

Royal Mail Holdings plc

Annual Report and Financial Statements Year ended 28 March 2010



Royal Mail Group is unique in reaching everyone in the UK through its mails, Post Office and parcels businesses – which directly employ over 168,000 people in the UK.

Every working day Royal Mail processes and delivers around 71 million items to 28 million addresses for prices that are amongst the lowest in Europe; each week we serve around 20 million customers through our network of 11,905 Post Office branches; and each year our domestic and European parcels businesses – General Logistics Systems and Parcelforce Worldwide – handle some 400 million parcels.

Royal Mail Holdings plc

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Chairman's Statement

Continued improved performance in the face of many challenges

I am delighted to report that Royal Mail Group ("the Group") has made further good progress in 2010, with operating profit* rising from £321 million to £404 million, a 26% increase on the previous year, despite continuing decline in mail markets in the UK and around the world, and a harsh economic climate.

Overall Group revenue dipped for the first time in a decade to £9,349 million amidst difficult trading conditions, but all four businesses within the Group remained in profit. Competitive pressures from other forms of communication intensified with over 13 million fewer items of mail being handled each day than just five years ago.

Royal Mail continued to make significant advances in implementing modernisation and efficiency measures during the year – including a significant increase in the volume of mail processed automatically. The financial performance of the Group shows a clear, positive impact of our modernisation programme, which will be boosted further following the recent agreement with the Communication Workers Union (CWU). Further momentum in our profitability is essential to mitigate the Group's net cash outflow.

Key performance highlights in 2010

Business unit performance	External revenue		Operating profit*	
	2010 £m	2009 £m	2010 £m	2009 £m
Royal Mail Letters	6,564	6,707	121	58
General Logistics Systems	1,487	1,495	112	124
Parcelforce Worldwide	399	399	17	12
Post Office Limited	838	908	72	41
Other businesses	61	51	82	86
Group	9,349	9,560	404	321

*Operating profit is defined as profit before exceptional items

Group cash flow summary

£m	2010	2009
EBITDA before pensions*	1,082	1,027
Pension payments	(867)	(873)
Exceptionals excluding redundancy related pension payments	(161)	(222)
ColleagueShares	(82)	(158)
Government grant income	0	152
Net capital expenditure	(441)	(494)
Other	(48)	(38)
Net trading cash outflow	(517)	(606)

*Excludes share of post tax profit from joint ventures and associates

Key aspects of the 2010 performance include:

- Group operating profit increased to £404 million – a 26% improvement on the previous year and for the second year running, all four of the Group's businesses are profitable.
- The recessionary trading conditions saw many customers posting fewer letters and belt-tightening by downtrading from premium services such as First Class to Second, together with further switches away from traditional mail to email and web communications. These factors, and falls in traditional Government business in the Post Office network, all resulted in revenue reductions – but the impact was more than offset by modernisation and efficiency improvements cutting costs across the Group.
- Despite strike action by the CWU at local and national level in Royal Mail Letters during 2009, the business made good progress in its transformation plan with a further 150 new or upgraded machines installed, bringing the total to 368 over the last three years. Over 80% of the mail is now sorted to the level of the individual postman or woman's walk, two thirds of A4 sized mail – including magazines and catalogues – are now sorted automatically, and the national rollout of walk sequencing machines, which sort the mail to the exact route followed by the delivery postman or woman began in 2009, and more than five million letters a day are now being processed using this automated technology. We expect this figure to rise steeply in the current year as we roll out the installation of further walk sequencing machines. Five years ago, just half the mail was being sorted automatically.

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Chairman's Statement (continued)

- Royal Mail Letters' operating profit has more than doubled to £121 million despite an overall revenue fall of £143 million. The profit margin remains low – less than 2% – but the financial performance shows convincingly that Royal Mail's modernisation plan is working and delivering real benefits.
- Post Office Limited's revenue fell by £70 million in 2010 and the business' net cash outflow reflects the investment being made to refurbish Crown branches and improve the network's IT capabilities to boost efficiency and reduce overheads. The recession naturally depressed income, but despite the difficult trading conditions, average branch remuneration across the network increased by 5% last year.
- The Group's headcount reduced by almost 8,000 in 2010 and as in previous years, the reduction was managed without any compulsory redundancy – an approach we will do our utmost to maintain as we complete Royal Mail's modernisation. The total UK workforce now numbers 168,500, more than 60,000 fewer than in the spring of 2002, when the company began its journey back from the time it was losing well over £1 million a day and regularly failing almost all its quality targets.
- Record target-beating performance was delivered by Royal Mail's postmen and women in the spring and early summer of 2009. However, we very much regret that CWU strike action during the summer and autumn inevitably resulted in Royal Mail falling short of some of its annual quality of service targets. A huge effort is underway to ensure we again deliver the above-target performance we have previously provided.
- Parcelforce Worldwide continued to perform well in the hugely competitive time-guaranteed parcel sector. Despite the recession, it maintained its revenue at £399 million for the year and its operating profit rose to £17 million – a 42% increase. Parcelforce 24 quality of service improved to 97.7% and there was also a 1.0% improvement to 96.8% in the level of parcels delivered on the first visit to the customer, a vital indicator of quality and customer satisfaction in the parcel sector.
- GLS's revenue fell slightly year on year, although it still delivered significant profits and strong margins for the Group and in the industry. As in the UK, the trading landscape was exceptionally tough, but cost savings in its delivery operations limited the resulting fall in operating profit – down just under 10% to £112 million in 2010.

Three major events

This was my first full year as Chairman and it was certainly eventful.

Towards the end of the year Adam Crozier decided to leave the Group to take up the position of Chief Executive of ITV plc. His clarity of purpose and strong leadership marked a period when the Group recovered from significant losses to be again profitable. Adam leaves behind a Group with a sense of purpose, a modernising agenda and good people. Together with colleagues I have been conducting a search for his successor.

The second major event was the withdrawal of the Postal Services Bill which was put on ice in the summer of 2009 and which then fell away with the advent of the General Election. The Board has consistently welcomed the plans for a new regulator and for the way in which the pension deficit would be handled by Government under the terms of the Bill. As it turned out it was not to be and, while the Bill may have gone, the three central challenges highlighted within it – resolving the historic pension deficit, establishing a fairer regulatory regime and allowing the company flexible access to capital – still need to be tackled.

The strikes called by the CWU in the summer and autumn of 2009 damaged customers' confidence in the Letters business and had an adverse effect on the Group as a whole. I understand that change is very difficult for everyone, but with falling revenue in core parts of the Group we have no choice but to modernise. It is therefore a great pleasure to note the result of the CWU ballot which endorsed the agreement struck between the Group and the CWU, and which will allow for further progress towards our modernisation goals. The agreement will help us to protect the Universal Service while providing our people with a fair reward which recognises the important role they play in achieving the transformation we need. On both sides there were tireless efforts to find a mutually agreeable way forward and I would like to place on record my gratitude to all involved within the business and the CWU, as well as to ACAS and especially to Roger Poole who so ably and independently helped to construct the framework within which this deal was able to be reached.

We still face major issues and challenges

- The average daily mail bag now contains around 71 million letters, packets and parcels. Mail volumes declined by 7.3% in 2010, the steepest fall since volumes peaked at 84 million in 2005. All other major postal operators around the world expect volumes to decline further – TNT Post Group in The Netherlands, for example, is planning for a volume reduction of up to 9% this year and around 30% over the next five years, while the United States Postal Service is currently seeing its mail volumes decline by 13% a year.
- The volumes of mail handled by rivals under access arrangements with Royal Mail grew by over 20% in the last 12 months and more than one in three letters – a total of 6,400 million items – was posted last year with a competitor, but delivered by a Royal Mail postman or woman. Access mail now accounts for more than half of all business mail.
- The Group had a net trading cash outflow of £517 million, reflecting the continued investment being made in sorting technology, new equipment for postmen and women, improvements to Crown Post Office branches – as well as continuing heavy cash payments to the Pension Fund amounting to £867m in 2010.

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Chairman's Statement (continued)

- With the structural decline we are seeing in mail volumes – a phenomenon also seen in postal markets around the world – and further decline in traditional Government business in the Post Office network, it is essential we become leaders in innovation and devise new products and services to offer our customers in the rapidly changing world in which we all live.
- We continue to engage with the postal regulator, Postcomm, on the regulatory framework within which we operate. As competition intensifies, we remain convinced that regulation should be as focused as possible, but of course with protection and safeguards for those customers, especially consumers and small businesses, who use stamped mail and may not have other or easy access to other forms of communication like email. But with most mail now subject to full competition – from rival operators or rival forms of communication – it is essential that the regulatory constraints we face are appropriate and relevant to the competitive market in which we are operating.
- In March 2010, we agreed Post Office network funding of £180 million with the Government to cover 2011-12.

- and pensions

The Group and the Trustees have worked hard to find a solution to the problem of the actuarial deficit, which is expected to be significantly higher than the previous figure of £3.4 billion when the current valuation is completed, and continue to do so. In 2010 the Group paid £867m into the pension schemes, of which £291m was to help fund the historic deficit. I would like to thank Jane Newell and her fellow Trustees for all their work in the past year.

Royal Mail Letters – the next phase

Royal Mail has continued to modernise its operations, with a further £500 million invested in the last 12 months largely in new technology and equipment for our postmen and women, bringing the total to over three quarters of the £2 billion investment programme since 2006. Continuing to invest in our business will be essential to keep up the pace and progress of modernisation.

Two years ago, just 34 new or upgraded sorting machines had been installed across the nationwide Royal Mail network. Now, there are 368 new or upgraded machines in operation with 150 new pieces of equipment installed over the last 12 months. The next phase of modernisation will involve the completion of the installation of over 500 walk sequencing machines – 100 of which are already in place.

We have also made progress in rationalising our mail centre network. Four centres closed in the last 12 months – Oxford, Reading, Oldham and Stockport – and further consultations are planned. The final size of the mail centre network – currently there are 64 centres – will depend on mail volumes.

We have also made significant progress on the World Class Mail programme to improve the efficiency of our large sorting offices, with strong input from our people at all levels being crucial. After the significant efficiency gains already seen at Gatwick mail centre where the programme began, there are now 12 centres engaged in the drive to ensure that mail centres – which typically sort several million letters a day – are not just using the most modern equipment, but are operating at world class levels of efficiency.

Royal Mail Letters has put the safety of its people at the heart of its operations and the investment in the well-being of our people as they go about their daily work has resulted in an impressive 12% reduction in serious accidents last year. Our ultimate goal remains zero accidents and we are determined to keep our focus on safety with this topic high on the agenda of every Board meeting.

The decline in mail volumes accelerated in 2010. The daily mail bag of around 71 million items is now at levels last seen in the mid 1990s, a time when we were accustomed to seeing year on year growth in letter volumes. The trend for e-substitution will continue and a key priority going forward must be for Royal Mail to become a leader in innovation with new products and services based around our unique ability to deliver to the UK's 28 million addresses and a passion for meeting the needs and wishes of our customers.

Post Office Limited

The Post Office ended the year with a change of leadership with the appointment of David Smith to succeed Alan Cook as Managing Director. The business has already undergone significant change under Alan Cook's leadership as it continued to adapt to the challenges of a changing market and to develop new revenue streams. However, challenges remain for the new leadership.

Overall Post Office Limited's revenue declined by £70 million to £838 million mainly as a result of less income from the Post Office Card Account (POCA) used by around 4.5 million people to receive their pensions and other benefits. Customers have continued to switch from the POCA to a bank account – resulting in less revenue for the network – and a new contract for the POCA, which came into effect in October 2009, rewards the Post Office at a lower rate per account.

The Post Office has continued to expand its range of financial services – a business insurance product was launched last year and mortgages at competitive rates of interest were rolled out to the nationwide network after a successful regional trial – and it remains one of the fastest growing brands in the highly competitive financial services sector with more than 2.2 million customers. However, revenue fell back in this sector due to the difficult market conditions.

The Post Office has attracted £9 billion in savings, it insures the cars, homes, pets or businesses of 550,000 customers, it issues more than 3,000 credit cards a week to new customers and over 600,000 consumers now carry one in their wallets. The rollout of free-to-use cash machines continued with 2,000 now installed at Post Office branches, making it one of the UK's biggest no-fee cash machine networks.

Royal Mail Holdings plc

Chairman's Statement (continued)

In addition, the Post Office remains the market leader in the provision of foreign currency and one of the biggest providers of travel insurance. It also grew its revenue from its HomePhone services in 2010.

The future

Despite the very significant pressures in all parts of the Company, Royal Mail Group has continued to demonstrate its ability to withstand the combined pressures of recession and competition and has shown real momentum in driving forward our modernisation and making the changes which are so important if the Company is to survive and thrive.

As we enter the next stage of our evolution it is against a backdrop of regulatory uncertainty with our regulator, Postcomm, shortly to conduct a Licence review, the result of which will have profound implications for the Group. Together with the management team I have been leading a programme of work to define our longer term future in a competitive environment and one in which digital services will be ever more relevant. The output of this work will form an important input to Postcomm's review and will, of course, help to inform the incoming Government. I anticipate that the results of this work will be made public in the next few months.

To echo the words of Adam Crozier at this time last year, we know that despite the challenges of difficult and uncertain markets, we have the resilience and determination to continue our transformation and to become the world's best postal company. The strong and robust performance we have shown over the last 12 months shows we are making good progress.

Thanks

Towards the end of my first year as Chairman I have assumed a more executive role pending the arrival of our new Chief Executive and I would like here to record my thanks to all the colleagues in the Group who have not only made me welcome but given me support and encouragement at all times. As we announced on 27 May, Moya Greene will be joining us as Chief Executive in July. I look forward greatly to working with Moya who brings a proven leadership track record – as well as hugely relevant experience – to the business at an important moment in its evolution.

I was sorry to lose Helen Weir from the Board – she had been an excellent Chair of the Audit and Risk Committee – and to lose Andrew Carr-Locke but delighted to welcome Paul Murray, Les Owen and, after the year end, Nick Horler. As we also announced on 27 May, the Board will be further strengthened by the appointment of two new members with specific consumer experience, Orna Ni-Chionna and Cath Keers.

Royal Mail Group is a great enterprise which is proud to be part of the social and economic fabric of our country, and which plays a key role in communities around the UK. Working together we can ensure a long and successful future for the business and its employees and provide a fantastic service for our customers that meets their changing needs.

Donald Brydon
Chairman
Royal Mail Group
28 May 2010

All references to operating profit are before exceptional items.

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Annual Review 2009-10

A stronger, more efficient Letters business...iconic album cover stamps...2,000th free-to-use cash machine at the Post Office...a boom in online shopping...50th anniversary of the Royal Mail's postcode system...time to tweet...£2.7 million raised for charity through payroll giving

A new age is dawning for Royal Mail as it modernises and builds on its reputation as the customers' champion and a business with a world class edge. After a period of uncertainty, the Company is well placed to compete in a fiercely competitive marketplace. Our brands are trusted household names and with the growth in email and text messaging, together with the booming home shopping market, Royal Mail is changing quickly to give customers exactly what they want.

Despite experiencing difficult trading conditions and falling volumes over the last year, Royal Mail has embraced opportunities to better cater for customers' needs. UK stamp prices have remained amongst the lowest in Europe and a recent Postcomm survey confirmed that the vast majority of customers are happy with our services. The last 12 months have seen Royal Mail significantly enhance its firmly established role in the fulfilment of internet shopping orders. We are using our postcode data to help businesses target their mailings and are opening more than 100 enquiry offices across the UK for longer, and are planning to open many more, enabling people to pick up their mail when it is convenient for them.

A boom in online shopping

Online shopping is big business and we are taking advantage of this boom, offering modern products like Royal Mail Tracked™ to become more commercial and bring in vital revenues as letter volumes fall. Tracked™ follows items from the moment they are despatched to the time they are delivered, and people can now get emails and texts to track their purchases. We are also making it easy for smaller businesses to benefit from Tracked™, lowering the threshold for using the service from 5,000 to 2,000 items from June 2010. The success of the service saw postmen and women at our state-of-the-art North West regional distribution centre star in a film for retail giant Marks & Spencer who wanted to show its customers how we process their orders quickly and safely.

Modernising our operations

Outdated working methods are being replaced so mail arrives in delivery offices already sorted to exact rounds by walk-sequencing machines. We have now installed around 100 of these speedy bits of kit which can put thousands of items an hour into their exact delivery order. This means postmen and women spend less time preparing the mail in delivery offices, and more time out on delivery. In the next 18 months, Royal Mail will put in around 450 more machines across the country, meaning that three quarters of our mail will be 'walk sequenced' by 2013. New equipment such as 2,400 electric powered trolleys, 4,000 high capacity trolleys and 24,000 lightweight trolleys is also being introduced to take the weight off postmen and women's backs, helping them deliver safely and efficiently.

Communicating with our customers

We are using new ways to connect with customers. Since March, Royal Mail has been using the social networking website Twitter (www.twitter.com/RoyalMail) to keep in touch with people, help answer their questions and suggest solutions to their problems. Twitter gives us real-time feedback about what people are saying about us, which helps shape our service. Having such a rapid way to talk to our customers came in especially handy during the disruption caused by volcanic ash which closed airspace. Online chat, blogging, podcasts and quick query management systems are all things we are looking at to further improve the service we provide.

Information is also posted at www.royalmail.com/serviceupdates which allows customers to find regular bulletins such as disruption alerts. Royal Mail has also launched a new magazine to target small and start-up businesses. UnLtd goes to businesses with up to ten employees and is aimed at showing business owners how Royal Mail can help them provide a better service for their customers and then help them grow their customer base through effective marketing.

Prize winning innovation

We have been winning prizes too. A revolutionary new truck kitted out with cutting edge safety features saw Royal Mail take to the winner's podium to collect the EuroTra (European Transport Training Association) Safety and Innovation Award in 2009. Our safety concept vehicle is challenging the rest of the industry to improve drivers' safety and that of other road users. The prototype was fitted with 55 safety elements and is undergoing a year-long trial spending two months at six sites across Britain.

Eco-friendly business

Royal Mail is one of the first major companies in the UK to separate recyclable waste. As well as being good for the environment, the scheme helps the Company make savings. Leading by example was Cardiff mail centre, but all recycling facilities were in place by the end of May 2009.

We delivered more than 100 million Sustainable Mail items by February this year, just nine months after the service started. This is an important and impressive milestone for Royal Mail. The environmentally friendly product is now used by more than 75 firms including retailer Bhs, EDF Energy and National Grid. It offers customers a discount for making direct mail eco-friendly by rewarding good practices such as using paper from sustainable sources, making envelopes from recyclable materials and ensuring mail items are correctly addressed so they do not go to waste. We are pleased to report that last year 76.5% of direct marketing material was recycled, outstripping the 2009 target of 55% as well as the 70% goal for 2013.

Royal Mail Holdings plc

Annual Review 2009-10 (continued)

50th anniversary of the postcode

The last year has seen a great British invention – the modern postcode – celebrate its 50th anniversary. The system helped revolutionise mail services worldwide and the simple idea forms the basis of our whole mail delivery system. When used with modern machinery, it allows us to sort millions of items across the business every hour. Managers from postal services worldwide have come to see how we do things. The Postcode Address File keeps the mail going but it also keeps the wheels of the country turning. Who would have thought when the modern postcode was invented that it would become such an integral part of life?

Stamp of approval – from Pink Floyd to Great British Railways

It is no secret that we are processing fewer items of mail. But what does this mean for stamps? Philately is actually more popular than ever, due in part to some of the excellent designs we have run to mark special occasions. Royal Mail has always celebrated and commemorated significant moments in history and our special stamps are famous for their ability to capture, on millions of miniature canvasses, the richness and diversity of British heritage and culture. They generated enormous interest over the last year and among the most popular were the ten iconic album covers from the past four decades. Stamps showed the bent chromed pipe of Mike Oldfield's 70's masterpiece Tubular Bells, the astonishing statues of Pink Floyd's The Division Bell and the racing greyhounds of Blur's Brit Pop classic, Parklife.

It was not just music that was celebrated. In February Royal Mail said 'Happy Birthday' to the largest youth organisation in the UK, with Girlguiding UK stamps, and eminent Britons from the realms of sport, science, art, literature and politics were celebrated – such as Fred Perry, Henry Purcell, Sir Arthur Conan Doyle and William Gladstone. The bravery of men and women were marked by dramatic images across six stamps portraying the many dangerous and demanding situations faced by those who work in the Fire and Rescue Service.

Stamp issues to look forward to later in 2010 include Children's Books and Great British Railways, and we should not forget the success of Smilers – our popular product enabling people to create personalised stamps online with their own photographs. In the past we have only offered 1st Class Smilers, but at Christmas we offered 2nd Class and Overseas stamps too. The popularity of our stamps is evidenced by the Royal Philatelic Society reporting its highest ever number of members and due to the soaring popularity of stamps, we set up an eBay stamp shop last year.

Giving back

The generosity of employees across the Group giving their own money to good causes was reflected in the £2.7 million donated by people across the Company through payroll giving. Around one in four of our people make contributions in this way. A three year partnership with Barnardo's was launched in June 2008 and raised £195,000 in the year ended 2010 on top of the £175,000 raised in the previous year through a wide variety of fund-raising activities. A total of 68 young people from Barnardo's have done work placements at Royal Mail over the past 12 months with 22 landing permanent jobs with the business after impressing managers.

