

# Royal Mail Industry Workshop 24 April 2007



# Agenda

- Context
- Making the licence work
- Strategy Review Position
- Licence Condition 21 and Royal Mail's applications
- Summary

# 2006-07 sustained excellent quality of service

<b>Quality of Service Performance - Results to Period 11 2006-07</b>	<b>Licence Full Year Target</b>	<b>Actual cumulative to period 11</b>	<b>Performance Above Target</b>
Retail First Class	93.0	94.0	☑
Retail Second Class	98.5	98.9	☑
Bulk First Class	91.0	93.2	☑
Bulk Second Class	97.5	98.3	☑
Bulk Third Class	97.5	99.4	☑
Standard Parcels	90.0	94.6	☑
European International Delivery	85.0	92.7	☑
Special Delivery Next Day Non-Account Customers	99.0	99.0	☑
Postcode Area: 1st Class Stamped And Meter Delivered From UK*	118	115	☒
Percentage Of Collection Points Served Each Day (USO)	99.90	100.0	☑
Percentage Of Delivery Routes Completed Each Day (USO)	99.90	100.0	☑
Percentage Of Items Delivered Correctly	99.5	99.7	☑

\* 91.5% minimum in all Postcode Areas except 3

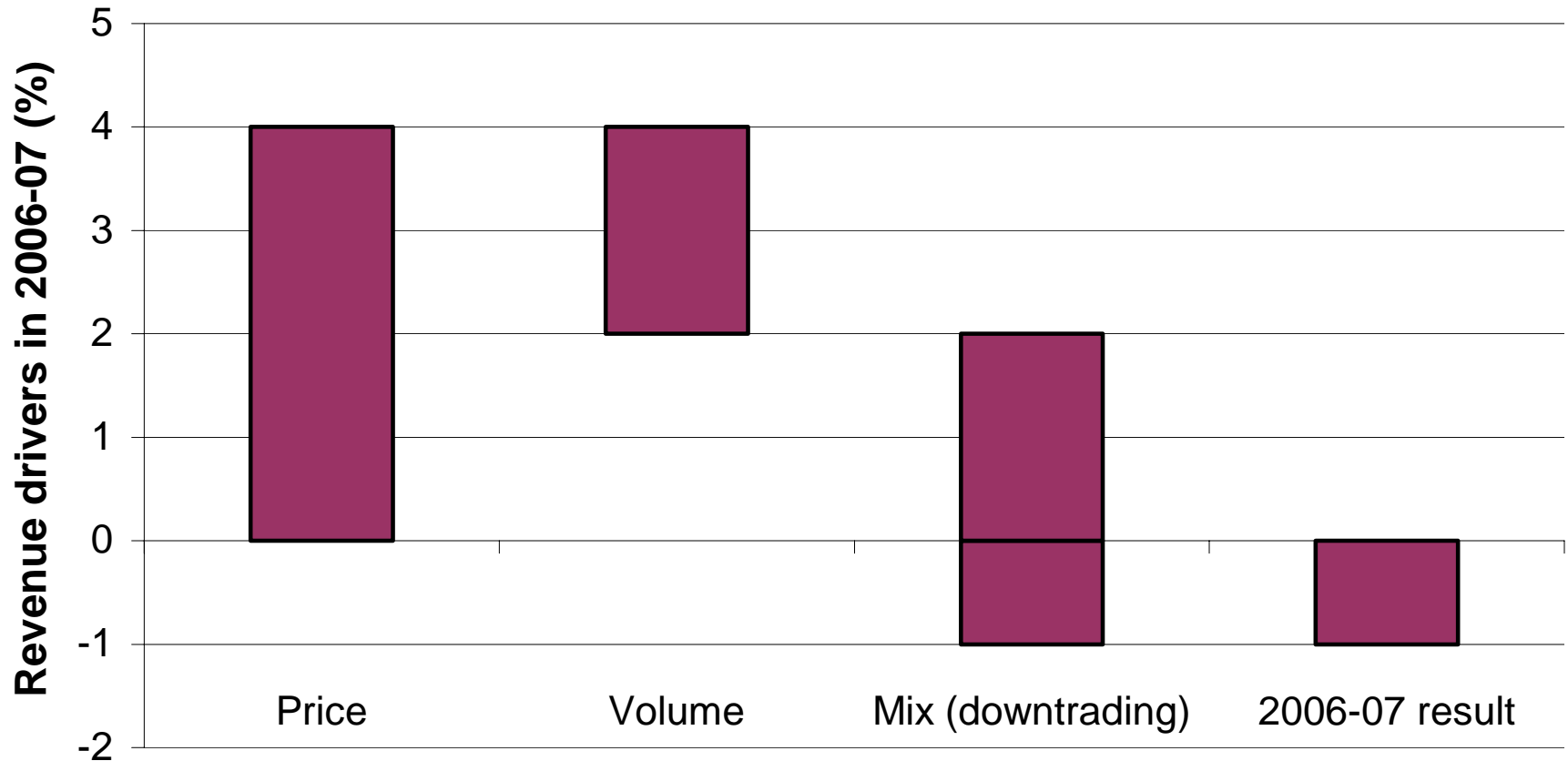
# Downtrading and volume loss are accelerating

