



# Chief Executive Officer's review

We have delivered a resilient performance in challenging markets. We are continuing to deliver service improvements and product innovations to meet customer needs. We are stepping up our investment in growth, to ensure we are agile and responsive in our fast-changing market place.

**Moya Greene**  
Chief Executive Officer  
18 May 2016

## Our performance

Group revenue increased by one per cent<sup>1</sup>. GLS revenue growth of nine per cent offset a one per cent reduction in UKPIL revenue.

As a result of our strategic focus on costs across the Group, adjusted<sup>2</sup> Group operating profit before transformation costs was £742 million. Transformation costs were £191 million due to our accelerated efficiency programme. This led to a decline of 10 basis points in the adjusted Group operating profit margin after transformation costs to 6.0 per cent.

In-year trading cash flow of £254 million was £61 million lower than the prior year, reflecting higher investment spend in 2015-16.

## Our strategy

We have a plan in place to help us protect our core business and grow in new areas. We are responding to our changing environment by updating our strategic priorities. They are underpinned by putting the customer at the heart of everything we do.

### Our strategic priorities are:

- Winning in parcels;
- Defending letters; and
- Growing in new areas.

### Enabled by:

- Strategic focus on costs;
- Technology and innovation; and
- An engaged and motivated workforce.

➔ [See pages 16–17 for more information.](#)

## Winning in parcels

We are the UK's leading parcels carrier. Our scale as the Universal Service Provider means that businesses selling goods online can operate just as effectively from a village in rural North Wales as a business in the centre of London. We provide a vital delivery network that, in particular, supports consumers and small and medium-sized enterprises (SMEs).

<sup>1</sup> All movements are on an underlying basis unless otherwise stated. Underlying change is calculated after adjusting for movements in foreign exchange in GLS, working days in UKPIL and other one-off items that distort the Group's underlying performance. For volumes, underlying movements are adjusted for working days in UKPIL and exclude elections in letter volumes

<sup>2</sup> All adjusted results are a non-IFRS measure and exclude specific items. The commentary in this report, unless specified otherwise, focuses on the operating results on an adjusted basis. This is consistent with the way that financial performance is measured by Management and reported to the Board and assists in providing a meaningful analysis of the results of the Group

## Competitive marketplaces

The UK parcels market remains one of the most competitive in Europe. We estimate that the total blended market<sup>3</sup> volume of parcel deliveries in the UK will grow at four<sup>4</sup> per cent per annum in the medium-term. However, we estimate that annual addressable market volume growth will be impacted depending on the expansion of Amazon Logistics.

In the consumer/SME segment, competition is intense and growing. Increased collection, delivery and return options are giving consumers more choice. We have introduced a wide range of initiatives to maintain our pre-eminent position in this segment. We are seeing an improvement in the volume trend through these channels.

Large retailers are seeking new fulfilment channels by building or expanding delivery and/or collection networks, cutting other delivery operators out of the value chain. Carriers are bringing new capacity online, which is putting pressure on prices. We are also seeing growth in the use of disruptive technologies and fast-growing delivery options, albeit from a low base. Royal Mail is performing well in the account parcels segment. We have won new contracts with John Lewis Partnership, Urban Group, M&S and Waterstones. New contract wins have more than offset lost Amazon volumes, and we are seeing some uptrading to higher revenue tracked services.

International markets are intensely competitive, with UK market dynamics increasingly replicated in international, cross-border services. International accounts for 19 per cent of UKPIL parcel volumes and 18 per cent of revenue. We saw a reduction in export volumes during the year. We have spent a significant amount of time developing strategies to address this. However, it remains a key strategic focus for the next 12 months.

## Our performance

Our broad customer base means that we are less exposed to the actions of our larger customers than some of our peers. Our largest parcels customer, the Amazon

Group<sup>5</sup>, now accounts for around five per cent of UKPIL parcel revenue.

UKPIL parcel volume growth of three per cent was driven by growth in import, Royal Mail account and Parcelforce Worldwide, where volumes increased by 12 per cent. Excluding Amazon volumes, total Royal Mail account parcel volumes increased by seven per cent. This growth more than offset the effects of the competitive environment in consumer/SME and export parcels. Parcel revenue increased by one per cent, due to the impact of this mix.