Postman Craig Francis rescued a stroke victim he found lying unconscious on her kitchen floor as he delivered letters to her house in Dodworth, near Barnsley, South Yorkshire in September. He gave her first aid while he waited for an ambulance. Postman Eric Smart raised more than £11,000 for the Myalgic Encephalopathy (ME) Association by cycling to Australia and back, a distance of 21,500 miles. Meanwhile, thousands of Royal Mail bikes judged past their prime have found a new lease of life in Africa, helping medical workers to save lives and local people to get around. Bicycles have found their way to 13 countries from Ghana to Uganda and recipients include hundreds of children who previously faced round-trips on foot of up to 20 miles a day to get to school.

Serving their country

Postman Paul Brennan was one of 14 postmen and one postwoman who flew out to Afghanistan in April 2010 as part of the Territorial Army's 88 Postal and Courier Regiment. They are helping to continue an honourable tradition, that has lasted well over a century, of our people serving their country and distributing vitally important, morale-boosting mail. The 15 are being split into groups to work at several locations where they will run sorting offices and transport mail between locations.

Royal Mail has a long tradition of supporting the Armed Forces, from the formation of the Army Post Office Corps in 1882 and the distinguished service of the Post Office Rifles in the First World War, through to the efforts today of more than 200 Royal Mail people who currently serve with the Territorial Army. And it doesn't stop there. Volunteers from Royal Mail have rebuilt a memorial garden in honour of the Company's fallen in two world wars and other conflicts around the globe.

Post Office Limited

The Post Office network comprises over 11,500 branches and lies at the core of communities nationwide. It serves around 20 million customers undertaking almost 60 million transactions a week. It is our aim to keep the size and coverage of the branch network around its current level where over 90% of the UK the population is within one mile of a Post Office.

The Post Office's joint venture with the Bank of Ireland provides a wide range of financial services products and reached its sixth anniversary in March 2010. The Post Office is one of the fastest growing providers of financial and travel services in the UK, with products attracting income to the network helping to support its infrastructure.

In 2009, the Post Office won numerous awards and the public once again named the Post Office as its favourite travel insurance and foreign exchange provider. We handle over 10 million travel money transactions annually and issue almost one million travel insurance policies every year.

Royal Mail Holdings plc

Annual Review 2009-10 (continued)

There are now more than 2,000 free-to-use cash machines at branches and over 3,000 credit cards a week are being issued. £9 billion has been invested in Post Office savings products and we insure one in 50 cars and one in 120 homes in the UK. A new expanded mortgage range has also been rolled out and over £1 billion has been lent to home buyers.

As the bulk of financial services transactions have so far been in Crown branches, it shows the significant potential for growth in sales in other Post Offices. We continue to work hard to develop further our financial services and generate as much additional revenue as possible for the entire network.

In order to help deliver the renewal of driving licence photocards, we are installing digital technology in 750 of our busiest branches. Therefore we are starting to build on the unique capabilities of our network to provide the necessary interface between the physical and digital worlds. This is the kind of forward looking concept that will help the entire network thrive and develop in the fast changing world of the future.

Parcelforce Worldwide

Parcelforce Worldwide is one of the UK's leading guaranteed express delivery operators handling around 55 million parcels a year. It operates in an intensely competitive, open market, but despite this, the latest results show significant profit growth. In the face of such intense competition, with many competitors affected by a downturn in volumes and revenue, Parcelforce Worldwide has grown its volumes, maintained revenue and increased its market share.

With UK companies taking advantage of the weak pound to seek out new market opportunities, Parcelforce Worldwide has seen strong export growth, with exporting hotspots including major Asian and Eastern European destinations. This enables customers to receive consistently high levels of service and reliability, whilst benefiting from a far-reaching, locally based network. Parcelforce Worldwide's membership of the Kahala Postal Group, a coalition of leading postal providers, has helped strengthen export services to major destinations across Asia-Pacific, Europe and the USA.

New services introduced in June 2009, including Global Express, Global Priority and Global Value, mean customers are able to choose delivery options to best suit their needs. That could be a fast, efficient, fully-trackable global service, a value tracked service for times when a lower price is more important than speed, or a balance of the two. Customers posting into Europe are also able to select between tailored business and residential delivery services for the first time.

As well as the international service launches, Parcelforce Worldwide rebranded and simplified its UK range last year, introducing new benefits for customers. It also rolled out one of the biggest green delivery fleets in the UK, with 1,100 eco-start vans and continues to invest in area customer service teams, providing them with coaching.

General Logistics Systems (GLS)

Founded in 1999, with strong historical roots in each of its domestic markets, GLS is the third biggest parcel service provider in Europe today. As our European parcels business with Parcelforce Worldwide as its UK partner, GLS has a strong strategic position as a leading ground-based provider of business-to-business parcel services, being a major player in this market with class-leading profit margins. Royal Mail Letters, Parcelforce Worldwide and GLS together, create a unique platform to be a customer champion for packages and parcels.

The GLS head office is based in the Netherlands. The business employs around 13,000 people and handles over 1 million parcels a day through its network of 665 depots, 38 hubs and almost 17,000 vehicles. Its core operation is business-to-business parcel deliveries and it has 220,000 customers in 36 states across Europe.

Despite very tough trading conditions in the year, GLS continued to deliver significant profits and strong margins for the Group. This was realised through maintaining focus on delivering quality for its customers and making efficiencies to deliver cost savings.

Royal Mail Holdings plc

Operating and Financial Review



Note: In the following analysis, all references to operating profit are before exceptional items.

Performance Highlights

- Despite very difficult trading conditions in the year leading to falling revenues, the Group increased its operating profit from £321m to £404m, an improvement of £83m (26%)
- The Royal Mail Letters business, Post Office Limited and Parcelforce Worldwide all saw their profits grow year on year
- Group external revenue fell by £211m, from £9,560m in 2009 to £9,349m in 2010, the first time in a decade that revenue was lower than the previous year. The underlying decrease excluding exchange rate movements was even greater at £298m
- Royal Mail Letters revenue fell by £143m as tariff increases were not enough to offset volume decline of 7.3%, losses to competition and customers switching to lower priced products
- Post Office Limited saw revenue fall by £70m year on year, as income from Government Services fell heavily and the recession impacted revenues from Financial Services products
- Modernisation through a combination of investment and the efforts of the Group's people in embracing changing working practices, is enabling efficiencies to offset declining revenues
- Across the Group, total costs excluding the adverse impact of exchange rate movements fell by £381m (4.1%), reflecting modernisation efficiencies realising a headcount reduction of around 8,000
- Investment in the business has allowed gross hours to fall by over 5% in the Letters operation as levels of automatic sorting have rapidly increased, 150 new and upgraded machines have been deployed in the year and 12 mail centres piloted the introduction of world class processing
- Despite operating profit growth, profit before financing and taxation fell by £65m year on year as Government grant income received by Post Office Limited ended in 2009, and restructuring costs increased
- The accounting pension deficit has increased from £6.8bn in 2009 to £8.0bn in 2010, driven by changes in market conditions giving rise to higher projected liabilities. Cash payments of £867m were made in the year to fund pensions
- A cash inflow of £1,082m was generated by earnings before interest, tax, depreciation, amortisation and pensions** reflecting a strong operating performance in a tough climate
- However, the net trading cash outflow of £517m reflects the Company's level of commitment to continue modernising operations whilst fulfilling the Group's most significant ongoing cash obligation, pension funding

Summary Income Statement

£m	2010	2009
External revenue	9,349	9,560
People costs	(5,746)	(6,012)
Distribution & conveyance operating costs	(1,579)	(1,577)
Other operating costs	(1,661)	(1,697)
Share of profits from Joint Ventures & Associates	41	47
Operating profit*	404	321
Government grant income	0	152
ColleagueShare costs	(44)	(84)
Net other exceptional costs	(242)	(206)
Profit before financing and taxation	118	183

*Operating profit is defined as before exceptional items

Summary Cash Flow

£m	2010	2009
EBITDA before pensions**	1,082	1,027
Pension payments	(867)	(873)
Exceptionals excluding redundancy related pension payments	(161)	(222)
ColleagueShares	(82)	(158)
Government grant income	0	152
Working capital	(83)	(80)
Cash outflow from operations	(111)	(154)
Dividends from Joint Ventures & Associates	35	42
Net capital expenditure	(441)	(494)
Net trading cash outflow	(517)	(606)

**Excludes share of post tax profit from joint ventures and associates

Royal Mail Holdings plc

Operating and Financial Review (continued)

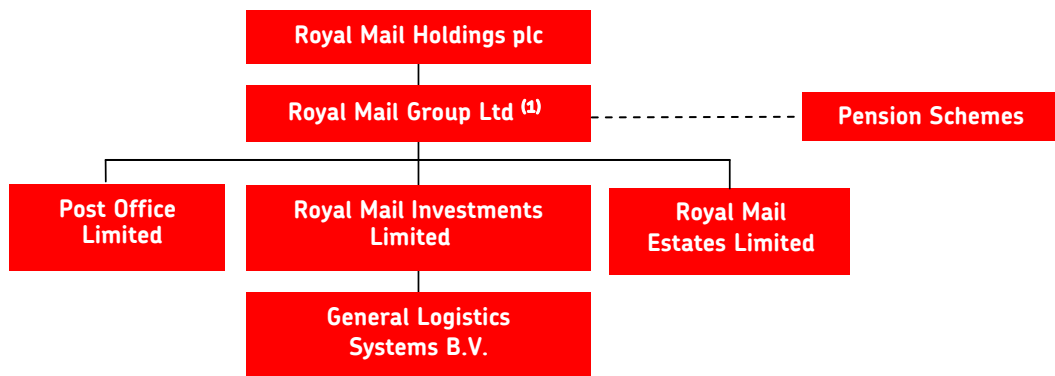
Background

Royal Mail Holdings plc (the Company) is a public limited company wholly owned by the UK Government. It became a plc on 26 March 2001. The framework for change was the Postal Services Act 2000 that created a commercially focused company with a more strategic relationship with the Government. Royal Mail Holdings plc together with its subsidiaries, associates and joint ventures comprise 'the Group'. The Group operates within a regulatory framework comprising of an independent Regulator, Postcomm and a statutory consumer organisation, Consumer Focus.

Royal Mail Group encompasses a set of trusted brands and companies that combine the best of a public service ethos, with the commercial requirement to operate effectively in the highly competitive communications and fulfilments markets. Through its brands it reaches everyone in the UK by way of its mail, parcels and express services together with its Post Office branches. Full market liberalisation took place in the UK in January 2006 and since then, all of the Group's businesses have been operating in competitive marketplaces.

Legal Structure

Royal Mail Holdings plc is directly owned by HM Government and is the ultimate parent company of the Group. The Group primarily operates within the United Kingdom, having a number of subsidiaries, joint ventures and associates, but also has presence in most European countries, mainly through General Logistics Systems B.V. Its basic legal structure is as follows:



⁽¹⁾ The Royal Mail and Parcelforce Worldwide business units included in Royal Mail Group Ltd are not separate legal entities

Further details on the principal subsidiaries are provided in note 28 to the financial statements.

Operating Units

The Group is organised into four principal operating units:

Royal Mail processes and delivers around 71 million letters and packages to 28 million addresses every working day, in line with its unique Universal Service Obligation (USO). It is also responsible for designing and producing the UK's stamps and philatelic products.

General Logistics Systems B.V. (GLS) is the holding company for a pan-European group of companies providing reliable, high quality parcel services, logistics and express services throughout Europe.





Parcelforce Worldwide is a leading provider of collection and delivery services for express packages and parcels within the UK and throughout the world, providing both business and private addresses with a full range of timed delivery options.

Post Office Limited has a national network of branches at the heart of communities across the country. They provide a trusted access point for everyday products, services and information in postal services, financial services, travel, banking, telephony, bill payments, Government information, retail and the secure transportation of cash.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Operating Units Facts and Figures

Unit and % of Group External Revenue* & Profit*	No. of Employees	Region	Revenue* (£m) Profit* (£m) Margin (%)	Facts and Figures	Vision
 70.2% of Group revenue, 30.0% of profit	155,312	UK	Revenue £6,564m Profit £121m Margin 1.8%	<ul style="list-style-type: none"> c.115,000 pillar boxes; 64 mail centres; 1,390 delivery offices; 29,900 vehicles; Around 71 million items per day delivered to 28 million addresses; 82% of mail walksorted; and 368 new or upgraded machines – 150 during the year. 	...to be 'demonstrably the best and most trusted postal services company in the world'.
 15.9% of Group revenue, 27.7% of profit	12,885	Europe	Revenue £1,487m Profit £112m Margin 7.5%	<ul style="list-style-type: none"> 38 hubs; 665 depots; 16,950 vehicles; 220,000 customers; Over 1.3 million parcels handled every working day; 21 Subsidiaries; and Covers 36 states in Europe. 	...to be 'the best European parcel logistics & express system with global reach'.
 4.3% of Group revenue, 4.2% of profit	4,434	UK	Revenue £399m Profit £17m Margin 4.3%	<ul style="list-style-type: none"> 2 hubs (1 national, 1 international); 47 depots; 5 satellites; 1 parcel exchange area; 1,800 vehicles; 205,000 parcels delivered every day, 272,000 every day in December; and Parcelforce 24 Quality of Service – 97.7%, delivered on time and with electronic proof of delivery. 	...to be the UK's most trusted high value express carrier'.
 9.0% of Group revenue, 17.8% of profit	8,209	UK	Revenue £838m Profit £72m Margin 8.6%	<ul style="list-style-type: none"> 11,905 branches, including 373 Crown Offices; Over 28,000 customer facing positions; Each week around 20 million customers conducting almost 60 million transactions; UK's leading supplier of foreign currency with a 25% market share; and Customer satisfaction levels at 89%. 	...'The People's Post Office, always socially and commercially relevant by providing essential services for a fair return'.
Other 0.6% of Group revenue, 20.3% of profit	545 in wholly owned subsidiaries 4,217 in part owned subsidiaries	UK	Revenue £61m Profit £82m	Royal Mail Estates Limited – Group's property unit (100% subsidiary); PostCap Guernsey Limited – captive insurers (100% subsidiary); iRed Partnership Limited – document management operation (100% subsidiary); Romec Limited – facilities management operation (51% subsidiary); NDC 2000 Limited – building engineering services operation (51% subsidiary); Quadrant Catering Limited – catering services (51% associate); and Camelot Group plc – UK National Lottery operator (20% associate).	

*Revenue is for subsidiaries only, profit is before exceptional items

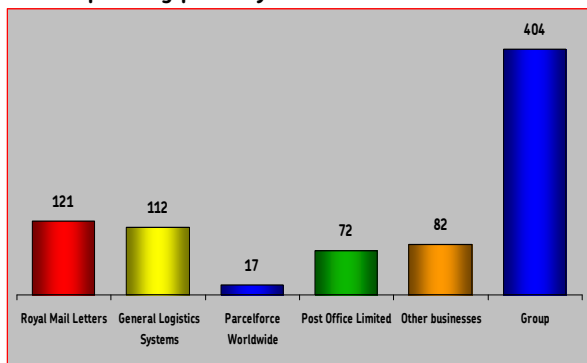
Royal Mail Holdings plc

Operating and Financial Review (continued)

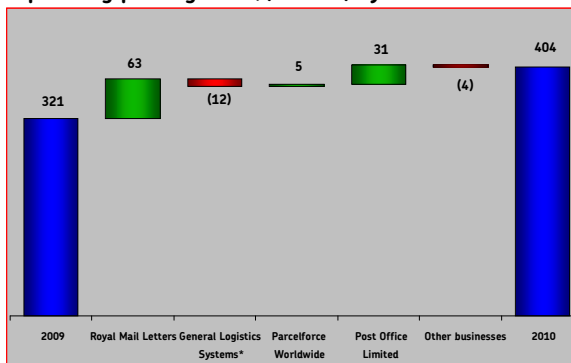
Group Financial Analysis

In 2010, Royal Mail Group is reporting an operating profit of £404m compared to £321m in 2009, an increase of £83m (25.9%). All four Group businesses remain profitable, despite the impact of the difficult economic climate on their trading environments. Royal Mail Letters, Post Office Limited and Parcelforce Worldwide all delivered year on year profit improvements given falling revenues. GLS still generated significant profits and achieved strong margins in the face of prevailing recessionary conditions across Europe.

Operating profit by business unit - £m



Operating profit growth/(decline) by business unit - £m



*The impact of the difference in FX rates year on year was c.£6m favourable in GLS

External Revenue

The Group's external revenue fell by £211m from £9,560m to £9,349m in 2010, the first time in a decade that revenues are lower year on year. When excluding the favourable impact of foreign exchange (FX) in GLS, underlying revenue has fallen by £298m. The decline in revenue has been experienced by Royal Mail Letters, GLS and Post Office Limited, with Parcelforce outturning flat to 2009. Other businesses outperformed year on year, driven by Romec (the Group's facilities management subsidiary) winning new contracts in the year.

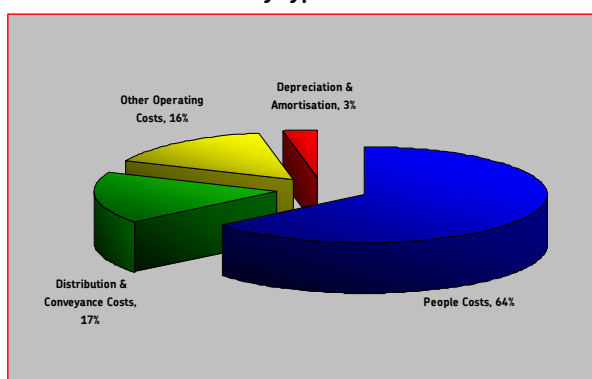
Royal Mail Letters revenue outturned £143m lower in 2010, despite a tariff increase of c.6% on the regulated area. The fall year on year is driven by continuing decline in volumes of 7.3% in the year, impacted by the recession and losses to other forms of media. Customers switching to lower priced products, including Downstream Access, has further decreased revenues.

GLS revenue has fallen year on year by £8m, from £1,495m to £1,487m. Ignoring the favourable impact of FX driven by the strengthening of the Euro against Sterling, revenue has actually declined by £95m. This underlying decline is driven by downward pressure on prices and volumes as a result of recessionary conditions across Europe and a highly competitive environment. Post Office Limited revenues also decreased, from £908m to £838m, a reduction of £70m, predominantly due to year on year decline in Government and Financial Services income. This is driven by changes in the Post Office Card Account contract and the impact of the recession on travel and savings products.

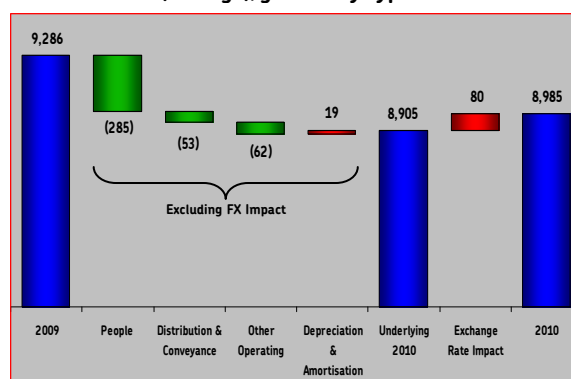
Costs (excluding exceptional items)

Total costs of £8,985m have decreased from £9,286m by £301m (3.2%). However, when removing the impact of FX differences year on year, costs have fallen even further reflecting underlying savings of £381m. All the business units have made huge efforts to reduce spending to maintain and grow profits in a difficult economic climate.

Cost by type - %



Cost (savings)/growth by type - £m



People costs of £5,746m represent 64% of the Group's cost base and have fallen year on year by £285m. This decrease is driven by modernisation delivering efficiencies enabling a headcount reduction of c.8,000 for the Group. Distribution and conveyance costs make up 17% of the Group's cost base and have fallen by £53m, principally due to delivery of operational efficiencies and volume decline. Other operating costs have decreased by £62m to £1,367m, driven by cost saving initiatives across the business. The depreciation and amortisation charge has increased in line with capital investment supporting modernisation of the Royal Mail Letters operation.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Cash Flow

The following table is a summary of the Group cash flow statement:

Summary of cash flows	2010 £m	2009 £m
EBITDA	641	531
Exceptional items	(293)	(412)
Working capital	(83)	(80)
Pension payments not included in EBITDA	(376)	(345)
Government grant income	0	152
Cash outflow from operations	(111)	(154)
Dividends from joint ventures and associates	35	42
Property, plant and equipment, intangibles purchases and disposal proceeds	(441)	(494)
Net trading cash outflow	(517)	(606)
Acquisition and sale of financial assets	(80)	(5)
Net drawdown of borrowings and financing	500	310
Tax, interest and other	(28)	(72)
Net cash outflow	(125)	(373)

Cash outflow from operations of £111m (2009 £154m) comprises:

- Earnings before Interest, Tax, Depreciation, Amortisation and share of post tax profit from joint ventures and associates (EBITDA) inflow of £641m (2009 £531m);
- Payments relating to exceptional items of £293m (2009 £412m), comprising ColleagueShare payments of £82m (2009 £158), restructuring costs of £161m (2009 £222m) and pension top ups of £50m (2009 £32m);
- Working capital outflows of £83m (2009 £80m);
- Outflow attributable to cash paid in respect of retirement benefit obligations in excess of that charged in operating profit of £376m (2009 £345m); and
- In 2009, non-recurring Government grant income of £152m was received to compensate Post Office Limited for providing certain specified "services of general economic interest" under the Industrial Development Act (IDA) 1982. £nil was received in 2010.