	Growth		Volume		Growth Q4
		2006	2006	2005	
		%	(items m)	(items m)	%
First Class	↓	(7.9%)	4,435	4,827	(8.4%)
Second Class	↓	(5.6%)	4,888	5,187	(5.4%)
Mailsort	↓	(12.1%)	7,153	8,155	(14.7%)
Access	↑	> 100%	2,440	1,157	76.9%
Presstream	↓	(13.0%)	635	731	(22.8%)
Special Delivery, Std Parcels	↓	(2.3%)	95	98	(0.7%)
<b>Total addressed inland products</b>	↓	<b>(2.3%)</b>	<b>19,645</b>	<b>20,156</b>	<b>(3.6%)</b>
Door to Door	↓	(4.1%)	3,210	3,354	(9.7%)
International	↑	0.6%	1,235	1,229	(7.8%)
<b>Total</b>	↓	<b>(2.4%)</b>	<b>24,089</b>	<b>24,739</b>	<b>(4.7%)</b>

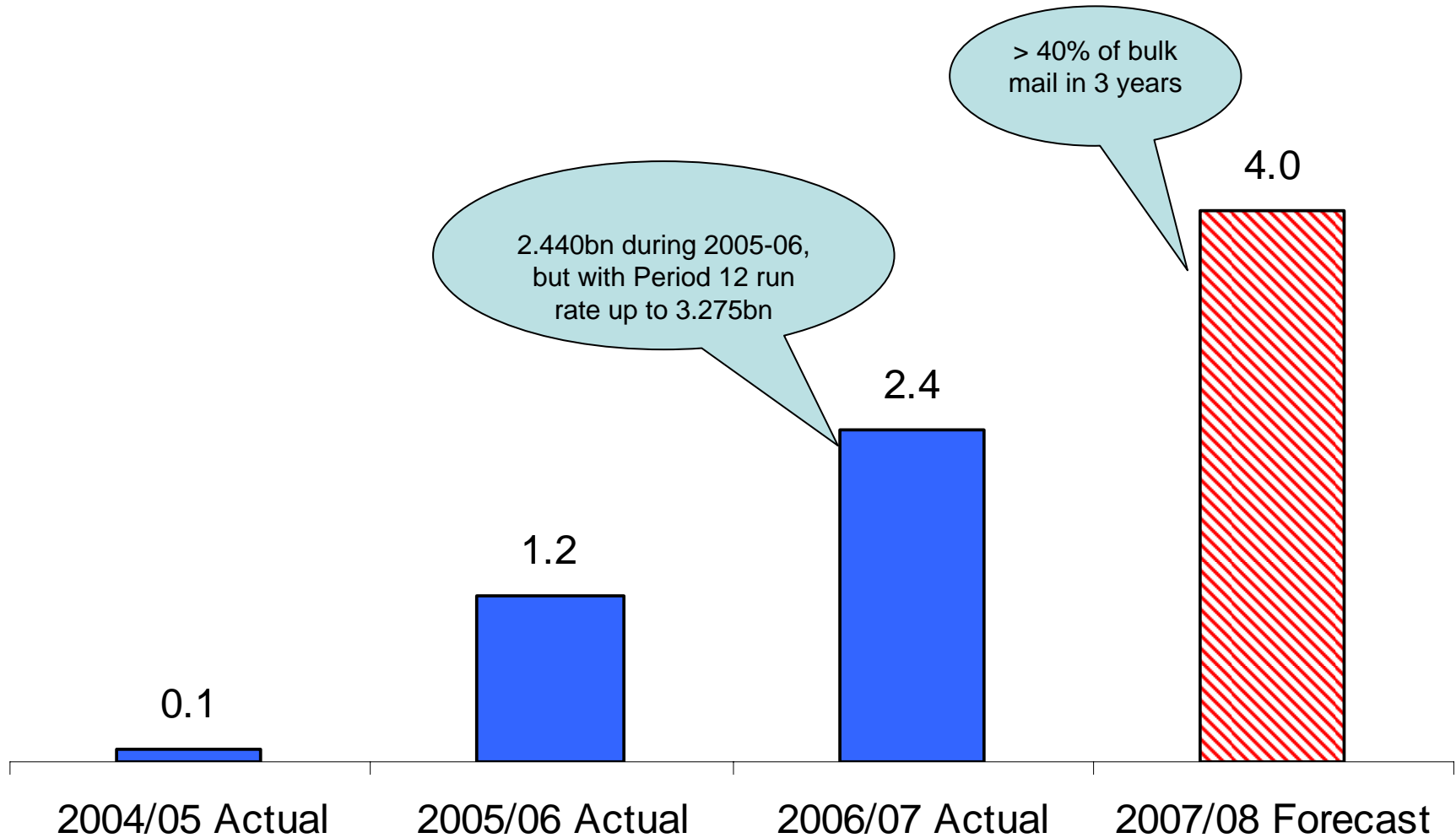
Includes DWP, BT, Centrica

Vs (1.9%) at half year and (0.7%) for 2005-06

# Flowing through to revenue decline

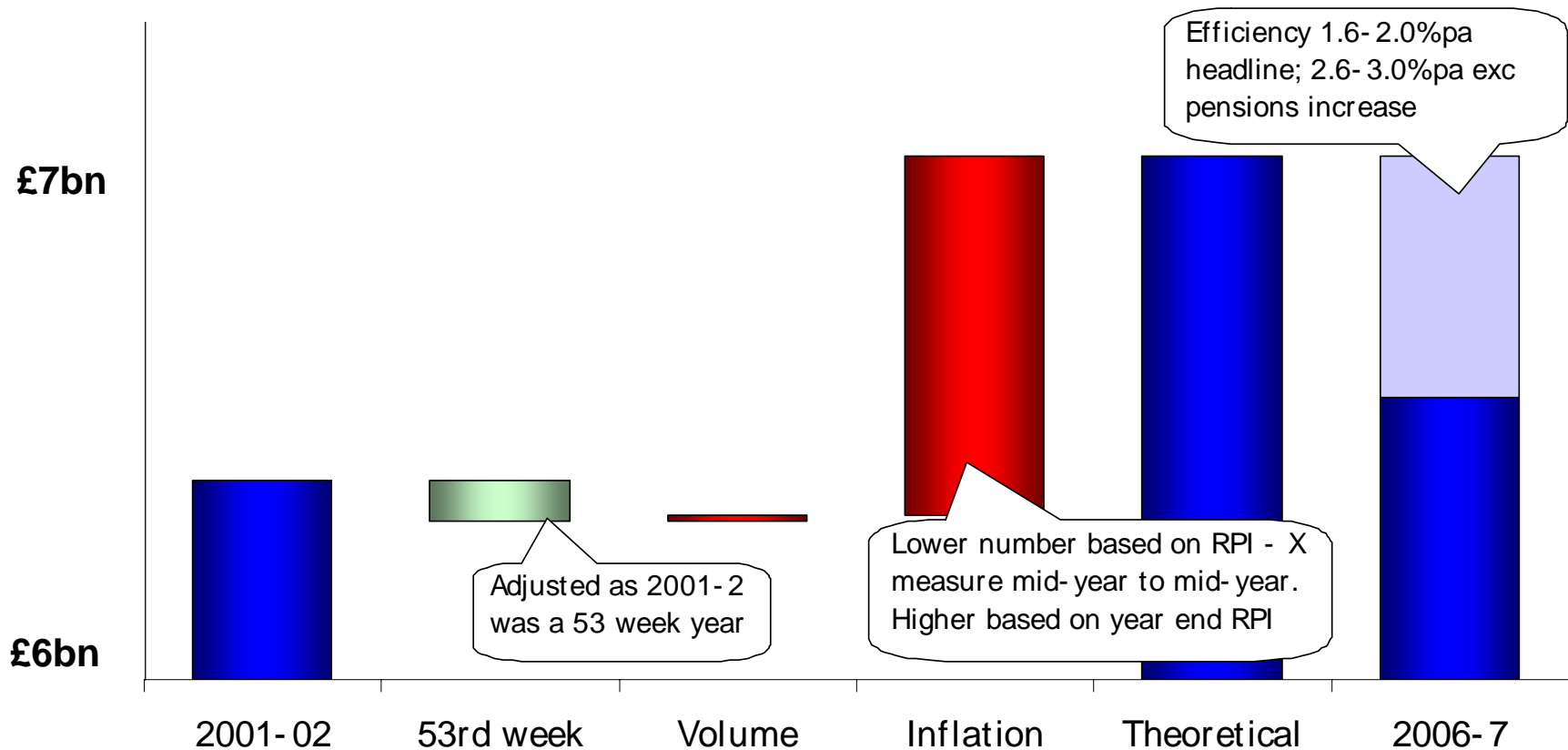