Our European parcels carrier, GLS, delivered revenue growth in almost all of its markets. Growth continues to be fuelled by increasing cross-border trade, driven by e-retail.

### Winning in parcels: key points

- Pursuing faster growing areas of the UK and international markets;
- Adding value by improving our products and services; and
- Expanding and automating our networks.

### Pursuing faster growing areas of the UK and international markets

We are successfully targeting the faster growing areas of the UK parcels market and are developing initiatives to address the impact of increased competition in the consumer/SME and export markets.

We are increasing our capability, where appropriate, to handle larger parcels. Leeds Mail Centre is piloting a mechanised parcel conveyor that can safely, and more efficiently, handle larger parcels – a growing segment of our parcels mix.

Our returns volumes have grown by 24 per cent this year. We are improving and extending our Tracked Returns<sup>®</sup> service to contract customers, including eBay merchants. We are also growing our business with existing customers, such as ASOS.

We are developing initiatives to address the impact of increased competition in the export market. In February 2016, Parcelforce Worldwide extended its tracked globalpriority<sup>®</sup> return service to retailers sending items to Australia, which is the first country outside the EU to benefit from this express returns service. The service is currently available in 18 countries.

<sup>5</sup> Amazon Group includes Amazon Logistics, Lovefilm and Book Depository

We have a range of international delivery options designed to make exporting as simple and cost effective as possible, as part of the Government's Exporting is GREAT campaign. International postage can now also be purchased through Click & Drop, our easy to use online postage service. We have expanded this service across more than 200 international destinations. Royal Mail International Tracked & Signed is now available in 54 destinations.

We have extended our strategic service with Alibaba, linking Chinese exporters with UK online shoppers, and allowing them to supply goods for UK delivery much more quickly. We have increased the number of brands on the Tmall shop front to 34 since we launched the partnership in March 2015.

### Adding value by improving our products and services

We are becoming more flexible to suit the needs of our sending and receiving customers. For example, we have extended latest acceptance times in our Mail Centres and RDCs for our Tracked 24<sup>®</sup>/48<sup>®</sup> products, reflecting customer demand.

We are expanding the support we offer to key business customers and online marketplace traders, including eBay sellers. In October 2015, we launched and have subsequently extended a trial of doorstep collections in North West England. This service offers marketplace sellers and SMEs next day parcel collection from their address. Around 300 sellers are participating in the trial.

We have reduced our prices for Second Class medium parcels under two kilograms and we are maintaining the online price of small and medium parcels for 2016-17.

We are working with Post Office Limited to improve our customers' experience. This includes more Post Office branches being open for longer, and on Sundays, and our expanded Local Collect network. Local Collect is the largest UK network of click and collect locations. It has been extended to Enquiry Offices to create a network of more than 11,700 sites. Royal Mail Local Collect has more collection points across the UK than the next two largest competitor click and collect networks combined.

### Expanding and automating our networks

Parcel automation is one of the next stages on our transformation journey. The first parcel sortation machine has been installed in Swindon. The roll-out to further sites will continue over the next two years.

<sup>3</sup> Internal estimate based on Triangle Management Services/RMG Fulfilment Market Measure (2014); defined as individually addressed parcels and packets, generated and delivered in the UK, weighing up to 30kg, that do not require special handling. Includes access fulfilment large letters & parcels and excludes click and collect, same-day, small local operators and all international traffic. Includes Amazon Logistics and other retailers own-delivery networks

<sup>4</sup> Based on Verdict UK E-retail survey and RMG market insight

We are working with our customers to put 2D barcodes on as many parcels as possible. Nearly 100 per cent of parcel volumes through the Post Office network now use Royal Mail 2D barcodes. Around 50 per cent of all our UKPIL parcels now carry a barcode and one-third can be tracked by customers in some way.

GLS is setting new standards in the German parcels market. Together with DPD and Hermes, it has founded ParcelLock GmbH, which operates carrier-neutral parcel boxes for private customers. With the secure parcel box system, delivery operators can leave items in the parcel box for the customer to pick up. GLS' FlexDeliveryService is continuing to roll-out and is now available in 13 countries.