Dividends received from joint ventures and associates of £35m (2009 £42m) are from First Rate Exchange Services Holdings Limited: £29m (2009 £27m), Camelot Group plc: £6m (2009 £10m) and Quadrant Catering Limited: £nil (2009 £5m).

Property, plant and equipment, intangibles purchases and disposal proceeds generated a £441m outflow (2009 £494m), comprising £455m (2009 £514m) of expenditure, partially offset by inflows of £14m (2009 £20m) from surplus property disposals. Expenditure includes £157m (2009 £138m) for property improvements, £134m (2009 £207m) for plant and equipment, £84m on motor vehicles (2009 £91m) and the remaining £80m (2009 £78m) on information technology. This analysis includes £52m (2009 £54m) in respect of GLS projects.

Acquisition and sale of financial assets generated an outflow of £80m (2009 £5m) and represents the net purchase of investments made by the Group from cash and cash equivalent resources. The £80m outflow comprises £41m relating to the investments in escrow provided as security for the Royal Mail Pension Plan and £45m relating to investment in (non-current) bank deposits, partially offset by the sale of £6m financial assets used for liquidity within the Group.

Net drawdown of borrowings and financing of £500m inflow (2009 £310m), principally comprises £340m drawdown (2009 £300m) of Government loans to Royal Mail Group Ltd, £111m drawdown (2009 £48m net repayment) of Government loans to Post Office Limited and £73m cash received (2009 £75m) on property sale and leasebacks, partially offset by £22m payments (2009 £18m) of the capital element of finance lease obligations.

Pensions

Schemes

Royal Mail Group Ltd is the sponsoring employer for the Royal Mail Pension Plan (RMPP) and the Royal Mail Senior Executives' Pension Plan (both defined benefit schemes), and for the Royal Mail Retirement Savings Plan and the Royal Mail Defined Contribution Plan (both defined contribution schemes). Based on assets, the Royal Mail Pension Plan is one of the largest pension schemes in the UK. The assets and liabilities of the defined benefit schemes, as measured under accounting standards, are reported as a net pension deficit in the Group balance sheet. The gross assets and liabilities and the net deficit are significantly larger than any of the Group's other assets and liabilities. This results in the Group being one of the most exposed UK corporates to pension volatility, particularly with respect to movements in equity values and future expectations of inflation and bond rates.

Both defined benefit schemes are now closed to new members. The Retirement Savings Plan is in the process of being wound-up, and new employees are offered membership of the Defined Contribution Plan.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Charges in Profit

Pension charges within profit	2010 £m	2009 £m
Within operating profit before exceptionals	441	496
Within exceptionals (relating to redundancy)	42	31
Net pensions interest charge	329	114
Pension charges	812	641

Pension charges within profit have increased year on year by £171m, from £641m to £812m. Pension costs (pre-exceptionals) have reduced by 11.1% from £496m to £441m. The £55m reduction is principally as a result of a reduction in the number of people employed and market conditions resulting in a pension charge that is 16.8% of pensionable pay, compared to 18.1% last year.

The balance sheet pension deficit has increased from £6,776m in March 2009 to £8,041m this year end. The increase in the deficit of £1,265m principally relates to an actuarial loss of £1,312m.

The actuarial loss arose due to changes in market conditions giving rise to higher liabilities, only partially offset by improved asset values. This loss is recorded in the statement of comprehensive income.

The net pensions interest charge reflects the unwinding of the discount on the schemes' liabilities less the long-term expected rate of return on the schemes' assets. This interest is recorded in the income statement after profit before financing and taxation. Net pensions interest charge of £329m (2009 £114m), a non-cash item for the Group, has increased by £215m mainly due to a reduction in the expected returns on Plan assets in line with market trends.

As part of the actuarial valuation as at March 2006 the Group agreed a Memorandum of Understanding with the trustee to fund the deficit over 17 years. One of the key terms was the establishment of escrow accounts totalling £1bn secured in favour of the RMPP. The Group established £1bn in escrow on 23 March 2007 and charges over these assets have been registered.

Cash Payments

Pensions cash funding: Group contributions	2010 £m	2009 £m
Regular pension contributions	526	551
Funding of pension deficit	291	290
Payments relating to redundancy	50	32
Prepayment of 2009 regular pension contributions	-	(50)
Net cash payments	867	823

Net cash payments to fund pensions have risen by £44m, from £823m to £867m. Regular pension contributions reduced from £551m to £526m, in line with lower pensionable pay. The regular rate of employer contributions for the Royal Mail Pension Plan has remained at 20.0% of pensionable pay, effective from April 2006. The regular rate of employee contributions for the Royal Mail Pension Plan remains unchanged at 6.0%.

Deficit recovery payments by the Group have increased by £1m (0.3%) from £290m to £291m and include £5m (2009 £5m) relating to the Royal Mail Senior Executives' Pension Plan. Deficit recovery payments are planned for the Royal Mail Pension Plan over the 17 years from the date of the latest full actuarial valuation – March 2006. The planned

payments are £260m per annum, increasing in line with RPI, for 16 years from the beginning of the 2007 financial year. There have been no employee deficit contributions.

Share of Profits in Joint Ventures and Associates

The Group's share of profits in joint ventures and associates of £41m (2009 £47m) comprises profits from Post Office Limited's Bureau de Change joint venture (First Rate Exchange Services Holdings Limited), Camelot Group plc associate – UK National Lottery operator, Quadrant Catering Limited – the Group's catering associate, G3 Worldwide Mail N.V. (Spring) – the Company's international mail distribution associate and a loss from Post Office Limited's financial services associate (Midasgrange Limited).

Net Exceptional Items

Net exceptional items of £286m (2009 £138m) comprise operating exceptionals of £291m (2009 £149m), partially offset by profits from property disposals of £5m (2009 £11m). Operating exceptionals include: £178m of restructuring costs (2009 £113m), £44m of ColleagueShare costs (2009 £84m), £76m impairments (2009 £77m), and a net £7m credit for other exceptional items (2009 £27m charge). There was no Government grant income received during the year (2009 £152m).

ColleagueShare Scheme

ColleagueShare is the Royal Mail phantom share plan and has a five year life span during which notional shares may be allocated to employees. In addition, related stakeholder dividends may be paid for the first three years of the plan based on the achievement of certain targets. The ColleagueShare scheme has now completed a third year. The costs of the scheme continue to be treated as an operating exceptional item due to both the magnitude and the nature of the plan, outside of business as usual costs.

The Company will again be making a stakeholder dividend payment of up to £400 to all eligible employees in recognition of achieving certain Group and business unit targets. The total charge to the income statement in exceptional items arising from the stakeholder dividend is £72m (2009 £70m) payable in 2010.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Fully eligible employees continue to hold 711 notional shares in the Company, following their issue in 2007 (408 shares) and 2008 (303 shares). The Board has agreed that the third and final issue of notional shares is to be replaced by the payment of an additional stakeholder dividend, the payment of which will be linked directly to the achievement of key modernisation milestones. The value of the ColleagueShares is based on the regularly updated Group share plan valuation model.

The provision in the balance sheet for share payments at the end of the scheme is now £108m. In line with the rules of the scheme, all ColleagueShares will be redeemed by the Company by 2012-13.

Net Finance Costs

Net finance costs of £51m (2009 £20m) comprises finance costs of £98m (2009 £56m), offset by finance income of £47m (2009 £36m). The increase in finance costs of £42m is mainly due to higher borrowings, partially offset by lower borrowing rates. The increase in finance income of £11m is mainly due to higher investment yields on index linked gilts within the pension escrow investment portfolio, partially offset by lower investment yields in the other portfolios of Group funds and lower interest receivable within General Logistics Systems.

Taxation

The taxation charge in the income statement of £58m (2009 £278m) comprises £27m current tax credit (2009 £1m payable) with respect to UK operations, a £31m (2009 £35m) current tax charge on overseas profits, a UK deferred tax charge of £53m (2009 £237m) and an overseas deferred tax charge of £1m (2009 £5m). A tax charge of £19m (2009 £192m) was taken directly to equity. The reduction in the tax charge reported in relation to the pre-tax loss compared to last year is mainly due to the decreased amount of deferred tax asset written off.

Provisions

Provisions at the end of March 2010 were £276m (2009 £310m). The £34m net reduction comprises utilisation of £211m and a reduction in the ColleagueShare provision of £28m, partially offset by new provisions for restructuring, onerous property contracts and estimated exposure resulting from legal claims, totalling £196m and the unwinding of the ColleagueShare provisions discount of £9m.

Segmental Analysis – Revenue and Profitability

In the following analysis, all references to operating profit are before exceptional items.

The Group's external revenue of £9,349m (2009 £9,560m) and operating profit before exceptionals of £404m (2009 £321m) are made up as follows:

Business unit performance	External revenue		Operating profit	
	2010 £m	2009 £m	2010 £m	2009 £m
Royal Mail Letters	6,564	6,707	121	58
General Logistics Systems	1,487	1,495	112	124
Parcelforce Worldwide	399	399	17	12
Post Office Limited	838	908	72	41
Other businesses	61	51	82	86
Group	9,349	9,560	404	321

A further analysis of results, by business unit, is shown below:

Royal Mail Letters	2010 £m	2009 £m
External revenue	6,564	6,707
Operating profit before exceptionals	121	58

External revenue of £6,564m was lower than last year by £143m (2.1%). A price increase on the regulated area of c.6% was more than offset by volume decline, customers switching to lower priced products and the impact of competition. The decline in inland addressed mail volumes has continued to accelerate year on year and now stands at 7.3% (2009 5.5%). This is due to a number of factors including structural change in the mail market, the impact of recession and

industrial action during the year which also adversely impacted quality of service.

Operating profit has increased from £58m to £121m, an improvement of £63m (108.6%). This is primarily due to cost savings of £206m outweighing the revenue loss, demonstrating that modernisation is driving operational efficiencies. The decrease in costs is mainly due to a significant reduction in people costs, with 5.2% lower gross hours and c.7,000 fewer people.

Royal Mail Holdings plc

Operating and Financial Review (continued)

General Logistics Systems	2010	2009
	£m	£m
External revenue	1,487	1,495
Operating profit before exceptionals	112	124

External revenue fell by £8m (0.5%), from £1,495m to £1,487m, despite the impact of favourable foreign exchange movements. When removing the exchange impact, the underlying reduction in revenue is £95m (6.4%), as lower average prices and marginally lower volumes have resulted from recessionary conditions across Europe, an extremely competitive market.

Operating profit has reduced by £12m (9.7%), from £124m last year to £112m, with an underlying decline excluding exchange rate movements of £18m. The profit fall has resulted from difficult trading conditions across Europe and therefore revenue decline could not be fully offset by the delivery of cost savings.

Parcelforce Worldwide	2010	2009
	£m	£m
External revenue	399	399
Operating profit before exceptionals	17	12

Although external revenue outturned flat year on year, working day adjusted revenues grew by £3m (0.6%). The underlying increase in revenues was driven by volume growth of 1.8%, partially offset by revenue per parcel declining by 1.2%. Revenue growth has been underpinned by continued focus on providing quality for the customer. Quality of service for the year has improved by 0.2%, from 97.5% to

97.7% and the ongoing emphasis on customer service has led to a 1.0% improvement in the first time deliveries to 96.8%.

Operating profit of £17m has grown by 41.7% from £12m. A reduction in operating unit cost per parcel and strong overhead cost control, coupled with underlying revenue growth has generated profit growth in a difficult economic environment.

Post Office Limited	2010	2009
	£m	£m
Turnover	688	758
Network Subsidy Payment	150	150
External revenue	838	908
Operating profit before exceptionals	72	41

External revenue fell by £70m (7.7%) to £838m. The main driver of revenue decline has been in Government Services income relating to the provision of the Post Office Card Account. Customers have continued to migrate to bank accounts and the new contract, effective from October 2009, is at a lower rate per account. Financial Services income has also declined due to difficult market conditions, but there has been continued growth in Homephone and broadband revenues.

Operating profit saw an improvement of £31m from £41m to £72m. This was driven by savings from transformation programmes

significantly reducing costs in line with expectations. In addition tight cost control measures have continued with robust challenge of all areas of expenditure including working with key suppliers to deliver efficiencies.

Other businesses	2010	2009
	£m	£m
External revenue	61	51
Operating profit before exceptionals	82	86

External revenue from other Group business has increased, from £51m to £61m (19.6%). Growth has been driven by Romec - the Group's facilities management subsidiary - who have generated more revenue by winning new customer contracts. Operating profit has decreased by £4m, mainly driven by a one off VAT settlement credit received in 2009.

Funding

Royal Mail Group Ltd

Royal Mail Group Ltd continues to face considerable cash requirements with respect to its investment in modernisation and funding its pension deficit at a time when the mails market has been opened up to full competition and there is ongoing volatility in mail volumes.

On 23 March 2007, a funding package totalling £1.2bn was completed with Government and for which State Aid clearance was received in April 2009. The £900m senior debt facility expires in March 2014. It has been assumed that another facility will be negotiated to be available by this time. The remaining £300m subordinated loan was fully drawn in March 2009 and will not be repaid until the later of the unconditional release of the monies held in escrow for the Royal Mail Pension Plan Trustee or 19 March 2016.

In making an assessment on Royal Mail Group Ltd's ability to continue as a going concern, the Directors have assumed the successful execution of the modernisation plan, that an affordable payment profile will be agreed with the Royal Mail Pension Trustee in relation to the 2009 valuation and have considered the ongoing volatility in the mails market, along with the risk of greater market decline than forecast. These considerations are set out in greater detail in note 2 to the financial statements.

If risks in relation to the business plan materialise, the Directors have identified a portfolio of operational actions and strategic options that could be taken to mitigate any cash headroom exposures.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Post Office Limited

As part of the funding package announced in May 2007, £150m (2009 £150m) was paid to Post Office Limited during the year to fund the maintenance of a social network of post offices, which was recorded within revenue as a Network Subsidy Payment. The Group did not receive any non-recurring Government grant income in the year under the Industrial Development Act 1982, to compensate Post Office Limited for the other net costs of providing certain specified "services of general economic interest" (2009 £152m).

All the above payments made during the year were in accordance with approval received from the European Commission under relevant State Aid rules.

On 24 March 2010, a further funding package was agreed that provides up to £180m for compensation for losses to be sustained in parts of the network in the financial year ending March 2012, as well as providing access to the working capital facility for that year. These arrangements remain subject to State Aid approval.

Treasury Management

The Group operates a central Treasury function that manages £1.3bn of financial asset investments (substantially all of which are now held in escrow in favour of the pension fund trustees) and £0.9bn of cash and cash equivalent investments (including £708m cash in the Post Office network funded partly by a Government loan facility), in accordance with investment restrictions set by the Government. It also manages £1.7bn of financial liabilities (mainly Government borrowings) and acts as internal banker for the Group's business units. The Group finances its operations largely through cash generated from its operations, borrowings and grants.

Group Treasury derives its authority from the Royal Mail Holdings plc Board, and provides quarterly monitoring reports for their review. It only has the authority to undertake financial transactions relating to the management of the underlying business risks; it does not engage in speculative transactions and does not operate as a profit centre. All strategies are risk averse, and the treasury policy has remained substantially unchanged during the year. The principal financial instruments are Treasury bills, Government gilt edged securities, deposits and long and short term borrowings.

At the balance sheet date the Group is financed from the following facilities provided by the Department for Business, Innovation and Skills (BIS):

Borrower	Purpose	Facility end date	Facility £m	Utilised £m	Average loan maturity date
Royal Mail Group Ltd	Acquisition funding	2021-2025	500	500	2023
Royal Mail Group Ltd	Capital Expenditure and Restructuring	2014	600	300	2014
Royal Mail Group Ltd	General Purpose/ Working Capital	2014	300	40	2010
Royal Mail Group Ltd	General Purpose/ Working Capital	*	337	337	*
Post Office Limited	Network cash	2011	1,150	343	2010

*Loan is repayable on the later of March 2016 and the release of the pension escrow investments. The loan (and facility) increased by £37m (2009 £nil) as a result of accrued interest added to the loan balance. This Royal Mail Group Ltd loan is subordinate to all other creditors.

The terms of the Government borrowing facility and the associated Framework Agreement impose strict constraints on the separation of cash funds within the Group and the purposes for which they can be used.

The principal treasury risks arising from the Group's activities are currency, liquidity, commodity (fuel) and counterparty risk. These are managed as follows:

- the Group is exposed to foreign currency risk due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, revaluation of the currency balances held to operate the Bureau de Change services within Post Office Limited, revaluation of a US\$ bank deposit and various sales and purchase contracts denominated in foreign currency. Hedging programmes managed by Group Treasury mitigate these risks. Where possible, exposures are netted internally and any remaining exposure can be hedged using a combination of external spot and forward contracts;
- the Group's obligation to pay overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising US Dollar (US\$), Japanese Yen, Sterling and Euro. The Group has a policy of matching receipts and payments for individual currencies where possible and then hedging any material net exposure. The policy is that up to 80% of the forecast net exposure is hedged with agreement of the internal business unit. Group Treasury operates a rolling 18-month programme, which is subsequently reviewed on a quarterly basis. There has been no external hedge in place throughout the 2010 financial year;
- Bureau de Change balances are grouped into baskets of closely correlated currencies. Each currency basket (e.g. US\$ or Euro) is then sold forward, up to 100% of the exposure, creating a liability to match the underlying asset;
- significant foreign currency risk arising from capital purchase contracts, primarily in Euros, may be hedged up to 100% depending upon the reliability of the forecast of the underlying cash flows; and
- the Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries. However, it does hedge the transactional exposure created by inter-company loans with these subsidiaries;

Royal Mail Holdings plc

Operating and Financial Review (continued)

- the Group is exposed to various commodity price risks, namely fuel price risk arising from operating one of the largest vehicle fleets in Europe, jet fuel price risk arising from the purchasing of air freight services and electricity/gas price risks arising from the Group's power usage. The Group's commodity risk management strategy aims to reduce uncertainty created by the movements in the commodity and foreign currency markets. The strategy operates within the parameters set by the Board, which allow the use of over-the-counter derivative products, together with fixed price purchase contracts, to manage up to 100% of these exposures for up to 24 months in advance;
- the Group actively manages its liquidity risk through regular reviews of plan and budget projections against all available sources of funding. The projected headroom on these sources of financing is assessed regularly for adequacy; and
- counterparty risk is managed by limiting aggregate exposure to any individual counterparty based on their financial strength.

These exposures are reviewed regularly and adjusted as appropriate. The policies for financial assets - investments and derivative financial instruments - are shown in note 2.

Business Environment

Competitive Markets

The Group's business units operate in a competitive marketplace. Parcelforce Worldwide and GLS have been operating in an open market since their inception. These units have demonstrated their ability to perform in a non-regulated and competitive environment, which is reflected in their annual results.

Since February 2004, Royal Mail's operating environment has gradually been opened up to competition, with the letters market fully liberalised in January 2006 - well in advance of the rest of Europe. Competitors are now able to offer customers the opportunity of end-to-end service for the collection, sorting and delivery of their mail.

The harsh economic climate is creating greater competitive pressures within the communications and logistics markets. Difficult overall market conditions are stimulating competition within the market and, with the regulatory constraints imposed upon the business, Royal Mail Letters is losing substantial market share to external competitors. The proportion of volumes handled by competitors upstream (that is, collected, sorted and then transported to a Royal Mail mail centre) before it is delivered by Royal Mail, accounted for almost 6.5 billion items of mail in the year ended March 2010. Over half of Royal Mail business letters are now handled by competitors. This, in addition to cost saving measures by customers, is leading to a long-term dilution of Royal Mail letter revenues. This income dilution is likely to be offset somewhat going forward by increasing packet and parcels income, but competitive pressures within the industry remain high.

Post Office Limited, due to a reduction in income from benefit payments and a significant and continuing decrease in Government use, has developed revenue streams from Financial Services (products include car and home insurance, a 'two-in-one' credit card and range of savings products) and its HomePhone and broadband services. These new products are in direct competition with services offered by banks, insurance and telephony companies. Many of the other services it offers also face direct competition, e.g. bill payments, renewal of car tax discs and travel services.

Regulation and Compliance

The EU Postal Services Directive 97/67/EC ("PSD") establishes the legal framework applying to postal services throughout the EU. It requires the provision of a universal postal service across the EU within the framework of an internal EU postal market, with the gradual and controlled liberalisation of that postal market.

In 2000, the Postal Services Act came into force in the UK, creating an independent postal regulator - Postcomm - which commenced a process of market liberalisation and licensing regime of Royal Mail and competitors. Postcomm currently regulates the prices of over 80% of the Royal Mail letters business, controls the terms and conditions for nearly all of its services, sets the quality of service targets and determines compensation arrangements.

Post Office Limited is subject to regulation in financial services (Financial Services Authority) and in telephony (Ofcom). Post Office Limited is an appointed representative of the Governor and Company of the Bank of Ireland, which in turn is regulated directly by both the Irish Financial Regulator and Financial Services Authority (FSA) for conduct in the UK.

It is the Group's policy to be compliant with the regulatory framework in which it operates. The focus of Royal Mail's Compliance team remains to work with all business units to minimise the risk of breaching licence conditions through raising awareness and promoting adherence to agreed standards and procedures. An investigation into the end-to-end quality of service performance measurement system by the Regulator is currently being finalised. However it has already been agreed by the Regulator that there was no material impact on the results. An independent review of the testing methodology was undertaken and the suggested improvements are currently being implemented.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Major Regulatory Activity in 2010

In February 2009, the Government published legislation (the Postal Services Bill), in support of the independent review proposals and aimed at ensuring the maintenance of a universal postal service and securing the future of a healthy Royal Mail. The Bill provided for the restructuring of Royal Mail Group Ltd, changes in the Royal Mail Pension Plan, and a change in the regulation of postal services (move of Regulator from Postcomm to Ofcom). The Bill, however, was not progressed through Parliament due to the difficulty in securing investment within the economic climate at the time.