# With downstream access volumes seeing explosive growth (bn items)



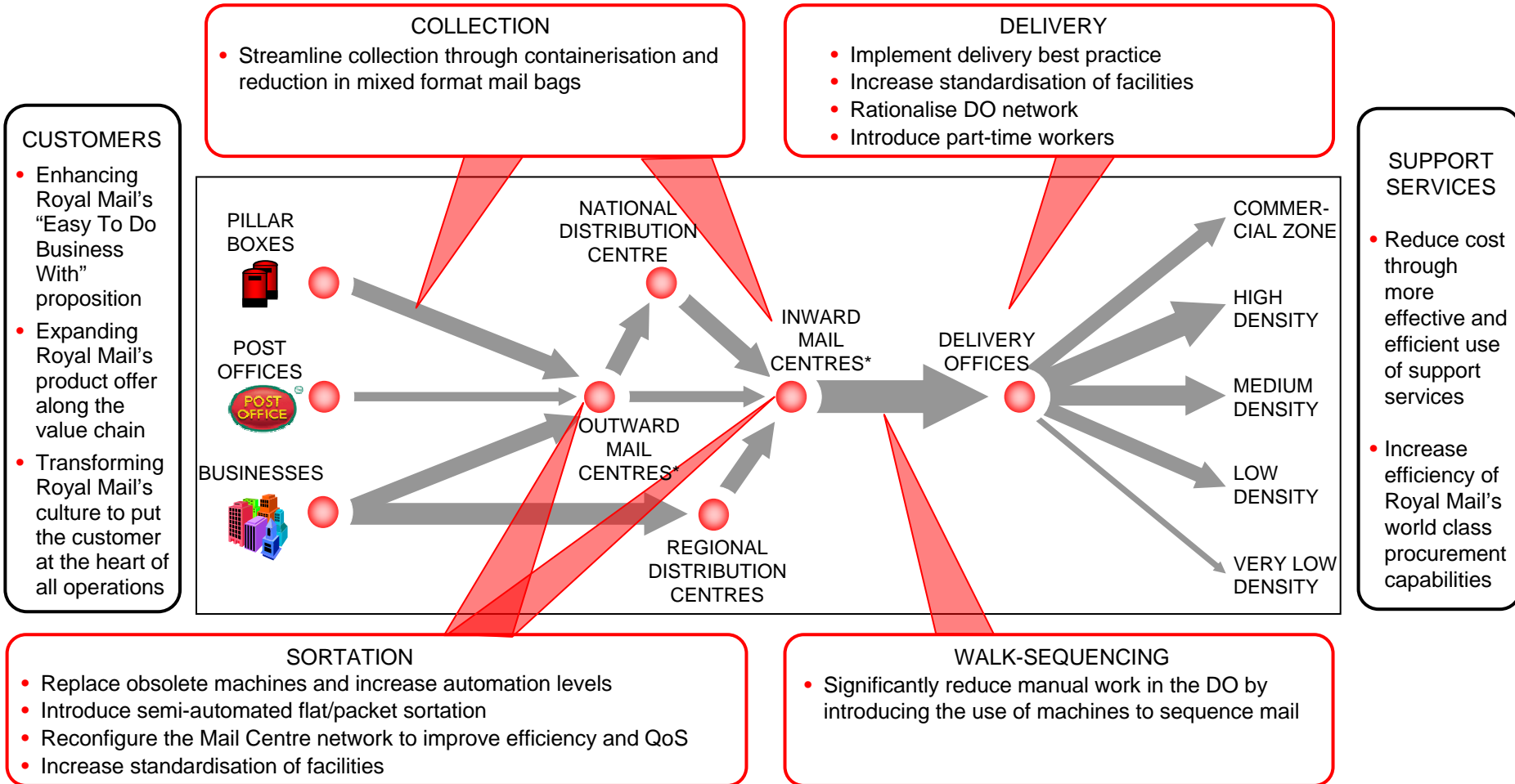
Source: Royal Mail

# We have made significant progress in reducing costs – even after the cost of pension increases



Source: Regulatory Accounts for 2001-2 and RM Letters flash results combined with Regulatory results for 2006-7

