UK Parcels, International & Letters (UKPIL)

Summary trading results (£m)	**Adjusted[1] 52 weeks ended 27 March 2016**	Adjusted 52 weeks ended 29 March 2015	Underlying change[2]
Letters & other mail	**3,312**	3,400	(2%)
Marketing mail	**1,158**	1,167	Flat
Total letters	**4,470**	4,567	(2%)
Parcels	**3,196**	3,190	1%
Revenue[3]	**7,666**	7,757	(1%)
Operating costs before transformation costs	**(7,058)**	(7,142)	(1%)
Operating profit before transformation costs	**608**	615	3%
Transformation costs	**(191)**	(145)	
Operating profit after transformation costs	**417**	470	(6%)
Margin	***5.4%***	*6.1%*	*(30 bps)*
Volumes (m)			
Addressed letters	**12,563**	13,009	(3%)
Unaddressed letters	**2,993**	3,157	(5%)
Parcels			
Core network	**1,034**	1,015	2%
Parcelforce Worldwide	**96**	86	12%
Total	**1,130**	1,101	3%

Revenue and volumes

UKPIL revenue was down one per cent, with parcels revenue up one per cent and total letter revenue down two per cent.

Total parcel volumes increased by three per cent. Parcel volume growth was driven by import parcels, Royal Mail account parcels and Parcelforce Worldwide more than offsetting the decline in higher AUR consumer/SME volumes and export parcels. We continue to see higher volumes of lower AUR import parcels, largely from China. Our improved product offering in account parcels resulted in new contract wins, which more than replaced lost Amazon traffic. Royal Mail account parcel volumes, excluding Amazon, grew by seven per cent. Parcelforce Worldwide continued to perform strongly with volume growth of 12 per cent due to new customer wins and increased business from existing customers. Given this particularly strong performance, we expect that the rate of growth will slow in 2016-17. The decline in international export parcel volumes was driven by difficult market conditions, including unfavourable exchange rate movements and an increasingly competitive environment. Parcel revenue was up one per cent, largely as a result of the change in mix.

Addressed letter volumes declined by three per cent (excluding the impact of election mailings), better than our forecast range. The one-off return of direct delivery volumes had a positive impact of around one percentage point. Overall, this was a good performance given the absence of a year-on-year improvement in general economic conditions. Total letter revenue (including marketing mail) decreased by two per cent. Price increases and growth in lower AUR network access and import letters were offset by declines in higher AUR consumer/SME and export letters.

Revenue from election mailings, relating to the general election in 2015-16, was slightly lower than the prior year. We are expecting a smaller benefit from election mailings in 2016-17, which will have a disproportionately negative impact on letter revenue in the first three months of the financial year.

Marketing mail revenue, which includes revenue from our data business, redirections, Address Management Unit, and addressed and unaddressed advertising mail, was flat. We saw an increasing slow-down in activity in the second half of the year, reflecting the softening economic conditions. Unaddressed letter volumes declined by five per cent, better than the performance in the first half, which was impacted by a reduction in door-to-door marketing spend in certain sectors in that period.

Operating costs

Total adjusted operating costs before transformation costs declined by one per cent on an underlying basis, in line with our expectations and reflecting our strategic focus on cost avoidance and efficiency. Our cost avoidance programme, which targets avoiding around £500 million of annualised costs cumulative over the three financial years to 2017-18, is on track. We avoided £182 million of costs in the year, split broadly evenly between people (£89 million) and non-people (£93 million) costs.