The current Price Control was set in 2006 and was expected to run for four years, however, given the change in regulation proposed by the Bill, Postcomm decided that the best way to secure their statutory duties, in the interim, was to maintain the current Price Control - which is capable of operating for a further year to April 2011. Therefore, the current Price Control will continue from April 2010 to April 2011.

However, in recognition of the significant changes in the postal market since the Price Control was set, in November 2009 Postcomm made two changes to Royal Mail's Licence, for effect in the period from April 2010 to March 2011, namely:

- allowing Royal Mail to use a zero inflation figure rather than negative inflation when setting its prices; and
- a change to the detailed workings of the Price Control (the "sub-cap mechanism"), so that it can work as intended when the Price Control was first introduced.

Postcomm made these changes to ensure that over time, Royal Mail's total revenue allows it to afford to deliver the universal service, as the provision of the universal service is the Regulator's primary duty.

On 31 March 2010, Postcomm issued their Forward Work Plan which aims to introduce a new regulatory framework in April 2012 (implementing some elements earlier if possible) with the following objectives:

- to ensure the future of the universal postal service and protects the interests of customers;
- to allow freedom for Royal Mail and its competitors to innovate and become more efficient in meeting customers' changing needs; and
- to provide flexibility and resilience so that it can be applied within any future statutory framework.

The expectation is that some changes to the current regulatory framework could be in place by April 2011.

Group Strategy and Key Performance Indicators (KPIs)

A passion for customers remains at the centre of everything we do. The Group's strategic vision is to become an efficient world class operator of the mails universal service in the UK, a true customer champion in the UK and European parcels markets and sustain and grow the Post Office both commercially and in its vital social and community roles. Within the context of an industry undergoing major structural change, the Group has six strategic objectives to deliver its vision:

- Be increasingly focused on delivering customer needs and becoming the customer champion in its markets;
- Develop an efficient world class universal service in the UK;
- Develop a leading role in the growing fulfilment market across Europe;
- Provide integrated solutions to customers through an expanded presence across the supply chain;
- Continue to develop green solutions for customers consistent with the overall approach to Corporate Social Responsibility; and
- Achieve efficient retail distribution primarily through the network of Post Office outlets, and to become the most trusted provider of essential Government and financial services to every person in the land.

To support these objectives it is essential that we build excellent relationships with our Regulators so that we can play our part in helping to ensure that the framework of regulation within which we operate is appropriate to our changing environment.

Our success is measured by the four areas central to our operating units' objectives. These key strategies and objectives are communicated widely across the Group, embedded into its day-to-day activities and measured on a timely basis by appropriate KPIs and monitored by the Royal Mail Holdings plc Board and its sub Committees, as highlighted below:

Royal Mail Holdings plc

Operating and Financial Review (continued)

Customer Service	Great Place to Work	Profitability and Cash Flow	Good Corporate Citizen
<p>Our customers are at the heart of everything we do. The key to winning and keeping customers is to provide a consistently high quality of service. This has been the top priority of everyone in the business and is at the heart of our strategy moving forward. That means:</p> <ul style="list-style-type: none"> • delivering a high quality of service and mails integrity; • developing products that match the needs of our customers; and • becoming easier to do business with. 	<p>We take health and safety very seriously and this subject comes first at each Board meeting. Throughout our businesses we are committed to ensuring our employees and customers are kept as safe as possible.</p> <p>We understand that we can only move forward and succeed if we involve our people in making change happen. This underpins our commitment to employee engagement through our regular survey established in 2003, and recently refreshed to ensure we remain aligned to our long term strategy and ensure maximum benefit to our people.</p>	<p>Funding from Government on commercial terms continues to be used to support the capital investment programme which addresses the historic underinvestment in the Letters business.</p> <p>Post Office Limited and Government remain in discussions regarding a new long-term funding package which will maintain a national network and keep Post Office Limited on a sustainable footing.</p> <p>Continuing to develop more efficient ways of working will empower us to succeed in a competitive marketplace, allowing us to maintain sustainable profitability and cash flow to eventually generate a return for our stakeholders.</p>	<p>Corporate Social Responsibility (CSR) is doing the right thing for our people, our business and the communities we operate in, as our:</p> <ul style="list-style-type: none"> • customers want to buy from companies that share their values; • colleagues want to work for companies that provide a healthy and safe environment and whose values align to theirs; and • communities want companies that create the incomes, the jobs and contribute to the cohesion that builds the neighbourhoods where people want to live and work.
Customer	People	Financial	Environmental
Quality of Service targets	Employee Survey	External revenue	CO ₂ Emissions
Number of Complaints	Health & Safety	Operating profit*	Social & Community
Customer Satisfaction	RIDDORs (reportable accidents)/1000 staff	Profit margin*	Charitable Donations
	Total Attendance	Return On Total operating Assets [#]	
		Operating cash flow	

*before exceptional items

[#]as defined in the Directors' Remuneration Report

In addition, management attention remains focused on three areas vital to securing our future success:

- Becoming leaders in innovation, devising new products that will serve our customers better in a rapidly changing, increasingly digitalised world;
- Continuing to invest and act with pace to deliver the modernisation needed within our core business operations in Letters and transformation of the Post Office network; and
- Growing our fulfilment and non postal revenue streams.

The following non-financial KPIs monitored during the year demonstrate that we have delivered on key priorities such as improving safety, which we will continue to focus on for the benefit of our people and business. We have also made good progress with our commitment to reduce carbon emissions. Retail First Class quality of service was adversely affected by the period of industrial action, but has improved again by the year end. The Engagement Index and Attendance KPIs also reflect, in part, the impact of industrial action. We have nevertheless made significant progress with modernisation this year, piloting 12 mail centres for world class processing, investing in 150 new/upgraded machines and improving to walk sorting rates of 82%.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Area	Non Financial KPIs	2010	2009
Customer Service	Retail First Class Quality of Service	87.9%	93.0%
	No. of Complaints (millions)	1.20	1.32
	Post Office Limited Customer Satisfaction	89%	90%
	Parcelforce Worldwide 24 Quality of Service	97.7%	97.5%
Great Place to Work	Engagement Index	54%	57%
	RIDDOR Accidents/1,000 staff	23.8	25.6
	Total Attendance	95.0%	95.2%
Good Corporate Citizen	Total CO ₂ Emissions (tonnes)*	810,302	993,879
	Charitable donations (£m)	1.7	2.0

*Represents preceding year

Corporate Social Responsibility

Corporate Social Responsibility (CSR) is a key priority for the Group's Board members. The business fully integrates CSR into its strategic management processes and engages its senior internal stakeholders.

The Group is proud of its CSR achievements over many years, but recognises the need to strive for continued improvement in the future. The business is aiming to build a leadership role in CSR to enable it to differentiate itself in the marketplace, by demonstrating innovative approaches to reducing costs and any negative impacts on the environment, recruiting and retaining the best talent, ensuring a safe and healthy workforce and increasing positive impacts on the communities it touches. As the business faces significant commercial challenges, CSR activities will help the Group's customers and people benefit from the improvements made.

As a unique organisation, the Company serves every single person in the UK through its Royal Mail, Post Office Limited and Parcelforce Worldwide brands. The scale of its operations help keep the UK connected and the Group actively contributes to the success of communities across the country. The Company connects people in the course of what it does and wants to ensure that the issues that matter to them are taken seriously and opportunities are used to make a real difference and a positive impact.

2009 was the seventh year that the Group published an external CSR report and 2010 is the second successive year activities were reported using Business in the Community's four-fold classification framework. Through five major CSR ambitions delivered by a partnership approach, the Group aims to demonstrate its commitment to do the right thing for its customers, employees and suppliers. The Company's partnership approach to CSR enables stakeholders to be engaged in identifying the issues where the organisation and its operations have the greatest impact, and where the CSR programme can deliver the most benefit.

Four-fold classification framework:

- Workplace;
- Community;
- Marketplace; and
- Environment.

Five major CSR ambitions:

- Demonstrate equality and fairness throughout the workforce;
- Ensure unrivalled standards of safety in the workplace;
- Provide first class support to improve and maintain the health of colleagues;
- Make a positive impact on colleagues, communities, customers and suppliers; and
- Aspire to become carbon neutral by 2015 and help customers to do business in a sustainable and competitive way.

Workplace – The Group aims to become a world class organisation, demonstrating equality and fairness throughout its operations, securing unrivalled standards of safety for suppliers and customers and providing support to maintain the health and well-being of its workforce. The approach of the business has been to identify and manage key risks, ensure effective monitoring and reporting is in place, and focus on engagement to build on successes and to identify areas for improvement.

Community – Royal Mail has a unique position in local communities and seeks to deliver a positive benefit wherever it can. The Group's social action programme helps harness its employees, products, services and purchasing power to address important community issues and to help the people whose lives are touched by the business. Royal Mail wants its employees, customers and suppliers to share its commitment to having a positive impact on local communities and have focused community strategy on areas where the enthusiasm of employees and customers can be unlocked to help others, using partnerships with organisations to focus and direct efforts.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Marketplace – As a large service provider, employer and purchaser of products and services, Royal Mail has a high profile in the marketplace and opportunity to influence its supply chain. The business is committed to sharing best practice amongst its suppliers and using its influence in the supply chain to improve industry standards. The Group has focused on recognising CSR for its products and services, customers and supply chain. The Group continues to develop its strategy in these areas to manage the impacts of its products and services through innovation and to work in partnership with its suppliers to adopt and implement good practice CSR throughout the supply chain.

Environment – Climate change is the greatest environmental challenge facing this generation. As a company with a large fleet of vehicles, the Group believes it must take responsibility in helping deliver a low carbon economy in a commercially viable way to achieve a sustainable business approach. The Group's sustainability strategy adopts two main principles: firstly, reducing the significant environmental impacts by applying the hierarchy of avoid, reduce, replace and offset; and secondly via the Group's Carbon Management Programme. The Company's approach to sustainability is supported and governed by key business principles including: creating innovative approaches to improving environmental sustainability; effective management of impacts; developing sustainable products and services; and reporting and monitoring progress on targets set. The focus of the environmental sustainability programme has been on climate change mitigation measures and looking to the future, adapting to climate change is a key area for development.

For more detailed information on the Group's CSR initiatives and performance, please refer to Royal Mail's annual CSR report to be published later in the year.

Key Relationships

The Group has several key relationships that are critical to its day-to-day activities and its overall success.

People – The Company's people are the lifeblood of the organisation and brands. Without their continued support and dedication it will be impossible to function on a day-to-day basis and embrace the change within the Group's markets. Training, diversity, flexible resourcing and making the business a great place to work are some of the ways Royal Mail continues to improve this relationship.

Unions – The Communications Workers Union (CWU) represents non-managerial staff, with Unite the Union - Communication and Managers' Association (CMA) sector representing managerial staff. The Group's policy is to work with the CWU and CMA to engage staff in the development and execution of business decisions.

Pension trustees – The pension trustee board for the main Pension Plan comprises an independent chair plus 10 others including employees, union representatives, a pensioner and independent members. They take external professional advice from Sacker & Partners LLP (legal), Towers Watson Limited (actuary), KPMG LLP (auditors) and PricewaterhouseCoopers LLP (financial). They are responsible for obtaining regular actuarial valuations of the plan to satisfy the statutory funding objective, which involves reaching agreement with the Group on the statement of funding principles, the recovery plan and the schedule of contributions. There is a separate trustee board for the Senior Executives' Pension Plan which comprises the chair plus 5 individuals including employees, pensioners and an independent member. The Defined Contribution Plan's trustee board currently comprises 5 individuals including an independent chair, employees and an independent member.

Customers – The Group's businesses and brands are used or recognised by almost everyone in the UK – from the largest of companies to individuals. However, the 30 largest customers generate c.13% of Royal Mail Retail's turnover and consequently the business is reliant on a relatively small customer base. As competition increases, the Group will have to continue to simplify ways of doing business and design products around customers' needs. Customers are offered standard terms and conditions for the markets and countries in which the Group operates.

Subpostmasters – 97% of Post Offices are operated on a contractual basis by subpostmasters, franchisees or multiple partners. Post Office Limited provides operational, commercial and technical infrastructure and resources to underpin positive working relationships with these Post Office branches in order to ensure that high standards of consistent and compliant service are provided to customers wherever they are in the UK. As part of this general approach, Post Office Limited has constructive relationships with the National Federation of Subpostmasters (which acts as a representative body for subpostmasters), as well as with a number of national multiple retail organisations, which each operate significant numbers of Post Offices. In conducting its business and in determining future strategy Post Office Limited remains aware of the interests of subpostmasters and other agents, and it works despite an often challenging economic environment, to help promote the sustainability and success of these local businesses.

Suppliers – The Group has a wide range of suppliers, with its primary reliance on those relating to outsourcing of non-core services, such as IT support. It works in partnership with its suppliers to ensure the right products and services are delivered at the right time at competitive costs. A Group purchasing team monitors compliance to Group policy in awarding contracts or new business and adheres to agreed credit terms.

The consumer body: Consumer Focus – In October 2008, Postwatch merged with energywatch and the Welsh, Scottish and National Consumer Councils to form Consumer Focus. It is the statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. Consumer Focus wants to ensure postal consumers throughout the UK are receiving a fair deal. It has strong legislative powers including the right to investigate any consumer complaint if it is of wider interest, the right to open up information from providers, the power to conduct research and the ability to make an official super-complaint about failing services.

Royal Mail Holdings plc

Operating and Financial Review (continued)

The Regulator: Postcomm – The independent regulator for the postal market, Postcomm, set up by the Postal Services Act 2000, is responsible for setting a framework for Royal Mail's prices – the Price Control, in the form of a cap on the average price of a basket of products. The price increases or reductions allowed by Postcomm through the Price Control have a very material impact on the likely levels of cash flow the Company can generate. Postcomm also investigates compliance with Licence conditions and has broad powers to reprimand publicly, or fine, Royal Mail if it finds it in breach of those conditions.

Shareholder – The Company is a plc 100% owned by the Government. The Shareholder Executive (within BIS) manages its relationship with the Company as a commercial shareholder. While management of the Group therefore lies with the Company's Board of Directors, the shareholder is kept advised through regular performance reviews and provision of information. Any new funding required by the Group (apart from short term borrowings of less than one year), can only be obtained from and approved by Government.

Principal Risks and Uncertainties

The Group uses a business-wide framework for the identification, assessment, treatment, monitoring and reporting of risk. The process helps support business objectives by linking into business strategy, identifying and reacting to emerging risks, and developing cost effective solutions for the management of risk.

The Audit and Risk Committee (ARC) reports to the Board and meets quarterly to monitor and review the effectiveness of the risk management processes and the control environment. In addition the Corporate Risk Management Committee reports to the ARC and meets quarterly to support the Group Executive Team in ensuring proactive management of risks within the business. The committee promotes the establishment, communication and embedding of risk management throughout the business. Furthermore, independent assurance is given to the Board and ARC by Internal Audit & Risk Management as to the existence and effectiveness of risk management activities described by management.

The following Group-level risks have been identified and are actively being managed to support the long-term sustainability of the Group. The impact of some of these risks could be impairment to the value of the Group's brands – Royal Mail, GLS, Parcelforce Worldwide and Post Office, which are some of the most well known and trusted brands in the UK.

The Group has a large pension fund deficit that requires funding

The size and volatility of the Royal Mail's pension fund deficit is a major challenge to ensuring modernisation of the Company. There remain uncertainties over the impact of fluctuations in the equity and debt markets affecting the value of the funds' assets and liabilities and the ability of the business to achieve the required levels of profitability and to maintain cash contributions at the agreed level.

Weakness in the UK economy is likely to have a detrimental impact on the Group's profits

Historically there has been a correlation between the state of the UK economy and level of mails revenue. Economic weakness or uncertainty will have a direct impact on mail volumes and consequently on Group profit. In addition, there are certain critical suppliers to the Group. If any of them were unable in the current economic climate to meet their service obligations, this would adversely impact the Group's operations and results. Economic downturn may also impact the ability of key customers to continue trading, which would directly impact Group revenue and profits.

The Government is the Company's only shareholder and the Group may be affected by any future change of Government and/or Government policy

The influence of public policy considerations on Government may adversely affect the Group's ability to promote an effective business strategy. This is particularly significant for Post Office Limited which is required to run its branch network as a commercial business and is reliant on Government support for loss-making branches.

The financial restructuring package agreed with the Government needs to be managed effectively

The business agreed a financial restructuring package that is allowing it to invest in new equipment and meet instalments towards the pension fund deficit that has a major impact on the Group profit and balance sheet. Effective management of this package is crucial for the business to remain within the agreed financial restructuring parameters and to avoid potential sanctions or penalties that could ensue.

The Group is subject to regulatory restrictions on its operations and the risk of penalties for non-compliance

Royal Mail's postal operator's Licence contains material restrictions on the operation of the business. These include:

- Obligations over the delivery and collection of mail;
- Restrictions over the freedom to set prices; and
- Obligations to give competitors access to the network.

If Royal Mail breaches certain postal operator's Licence conditions or other regulatory requirements it may be subject to financial penalties.

In addition to the postal operator's Licence the Group is also subject to oversight by other regulators. This affects Post Office Limited which has to satisfy the FSA's requirements as an appointed representative of The Governor and Company of the Bank of Ireland who are regulated by the FSA in respect of investment, mortgage and insurance intermediation activity in the UK. It is also subject to anti-money laundering regulations issued under the Proceeds of Crime Act 2002 and enforced by HM Revenue and Customs. Post Office Limited is also licensed as a telephone service provider by Ofcom, which requires service providers to issue and adhere to Codes of Practice.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Ineffective investment in the operational network could affect productivity levels and the ability to compete effectively

The business is continuing a major investment programme to replace equipment and technology that is nearing the end of its life cycle. The investment programme needs to be deployed effectively and future ongoing investment in the Group's operational network maintained to ensure the Group's ability to compete effectively in the open market.

Group revenues and profit are subject to several uncertainties

The postal market has evolved rapidly as a result of liberalisation. Competitors are increasingly targeting business customers. Additionally business customers are downtrading using less profitable products and overall mail market volumes are declining. Technological innovation is increasing, customers can now switch to alternative offerings and information can be sent or made available faster and, in many cases, at a lower cost than traditional mail services. If technological substitution continues, market volumes will decrease further. The Group is currently undertaking a modernisation plan, which is not yet complete. At the same time, increased awareness of and sensitivity to "green" issues, including the use of paper, may impact customer sentiment and drive down usage of mail or increase switching to alternatives.

Furthermore Royal Mail's regulatory regime impacts the business' profitability in two key areas:

- The Universal Service Obligation (USO) requires Royal Mail to maintain a national collection and delivery network, resulting in Royal Mail incurring a higher fixed cost base than its competitors. Unless the applicable regulatory restraints permit Royal Mail to recover from this imbalance, there is a risk that Royal Mail will always lose money on stamped mail, whilst competitors procure more profitable products such as business mail; and
- Royal Mail's prices for most of its letters products are determined by Price Control reviews and negotiation with the Regulator, which can reduce its flexibility and profitability, leading to uncertainty over how the future Licence and regulatory regime will affect Royal Mail.

The Group's business activities are time critical and, if key infrastructure facilities were disrupted, it could have an impact on results

The business is subject to a number of operational risks to its nationwide delivery and retail outlet networks, including natural disasters, fire, flood, explosion, possibility of work stoppages or civil unrest, transport infrastructure disruption, power failures, unavailability of key supplies, breakdown or failure of equipment, health pandemics, terrorism and the normal hazards associated with running a complex infrastructure. A major disruption could have an adverse impact on customer services as well as business and operating results.

The Group is exposed to credit risk

As a result of the economic recession, the exposure of the business to credit risks with major trading partners has increased. Management have taken all the steps they believe to be practical and appropriate in the circumstances to guard against these risks and continue to monitor the situation carefully.

The Group is subject to changes in both domestic and European regulation and legislation, which could expose it to possible additional costs

Various changes to European or domestic law will have a direct impact on the Group, such as the European Working Time Directive, international financial reporting standards, speed restrictions on the Group's vehicles and increased liberalisation of the market for postal service providers.

Without a continued change of culture within the organisation, future development may be affected

The changing and uncertain postal market place, the impact of competition and regulation, and increased customer expectations place major challenges on all employees to adapt and improve productivity to levels that will allow the business to compete effectively. These challenges need to be met by ongoing cultural change within the organisation.

Without a flexible, efficient and co-operative culture, Royal Mail could become loss making as mail volumes decline. Significant industrial action could have a major detrimental effect on the Group's reputation and profits.

The Group may be affected by future environmental and related fiscal measures

The Group operates a large vehicle fleet and a substantial property portfolio that consume large amounts of energy. Although the Group is disposing of surplus property and is deploying a Carbon Management Programme, it may be affected by future environmental measures and adverse fiscal impact from increased energy costs and "green" taxation.

The Group operates a substantial treasury operation and is exposed to foreign currency risk and fuel price risk

Foreign currency risk is due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, revaluation of currency balances held to operate the Bureau de Change services and various sales and purchase contracts denominated in foreign currency. The fuel price risk arises from operating a large vehicle fleet and, on jet fuel risk, from purchasing air freight services. If the treasury strategy does not fully cover the Group's exposures, this could result in funds not being readily available when required or a negative impact on profit due to increased costs.