## Defending letters

Addressed letter volumes decreased by three per cent – better than our forecast range of a 4-6 per cent decline per annum – due to the one-off return of direct delivery volumes.

Marketing mail revenue was flat. This follows growth of three per cent in the first six months and reflects a slowing in UK economic activity. Direct mail is the fourth largest advertising medium in the UK. Overall, UK direct mail advertising spend grew one per cent during 2015, the first increase in four years, while print advertising media declined 11 per cent<sup>6</sup>.

### Defending letters: key points

- Promoting the value of mail;
- Optimising mail handling to increase efficiency; and
- Participating in Ofcom's consultation on the Fundamental Regulatory Review, to ensure the provision of the Universal Service in the UK.

## Promoting the value of mail

Since 2005, Ofcom has tracked consumer ratings of value for money in eight sectors. Postal services and delivery is the only sector to see an increase in customers' perception of value for money from 2005 to 2015.

The Keep Me Posted campaign aims to give every consumer the right to choose, without disadvantage, how they are contacted by companies. To date, 10 service providers have been awarded a Keep Me Posted Mark of Distinction – the most recent recipients being Royal Bank of Scotland, NatWest and Ulster Bank, which have a combined customer base of around 16 million. This means these

consumers are now realising the value and opportunities of retaining mail as a customer communications channel.

Marketing mail revenue is important for our business – it provides access to revenue pools to support the delivery of the Universal Service. Through our MarketReach business, we are increasing awareness of the value of advertising mail, through campaigns like MAILMEN (see case study).

We are launching MailshotMaker, a new online tool that enables SMEs to design and implement direct mail campaigns. We have also launched a new digital stamp indicia for business customers. They can now add high quality, full-colour printed versions of some of Royal Mail Special Stamps range and our iconic blue Second Class stamp – to their business mailings. We intend to extend the range of designs available over time.

Royal Mail's stamp prices are amongst the best value in Europe. In February 2016, we announced price increases of one penny for First Class and Second Class consumer stamps. We carefully considered the impact on our customers and our business before deciding to apply the lowest possible increase in stamped letter prices. We believe these changes are necessary to help ensure the sustainability of the Universal Service.

## Optimising mail handling

We continue to implement processes to ensure that mail is handled as efficiently as possible. We have improved large letter sorting machines and will be upgrading Optical Character Reading technology to sort more mail automatically. We began a pilot to optimise the processing of mail through our collection hubs, working closely with our unions. Our Bristol and Jubilee Mail Centres will handle this pre-processed mail allowing us to streamline the sorting and trunking process.

## Regulation

We await the publication of Ofcom's proposals under the Fundamental Regulatory Review. We will actively participate in the consultation process.

## Promoting the value of direct mail



Tess Macleod Smith, vice president of publishing and media at Net-a-Porter on making the company's print magazine, Porter, shoppable.

'Porter has revolutionised print. Eighty-five per cent of our core audience – who are devoted digital shoppers – say that print is the number one influencer in telling them what to buy and from where.

'Porter is sent out in the post to our highest spenders. These days, many of us simply don't have time to go to a newsstand, so mail is the best medium for reach as well as impact. In a world of convenience and online shopping, having things delivered directly to us is the new norm.

'We use direct mail because we know it works – we invested in two very successful campaigns in the UK and US this year – and they can be directly attributed to an uplift in Porter subscribers.

'The mag, like mail, is a great acquisition tool. We know that once someone is a subscriber to Porter, they visit the site 25 per cent more often and spend 120 per cent more with us. You can't argue with figures like that.'

<sup>6</sup> WARC UK expenditure report, April 2016. Data from January to December 2015

## Growing in new areas

### Growing in new areas: key points

- **Making the most of our existing assets;**
- **Targeted investments to build our presence in growing areas of the market; and**
- **Becoming a digital organisation and building e-commerce capability.**

As part of our focus on growth, we are seeking ways to generate more value from our existing assets. The UK vehicle service, maintenance and repair market is estimated to be worth around £3.4 billion per annum<sup>7</sup>. We have around 100 fleet workshops that are expert in vehicle maintenance services. We are conducting a pilot offering third parties access to our vehicle maintenance services.

