capital Markets

Two questions, parcel orientated. First of all, you mentioned in the press release, and also in the presentation, looking at automating 20 of your largest parcel centers. How much of the parcel volume does that touch? What's the timescale on that; has any of that already started? And as that goes on, are there any dual running costs included in your cost assumptions for the next year that could then wash out in future years?

And then second area, GLS, previously you've talked about expansion into B2C there. Could you give us an update on how that's going, what's worked, what hasn't and how that changes in future? Thank you.

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Moya Greene – Chief Executive Officer

We're just starting in terms of parcel automation equipment being rolled out into the 20 largest facilities. I'll have to get you the number. I'm just not sure offhand the exact share of our parcel traffic.

And yes, we will certainly have some dual running costs because this is a gradual transformation of how we handle parcels. As you know, we have the most wonderful people in the world. If any of you have visited Mount Pleasant, you will see what parcel sortation is like. It's a mountain of parcel and packets that are now being sorted mostly by hand. So it's a big undertaking and there will be some dual running costs.

On GLS and B2C, GLS is predominantly a B2B player. But the rate of growth in B2C, and many of the B2C customers have some B2C requirements, and so the way in which GLS has approached B2C is to say, where our customers have B2C requirements, we will try very hard to serve them.

In order to improve drop density in their markets, and particularly markets like Germany, they have done a lot of really interesting and clever things. They have relationships with parcel shops. They are now, with others in the business, they're investigating parcel lockers that will have special security features to them. So all of that to improve the situation for B2C drop off which, by definition, is more expensive.

Mark McVicar – Barclays

Two questions, really; one slightly follows on from Damian's question. In terms of the rollout of track and trace and parcel automation, what do you think are the big milestones? When will you be through these programs, or so far through them as makes no difference? What sort of timeline are we looking at?

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Moya Greene – Chief Executive Officer

In terms of the full track and trace and the full automation, I really think you have to think in terms of about three years, because our core network is a huge network and the amount of track and trace that we add every year, it's about the size of a whole participant in the parcels industry. So the scale is on a different level.

To completely build out a new parcel system that makes sure that your customers are moving at pace with you, to put more intelligent bar coding, make sure that your scanning is being focused everywhere, not just on acceptance but, even more importantly, everywhere on delivery, make sure that more and more of that rich data is being uploaded so that you can use it to harvest efficiencies in other parts of your undertaking, I really think that you should be looking at three years.

And it starts with the barcoding; that's what contains the information. It continues with the scanning. That's what allows you to give more visibility to your customers and actually, know more about how you're handling things in your own network. And then it continues on with parcel sortation.

It's a big change agenda, but I can tell you that we're well advanced on it. And hopefully, by this Christmas, the majority of our parcels in the core network will be tracked. We already started scanning on delivery for Christmas last year, but realistically, I think this is a three-year program.

Mark McVicar – Barclays

Thank you. And my other question was, could you just flesh out a bit the new, well new to me anyway, the other Ofcom reviews, the ones around parcels and efficiency? What's the sort of scope of those things, and is there anything we should be looking for or worried about in them?

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Moya Greene – Chief Executive Officer

The honest answer is that I don't know if you should be worried about them. I think our regulator is new to our industry, and we have to give our regulator a sufficient amount of time to really learn and understand the pretty quickly changing dynamics in our industry.

As you know, Mark, we have leveraged the universal service network. We use that network as a common network. We have a costly, but honorable, obligation to be able to go everywhere in the country. And we, in fact, have to go everywhere in the country whether we have two items or 202 items.

As a result, with mail declining, parcels that are of the right size and configuration for our network, we have done a number of things over the past three or four years to make sure that we are putting as much traffic as can be sensibly accommodated through that core network.

So they need to understand the dynamics of the parcel market, because you can, obviously, overstate how much that side of the business is going to contribute to the universal service market. And it wasn't that long ago, as you recall, Mark, that we were losing money on both access letters and parcels.

So I think what we're seeing is a regulator who's very professional and who's going at things in a very professional way. They know that they are new to this business; it's changing under our feet. And when you try to regulate a declining industry, that's exceedingly difficult. You really need to understand where things are likely to go and what are the range of possible outcomes.

So I'm looking at these reviews honestly, even if they are quite lengthy. I'm looking at them as an opportunity to engage and to help our regulator get that deep knowledge base that it needs of our industry, so that we can get that forward-looking regulatory framework that we really need.

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David Kerstens – Jefferies

I have two questions. First of all, what's your view on Ofcom's proposals regarding downstream access pricing? I think they have suggested that access prices should reflect differences in underlying delivery costs.

And secondly, regarding your dividend policy, I think you had previously indicated that that would be dependent on further clarity from the regulator. Do I understand correctly now that you do not anticipate this before the end of the current book year, so not before March 2016? Thanks very much.

Moya Greene – Chief Executive Officer

Well, let me deal with the last one first. Ofcom has not yet indicated precisely when it's going to be in a position, but they have a number of reviews underway. They're working very hard in terms of gaining knowledge about our industry, so I am hopeful that we will have some clarity by the end of this year. I think Matthew has given our guidance on our dividend policy. We know that we have to have a competitive dividend. We want to be progressive, and that's where we are.