Royal Mail Holdings plc

Operating and Financial Review (continued)

Summary

In 2010, the Group generated a strong set of results with operating profit growth of £83m and all businesses remaining profitable, despite revenue falling year on year for the first time in nearly 10 years. This was achieved in a difficult trading environment impacted by recessionary conditions, an increasingly competitive market place and a period of industrial action. However, the Group outturned with a net trading cash outflow of over £500m. This was attributable to the continued funding of the Group's pension obligations and investment in modernisation critical to the future success of the business.

Royal Mail Letters improved their operating profit by over 100% year on year, despite losing £143m of revenue. This performance shows that investment in modernisation is generating significant efficiencies. As volumes continue to fall, competition intensifies and customers switch to lower priced products, this has to be offset by cost savings enabled by modernisation and revenue growth through the launch of innovative new products and services.

Post Office Limited grew profits by £31m in 2010, despite a £70m fall in revenue largely in Government and Financial Services. Savings from transformation programmes and other tight cost control measures led to this improvement despite a decline in revenue of nearly 8%. On 24 March 2010, a further funding package was agreed to help maintain the network although these arrangements remain subject to State Aid approval.

The Group's parcel businesses operate in fiercely competitive markets and although recessionary conditions have put them under further pressure, they have performed strongly. Parcelforce Worldwide grew its profits by over 40% year on year through cost control coupled with underlying revenue growth and a continued focus on quality of service. GLS saw profit fall by 10% as difficult trading conditions in Europe meant revenue decline could not be fully offset by cost savings. However, it still generated significant profits and achieved strong margins for the Group.

Net trading cash outflow for the Group of £517m, was driven by pension payments and investment in modernisation. Funding on pension obligations continues to be a heavy drain on the Group's cash resources, with cash payments in excess of £850m. The investment in modernisation is allowing operating profits to grow despite falling revenues.

After another encouraging year, the Group's performance is evidence of real progress being made, however big challenges remain. The continuing trend of decline in traditional mail volumes may improve slightly as the UK economy recovers, but will still leave the Group needing to explore and develop new revenue streams and to generate further efficiencies through continuation of modernisation. A solution to the historic pension deficit and access to funding will also be critical to ensure the long term success of the Group.

Following the recent agreement with the union leadership, Business Transformation 2010 and Beyond, we are now well placed to build upon this year's progress. Working together to deliver great products and services to the Group's customers is now more important than ever before.

Ian Duncan

Group Finance Director

28 May 2010

Royal Mail Holdings plc

Operating and Financial Review (continued)

Understanding the Operating and Financial Review

Governance

The EU Accounts Modernisation Directive applies for all medium and large EU companies including listed companies and requires a mandatory inclusion to the existing Directors' Report to provide an enhanced review of a company's business.

The Directive states that the review should provide a balanced and comprehensive analysis of the development, performance and position of the Company's business, including the principal risks and uncertainties facing the organisation. The analysis should include both financial and, where appropriate, non-financial KPIs relevant to the particular business including information relating to environmental and employee matters. It is recognised that to the extent that this information appears in the Operating and Financial Review (OFR), it is incorporated by reference into the Directors' Report.

Statement of Compliance

This OFR is intended to develop the Group's narrative reporting to meet many of the recommendations of the Accounting Standards Board's 'Reporting Statement of Best Practice on the OFR'. This OFR ensures compliance with the legal requirement under the Companies Act to provide a Business Review and is referenced from the Directors' Report.

The Group will continue to review the narrative disclosures it provides in the Annual Report and Financial Statements to ensure that the disclosures provided meet the requirements of the Group's stakeholders.

Cautionary Statement

The OFR focuses on matters that are relevant to the interest of the Shareholder of the Company. The purpose of the OFR is to assist the Shareholder of the Company in assessing the strategies adopted by the Company and the potential for those strategies to succeed. It should not be relied on by any other party or for any other purpose.

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

Royal Mail Holdings plc

Royal Mail Holdings plc Board

Chairman

DONALD BRYDON (65) became a non-executive Director on 27 January 2009 and Chairman on 26 March 2009. He is Chairman of the Nominations Committee and a member of the Remuneration Committee. He is also Chairman of Smiths Group plc, the ifs School of Finance and the David Rattray Memorial Trust (UK). He had a 20-year career with Barclays Group, during which time he was Chairman and Chief Executive of BZW Investment Management and acting Chief Executive of BZW followed by ten years with the AXA Group including holding the posts of Chairman and Chief Executive of AXA Investment Managers and Chairman of AXA Framlington. He has also recently been Chairman of Amersham plc and Taylor Nelson Sofres plc and a Director of Allied Domecq plc and Scottish Power plc. He is a past Chairman of EveryChild.

Non-executive Directors

LORD CURRIE (63) joined the Board on 1 January 2009 and is a member of the Audit and Risk Committee. He was the founding Chairman of Ofcom (2002 – April 2009). He is also Chairman of the International Centre for Financial Regulation and of Semperian PPP Investment Partners Holdings Ltd, and sits on the Boards of the accountancy firm BDO, the Dubai Financial Services Authority, IG Group plc, and the London Philharmonic Orchestra. Previous appointments include positions with Nomura, Terra Firma, Unisys, T-Systems and on the Boards of Abbey National plc and Ofgem.

RICHARD HANDOVER CBE (64) joined the Board in January 2003. He is the Senior Independent Director and is Chairman of the Remuneration Committee, and a member of the Nominations Committee and the Audit and Risk Committee. Richard was Chairman of WH Smith plc until January 2005, and is currently non-executive Chairman of Alexon Group plc.

PAUL MURRAY (48) joined the Board in August 2009 and is Chair of the Audit and Risk Committee and a member of the Nominations Committee. Paul was Group Finance Director of the broadcasting company Carlton Communications and the oil and gas exploration business Lasmco. He is non-executive Director of Thomson, the media and telecoms technology, services and systems provider and a non-executive Director of Knowledge Peers and Tangent Communications. He was previously independent Director of TNS, the Global market research business.

LES OWEN (61) joined the Board in January 2010. Les is a qualified actuary with 35 years experience in the financial services industry. From 2000 to 2006 he was the Group Chief Executive Officer of AXA Asia Pacific Holdings Limited and responsible for AXA's Asian life insurance and wealth management operations. Prior to this he was Chief Executive of AXA Sun Life plc. He was a member of the Global AXA Group Executive Board. Les is currently a Non-Executive director of Computershare, the Football Federation of Australia and of Discovery Holdings, a South African listed health and life insurer.

BARONESS PROSSER OBE (72) joined the Board in November 2004 and is a member of the Nominations Committee and Remuneration Committee. Baroness Prosser has been a Member of the House of Lords since 2004. She is a non-executive Director of the Trade Union Funds Managers and has been Chair of the Women and Work Commission since July 2004. She is also Deputy Chair of the Commission for Equality and Human Rights.

Non-executive Director appointed since the year end

NICK HORLER (51) was appointed as a non-executive Director in April 2010. He is Chief Executive Officer of Scottish Power and has held senior strategic roles in major companies both in the UK and abroad.

Executive Directors

ADAM CROZIER (46) joined the Company in February 2003. He was Group Chief Executive, and led the Group Executive Team, and was the Company's Shareholder representative on the Board of Camelot Group plc. Adam is a non-executive Director of Debenhams plc, and Chairman of the Employers' Forum on Disability. He was Chief Executive of the Football Association from 2000-2003. Between 1988 and 1999 he held a number of senior roles at Saatchi and Saatchi Advertising, including that of Joint Chief Executive from 1995. He left the Company on 31 March 2010.

IAN DUNCAN (49) was appointed as Group Finance Director in September 2006, and is a member of the Group Executive Team and the GLS Supervisory Board. He is Chairman of the Pensions Committee. He joined from Westinghouse Electric Company based in the USA, where he had been Chief Financial Officer since 1999. Prior to joining Westinghouse, Ian was Corporate Finance Director at British Nuclear Fuels plc and before that in corporate finance with Dresdner Kleinwort Benson Ltd and Lloyds Merchant Bank Ltd. Ian started his career with Deloitte & Touche in London, and is a member of the Institute of Chartered Accountants of England and Wales.

MARK HIGSON (54) joined the Company in November 2007 as Managing Director of the Letters Business, and is a member of the Group Executive Team. Mark was previously divisional Chief Executive and Group Operations Director of BPB plc. Prior to that, he held senior positions at Courtaulds Plc, including CEO at its UK Coatings division. He has also worked at HJ Heinz and British Aerospace.

Royal Mail Holdings plc

Royal Mail Holdings plc Board (continued)

Executive Director appointed since the year end

DAVID SMITH (45) was appointed Managing Director of Post Office Ltd in April 2010 after three years as Managing Director of Parcelforce Worldwide. David joined Royal Mail Group in 2002, initially as Finance Director of Royal Mail's Business Sales division before being appointed as Finance Director of Parcelforce Worldwide in January 2003 and then Managing Director of Parcelforce Worldwide. He is a qualified Chartered Accountant and, prior to 2002, held a number of financial and commercial positions in the electronics industry, including Finance Director of RS Components UK.

Company Secretary

JONATHAN EVANS OBE (58) joined the Company directly from university in 1974 and was Company Secretary since 1999, having held a wide range of management positions throughout the Group. He was a member of the Group Executive Team, Secretary to the Audit and Risk, Remuneration and Nomination Committees, a Trustee Director of the Royal Mail Pension Plan, Chairman of the Royal Mail Senior Executives Pension Plan and a member of the GLS Supervisory Board. Jonathan retired from the Company in May 2010.

JON MILLIDGE (46) was appointed Company Secretary in May 2010. He is also Acting Group HR Director and Chairman of NDC 2000 Limited. He is a Pension Scheme Trustee of the Royal Mail Retirement Savings Pension Plan and the Royal Mail Defined Contribution Plan. Jon joined Royal Mail in 1985 as a graduate entrant, and has worked across many of the businesses in the Group, notably as HR director in Royal Mail Letters, Parcelforce Worldwide and as a General Manager in Post Office Limited. Jon is a fellow of the Chartered Institute of Management Accountants.

Directors who left during the year

ANDREW CARR-LOCKE was a non-executive Director from 1 September 2008 and left the Company on 24 March 2010.

ALAN COOK CBE was Managing Director of Post Office Limited from 1 March 2006 and left the Company on 31 March 2010.

HELEN WEIR was a non-executive Director from 1 January 2006 and left the Company on 31 July 2009.

Royal Mail Holdings plc

Directors' Report

The Directors present the Group financial statements for Royal Mail Holdings plc. These financial statements relate to the year ended 28 March 2010 (2009 year ended 29 March 2009).

Principal activities

The Group provides a nationwide and international distribution service, principally of mails and parcels. The Group also provides access to a wide range of financial and retail services through its network of Post Office branches across the United Kingdom.

Review of the business and future developments

A review of the Group's business and future developments is presented in the Chairman's Statement, Annual Review and the Operating and Financial Review.

Results and dividends

The loss before taxation amounted to £262m (2009 £49m profit). After taxation, the loss was £320m (2009 £229m loss). Of the loss after taxation, £1m profit (2009 £3m profit) is attributable to minority interests. The Directors do not recommend a dividend (2009 £nil dividend).

Directors

The names and biographies of the current Directors appear in the Royal Mail Holdings plc Board section pages 29 to 30.

Political and charitable contributions

During the year the Group made charitable contributions of £2m (2009 £2m). No political contributions were made in the year (2009 £nil).

Research and development

Research and development expenditure during the year amounted to £nil (2009 £nil).

Policy on the payment of suppliers

The policy of the Company and its principal operating subsidiaries is to use their purchasing power fairly. Payment terms are agreed in advance for all major contracts. For lower value transactions, the standard payment terms of the supplier apply. It is the Company's policy to abide with the agreed terms. The Company and its principal operating subsidiaries in the UK have sought to comply with the Department for Business, Innovation and Skills (BIS) Better Payment Practice Code. Copies of this can be obtained from BIS. As the Company is a non-operating company, the creditor days are zero. The creditor days of the operating subsidiaries are set out in their financial statements.

Land and buildings

The net book value of the Group's land and buildings, based upon a historic cost accounting policy and excluding fit-out, is £749m (2009 £721m). In the opinion of the Directors, the aggregate market value of the Group's land and buildings exceeds this net book value by £460m (2009 £470m).

Financial instruments

Details of financial risk management objectives and policies and financial instruments are shown in note 23 and note 24 respectively.

Directors and their interests

The Directors of the Company and details of changes during the year are given on pages 29 and 30. The Secretary of State appoints the Chairman; all other Directors are appointed by the Company with the Secretary of State's consent.

HM Government is the Company's sole shareholder and accordingly the Directors have no interest in shares of the Company.

Audit information

The Directors confirm that, so far as they are aware, there is no relevant audit information of which the auditor is unaware and that each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

Qualifying third party indemnity provisions for Directors

A partial qualifying third party indemnity provision (as defined in section 234 of the Companies Act 2006) was and remains in force for the benefit of all the Directors of the Company and former Directors who held office during the year. The indemnity is granted under article 129 of the Company's Articles of Association. The indemnity is partial in that it does not allow the Company to cover the costs of an unsuccessful defence of a third party claim.

People

The Group employs over 168,000 people (2009 over 176,000) in our UK wholly owned subsidiaries. An analysis of the Group headcount is shown in note 4 to the financial statements. Our people are our ambassadors, our brand and our service.

The Group's policy is to encourage effective communication and consultation between our people, particularly on matters relating to strategy, financial and economic factors that may influence their business unit's performance. This is achieved through the use of an extensive range of communication channels, including our employee opinion survey, magazines, briefings, open forums, TV screens and an intranet website. Our people have various bonus schemes, significant elements of which are based on business-related targets.

We actively encourage continuous training and skill development for all our people to ensure achievement of corporate and individual objectives. Management development and training programmes have been designed to attract and retain the best. The Group has worked with the unions to introduce several innovative working practices to improve efficiency.

Royal Mail Holdings plc

Directors' Report (continued)

An Equal Opportunities policy is maintained in all respects including disability, age, religion, colour, sex, nationality, ethnic origin, sexual orientation, race, creed, marital status and equality.

In 2003, we embarked on a business wide engagement programme to make Royal Mail Group a 'Great Place to Work'. The purpose of the programme is to encourage colleagues to contribute to improving their working environment; to equip them with the skills they need; to develop pride in and understanding of the business; and to drive respect for colleagues. In short, to ensure people considerations are at the heart of all major business decisions. The programme is ongoing and remains an integral part of our people strategy.

This strategy will ensure we realise our full potential through the strength of our people by developing a high-performing, sustainable culture where everyone feels involved and valued. It focuses on seven key areas:

- creating interesting, meaningful jobs with more flexible working patterns;
- identifying and developing for all our people a set of core behaviours that determine how we treat each other, our customers and our shareholder;
- building a fluid, innovative and agile organisation to improve our response to environmental and market changes;
- developing a high-performance culture in which everyone understands their contribution and is motivated to achieve their full potential;
- defining, recruiting and developing the core capabilities we need to thrive in a competitive, deregulated market;
- recruiting, attracting and developing the leadership and management capability we need to deliver our goals; and
- enhancing our ability to attract and retain the talent required to compete successfully.

Currently, the way we monitor our progress towards becoming a 'Great Place to Work' is by using *Have Your Say*, our colleague opinion survey, launched in January 2003. This is carried out on a rolling basis, reaching 1/12th of our people every month, and the results are reviewed monthly right through the business – from local level up to Board level.

Corporate Social Responsibility

The Group is committed to carrying out its activities in a socially responsible manner in respect of the environment, employees, customers and local communities. A Corporate Social Responsibility (CSR) Governance Committee reports to the Board, which publishes an annual report of its activities. Further details of our CSR governance structure and activities will be available in our 2010 CSR Report, due to be published later in the year.

Disabled employees

The Group's policy is to give full consideration to applications for employment from disabled persons. Employees who become disabled whilst employed receive full support through the provision of training and special equipment to facilitate continued employment where practicable. The Group provides training, career development and promotion to disabled employees wherever appropriate.

Going concern

After analysis of the financial resources available and cash flow projections for the Group, the Directors consider that it is appropriate to prepare the financial statements on a going concern basis. Further details are provided under funding in note 2 to the financial statements.

Auditor

A resolution to reappoint Ernst & Young LLP as auditor will be put to the Annual General Meeting.

By Order of the Board

Jon Millidge

Company Secretary

28 May 2010

Royal Mail Holdings plc

Corporate Governance

Statement by the Directors on compliance with the Combined Code

The Board is committed to high standards of Corporate Governance and supports the Combined Code on Corporate Governance (the Code), published in July 2003 and revised in June 2008. The Company has fully complied with the provisions set out in section 1 of the Code during the year in so far as they are appropriate to a public company with a single shareholder. The following statement is intended to explain our governance policies and practices in light of the Code principles and provisions and to provide insight into how the Board and management run the business for the benefit of the shareholder.

The Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance. At the end of the year, the Board comprised a Chairman, three executive Directors and five non-executive Directors. At that date there were two executive and two non-executive Director vacancies. The biographies of each of the Directors, setting out their current roles, commitments and previous experience, are on pages 29 and 30. The Board met on ten occasions during the course of the year under review.

The Board has defined those matters that are reserved exclusively for its consideration. These include the approval of strategic plans, financial statements, acquisitions and disposals, major contracts, projects, and capital expenditure. It delegates responsibilities to the Board Committees detailed below. For each scheduled meeting of the Board, the Company Secretary, on behalf of the Chairman, collates and circulates the papers, aiming to allow sufficient time for the Directors to review the information provided.

The Board is confident that all its members have the knowledge, talent and experience to perform the functions required of a Director of the business. Executive Directors have rolling 12-month contracts and non-executive Directors are generally appointed for three-year terms. The Board considers that each of the non-executive Directors is independent. This means that in the view of the Board, they have no links to the executive Directors and other managers, and no business or other relationship with the Company that could interfere with their judgement. There is also a clear division of responsibilities between the Chairman and the Chief Executive.

Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis, led by Richard Handover the Senior Independent Director, with the support of the Company Secretary. This year's evaluation was conducted using an external facilitator, Professor Rob Goffee of London Business School, using a combination of questionnaires, individual interviews, and a full board discussion. Performance evaluations of Board Committees were conducted by the Chairmen of the respective Board Committees. The non-executive Directors, led by the Senior Independent Director, reviewed the performance of the Chairman and the executive Directors. The executive Directors, led by the Group Chief Executive, reviewed the performance of the non-executive Directors.

Directors may take independent professional advice in the furtherance of their duties, at the Group's expense. All Directors have access to the advice and services of the Company Secretary, the appointment and removal of whom is a matter for the Board as a whole.

All Directors appointed by the Board are required by the Company's Articles of Association to be elected by the shareholder at the first AGM after their appointment. On appointment, the Directors take part in an induction programme in which they receive information about the Group, the role of the Board and matters reserved for its decision, the role of the principal Board Committees, the Group's Corporate Governance arrangements and the latest financial information about the Group. This is supplemented by visits to key business locations. The Group engages in two-way communication with the shareholder to discuss information on its strategy, performance and policies. The Board receives feedback on these meetings from the Directors attending them.

Royal Mail Holdings plc

Corporate Governance (continued)

Number of meetings

During the year, the Directors attended the following number of meetings of the Board and its main Committees with the maximum number that each could have attended shown in brackets.

	Board	Audit and Risk Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	10	5	5	5
Chairman				
Donald Brydon	10 (10)	-	5 (5)	4 (4)
Executive				
Ian Duncan	10 (10)	-	-	-
Mark Higson	10 (10)	-	-	-
Non-executive				
Lord Currie	10 (10)	3 (3)	-	-
Richard Handover	9 (10)	4 (5)	5 (5)	4 (5)
Paul Murray	6 (6)	3 (3)	-	3 (3)
Les Owen	2 (2)	-	-	-
Baroness Prosser	10 (10)	2 (2)	4 (5)	5 (5)
Former Directors				
Andrew Carr-Locke	10 (10)	5 (5)	5 (5)	5 (5)
Alan Cook	8 (9)	-	-	-
Adam Crozier	10 (10)	-	-	-
Helen Weir	3 (4)	2 (2)	-	-

Outside appointments

The Board believes that there are significant benefits to both the Group and the individual from executive Directors accepting non-executive Directorships of companies outside of the Group. The Board's policy is normally to limit executive Directors to one non-executive Directorship, for which the Director may retain the fees (see the Directors' Remuneration Report on page 38 for details).

Board Committees

The following Committees deal with specific aspects of the Group's governance. The full terms of reference for each of the principal Committees are available on the Company's website www.royalmailgroup.com or on written request from the Company Secretary. The details of Committee membership shown are as at 28 March 2010.