# We have now got a funding deal and can commence transformation

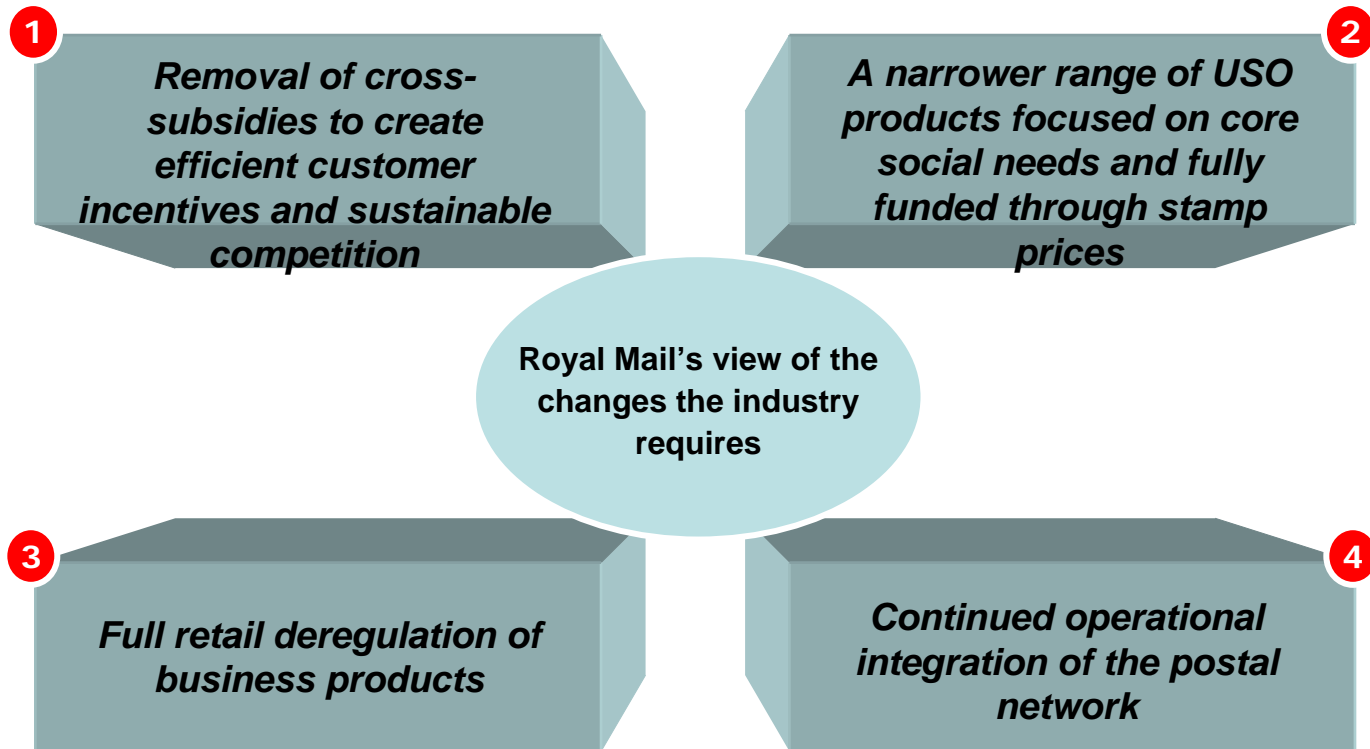


\* Inward and outward Mail Centres are the same building using the same machines and the same staff

# We have made most of the new licence work

- Condition 4 – targets being met and other reporting requirements being delivered
- Condition 7 – notification
- Condition 10 - arrangements in place and subject to routine legal reviews
- Condition 19 – capex reporting