People costs declined by one per cent. This was driven by a 2.4 per cent improvement in productivity[4] and £40 million

[1] 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

[2] 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

[3] Stamp, metered and other prepaid revenue channels are subject to statistical sampling surveys to derive the revenue relating to parcels, marketing mail and letters. These surveys are subject to continuous refinement, which may over time reallocate revenue between the products above, and which may occasionally lead to a consequent change to this estimate

[4] Collection, processing and delivery in the UKPIL core network

Operating costs (£m)	**Adjusted 52 weeks ended 27 March 2016**	Adjusted 52 weeks ended 29 March 2015	Underlying change	Change after reclassification
People costs	**(4,764)**	(4,789)	(1%)	n/a
Non-people costs	**(2,294)**	(2,353)	(3%)	n/a
Distribution and conveyance costs	**(776)**	(821)	(5%)	n/a
Infrastructure costs	**(890)**	(919)	(3%)	Flat
Other operating costs	**(628)**	(613)	2%	(2%)
Total operating costs before transformation costs	**(7,058)**	(7,142)	(1%)	n/a

Transformation costs (£m)	**Adjusted 52 weeks ended 27 March 2016**	Adjusted 52 weeks ended 29 March 2015
Voluntary redundancy	**(117)**	(81)
Project costs	**(72)**	(55)
Business transformation payments	**(2)**	(9)
Total	**(191)**	(145)

savings in relation to the management reorganisation programme implemented in 2014-15. These offset pay increases, largely the 2.8 per cent frontline pay award, and an increase in volume-driven costs in Parcelforce Worldwide. The improvement in productivity was achieved through a 2.0 per cent reduction in core network hours, despite an increase in workload, partly driven by an increase in tracked products and the increasing size of parcels. We continue to target productivity improvements of 2.0-3.0 per cent per annum.

As previously disclosed, as a result of the new single-tier state pension scheme introduced in April 2016, the Group expects to see an increase in its employer National Insurance contributions for employees participating in the Royal Mail Pension Plan (RMPP) of around £70 million from 2016-17. In addition, other wage legislation such as the Working Time Directive, Apprentice Levy and increased costs relating to redundancy payments will impact people costs in the future. We would expect to exclude the first year impact of such legislative changes from underlying movements if material.

Non-people costs declined by three per cent. Distribution and conveyance costs reduced by five per cent. This was driven by a reduction in terminal dues, partly as a result of lower export volumes, improved fleet management and a reduction in the usage of UK air routes leading to lower jet fuel costs. Total diesel and jet fuel costs of £172 million were £14 million lower than the prior year. We buy forward a large part of our fuel requirements therefore we are not materially exposed to short-term fluctuations in oil prices. We expect fuel costs to be around £155 million in 2016-17. The overall reduction in distribution and conveyance costs was partly offset by costs associated with the increasing size of parcels in our network. Infrastructure costs were flat, after the reclassification of internal costs, as savings on facilities management, utilities and lower depreciation were offset by increases in IT costs in relation to the IT transformation programme. We have invested significantly in IT and other assets as part of the transformation programme and as a result, the depreciation and amortisation charge is expected to increase going forward, with an increase of around £20 million in 2016-17. Other operating costs were down two per cent, after the reclassification of internal costs, due to reductions in amounts payable to Post Office Limited and our continued focus on discretionary costs.

As a result of the acquisition of the minority shareholding in Romec Limited on 31 March 2016, the costs of Romec Limited, previously reported in the 'Other' segment, will be incorporated into UKPIL people and non-people costs from 2016-17, replacing the facilities management charge within infrastructure costs.

On a reported[5] basis, UKPIL operating costs before transformation costs increased by £44 million to £7,315 million. This was mainly as a result of the increase in the IAS 19 non-cash pension service charge caused by a decrease in AA corporate bond yields.

[5] Prepared in accordance with IFRS

Transformation costs

Transformation costs increased as expected, mainly due to higher voluntary redundancy costs. There was a net reduction of around 3,500 employees in UKPIL in the period, equivalent to around 2,800 full-time equivalents (FTEs). The reduction was largely driven by voluntary redundancies and was weighted towards the first half. Project costs increased by £17 million, largely in relation to projects supporting the cost avoidance and efficiency programmes.

Operating profit after transformation costs

Adjusted operating profit after transformation costs was £417 million, giving a margin of 5.4 per cent, down 30 basis points due to the increase in transformation costs.

Reported operating profit after transformation costs was £160 million, giving a margin of 2.1 per cent, reflecting the IAS 19 pension charge.