Group Executive Team

Chair	Adam Crozier
Membership	Stephen Agar (Managing Director Wholesale), Alan Cook (Managing Director Post Office Limited), Robin Dargue (Chief Information Officer), Ian Duncan (Group Finance Director), Doug Evans (General Counsel), Jonathan Evans (Company Secretary), Mary Fagan (Group Corporate and Government Affairs Director), Mark Higson (Managing Director Letters), Jon Millidge (Acting Group HR Director), Alex Smith (Strategy & Commercial Director - Letters), David Smith (Managing Director Parcelforce Worldwide) and Sue Whalley (Group Regulation and Strategy Director).
Role	<p>The Committee's responsibilities include:</p> <ul style="list-style-type: none"> ▪ to develop and monitor deployment of the Group's strategy, annual operating plans and budgets; ▪ to review operational activities, and set policies where these are not reserved to the Board; and ▪ to allocate resources, both people and financial, across the Group. <p>The Royal Mail Holdings plc Board has delegated authority to the Investment Committee of the Group Executive Team to make investment decisions of up to £20m.</p>

Royal Mail Holdings plc

Corporate Governance (continued)

Audit and Risk Committee

Chair	Paul Murray
Membership	Richard Handover, Lord Currie. The Board is confident that the collective experience of the Audit and Risk Committee members enables them, as a group, to act as an effective Audit and Risk Committee. The Committee also has access to the financial expertise of the Group and its auditor, and can seek further professional advice at the Company's expense if required.
Role	<p>The Committee, which is assisted by the Corporate Risk Management Committee, provides a forum for reporting by both internal and external auditors and is responsible for a wide range of matters including:</p> <ul style="list-style-type: none">▪ to monitor the integrity of the financial statements of the Group;▪ to review the Group's internal financial control system and, unless addressed by the Corporate Risk Management Committee or by the Board itself, internal control and risk management systems;▪ to monitor and review the effectiveness of the Group's Internal Audit function;▪ to recommend to the Board for shareholder approval the appointment of the external auditor, and to approve its remuneration and terms of engagement;▪ to monitor and review the external auditor's independence, objectivity and the effectiveness of the audit process;▪ to develop and implement policy on the engagement of the external auditor to supply non-audit services; and▪ where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, to make recommendations to the Board or management on action needed to address the issue.

Audit & Risk Committee Report

See Internal control on page 37

Non-audit services provided by the external auditor

In some cases the nature of advice required makes it more timely and cost effective to select the external auditor who already has a good understanding of the Group. In order to maintain the objectivity and independence of the external auditor, the Committee has determined what work can be provided by the external auditor and the approval processes associated with the auditor. The Committee monitors the level of non-audit fees paid to the external auditor.

Remuneration Committee

Chair	Richard Handover
Membership	Donald Brydon, Baroness Prosser
Role	<p>The Committee's responsibilities include:</p> <ul style="list-style-type: none">▪ to determine and recommend for the Board's approval, the framework for the remuneration of the senior executives of the Group;▪ to determine the individual remuneration arrangements for the Chairman, the executive Directors and the Company Secretary, subject where necessary to the consent of the Secretary of State; and▪ to agree the targets for any performance-related incentive schemes applicable to senior executives.

Remuneration Committee Report

See page 38.

Royal Mail Holdings plc

Corporate Governance (continued)

Nomination Committee

Chair	Donald Brydon
Membership	Richard Handover, Paul Murray, Baroness Prosser
Role	The Committee's responsibilities include: <ul style="list-style-type: none">▪ to lead a formal, rigorous and transparent process for appointments to the Board of the Company, to the boards of subsidiaries and to other senior executive positions;▪ to advise the Board on succession planning for the positions of Chairman, Chief Executive and all other Board appointments and other senior appointments; and▪ to keep under review the balance of Board membership to ensure that it has the required mix of skills, knowledge and experience.

Nomination Committee Report

The Committee met 5 times during the year. The Committee's main focus was on the selection and recruitment of Directors and other senior executives. The Committee took external advice from executive search consultants and considered internal candidates where appropriate. All Board appointments require the consent of the shareholder.

In addition to the principal Committees above there are also the following Committees:

Corporate Social Responsibility Committee

Chair	Adam Crozier
Membership	Group HR Director, Managing Directors of business units, Director of Corporate Responsibility, Head of Social Action & Inclusion, and other senior executives from across the Group
Role	The Committee's responsibilities include: <ul style="list-style-type: none">▪ to provide an overview of the social environmental and ethical impacts of the Group's activities; and▪ to make recommendations on Corporate and Social Responsibility standards and policies.

Corporate Social Responsibility Committee Report

The Committee is chaired by the Group Chief Executive and met on 4 occasions during the year. The principal activity of the Committee was to undertake a thorough review of the Group's CSR Strategy, Engagement & Inclusion and Social policies.

Pensions Committee

	Ian Duncan
Membership	Doug Evans (General Counsel), Jon Millidge (Acting Group HR Director)
	The Committee's responsibilities include: <ul style="list-style-type: none">▪ to review funding, benefits, scheme structure and strategic developments impacting on the Group's occupational pension schemes; and▪ to represent the Group in discussions with the Trustees of the Group's occupational pension schemes.

Internal Control

Overview

The Directors are responsible for the Group's system of risk management and internal control as well as the timely review of its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Group's approach to internal control is based on the underlying principle of line management accountability for control and risk management. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group in accordance with the guidance detailed by the Turnbull Committee as part of the Combined Code, including financial, operational, compliance risks and risks to reputation. The Board regularly reviews this process. The process has been in place throughout the year and up to the date of approval of these financial statements. The responsibility for joint ventures and associates rests, on the whole, with the senior management of those operations. The Company monitors its investments and exerts influence through Board representations.

The Board has reviewed the effectiveness of the system of risk management and internal control. The key elements include a review of Internal Audit reports, regular confirmations from local management and communications from the Chair of the Audit and Risk Committee on the outcome of Audit and Risk Committee meetings.

Audit and Risk Committee

The Committee reports to the Board and meets as a minimum on a quarterly basis to monitor and review the effectiveness of the risk management processes and the control environment. The Committee reviews the scope of work, authority and resources of the Internal Audit & Risk Management function. The Audit and Risk Committee regularly reviews the Group risk profile.

Corporate Risk Management Committee

The Committee acts as a sub-committee to the Audit and Risk Committee and meets quarterly to support the Group Executive Team in ensuring proactive management of risks within the business. The Committee promotes the establishment, communication and embedding of risk management throughout the business, as well as regularly reviewing emerging risks.

Key control processes

The key control processes are ongoing and include the following:

- the Group's Code of Business Standards sets the principles of professionalism and integrity for our people;
- the business units have authority to manage within the limits set by the Board and within the scope of reserved powers;
- the Board discusses and approves the strategic direction plans and objectives of the Group and each operating company, and the risks to achieving them;
- the Board and Group Executive Team review and approve budgets and forecasts;
- the Group Executive Team and executive business unit management review performance monthly by reference to key performance indicators, updated forecasts and information on the key risk areas;
- the Audit and Risk Committee reviews quarterly the scope and results of internal audit work across the Group. The scope of the work covers all key activities of the Group and concentrates on higher risk areas;
- the Audit and Risk Committee reviews the scope of the work of the external auditor and any significant issues arising; and
- the Audit and Risk Committee reviews key accounting policies and delegated authority levels.

Risk Management process

The process consists of formal identification by management at each level of the Group of the key risks to achieving their business objectives and the controls in place to manage them. The likelihood and potential impact of each risk is evaluated. Risk management action plans are monitored at executive level to ensure key risks are being mitigated. The process also includes:

- bi-annual certification by management that they are responsible for managing the risks to their business objectives and that the internal controls are such that they provide reasonable but not absolute assurance that the risks are appropriately identified, evaluated and managed; and
- independent assurance by Internal Audit & Risk Management as to the existence and effectiveness of the risk management activities described by management.

The system of risk management and internal control is embedded into the operations of the Group, and the actions taken to mitigate any weaknesses are monitored.

Royal Mail Holdings plc

Directors' Remuneration Report

The Company's remuneration policy follows the Combined Code and best practice in other UK organisations. The Royal Mail Group strategic plan demands fundamental change in the Group. The Board believes that to achieve this it is necessary to have people of the right calibre who are given incentives to produce results which benefit customers and the shareholder.

The parts of this Report that have been audited are:

- Directors' emoluments with respect to 2009-10;
- Performance-related, annual bonuses outturn for 2009-10;
- Company Awards and Bonus Awards under Long Term Incentive Plans (LTIP). 2009-10 was the final year of a three year Long Term Incentive Plan; and
- Pensions.

Directors' emoluments with respect to 2009-10

	Current annual salary /fees £000	Salary/ fees £000	Annual performance bonus		Annual performance bonus payable in June £000	Benefits £000	Cash supplement in lieu of pension £000	Total excluding LTIP and Pensions		Total emoluments plus amounts payable on vesting of the 2007-10 LTIP scheme	
			Performance-related bonus including ColleagueShare £000	Waived into LTIP* £000				2010 £000	2009 £000	Includes 3 year LTIP including deferred bonuses 2010 £000	2009 £000
Chairman											
Donald Brydon ¹	200	200	-	-	-	-	-	200	8	200	8
Executive											
Adam Crozier ²	633	633	---	---	---	19	206	858	995	2,428	995
Ian Duncan	325	325	184	(99)	85	17	81	508	498	1,396	498
Mark Higson	428	428	221	(114)	107	15	171	721	722	1,733	722
Non-executive											
Lord Currie ³	40	38	-	-	-	-	-	38	9	38	9
Richard Handover	65	65	-	-	-	-	-	65	64	65	64
Paul Murray ⁴	40	34	-	-	-	-	-	34	-	34	-
Les Owen ⁵	35	6	-	-	-	-	-	6	-	6	-
Baroness Prosser ⁶	55	55	-	-	-	-	-	55	51	55	51
Former Directors											
Andrew Carr-Locke ⁷	50	50	-	-	-	-	-	50	28	50	28
Alan Cook ⁸	282	282	149	(78)	71	18	113	484	480	1,252	480
Allan Leighton ⁹	-	-	-	-	-	-	-	-	100	-	100
David Fish ¹⁰	-	-	-	-	-	-	-	-	23	-	23
Helen Weir ¹¹	48	16	-	-	-	-	-	16	46	16	46
Total 2010	2,201	2,132	554	(291)	263	69	571	3,035	-	7,273	-
Total 2009	2,125	1,903	1,116	(625)	491	63	567		3,024		3,024

* The annual performance bonus waived into LTIP is explained on page 41

¹ Donald Brydon joined the Board on 27 January 2009 and became Chairman on 26 March 2009.

² Adam Crozier left the Board on 31 March 2010. He was released from his notice period four months early and it was mutually agreed that he should not be awarded an annual bonus for 2009-10. As part of this bonus could have been waived in return for an award in the LTIP and the LTIP value was capped, the total amount forgone was £653,802.

³ Lord Currie joined the Audit and Risk Committee on 7 October 2009.

⁴ Paul Murray joined the Board on 1 August 2009 and became a member of the Audit and Risk Committee on 7 October 2009.

⁵ Les Owen joined the Board on 27 January 2010.

⁶ Baroness Prosser left the Audit and Risk Committee and stood down as Chair of the Nomination Committee on 7 October 2009. She remains a member of the Nomination Committee.

⁷ Andrew Carr-Locke left the Board on 24 March 2010.

⁸ Alan Cook resigned from the Board with effect from 15 March 2010 and left the Company on 31 March 2010.

⁹ Allan Leighton left the Board on 25 March 2009.

¹⁰ David Fish left the Board on 30 September 2008.

¹¹ Helen Weir left the Board on 31 July 2009.

The total emoluments plus amounts payable on vesting of the 2007-10 LTIP scheme columns have been included as they represent the total that is paid or payable in respect of the year.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

The figures in the table represent the qualifying emoluments earned and receivable by anyone who has served as a Director at any time during the financial year, whenever paid. Such emoluments are normally paid in the same financial year with the exception of the annual, performance-related bonus, which is paid in the year following that in which it is earned and the amount deferred into LTIP that is not paid until the LTIP matures.

These payments are consistent with the policy of the Remuneration Committee. The following sections describe the Committee, its general policy and the main elements of remuneration.

The Remuneration Committee

The Board retains overall accountability for the framework and costs of executive remuneration and the terms of the service contracts offered to all executive Directors. These also require the consent of the Secretary of State for Business, Innovation and Skills. The Secretary of State also gives consent for the remuneration arrangements for non-executive Directors. The Remuneration Committee's role is to develop the remuneration policy for executive Directors and their immediate reports and specifically to make recommendations on their salary, benefits, bonuses and other terms and conditions of employment. The Committee also recommends appropriate compensation on the ending of employment, giving careful consideration to the circumstances of the particular case and the ability of the individual to mitigate.

The Remuneration Committee is made up wholly of independent non-executive Directors. Membership of the Committee is given on page 35. The Chief Executive and the Group HR Director, may attend these meetings by invitation and are not present at the discussion of their own remuneration.

Advice to the Remuneration Committee

The Committee calls for information and advice from inside and outside the Group. It takes advice from those independent, professional organisations that are best able to assist it on the particular topic under discussion.

During 2009-10, advice on the performance of key executives was given by the Chairman and the Chief Executive. Information on the external marketplace was given by Monks Partnership (a trading name of PricewaterhouseCoopers), Deloitte LLP, Hay Management Consultants and Towers Watson Limited. Internal support is primarily provided by the Acting Group HR Director, Jon Millidge, and from the Company Secretary, Jonathan Evans. Other advice and information has been provided by specialists from the HR and Finance Departments.

During the year, advice was given to the Company by Towers Watson Limited on pensions and actuarial matters.

Remuneration policy

The Company's policy on Directors' remuneration is that:

- the overall remuneration package should be sufficiently competitive to attract and retain executives of the necessary quality in a complex business and a competitive marketplace, who will deliver success for the shareholder and high levels of customer service, safety and environmental performance;
- a significant proportion of the remuneration package should be dependent on performance - both short and long-term; and
- the system of remuneration should bring together the interests of senior executives, customers and the shareholder.

The policy for senior executives takes into account pay and employment conditions elsewhere in the Group.

The Committee regularly reviews the benefits package offered to its key executives and its competitiveness. The Committee aims to ensure that the package is proportionate and effective, and that it follows accepted best practice.

The main components of remuneration

The main components for executive Directors are: basic salary, an annual performance-related bonus, a Long-Term Incentive Plan (LTIP), pension and other benefits. The Committee believes that there should be a particular emphasis on performance-related elements.

Base salaries

The Committee believes that base salaries should be set at levels that are sufficient to recruit and retain high calibre executives. In making its judgement, the Committee considers information from several sources so that a fair comparison can be made with enterprises of a similar size and complexity to Royal Mail. This data is provided by independent consultancies, usually based on the published annual reports of other organisations. Increases are recommended where the Committee believes that it is necessary to reflect contribution, increased individual responsibilities and market levels. The Secretary of State's consent is required for all material changes to Directors' remuneration.

In the light of the general economic circumstances no increases to base salary were awarded to the Chief Executive or the executive Directors in respect of the 2009-10 salary review. In 2008 it had been agreed that the salaries of Ian Duncan and Alan Cook would increase to £350,000 and £300,000 a year respectively. These increases were to apply in two phases, with the second due on 1 July 2009. At the request of Ian Duncan and Alan Cook, these second increases were postponed and will be implemented on 1 July 2010 in the case of Ian Duncan, Alan Cook having left the Company at the end of March 2010. Consequently no executive Director received a pay increase in 2009-10.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Performance-related annual bonus 2009-10

For 2009-10, the annual bonus plan for executive Directors had the same potential awards at threshold, on-target and maximum levels as in previous years.

For all executive Directors the factors were Profit, Quality of Service and Personal Objectives, with the Chief Executive additionally incentivised on Revenue and Costs. Quality of Service constituted 25% of the total bonus potential for all executive Directors and all had an element relating to the overall Group performance.

The Quality of Service measures were:

- Retail First Class;
- Retail Second Class;
- Bulk First Class;
- Bulk Second Class;
- Bulk Third Class;
- Special Delivery;
- Wholesale Access;
- Parcelforce 24;
- A Post Office Limited Customer Service Effectiveness measure;
- A Post Office Limited Customer Service Quality measure
- A Post Office Limited measure of new products sold; and
- A Post Office Limited measure of call centre performance.

The Quality of Service factors in the Plan which related to the Letters business were severely affected by industrial action.

Executive Directors also participate in the ColleagueShare plan on the same terms as all other eligible employees. This is explained in note 2 on page 55.

Long-Term Incentive Plans

A three-year LTIP was in place for the period 2007-08 to 2009-10.

Performance is measured by Return On Total Assets (ROTA).

The principles of the plan are as follows:

- (a) Company Performance Awards can be made each year which accrue on a sliding scale above a threshold level of performance, beginning at 12.5% of annual base salary. For on-target performance, the Company Award is 25% of annual base salary and for exceptional performance this rises to a maximum of 37.5%.
- (b) Bonus Awards. A Bonus Award can be made each year by the Remuneration Committee. These are only made if the Director waives a proportion of their annual bonus. LTIP Bonus Awards do not exceed the amount of annual bonus waived. A Director has the discretion to waive a maximum of one half of any annual bonus up to the on-target level. If a bonus above on-target would otherwise be payable, then three quarters of this additional amount above the on-target level will be compulsorily waived.
- (c) A Multiplying factor. Company and Bonus Awards may be increased by a factor that measures ROTA across the plan. If the on-target level is achieved for the relevant period then each of the Company Awards and Bonus Awards to which it applies are increased by an additional one third. In the case of exceptional performance, then up to a maximum addition of 100% is added.

Payments under the plan will be made in June 2010.

2010 to 2013

Discussions continue with the shareholder regarding a future long term incentive plan.

LTIP Awards for 2009-10

Company Performance Awards

These are measured against an annual Return on Total Assets (ROTA) target. ROTA incentivises the productive value of the business and emphasises the need to make efficient use of all operational assets. ROTA was chosen as it covers the need to make a proper return both on any new investments that are made and on the existing asset base.

For 2009-10 the following table against annual ROTA applied:

Royal Mail ROTA achievement	Percentage of Base Salary
Threshold 8.2%	12.5%
On-Target 8.6%	25.0%
Maximum 11.0%	37.5%

The outturn achievement was 11.3%, resulting in a Company Award of 37.5%.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Bonus Awards

As described above, a Director may waive a maximum of one half of any annual bonus up to the on-target level and must waive three quarters of any bonus earned above the on-target level. If a proportion of annual bonus is waived then a Bonus Award may be made within the LTIP, not exceeding that value. The table on page 42 shows the value of bonus waivers and Bonus Awards made for 2009-10.

Multiplying Factor

The Multiplying Factor is dependent upon cumulative ROTA over 2007-08 to 2009-10.

Royal Mail ROTA achievement		Multiplier
Threshold	17.4%	1
On-Target	19.4%	1.33
Maximum	30.0%	2

As 2009-10 was the final year of the plan, the Multiplying Factor was calculated. Over the three years the cumulative ROTA was 26.1% resulting in a Multiplying Factor of 1.76.

Benefits

Benefits include the provision of a company car, health insurance, relocation costs, or the cash equivalent of any benefits not taken.

Pensions

The Group has a liability to pay pensions in respect of Directors' services and, for some executive Directors, makes contributions to pension schemes for this purpose. The Company pays a cash supplement to Directors whose contributions to the Company scheme are restricted by the scheme-specific earnings cap. The Company continues to apply the scheme-specific earnings cap, indexed by inflation each year, as a constraint on the amount of salary that is pensionable through the Company scheme.

Following a review of its pension arrangements, the Company introduced changes for all employees including executive Directors with effect from 1 April 2008. These changes had two phases. From 1 April 2008 the defined benefit pension plans closed to new members and pension for future service accrues on a career salary basis. From 1 April 2010 the normal retirement age under the plans increased to age 65 and the earliest age for receipt of a reduced pension became 55.

Fixed and performance-related elements of Executive Directors' remuneration (excluding pensions)

For 2009-10, 33% of Directors' potential annual earnings related to fixed elements whilst 67% related to annualised performance elements, for the Group Chief Executive 30% was fixed and 70% was variable. The element of remuneration at risk to performance is that available through the Long-Term Incentive Plan and the performance-related annual bonus.

Service contracts

The Committee's policy is that executive Directors appointed to the Board are given notice periods of one year, and that they must give six months' notice of departure. The Committee has a defined policy on compensation and mitigation, to be applied in the event of a Director's contract being prematurely terminated. In such circumstances, steps would be taken to ensure that poor performance is not rewarded.

The rolling service contracts and letters of appointment of the Directors include the following terms as at 28 March 2010:

	Date of contract	Expiry date of current service contract	Unexpired term (months)
Chairman			
Donald Brydon	26 March 2009	25 March 2012	24
Executive Directors			
Adam Crozier*	1 February 2003		-
Alan Cook*	1 March 2006		-
Ian Duncan	1 September 2006		12
Mark Higson	5 November 2007		12

* Adam Crozier and Alan Cook both resigned from the Company with effect from 31 March 2010.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

The non-executive Directors do not have employment contracts. The dates of the current non-executive Director appointments are as follows:

	Date of contract	Expiry date of current service contract	Unexpired term (months)
Non-executive Directors			
Lord Currie	1 January 2009	31 December 2011	21
Richard Handover	1 January 2003	31 March 2011	12
Paul Murray	1 August 2009	31 July 2012	28
Les Owen	27 January 2010	26 January 2013	34
Baroness Prosser	1 November 2004	31 October 2010	7

Andrew Carr-Locke left the Board on 24 March 2010. Helen Weir left the Board on 31 July 2009.

Richard Handover's contract was extended on 16 December 2009 until 31 March 2011.

Non-executive Directors

The Company is committed for the remaining term of appointments, subject to annual review and notice, for non-executive Directors, including the Chairman. The fees paid to the non-executive Directors are determined by the executive Directors and approved by the Secretary of State. Independent market surveys are consulted in determining them. Fees comprise a basic fee for Board membership and, as appropriate, additional fees for the membership or chairmanship of committees and for the Senior Independent Director. Details of the fees are given below.