# And we have made a valid contribution to the Strategy Review response for the medium to long term



# The removal of cross subsidies...

- Aligns prices to costs
- Creates greater transparency to all stakeholders
- Sends the right market signals to customers and entrants
- Promotes effective and efficient entry
- Means customers pay for their own mail and not others'

However Licence Condition 21 makes it hard for us to be flexible and responsive to market changes in the short term

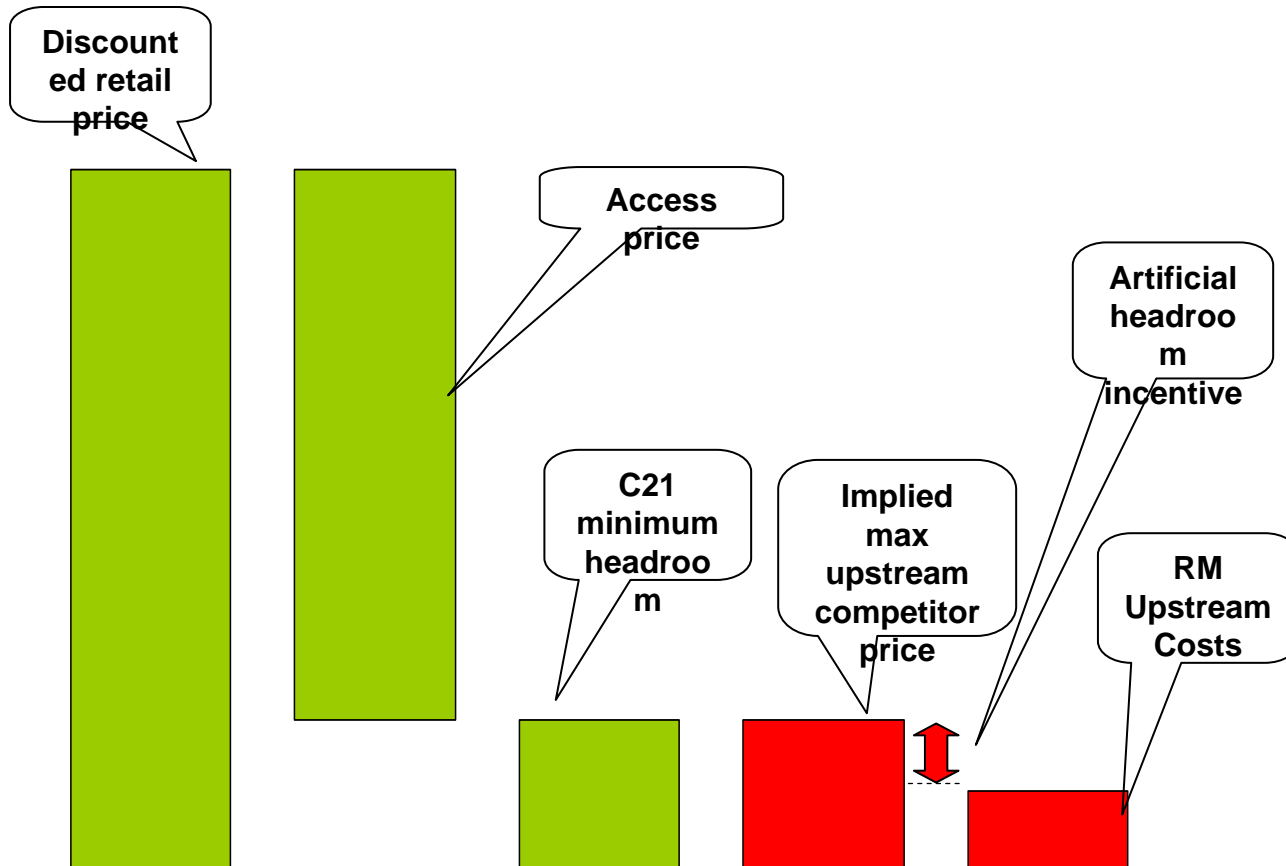
We seek to make the process as simple as possible by:

- Only asking for directions – not licence modifications
- Modifying the minimum headroom levels for products up to 750g
- Resetting the rebalancing percentages from 3% to 8.5% to tackle loss making products

We are not:

- Asking that the two baskets be collapsed
- Asking for headroom to be extended to other products
- Asking for the 'X' to be changed
- Re-opening the price control

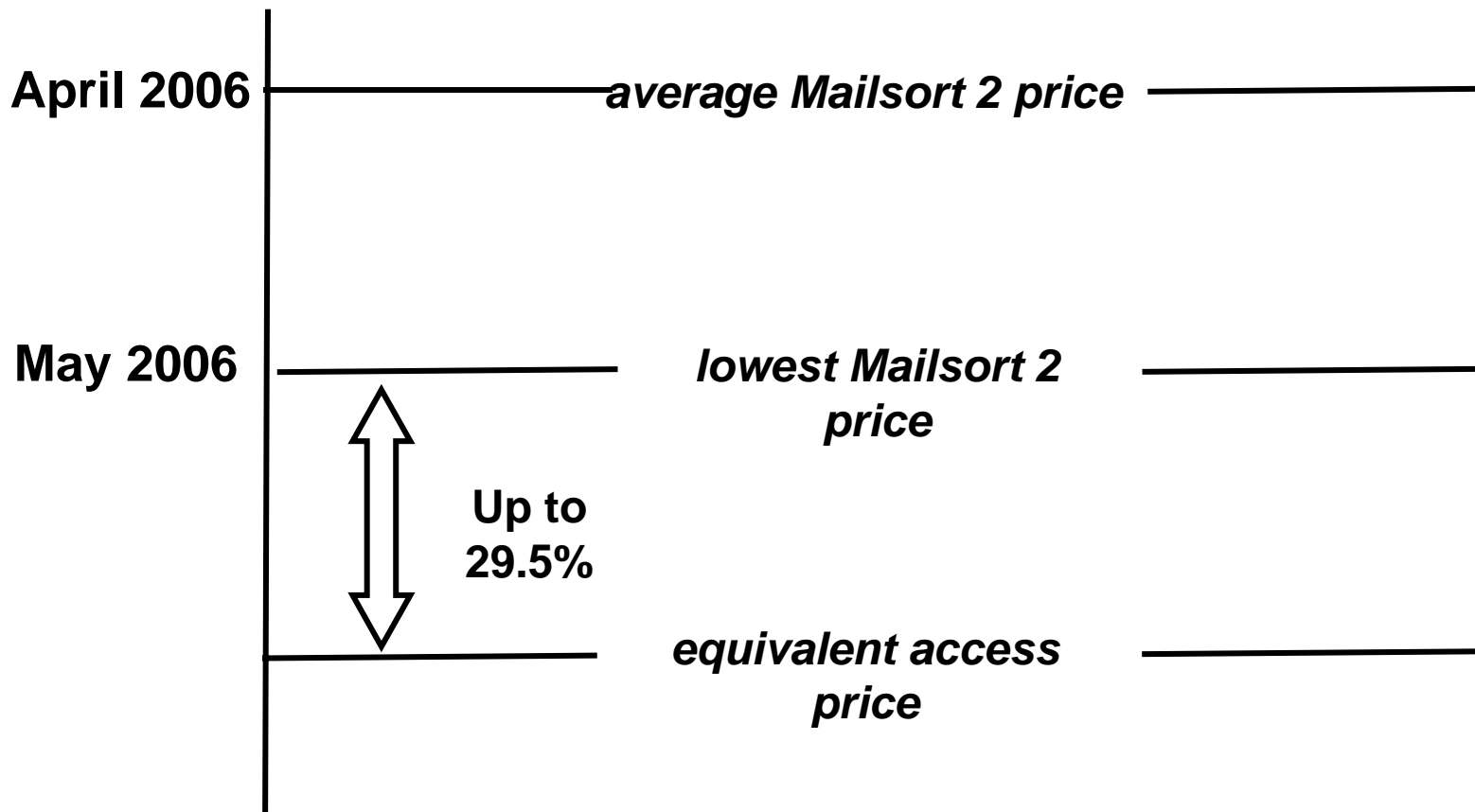
# Headroom constraint – what is it?