In terms of downstream access pricing, I think we're on record to say that we do not agree with the approach that Ofcom is proposing on downstream access pricing, because I think it brings us back to days that really amounted to regulatory failure, in Ofcom's own words. To bring us back to very, very stringent price controls is not the forward-looking regulatory framework that I would advocate.

Alex Paterson – Investec

Two questions, please. Firstly, on the pay increase of 2.8%, if I remember correctly, the inflation parameters around that were a range of 2.3% to 3.3% that you negotiated as part of the three-year settlement. I'm sure that negotiation wasn't easy. Why did you choose not to enforce those parameters in the third year pay award, please?

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And the second question, in this meeting last year I asked you about automation of parcels and you said it would take two years just to determine where you should automate. It seems you're rolling out in one year. Is this a response to, perhaps, a more competitive market than you thought? Or is it that it was just more straightforward than you thought, you were just being too conservative?

Moya Greene – Chief Executive Officer

Let me deal with the 2.8% first. We did not change what we had indicated in the negotiation for a number of reasons. We're trying to build a different culture in Royal Mail; a different industrial relations culture, a different employee engagement culture. And we have made some very significant strides along those lines. I can give you a perfect example.

We, thank goodness, in my five years at Royal Mail, have never had a national disruption. We've had lots of ballots for industrial disruption. In fact, a year and a half ago, over the 12 preceding months, we had 58 local ballots for industrial action. That is a very, very big distraction from what we need to do at Royal Mail.

Since we put the Agenda for Growth agreement in place, we have recognised that there are better means to resolve disputes. You're always going to have disputes. We have 140,000 people; we have a huge amount of change that we have been managing. It's hard and difficult change in terms of what it means for our people and the jobs they do.

So we're going to have disputes. It's how you solve them. So the difference is, we didn't have 58 ballots for industrial action last year, we had zero; that's a huge difference. So it was my judgment that it was not the time to defeat expectations.

The second thing I would say is that, again, as a result of that groundbreaking agreement, and I think if you had Dave Ward here he would say, not only is the union executive all throughout the Company, they have much more information on what we're doing, what we need to do in order to really beat the competition out there. He is committed to accelerating the rate of change. And for us, it's not just can we get there, it's can we get there faster.

Cont…

That leads me into your second question about parcel automation. No, I don't think at the time that we were being overly conservative. I think we were looking at how much change is involved in our operation as we start to move from manual sortation to parcel automation. I think we were mindful, Matthew and me, of how many expensive mistakes had been made, and what we would probably need to do to avoid them.

But again, because there is greater alignment amongst our people, and with our unions everywhere, we've been able to think about getting that automation effort off the ground faster.

So I hope that answers it. These are judgment calls that you make. I think we've made the right ones.

Alex Paterson – Investec

Thank you.

Chris Combe – JP Morgan

A couple of parcel questions. With respect to mechanisation, how much is contingent upon the next labour agreement, when broader based mechanisation cuts into the overall staffing structure? How far can you go, in the absence of clarity up front?

And then, in terms of market share this year, should we expect more of the same, i.e., small market share gains relative to 1% to 2% market growth?

And then lastly, Ofcom seems to have acknowledged there's a threat from parcels. Is there an obvious remedy that Ofcom can impose in an otherwise unregulated market?

Cont…

Moya Greene – Chief Executive Officer

On the last one, is there an obvious remedy, I don't think so. This is an intensely competitive business and I think what's important is that Ofcom learns, and realises, how much properly sized and configured parcels contribute to the financeability and sustainability of the universal service in Britain. That traffic stream and our ability to capture it is very important to having revenue that will cover the universal service cost base.

In terms of the agreement coming up in 2016, as I said, it's a continuous conversation now at Royal Mail. And yes, the agreement is coming to an end in 2016, and there will be a number of things that will be more prominent in the discussion. But I don't think, for the purposes of your models, that you should start thinking that, somehow, there is a step change that would have been possible that won't be possible. In fact, I'm hoping that it will be the opposite.

Matthew Lester – Chief Finance Officer

And in terms of market share, we would expect stable market share.

Andy Chu – Deutsche Bank

I've got two questions on parcels and one on GLS, please. Just in terms of parcels, could you just make a comment in terms of overcapacity in the industry and how long you expect that to last for?

Secondly, in terms of price/mix within UK parcels, what's your expectation, please, for this year for UK parcels price/mix?

And finally on GLS, I wondered if you could make a comment on FedEx and the TNT Express tie-up, both B2B operators, and whether you see any short - or long-term impact for GLS? Thank you.

Cont…

Moya Greene – Chief Executive Officer

Let me deal with GLS first. I actually don't think so. I think the FedEx and TNT tie-up, these are primarily express-based carriers. GLS is in the deferred market surface, so I don't think it's going to have a big effect and I don't think it will have a big effect in the UK either.