Performance-related, annual bonuses outturn for 2009-10

The details of the bonus plan are given on pages 40 and 41. Despite economic conditions causing letters volumes to decline, the Group exceeded its targets. Ian Duncan, Alan Cook and Mark Higson were awarded bonuses which were 71%, 66% and 64% of the maximum respectively. By mutual agreement, Adam Crozier was not awarded any annual bonus for 2009-10. Mark Higson and Ian Duncan were awarded £400 ColleagueShare stakeholder dividend for the year.

Company Awards and Bonus Awards under the Long Term Incentive Plans

The Remuneration Committee policy is that a high proportion of total remuneration is at risk to performance.

	Company and Bonus Awards held at 30 March 2009 £000	Bonus Awards in respect of 2009-10 for 2007-10 plan £000	Company Awards in respect of 2009-10 for 2007-10 plan £000	Total LTIP at 28 March 2010 £000
Executive				
Adam Crozier	706	-	237	1,500
Alan Cook	253	78	106	768
Ian Duncan	283	99	122	888
Mark Higson	300	114	161	1,012

The Final Multiplier, reflecting performance over the three years from 2007-08, of 1.76 is applied to the total of Company and Bonus Awards to reach the Total LTIP value. Further details are given on pages 40 and 41. In the case of Adam Crozier, the total LTIP payment was capped at £1.5m. An additional element of the previous year's annual bonus (£70,000) which had been deferred with the LTIP was repaid to Adam Crozier without the application of a multiplier.

Non-executive Directors

The fees of the Chairman and the non-executive Directors are agreed with the Secretary of State, and are currently £200,000 per annum and £35,000 per annum respectively.

The annual fee for committee membership is £5,000, £10,000 for chairmanship and £12,500 in the case of the chairman of the Audit and Risk Committee. The annual fee for the Senior Independent Director is £10,000.

Royal Mail Holdings plc

Directors' Remuneration Report (continued)

Executive Directors' outside appointments

The executive Directors may retain fees from their Directorships. The annual rate payable as at 28 March 2010 to executive Directors in respect of their non-executive Directorships are shown in the table below:

	Directorship	2010 £000	2009 £000
Adam Crozier	Debenhams plc	50	45
Alan Cook	Financial Ombudsman Service	22	20
	Department for Transport Board	20	20

Pensions

The Group previously offered its most senior people membership of the Royal Mail Senior Executive Pension Plan (the Plan) which is now closed to new members. Details of the Plan are set out in note 25 to the financial statements. The Plan is a funded, Inland Revenue-registered defined benefit occupational pension scheme. The Plan provides for a pension on a final salary basis for service up to 31 March 2008 and for subsequent service on a career salary basis. The pension is payable from normal retirement age (currently age 65) and is subject to the maximum pensionable service and the scheme-specific earnings cap. Pensions in payment are increased annually in line with Retail Prices Index (RPI), subject in some cases to a cap of 5%. Pensions are also payable to dependants on the death of the member and a lump sum is payable if death in service occurs.

For senior executives whose membership of the Plan is restricted by the earnings cap, pension provision is made by a combination of the Company scheme and a cash pension supplement or its equivalent. Ian Duncan and Adam Crozier receive a cash supplement of 40% of base pay above the earnings cap. Alan Cook and Mark Higson are not members of the Plan and receive a cash supplement of 40% of base pay.

The following table is designed to indicate the increase in the value of Directors' accrued benefits during the period. The transfer value is calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes Directors' contributions.

The pension entitlements of the Directors at the year end were:

	Age at Year end	Accumulated accrued benefit at 28 March 2010 £000	Increase in accrued benefits during the period £000	Increase in accrued benefits during the period (net of inflation) £000	Transfer value of increase before inflation less Directors' contributions £000
Executive Directors					
Adam Crozier	46	82	4	4	52
Ian Duncan	49	15	4	4	62

The following table is designed to assess the change in transfer values during the year, taking into account movement in investment market conditions. Falls in market values may generate a negative movement in the transfer values.

	Age at Year end	Transfer value at 29 March 2009 or at date of appointment to Board if later £000	Plus transfers-in received £000	Sub total £000	Transfer value at 28 March 2010 £000	Movement in the period less Directors' contributions £000
Executive Directors						
Adam Crozier	46	963	-	963	1,192	222
Ian Duncan	49	137	-	137	229	85

The transfer values disclosed represent a potential liability of the pension plan rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.

Tony McCarthy, a former Director, is in receipt of an annual payment of £43,111 a year as an unfunded unapproved pension promise made to him on recruitment.

Marisa Cassoni, a former Director, had accumulated an unapproved pension fund of £779,390 to provide for pension on base salary above the earnings cap. At her request the accumulated fund was transferred to her on 4 December 2009.

By Order of the Board

Jon Millidge

Company Secretary
28 May 2010

Royal Mail Holdings plc

Statement of Directors' responsibilities in relation to the Group financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained by the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' responsibility statement pursuant to chapter 4 of the Disclosure and Transparency Rules (DTR)

The Directors confirm that, to the best of each person's knowledge:

- the financial statements, which have been prepared in accordance with applicable United Kingdom law and International Financial Reporting Standards as adopted by the European Union or, in the case of the Company's financial statements, UK GAAP, give a true and fair view of the assets, liabilities, financial position and profit of the Company and of the loss of the Group taken as a whole; and
- the Operating and Financial Review contained in this report includes a fair review of the development and performance of the business and the position of the Company and the Group taken as whole, together with a description of the principal risks and uncertainties that they face.

Donald Brydon

Ian Duncan

Royal Mail Holdings plc

Independent Auditor's Report to the members of Royal Mail Holdings plc

We have audited the Group financial statements of Royal Mail Holdings plc for the year ended 28 March 2010 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of changes in equity, the Consolidated balance sheet, the Consolidated statement of cash flows and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 44, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 28 March 2010 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Royal Mail Holdings plc for the year ended 28 March 2010.

Alison Duncan (Senior statutory auditor)

for and on behalf of Ernst & Young LLP,

Statutory Auditor

London

28 May 2010

Royal Mail Holdings plc

Consolidated income statement for the year ended 28 March 2010 and 29 March 2009

	Notes	2010 £m	2009 £m
Continuing operations			
Turnover		9,199	9,410
Network Subsidy Payment		150	150
Revenue		9,349	9,560
People costs excluding ColleagueShare and restructuring costs	4(a)	(5,746)	(6,012)
Distribution and conveyance operating costs	5(b)	(1,579)	(1,577)
Other operating costs	5(c)	(1,661)	(1,697)
Share of post tax profit from joint ventures and associates	14	41	47
Operating profit before exceptional items		404	321
Operating exceptional items	7	(291)	(149)
Government grant income		-	152
ColleagueShare costs		(44)	(84)
Other restructuring costs		(247)	(217)
Operating profit		113	172
Profit on disposal of property, plant and equipment		5	11
Profit before financing and taxation		118	183
Finance costs	8	(98)	(56)
Finance income	8	47	36
Net pensions interest	25(c)	(329)	(114)
(Loss)/profit before taxation		(262)	49
Taxation charge	9	(58)	(278)
Loss for the financial year from continuing operations		(320)	(229)
(Loss)/profit attributable to:			
Equity holder of the parent company		(321)	(232)
Minority interest		1	3

Royal Mail Holdings plc

Consolidated statement of comprehensive income for the year ended 28 March 2010 and 29 March 2009

	Notes	2010 £m	2009 £m
Loss for the financial year from continuing operations		(320)	(229)
Other comprehensive loss for the period		(1,305)	(4,186)
Translation differences on foreign currency net investments		(21)	88
Actuarial losses on defined benefit schemes	25	(1,312)	(4,084)
(Loss)/gain on cash flow hedges deferred into equity	24	(12)	8
Loss/(gain) on cash flow hedges released from equity to income	24	21	(9)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	24	(4)	(14)
Gains on financial assets deferred into equity		42	17
Taxation on items taken directly to equity	9	(19)	(192)
Total comprehensive loss for the period		(1,625)	(4,415)
Total comprehensive (loss)/income for the period attributable to:			
Equity holder of the parent company		(1,626)	(4,418)
Minority interest		1	3

Royal Mail Holdings plc

Consolidated statement of changes in equity for the year ended 28 March 2010 and 29 March 2009

	Share premium £m	Retained earnings £m	Financial Assets Reserve £m	Rural Network Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Minority interest £m	Total equity £m
At 30 March 2009	430	(5,331)	23		157	12	47	(4,662)	6	(4,656)
Loss for the period	-	(321)	-		-	-	-	(321)	1	(320)
Other comprehensive (loss)/income for the period	-	(1,316)	32		(21)	-	-	(1,305)	-	(1,305)
Translation differences on foreign currency net investments	-	-	-		(21)	-	-	(21)	-	(21)
Actuarial losses on defined benefit schemes	-	(1,312)	-		-	-	-	(1,312)	-	(1,312)
Loss on cash flow hedges deferred into equity	-	-	-		-	(12)	-	(12)	-	(12)
Loss on cash flow hedges released from equity to income	-	-	-		-	21	-	21	-	21
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	-	-	-		-	(4)	-	(4)	-	(4)
Gains on financial assets deferred into equity	-	-	42		-	-	-	42	-	42
Taxation on items taken directly to equity	-	(4)	(10)		-	(5)	-	(19)	-	(19)
At 28 March 2010	430	(6,968)	55		136	12	47	(6,288)	7	(6,281)
	Share premium £m	Retained earnings £m	Financial Assets Reserve £m	Rural Network Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Minority interest £m	Total equity £m
At 31 March 2008	430	(863)	10	36	69	27	47	(244)	3	(241)
Loss for the period	-	(232)	-	-	-	-	-	(232)	3	(229)
Other comprehensive (loss)/income for the period	-	(4,272)	13	-	88	(15)	-	(4,186)	-	(4,186)
Translation differences on foreign currency net investments	-	-	-	-	88	-	-	88	-	88
Actuarial losses on defined benefit schemes	-	(4,084)	-	-	-	-	-	(4,084)	-	(4,084)
Gain on cash flow hedges deferred into equity	-	-	-	-	-	8	-	8	-	8
Gain on cash flow hedges released from equity to income	-	-	-	-	-	(9)	-	(9)	-	(9)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	-	-	-	-	-	(14)	-	(14)	-	(14)
Gains on financial assets deferred into equity	-	-	17	-	-	-	-	17	-	17
Taxation on items taken directly to equity	-	(188)	(4)	-	-	-	-	(192)	-	(192)
Transfer from Rural Network reserve	-	36	-	(36)	-	-	-	-	-	-
At 29 March 2009	430	(5,331)	23	-	157	12	47	(4,662)	6	(4,656)

A description of the nature and usage of the reserves in the above tables is included in note 26.

Royal Mail Holdings plc

Consolidated balance sheet at 28 March 2010 and 29 March 2009

	Notes	2010 £m	2009 £m
Non-current assets			
Property, plant and equipment	10	1,935	1,886
Leasehold land payment	11	4	4
Goodwill	12	197	206
Intangible assets	13	99	78
Investments in joint ventures and associates	14	147	141
Financial assets – pension escrow investments	24	1,189	1,106
– investments	24	49	–
– derivatives	24	3	22
Other receivables		1	1
Deferred tax assets	9	95	154
		3,719	3,598
Non-current assets held for sale	15	5	3
Current assets			
Inventories	16	38	32
Trade and other receivables	17	1,155	1,155
Income tax receivable		14	17
Financial assets – investments	24	1	7
– derivatives	24	24	43
Cash and cash equivalents	18/24	937	1,060
		2,169	2,314
Total assets		5,893	5,915
Current liabilities			
Trade and other payables	21	(2,076)	(2,231)
Financial liabilities – interest bearing loans and borrowings	19/24	(388)	(234)
– obligations under finance lease and hire purchase contracts	19/24	(61)	(29)
– derivatives	19/24	(17)	(56)
Income tax payable		(8)	(13)
Provisions	20	(130)	(136)
		(2,680)	(2,699)
Non-current liabilities			
Financial liabilities – interest bearing loans and borrowings	19/24	(1,138)	(803)
– obligations under finance lease and hire purchase contracts	19/24	(120)	(81)
– derivatives	19/24	(1)	(5)
Provisions	20	(146)	(174)
Retirement benefit obligation – pension deficit	25	(8,041)	(6,776)
Other payables	22	(43)	(32)
Deferred tax liabilities	9	(5)	(1)
		(9,494)	(7,872)
Total liabilities		(12,174)	(10,571)
Net liabilities		(6,281)	(4,656)
Equity			
Share capital	26	–	–
Share premium		430	430
Retained earnings		(6,968)	(5,331)
Reserves		250	239
Equity attributable to equity holder of parent company		(6,288)	(4,662)
Minority interest		7	6
Total equity		(6,281)	(4,656)

The financial statements on pages 46 to 94 were approved by the Board of Directors on 28 May 2010 and signed on its behalf by:

Donald Brydon

Ian Duncan

Royal Mail Holdings plc

Consolidated statement of cash flows for the year ended 28 March 2010 and 29 March 2009

	Notes	2010 £m	2009 £m
Cash flow from operating activities			
Operating profit before exceptional items		404	321
Adjustment for:			
Depreciation and amortisation	5(c)	278	257
Share of post tax profit from joint ventures and associates	14	(41)	(47)
Working capital and other non-cash movements:		(83)	(80)
(Increase)/decrease in inventories		(6)	2
Decrease in receivables		24	66
Decrease in payables		(30)	(61)
Increase in client receivables		(14)	(74)
Decrease in client payables		(63)	(50)
Net increase in derivative (assets)/liabilities		(7)	24
Increase in non-exceptional provisions		13	13
Cash paid in respect of retirement benefit obligations in excess of that charged in operating profit		(376)	(345)
Receipt of Government grant		-	152
Cash payments in respect of operating exceptional items (see note (a) below):		(293)	(412)
ColleagueShare		(82)	(158)
Other		(211)	(254)
Cash outflow from operations		(111)	(154)
Income tax paid		(16)	(36)
Net cash outflow from operating activities		(127)	(190)
Cash flows from investing activities			
Dividends received from joint ventures and associates	14	35	42
Finance income received		47	38
Proceeds from sale of property, plant and equipment		14	20
Purchase of property, plant and equipment		(374)	(436)
Leasehold land payment		-	(4)
Acquisition of businesses	10	(1)	(2)
Purchase of intangible assets		(80)	(78)
Payment of deferred consideration in respect of prior years' acquisitions		(7)	(6)
Net purchase of financial assets investments (non-current)		(86)	(19)
Net proceeds from financial assets investments (current)		6	14
Net cash outflow from investing activities		(446)	(431)
Net cash outflow before financing activities		(573)	(621)
Cash flows from financing activities			
Finance costs paid		(52)	(62)
Payment of capital element of obligations under finance lease contracts		(22)	(18)
Cash received on sale and leasebacks		73	75
New loans		451	301
Repayment of borrowings		(2)	(48)
Net cash inflow from financing activities		448	248
Net decrease in cash and cash equivalents		(125)	(373)
Effect of exchange rates on cash and cash equivalents		(1)	13
Cash and cash equivalents at the beginning of the period		1,060	1,420
Cash and cash equivalents at the end of the period	18/24	934	1,060

The £934m cash and cash equivalents balance is net of a £3m overdrawn bank balance relating to the General Logistics Systems (GLS) subsidiary. This £3m is included in the Financial liabilities - interest bearing loans and borrowings (current) balance of £388m in the balance sheet.

Royal Mail Holdings plc

(a) Cash flows relating to operating exceptional items charged to the income statement in current and prior years

The net cash outflows relating to the above were as follows:

Net cash outflow relating to:	2010 £m	2009 £m
Current year operating exceptional items	85	38
Prior years' operating exceptional items	208	374
Total	293	412

The net cash outflow of £293m (2009 £412m) comprises £158m (2009 £217m) relating to cash utilised to settle exceptional provisions, £75m (2009 £154m) relating to ColleagueShare dividends, £11m (2009 £1m) relating to current year pension redundancy liabilities, £39m (2009 £31m) relating to prior year pension redundancy liabilities, £10m (2009 £9m) in respect of other costs which were recorded within other payables.

Royal Mail Holdings plc

Notes to the Group financial statements

1. Authorisation of financial statements and statement of compliance with IFRSs

The Group's financial statements for the year ended 28 March 2010 were authorised for issue by the Board on xx May 2010 and the balance sheet was signed on the Board's behalf by Donald Brydon and Ian Duncan.

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and as they apply to the financial statements of the Group for the year ended 28 March 2010. The principal accounting policies adopted by the Group are set out in note 2.

2. Accounting policies

Basis of preparation and accounting

The Group comprises Royal Mail Holdings plc (the Company) – which is wholly owned by HM Government – and its subsidiaries. The Company is incorporated in the United Kingdom under the Companies Act 2006 (the Act) and the financial statements are produced in accordance with the Act and applicable IFRSs.

The Group financial statements are presented in sterling and all values are rounded to the nearest £m except where otherwise indicated.

Royal Mail Group Ltd, a wholly owned subsidiary of the Company, may be exposed to the risk of being fined by its industry Regulator and of being required to pay compensation to certain customers, as a result of failing to meet operational targets set by the Regulator in its licence. In this situation the amount of such fines and compensation will be determined by the Regulator after further representations from Royal Mail Group Ltd and no further information will be disclosed on the grounds that it can be expected to prejudice the outcome of that process.

Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted the following new and amended accounting standards as of 30 March 2009. The impact on the financial statements or performance of the Group is also described below:

IFRS 7 Financial Instruments: disclosures

The amended standard requires additional disclosures about fair value measurements and liquidity risk. Fair value measurements related to items recorded at fair value are to be disclosed by source of inputs using a three level fair value hierarchy, by class, for all financial instruments recognised at fair value. In addition, a reconciliation between the beginning and ending balance for level 3 fair value measurements is now required, as well as significant transfers between levels in the fair value hierarchy. The amendments also clarify the requirements for liquidity risk disclosures with respect to derivative transactions and assets used for liquidity management. The fair value measurement disclosures are presented in note 24. The liquidity risk disclosures are not significantly impacted by the amendments and are presented in note 23.

IFRS 8 Operating Segments

IFRS 8 replaced IAS 14 Segment Reporting upon its effective date. The Group concluded that the operating segments determined in accordance with IFRS 8 are the same as the business segments previously identified under IAS 14. IFRS 8 disclosures are shown in note 3, including the related revised comparative information.

IAS 1 Presentation of Financial Statements

The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income and the option to present all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present two statements.

IAS 23 Borrowing Costs

The revised IAS 23 requires capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. The Group's previous policy was to expense borrowing costs as they were incurred. In accordance with the transitional provisions of the amended IAS 23, the Group has adopted the standard on a prospective basis. Therefore, borrowing costs are capitalised on qualifying assets with a commencement date for construction or development on or after 30 March 2009. Details of the borrowing costs capitalised during the period are disclosed in note 3.

Adopted improvements to IFRSs

The Group has now adopted the following relevant amendments, issued by the IASB in May 2008. These changes have no material effect on the financial statements.

- *IFRS 7 Financial Instruments: Disclosure:* Removal of reference to 'total interest income' as a component of finance cost.
- *IAS 1 Presentation of Financial Statements :* Assets and liabilities classified as held for trading in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* are not automatically classified as current in the balance sheet.
- *IAS 8 Accounting Policies, Change in Accounting Estimates and Errors:* Clarification that only implementation guidance that is an integral part of an IFRS is mandatory when selecting accounting policies.
- *IAS 10 Events after the Reporting Period:* Clarification that dividends declared after the end of the reporting period are not obligations.
- *IAS 16 Property, Plant and Equipment:* Replace the term "net selling price" with "fair value less costs to sell". Items of property, plant and equipment held for rental that are routinely sold in the ordinary course of business after rental, are transferred to inventory when rental ceases and they are held for sale.

Royal Mail Holdings plc

2. Accounting policies (continued)

- *IAS 18 Revenue:* Replacement of the term 'direct costs' with 'transaction costs' as defined by IAS 39. The IASB has also added guidance to determine whether an entity is acting as a principal or as an agent.
- *IAS 19 Employee Benefits:* Revised the definition of 'past service costs', 'return on plan assets' and 'short-term' and 'other long-term' employee benefits. Amendments to plans that result in a reduction in benefits related to future services are accounted for as curtailment. Deleted the reference to the recognition of contingent liabilities to ensure consistency with IAS 37.
- *IAS 20 Accounting for Government Grants and Disclosures of Government Assistance:* Loans granted in future with no or low interest rates will not be exempt from the requirement to impute interest. The difference between the amount received and the discounted amount is accounted for as government grant. Also, revised various terms used to be consistent with other IFRSs.
- *IAS 23 Borrowing Costs:* The definition of borrowing costs is revised to consolidate the two types of items that are considered components of 'borrowing costs' into one, the interest expense calculated using the effective interest rate method in accordance with IAS 39.
- *IAS 27 Consolidated and Separate Financial Statements:* When a parent entity accounts for a subsidiary at fair value in accordance with IAS 39 in its separate financial statements, this treatment continues when the subsidiary is subsequently classified as held for sale.
- *IAS 28 Investment in Associates:* If an associate is accounted for at fair value in accordance with IAS 39, only the requirement of IAS 28 to disclose the nature and extent of any significant restrictions on the ability of the associate to transfer funds to the entity in the form of cash or repayment of loans applies.
- *IAS 31 Interest in Joint ventures:* If a joint venture is accounted for at fair value, in accordance with IAS 39, only the requirements of IAS 31 to disclose the commitments of the venturer and the joint venture, as well as summary financial information about the assets, liabilities, income and expense will apply.
- *IAS 36 Impairment of Assets:* When discounted cash flows are used to estimate 'fair value less costs to sell' additional disclosure is required about the discount rate, consistent with disclosures required when the discounted cash flows are used to estimate 'value in use'.
- *IAS 38 Intangible Assets:* Expenditure on advertising and promotional activities is recognised as an expense when the Group either has the right to access the goods or has received the service.
- *IAS 39 Financial Instruments: Recognition and Measurement:* Changes in circumstances relating to derivatives are not reclassifications and therefore may be either removed from, or included in, the 'fair value through profit and loss' classification after initial recognition. Removed the reference in IAS 39 to a 'segment' when determining whether an instrument qualifies as a hedge. Require the use of the revised effective interest rate when remeasuring a debt instrument on the cessation of fair value hedge accounting.