## Problems:

- Headroom level was set based on 2006 prices which were not cost-reflective
- Constraint well in excess of standard ex-post 'margin squeeze' tests
- By linking to the very lowest available bulk mail price it means RM cannot create specialist /niche offerings without these becoming the 'floor' retail price – which the headroom is applied to for all products

And why it does not create the right incentives in a declining market...



# Royal Mail's 'headroom' application

## What it is not:

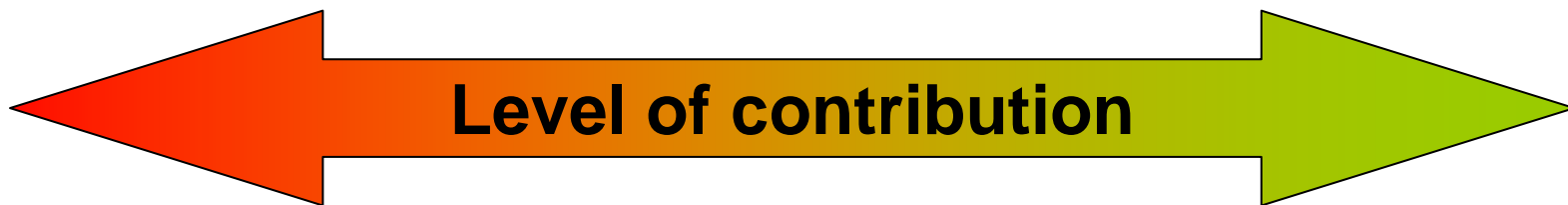
- A means to reduce all retail prices to the new headroom level - Mailsort is not sufficiently profitable
- A means to increase all access prices to the new headroom level - contracts are commercially negotiated
- An inappropriate margin squeeze
- A way to plug our finances

## What it is:

- A shift to more cost reflective prices
- A means to provide pricing flexibility to the retail business to enable it to react to current and projected market conditions
- Still sets an appropriate headroom margin based on RM's costs
- Based on 2005-06 audited costs
- Mitigates some but not all market risk

# Greater rebalancing would allow Royal Mail to move closer towards cost reflective pricing

<b>Basket A</b>	<ul style="list-style-type: none"><li>• Stamped mail (excl. 1<sup>st</sup> class basic weight step)</li><li>• 2<sup>nd</sup> class meter</li></ul>	<ul style="list-style-type: none"><li>• 1<sup>st</sup> class basic weight step</li><li>• 1<sup>st</sup> class meter</li><li>• PPI</li><li>• Special delivery (non contract)</li></ul>
<b>Basket B</b>	<ul style="list-style-type: none"><li>• Mailsort 2/3</li></ul>	<ul style="list-style-type: none"><li>• Mailsort 1</li></ul>



# Royal Mail's 'rebalancing' application

## What it is not:

- A means of moving all prices to costs – since Basket B is very competitive
- A way to plug our finances since allowed revenues in each basket are capped

## What it is:

- A shift to more cost reflective prices
- A means to provide pricing flexibility into the retail business to enable it to react to current and projected market conditions

# Summary

- Service quality excellent
- We have commenced transformation - 5 years
- We have responded to the Strategy Review – 2010 onwards?
- The market has and will continue to contract
- Royal Mail and its customers require greater flexibility with respect to pricing
- The shift to more cost reflective and commercial pricing benefits stakeholders