We are launching a new app – Swapshots – which aims to capture growth in the printed image market. Royal Mail is believed to be the first European postal operator to launch an app of this kind. Swapshots integrates digital technology, printing and delivery in order to print, post and deliver photos within three days. The app will sit alongside Mallzee, the 'personal shopping' app which aggregates inventory from over 150 fashion brands, as part of Royal Mail's growing digital portfolio.

We are also targeting higher growth areas. In particular, we are looking to leverage GLS' expertise and reach and to strengthen partnerships with marketplaces, e-retailers and other operators. In March 2016, we acquired Intersoft, a provider of carrier management software for international parcel shipments. This complements the purchases of data management and labelling provider NetDespatch and delivery software developer Storefeeder, further enhancing our in-house IT capabilities.

### Strategic focus on costs

Becoming more efficient and productive allows us to be more competitive. This, in turn, helps us to grow our existing customer relationships and win new business. It helps to fund investment in our growth and maintain our fair terms and conditions for our people.

UKPIL operating costs before transformation costs declined by one per cent, in line with our expectations. We have avoided around £180 million in operating costs during the year. We achieved productivity<sup>8</sup> improvements

of 2.4 per cent, within our 2.0-3.0 per cent target range. This builds on a productivity improvement of 2.5 per cent in 2014-15 and 1.7 per cent in 2013-14.

With more than 47,000 vehicles on the road, we have the biggest fleet in the UK. New driver technology has been installed in approximately 13,000 small, high-mileage vans. The new technology promotes better driving behaviour, keeping them safe and reducing fuel usage and maintenance costs.

We are extending Collections on Delivery, by which our postmen and women collect letters from low-volume postboxes. Alongside this, a nationwide review of our national and regional routes will help us to reduce mileage.

### Technology and innovation

We are strengthening our technology backbone so that we can support our objectives to win in parcels, defend letters and grow in new areas.

In parcels, we have begun the roll-out of 76,000 new PDAs across our operation. These handheld devices provide management data through functions like the scanning of 2D barcodes, and the capture of signatures on delivery. Three thousand finger scanners have already been introduced across our Mail Centres and RDCs. With better management information, we can benefit from more accurate billing for the services we provide and identify efficiency opportunities. Customers will enjoy easier signature capture and, in time, better tracking information.

In our letters business, we are continuing the rollout of Mailmark<sup>®</sup>, which provides barcode technology and online-reporting for machine-readable business, advertising and publishing mail. Over three billion letters have now been sent using Royal Mail Mailmark<sup>®</sup> and around 50 per cent of machine-readable mail currently carries the Mailmark<sup>®</sup> barcode. We are targeting 90 per cent of suitable letters by 2016-17.

We are focusing on improving our customer experience by rolling out improved technologies across our network. We have deployed the 'Service-Point-System' (online booking-in tool) to 460 Enquiry Offices. The tool allows colleagues to locate customers' items quickly and easily, providing a faster service.

### Engaged and motivated workforce

Our people are at the heart of our continued success. We want our workforce to reflect the communities we serve. We are pleased

that Royal Mail has been named in The Times Top 50 Employers for Women 2015, for our commitment to gender equality in the workplace, for the second consecutive year.

Through our Together for Growth programme, over 6,000 managers and union representatives took part in joint training over a 16 month period from July 2014 to October 2015. The programme was designed jointly with Communication Workers Union (CWU) and Unite/CMA and is one of the UK's largest ever investments in this form of training.

Royal Mail takes its Quality of Service very seriously. We are extremely disappointed that our full year regulatory First Class performance of 92.5 per cent narrowly missed the 93.0 per cent target. We again exceeded our Second Class target, with a performance of 98.8 per cent.

We are committed to delivering a high Quality of Service while seeking to become ever more efficient. In doing so, we actively review the absorbable rate of change and the appropriate balance between quality and efficiency. In the second half of the year, we increased the already very considerable resources deployed to improve our delivery performance.