Although, that said, the combination of TNT and FedEx in the UK, they will have a bigger position but, again, mostly in the express side of the business. Nobody's ever complacent though, FedEx is a great company, and so I certainly pay attention to everything they do.

In terms of price and mix and capacity in the market, since I've been in the UK there's been too much capacity in the parcels market. We got more players, more competitors, in the parcels market in the UK than probably any other country in Europe.

Every year I've been wrong about my predictions for consolidation and so I don't make them any more; I know I don't get it right. I do think we are going to have a continuation, for the next year and maybe then some, of this overcapacity situation. And if I look back to my time in Canada, there's something about this industry, it seems to add capacity in advance of need and then go through these spikes and dips.

The price and mix characteristics that Matthew called out about import traffic which is generally lower AUR traffic and a lot of it comes in under terminal dues, and sometimes, the people that have terminal dues they might have been developing countries at one time, but they're now some of the biggest economies in the world, you just wonder if any of that is going to change next year, and my call would be, no. So I think we're going to see the same sorts of pricing pressures continue.

Doug Hayes – Morgan Stanley

A couple of questions. First on the GLS business, you've made a couple of shifts to the portfolio this year with divestment and the acquisition; can you just give us an update on how you see that portfolio developing, and if there's scope for more acquisitions or divestments?

Cont…

Matthew Lester – Chief Finance Officer

Not likely divestments. The divestment, you should understand, was a franchise with DPD which dated back many years. Frankly, given the way that DPD were developing their organisation, it was something of an anachronism, and anyway, we found a mutually advantage solution to that. So I'm not really expecting to see many more divestments.

In terms of acquisitions, I think it's more of the same. You've seen every year we've expanded the Italian franchise, we'll carry on doing that, and as and when opportunities arise in Europe which represent value. I think that's a key point that we want to make here.

We must have looked at 20 different opportunities this year, all of which we've turned down on the basis that, actually, the prices the people were looking for were too substantial. So capital discipline is very, very important to us. That cash is precious.

Doug Hayes – Morgan Stanley

Great, thank you. And next on the working capital, as was alluded to earlier, the trade working capital looked like there was a pretty big improvement year over year. Is that something that's sustainable at this point, or should that tip the other way?

Matthew Lester – Chief Finance Officer

We said, at the time of privatisation, that we were going to be targeting to have a flat working capital, going forward. This year we achieved it. Mike, we're going to achieve it again, aren't we?

Doug Hayes – Morgan Stanley

Great. And then finally just on the dividend. You've reiterated your commitment to dividend growth; can you give us any more guidance into how you're going to think about that? Is it this adjusted operating profit before transformation costs, or are there other factors at play?

Cont…

Matthew Lester – Chief Finance Officer

Yes, it's called the Board will make its decision at the end of the year. I think the best guidance you're going to get is they've put a 5% increase on this year.

Doug Hayes – Morgan Stanley

Thank you very much.

Matthias Hopfgarten – Commerzbank

I have a question regarding your parcel business. Do you have any plans to work together with competitors using hubs or vehicles on the last mile to raise some synergies in costs?

Moya Greene – Chief Executive Officer

No, not yet. Where we do think that there may be some opportunities, but it's early days, we manage and maintain a very big fleet, the largest fleet in Britain. So it may be possible if we have very well trained people, it may be possible for us to manage and maintain the fleets of others, but not to consolidate delivery networks with competitors.

Matthew Lester – Chief Finance Officer

Let's make this the last one, and then we'll obviously be around for one-on-one questions.

Hugo Turner – Credit Suisse

I've got two questions; one on the pension and one on the property. Just on the pension side, there's growing disconnect between the pension P&L charge and the cash flow charge. Now, if bond yields are going to stay low, then that is going to have a cash impact at some stage. Is that the right way to think about it, and if so, how should investors think about that risk that's potentially growing? So that's the first one.

The second one is just on property timings. Are you still expecting to dispose of something this calendar year; what are the timings and when? Thanks.

Cont…

Matthew Lester – Chief Finance Officer

On the pension side, yes, I think the key point here is that we addressed the medium-term issue right at the time of flotation with that commitment round to March 2018, how we manage that. And you can see, just in terms of how the actuarial surplus is developing, exactly how we went about managing that risk over that period. We were very clear at the time when we entered into that commitment that it was, because of this prevailing problem and because of the creation of a surplus, we were able to keep it open for a period longer.

Who knows where the interest rates will go, and we're certainly not going to do the negotiations here, but it's something that we've highlighted and the unions are very fully involved. They see the numbers.

I run a committee where Dave Ward comes along and sits, so he actually understands how that risk is developing. So as part of Moya's on-going dialogue this is an issue which they understand. The pension at that rate is not something that we will be able to afford, so we need to do different things as at March 2018.

And in terms of the property, yes, we're actively seeing what the best thing for us is. At the time, we were not committing to a particular form of disposal so we will see how those negotiations pan out. But, yes, I'm expecting further announcements during this year.

Right, it's half past 10. I would guess, Moya, we'll hang around for a bit here if anybody's got any points of great detail. But otherwise, thanks very much.

Cont…

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