We note that Ofcom is launching an investigation into our Quality of Service for 2015-16. We believe the full year outcome was impacted by events outside our control. These include Cyber Week, which this year fell outside the Christmas exemption period, and significant disruption in parts of the network due to poor weather and road closures. Royal Mail believes that if the 2015-16 performance was adjusted for these two factors, an additional 0.31 per cent would be added to the 92.5 per cent performance. We are asking Ofcom to take these issues into consideration.

At Royal Mail, we strive to deliver a consistently high quality, value for money service. While our performance improved in two out of our four<sup>9</sup> main complaint categories, we were disappointed to see that an increase in other complaint categories offset this.

We take complaints seriously and have developed a 'root cause' approach to complaints management. This helps us to resolve customer issues quickly, while identifying hotspots and issues. Underpinning this, there is also a focus on first time delivery within our operation and constantly driving improved performance in our operational units. We are making it as easy

<sup>7</sup> Estimate based on analysis performed by OC&C Strategy Consultants

<sup>8</sup> Collections, processing and delivery in UKPIL core network

<sup>9</sup> Redirections, redeliveries, misdeliveries and 'Something For You' cards. Performance improved in 'Something For You' and redirection complaints

as possible for customers to receive their parcels through services such as Delivery to Neighbour and Nominate a Neighbour.

We are tackling other complaints through our Operations Standards, which give us a standard approach to key processes and tasks. These Standards are split into four key categories – safety, quality, efficiency and people – helping us to work more efficiently and consistently across the business.

Customer and You, a two-year programme which completed in March 2016, modernised our Enquiry Offices to create more welcoming and well-maintained environments, improved and standardised processes to ensure greater consistency in quality across sites and equipped our people with more customer facing skills. We completed Customer and You training for a total of 3,980 employees, exceeding our overall target of 3,500.

Subject to shareholders approving the final dividend, eligible employees with a maximum allocation of 832 Free Shares will have received dividend payments of over £430 by 29 July 2016.

## Outlook

Our outlook for UK letter and parcel market trends remains unchanged. However, we will need to meet the challenges caused by slowing economic growth, the current low inflationary environment, and continuing developments in the highly competitive markets in which we operate. In particular, in the first three months of 2016-17 we will be lapping the impact of elections in letter revenue in the prior period.

Our cost avoidance programme in UKPIL is on track and we expect to avoid a similar level of costs in 2016-17 as the prior year. We continue to target avoiding around £500 million of annualised costs, cumulative over the three financial years to 2017-18.

That said, we have additional challenges to manage in the coming year, in particular the negotiation of pay and pensions, while maintaining the climate of positive engagement with our people that we have created over the past five years. We will continue to seek opportunities to drive efficiency across the organisation such that transformation costs are likely to be above the previously indicated range of £120-140 million per annum over the period of the cost avoidance programme, with

around £160 million currently expected in 2016-17.

We expect that the rate of revenue growth in GLS will slow in 2016-17, given the particularly strong performance this year. Competitive pressures continue to intensify in our key markets, such as Germany.

We have invested heavily over the last five years in rebuilding our legacy IT systems and resizing the core network. We expect to keep total net investment spend, which includes replacement and growth capital expenditure and the cash cost of transformation, net of operational asset disposals, within the range of £550-600 million per annum in the medium-term. Within this we will be targeting an increased skew towards projects and initiatives supporting growth.

We remain focused on our in-year trading cash flow, which underpins our commitment to a progressive dividend policy.

## Thank you

2016 commemorates 500 years since Henry VIII knighted Brian Tuke, the first Master of the Posts, in 1516. This act was the first step in the creation of the Royal Mail. The history of the postal service in the UK reflects the tremendous societal and political change that has taken us from sixteenth century Tudor England to the United Kingdom of today.

We are proud to celebrate the heritage of this great Company. Against this backdrop of continued change, Royal Mail's people have been a constant presence. They are the heart of this Company. I hope that, through them, we will continue to deliver the Universal Service and play an instrumental role in people's lives for many years to come.

**Moya Greene**  
Chief Executive Officer  
18 May 2016