Significant accounting judgements, estimates and assumptions

The preparation of the Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

The key sources of uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year relate to the measurement of the defined benefit pension obligations, deferred tax and ColleagueShare plan costs.

Defined benefit pension obligations

Measurement of the defined benefit obligations requires certain assumptions to be made including on life expectancy, future changes in salaries, inflation and a suitable discount rate. The size of these obligations, and therefore the pension deficit, is materially sensitive to the assumptions adopted. The assumptions which have the most significant impact on the measurement of the defined benefit obligations are the real discount rate and the mortality rates. A 0.1 percentage point change to the discount rate could change the liabilities by approximately £660m. An additional one year on the life expectancy could increase liabilities by approximately £900m. The major assumptions and carrying value of the obligations are disclosed in note 25.

Deferred tax

Assessment of the deferred tax asset requires an estimation of future profitability. Such estimation is inherently uncertain in a market subject to various competitive pressures. Should estimates of future profitability change in future years, the amount of deferred tax recognised will also change accordingly. The carrying values of the deferred tax assets and liabilities are included within note 9.

ColleagueShare plan

The calculation of the ColleagueShare costs and liabilities is reliant on a number of judgements, estimates and assumptions. These include in particular forecasts for the potential equity value of ColleagueShares, forecasts of joiners and leavers throughout the life of the plan and judgements on when participants are likely to exercise their rights for the Company to redeem the ColleagueShares that they hold. The magnitude of the costs involved is sensitive to these forecasts and assumptions. The carrying values of the ColleagueShare liabilities are included within notes 20 and 21.

2. Accounting policies (continued)

Funding

Royal Mail Group Ltd

Royal Mail Group Ltd continues to face considerable cash requirements with respect to its investment in modernisation and funding its pension deficit at a time when the mails market has been opened up to full competition and there is ongoing volatility in mail volumes.

On 23 March 2007, a funding package totalling £1.2bn was completed with Government and for which State Aid clearance was received in April 2009. The £900m senior debt facility expires in March 2014. It has been assumed that another facility will be negotiated to be available by this time. The remaining £300m subordinated loan was fully drawn in March 2009 and will not be repaid until the later of the unconditional release of the monies held in escrow for the Royal Mail Pension Plan Trustee (the Trustee) or 19 March 2016.

In making an assessment on Royal Mail Group Ltd's ability to continue as a going concern, the Directors have:

- assumed the successful execution of the modernisation plan, which is reflected in detailed plans and supported by financial forecasts;
- assumed that an affordable payment profile will be agreed with the Trustee. The 2009 scheme valuation, together with agreement of the revised schedule of payments, is due to be completed by 30 June 2010. The pension deficit has increased since 2006, and repayment of the deficit is now likely to need to extend beyond the 13 years remaining of the 17 year repayment profile agreed in 2007. It is assumed that the pension escrow established in 2007 will continue to be required; and
- considered the ongoing volatility in the mails market, along with the risk of greater market decline than forecast, which creates uncertainties around the financial projections and, consequently, the funding and headroom requirements of Royal Mail Group Ltd. Current cash forecasts indicate cash funding headroom will need to be carefully monitored over the next few years and, in the absence of any modest increase in property values over the next few years, there is a potential breach of the Loan to Value covenant on the Group senior debt facility at March 2012. The Directors have identified a portfolio of operational actions and strategic options, including potential asset disposals, that will be taken to reduce the loan requirements and enable the covenant to be met or provide additional funding to mitigate any headroom exposures. In addition, the Directors have informed Government that they may seek to negotiate a change to the covenants. Any changes agreed will be on a commercial basis.

On the basis of careful consideration of the cash flow projections and the above considerations the Directors have concluded that it is appropriate that the financial statements have been prepared on a going concern basis.

Post Office Limited

Post Office Limited had net liabilities as at 28 March 2010 but has operated at a profit before exceptional items during 2009-10 for the second year running.

To become viable in the longer-term, new business areas continue to be developed and grown in order to replace the lost contribution from traditional income sources and significant cost reduction programmes continue to be implemented.

During the year, Post Office Limited has continued with the implementation of a number of programmes which are designed to improve the profitability of the company. The branch closure programme is completed and no further closures are planned but further work on efficiency improvements and improving the business model continues. These programmes include:

- the development of new business and drive for sales growth;
- bringing the crown branch segment into profit; and
- a programme of fundamental cost reduction.

The current plan 2006-2011 is supported by a funding agreement with Government announced on 17 May 2007, which provided for:

- £465m funding to compensate Post Office Limited for the other net costs of providing certain specified "services of general economic interest". £313m was received on 31 July 2007, £77m on 1 April 2008 and £75m on 15 April 2008;
- funding of £150m per year to compensate for losses sustained in parts of the network; and
- the extension, on 18 April 2008, of the existing working capital facility of £1.15bn to 2011.

State Aid approval has been received for the above funding which runs to March 2011.

On 24 March 2010 a further funding agreement was agreed that provides up to £180m for compensation for losses sustained in parts of the network in 2011-12 as well as providing access to the working capital facility to 31 March 2016. These arrangements remain subject to State Aid approval.

Whilst the Directors are satisfied with the progress that has been made it should be noted that Post Office Limited continues to face a challenging future. Accordingly there will be a need to gain agreement and State Aid approval with respect to the continuation of the Network Subsidy Payment for the period beyond March 2012.

Notwithstanding these uncertainties, the Directors recognise that significant progress has been made in delivering its plan for which funding is in place and, after careful consideration, continue to believe that Post Office Limited will be able to meet its liabilities as they fall due in the foreseeable future. Accordingly, on that basis, the Directors consider that it is appropriate that the financial statements have been prepared on a going concern basis.

2. Accounting policies (continued)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings. The financial statements of the major subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-group balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Transfer prices between business segments are set on a basis of charges reached through a negotiation with the respective businesses.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which control is no longer held by the Group. Where the Group ceases to hold control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group held control.

Minority interest represents the portion of profit/loss, gains/losses and net assets relating to subsidiaries that are not attributable to members of the Company. The minority interest balance is presented within equity in the consolidated balance sheet, separately from parent shareholder's equity.

Investments in joint ventures and associates

The Group's investments in its joint ventures and associates are accounted for under the equity method of accounting. Under the equity method, the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the joint ventures/associates, less any impairment in value. The income statement reflects the Group's share of post tax profits from the joint ventures/associates.

Any goodwill arising on acquisition of an associate, representing the excess of the cost of the investment compared to the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired, is included in the carrying amount and not amortised. To the extent that the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is greater than the cost of the investment, a gain is recognised and added to the Group's share of the associate's profit or loss in the period in which the investment is acquired.

Revenue

Revenue reported in the income statement comprises of Turnover and the Network Subsidy Payment. Turnover principally relates to the rendering of services as follows:

Royal Mail Letters

Account revenue is derived from specific contracts and recognised when the mail delivery is complete. Prepaid revenue mainly relating to stamp and meter income is recognised when the sale is made, adjusted to reflect a value of stamp and meter credits held but not used by the customer.

Parcelforce Worldwide

Account revenue is derived from specific contracts and recognised when the delivery of an item is complete.

Post Office Limited

Revenue is recognised when retail and financial services are provided.

General Logistics Systems

Revenue is derived from specific contracts and is recognised at the time of delivery.

The Network Subsidy Payment is Government grant revenue recognised to match the related costs of providing the network of public post offices that the Secretary of State for Business, Innovation and Skills considers appropriate and which would otherwise not be provided.

Distribution and conveyance

Distribution and conveyance costs relate to third party costs incurred in carrying mail. These include conveyance by rail, road, sea and air, together with costs incurred by international mail carriers and Parcelforce Worldwide delivery operators. These costs are disclosed separately on the face of the income statement.

Operating profit before exceptional items

Operating profit is the profit arising from the normal, recurring operations of the business. This incorporates revenue, people costs, distribution and conveyance costs, other operating costs and the Group's post tax share of profits from joint ventures and associates.

Operating exceptional items

Operating exceptional items are material items of income and expenditure arising from the operations of the business which, due to the nature of the events giving rise to them, require separate presentation on the face of the income statement to allow a better understanding of financial performance in the year, in comparison to prior years.

ColleagueShare plan

ColleagueShare is the name for the Group's phantom share plan. The plan, introduced in 2007-08, is a five-year plan spanning the accounting years from April 2007 to March 2012 and comprises both a phantom share scheme and a related stakeholder dividend worth up to £5,300 per person throughout the life of the plan. The ColleagueShares represent up to a total of 14% of the projected equity value of the Group. Additionally Royal Mail plans to pay a stakeholder dividend dependent on the achievement of certain targets.

The costs of the plan are included in the income statement as an exceptional item throughout the life of the plan and are included within payables or provisions as appropriate. Any long-term liabilities arising in relation to the plan will be discounted at an appropriate high quality corporate bond rate. These discounts will be unwound through the income statement during the life of the plan. The Group will redeem all ColleagueShares by 2012-13.

Royal Mail Holdings plc

2. Accounting policies (continued)

Operating profit

Operating profit is the profit arising from the normal, recurring operations of the business and after charging operating exceptional items defined above. It excludes the non-operating exceptional items for profit or loss on disposal of businesses and profit or loss on disposal of property, plant and equipment. These items are not part of the normal recurring operations of the business but are material, so are presented separately on the face of the income statement to allow a better understanding of financial performance in the year, in comparison to prior years.

Goodwill

Business combinations on or after 29 March 2004 are accounted for under *IFRS 3 Business Combinations* using the purchase method. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition is recognised in the balance sheet as goodwill and is not amortised.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill arising from business combinations is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use. For the purpose of such impairment reviews, goodwill is allocated to the relevant cash generating units.

Goodwill arising on the acquisition of equity accounted entities is included in the cost of those entities and therefore not reported in the balance sheet as goodwill.

Intangible assets

Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition. Intangible assets acquired separately or development costs that meet the criteria to be capitalised are initially recognised at cost and are assessed to have either a finite or indefinite useful life. Those with a finite life are amortised over their useful life and those with an indefinite life are reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the income statement on a straight-line basis. The useful lives of such intangible assets are in the range of 1 – 6 years.

Research and development

Expenditure on research is written off in the year it is incurred. Development costs are capitalised where they meet the criteria required under IFRSs. If these criteria are not met, then the costs are recognised in the income statement as they are incurred.

Property, plant and equipment

Property, plant and equipment is recognised at cost, including attributable costs in bringing the asset into working condition for its intended use. Depreciation of property, plant and equipment is provided on a straight-line basis by reference to net book value and to the remaining useful economic lives of assets and their estimated residual values. The useful lives and residual values are reviewed annually and adjustments, where applicable, are made on a prospective basis. The lives assigned to major categories of property, plant and equipment are:

	asset lives
Land and buildings:	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	3-15 years
Motor vehicles and trailers	1-12 years
Fixtures and equipment	2-15 years

An individual property that the Group has identified as surplus is reclassified within 'non-current assets held for sale', a separate category on the balance sheet, when a sale is highly probable. This has been determined to be when authority to market the property has been approved and the property is vacant and therefore available for immediate sale and occupation by a third party. Such properties are expected to generate economic cash flow primarily by sale of the asset rather than by operational activities, and are expected generally to be disposed of within a year.

For a disposal group of properties or other assets and liabilities, the requirements of *IFRS 5 Non-current assets held for sale and discontinued operations* are applied to the specific circumstances of the disposal group.

Impairment reviews

Unless otherwise disclosed in these accounting policies, assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Group assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Leases

Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group, are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and capital element of the lease liability to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Royal Mail Holdings plc

2. Accounting policies (continued)

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expense over the lease term on a straight-line basis.

A leasehold land payment is an upfront payment to acquire a long-term leasehold interest in land. This payment is stated at cost and is amortised on a straight-line basis over the period of the lease.

Inventories

Inventories are carried at the lower of cost and net realisable value after adjusting for obsolete or slow-moving stock. Cost includes all costs in bringing each item to its present location and condition and comprises weighted average cost for supplies and materials and purchase cost for merchandise.

Trade receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Financial instruments

Financial assets within the scope of *IAS 39 Financial Instruments: Recognition and Measurement* are classified as; financial assets at fair value through the income statement (held for trading); held to maturity investments, loans and receivables or available for sale financial assets as appropriate. Financial liabilities within the scope of IAS 39 are classified as either financial liabilities at fair value through the income statement or financial liabilities measured at amortised cost.

The Group determines the classification of its financial instruments at initial recognition and re-evaluates this designation at each financial year end. When financial instruments are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial instruments not at 'fair value through the income statement', any directly attributable transactional costs.

The subsequent measurement of financial instruments depends on their classification as follows:

Financial assets at fair value through the income statement (held for trading)

Financial assets are classified as held for trading if they are acquired for sale in the short term. Derivatives are also classified as held for trading unless they are designated as hedging instruments. Assets are carried in the balance sheet at fair value with gains or losses recognised in the income statement.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as 'held to maturity' when the Group has the positive intention and ability to hold to maturity. Held to maturity investments are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in the income statement when the investments are derecognised or impaired, as well as through the amortisation process. Investments intended to be held for an undefined period are not included in this classification.

Loans and receivables

Non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, do not qualify as trading assets and have not been designated as either 'fair value through the income statement' or available for sale. Such assets are carried at amortised cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available for sale financial assets

'Available for sale financial assets' are non-derivative financial assets that are designated as such or are not classified in any of the three preceding categories. After initial recognition, interest is taken to the income statement using the effective interest rate method and the assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised, or until the investment is deemed to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

Financial liabilities at fair value through the income statement (held for trading)

Derivatives liabilities are classified as held for trading unless they are designated as hedging instruments. They are carried in the balance sheet at fair value with gains or losses recognised in the income statement.

Financial liabilities measured at amortised cost

All non-derivative financial liabilities are classified as financial liabilities measured at amortised cost. Non-derivative financial liabilities are initially recognised at the fair value of the consideration received, less directly attributable issue costs. After initial recognition, non-derivative financial liabilities are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits (cash equivalents) with an original maturity date of three months or less. In addition, the Group uses Money Market funds as a readily available source of cash, which are bought and sold on a daily basis to meet the cash requirements of the business. These funds are also categorised as cash equivalents.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank overdrafts.

Cash equivalents are classified as loans and receivables financial instruments.

2. Accounting policies (continued)

Financial assets – pension escrow investments

Financial assets – pension escrow investments comprise short term deposits with banks, conventional gilt edged securities, index-linked gilt edged securities and Treasury bills.

Short-term deposits with banks (pension escrow investments) are classified as loans and receivables financial instruments.

Conventional gilt edged securities, index-linked gilt edged securities and Treasury bills are classified as available for sale financial instruments on the basis that they are quoted investments that are not held for trading and may be disposed of prior to maturity.

Financial assets – other investments

Financial assets – other investments comprise short-term deposits (other investments) with Government, local government or banks with an original maturity of three months or more. Short-term deposits are classified as loans and receivables financial instruments.

Financial liabilities – interest-bearing loans and borrowings

All loans and borrowings are classified as financial liabilities measured at amortised cost.

Financial liabilities – obligations under finance lease and hire purchase contracts

All obligations under finance lease and hire purchase contracts are classified as financial liabilities measured at amortised cost.

Borrowing costs

Borrowing costs are recognised as an expense when incurred, unless they are directly attributable to the construction or development of a qualifying asset, in which case they are capitalised using the weighted average cost of borrowing for the period of construction/development.

Derivative financial instruments

The Group uses derivative instruments such as foreign currency contracts in order to manage the risk profile of any underlying risk exposure of the Group, in line with the Group's treasury management policies. Such derivative financial instruments are initially stated at fair value.

For the purpose of hedge accounting, hedges are classified as cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecasted transaction.

In relation to cash flow hedges to hedge the foreign exchange risk of firm commitments that meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to relate to an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or non-financial liability, then at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit/loss, for example when the future sale actually occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement in the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the year.

Fair value measurement of financial instruments

The fair value of quoted investments (including conventional gilt edged securities, index-linked gilt edged securities and Treasury bills) is determined by reference to bid prices at the close of business on the balance sheet date. Hence the conventional gilt edged securities, index-linked gilt edged securities and Treasury bills are within Level 1 of the fair value hierarchy as defined within IFRS 7.

Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models. Specifically, in the absence of quoted market prices, derivatives are valued by using quoted forward prices for the underlying commodity/currency and discounted using quoted interest rates (both as at the close of business on the balance sheet date). Hence derivative assets and liabilities are within Level 2 of the fair value hierarchy as defined within IFRS 7.

For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date.

Derecognition of financial instruments

A financial asset or liability is derecognised when the contract that gives rise to it is settled, sold, cancelled or expires.

Income tax and deferred tax

The charge for current taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

2. Accounting policies (continued)

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- initial recognition of goodwill;
- the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Other than stated below, deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets, and unused tax losses can be utilised. Deferred tax assets are not recognised in respect of:

- deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference will be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and increased or reduced to the extent that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

Current and deferred tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity. Otherwise it is recognised in the income statement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate.

Pensions and other post-retirement benefits

The pension plans' assets for the defined benefit schemes are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet. Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and, with appropriate updates and accounting adjustments at each balance sheet date, form the basis of the deficit disclosed. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme.

For defined benefit schemes, the amounts charged to operating profit are the current service costs and any gains and losses arising from settlements, curtailments and past service costs. The net difference between the interest costs and the expected return on plan assets is recognised as net pensions interest in the income statement. Actuarial gains and losses are recognised immediately in the statement of comprehensive income. Any deferred tax movement associated with the actuarial gains and losses is also recognised in the statement of comprehensive income.

For defined contribution schemes, the Group's contributions are charged to operating profit within people costs in the period to which the contributions relate. Overseas subsidiaries make separate arrangements for the provision of pensions and other post-retirement benefits.

Foreign currencies

The functional and presentational currency of Royal Mail Holdings plc is sterling (£). The functional currency of the overseas subsidiaries in Europe is mainly the euro (€).

The assets and liabilities of foreign operations are translated at the rate of exchange ruling at the balance sheet date. The trading results of foreign operations are translated at the average rates of exchange for the reporting period, being a reasonable approximation to the actual transaction rate. The exchange differences arising on the translation, since the date of transition to IFRSs, are taken directly to the Foreign Currency Translation Reserve in equity.

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Currently hedge accounting is not claimed for any monetary assets and liabilities. All differences are therefore taken to the income statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment occurs, at which time they are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value is determined.

Royal Mail Holdings plc

2. Accounting policies (continued)

Contingent liabilities and financial guarantee contracts

Financial guarantee contracts are initially measured at fair value and subsequently at the higher of amounts under *IAS 37 Provisions, Contingent Liabilities and Contingent Assets* or the amounts initially recognised less, when appropriate, cumulative amortisation recognised in accordance with *IAS 18 Revenue*.

Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote.

Government grants

Government grants of a revenue nature are credited to the income statement and are shown separately to the expenditure to which they relate.

Government grants relating to assets are recognised as deferred income that is amortised over the useful life of the relevant assets.

Segment information

The Group's operating segments are organised and managed separately according to the nature of the products and services provided, with each segment representing a business unit that offers different products and serves largely different markets. There is no aggregation of operating segments. The four operating segments are:

Royal Mail Letters: Delivers letters to all addresses in the United Kingdom and offers a number of products to both business and domestic users. The segment also includes certain functions e.g. HR, IT and Finance which support the Group's UK operations.

Parcelforce Worldwide: The parcels business unit operating within the UK.

Post Office Limited: A limited company responsible for the network of Post Office branches offering a series of retail services.

General Logistics Systems (GLS): The European parcels business which, via its subsidiaries and partners, offers its services in 36 European states.

'Other' segments includes PostCap Guernsey Limited and iRed Partnership Limited, both wholly owned subsidiaries; Romec Limited, and NDC 2000 Limited, both part owned subsidiaries; investments in the following associates – Quadrant Catering Limited, Camelot Group plc and Camelot Global Services Limited; and the Group Property unit. The Group Property unit includes Royal Mail Estates Limited, a wholly owned subsidiary. The assets managed centrally by the Group Treasury function are also included within this segment.

The operating segments comprise operations in both the UK and other parts of Europe, the latter being relevant to the GLS business segment. The former includes the remaining three operating segments plus the 'Other' segments.

Segment revenues have been attributed to the respective countries based on the location of the customer.

Transfer prices between the segments are set on a basis of charges reached through negotiation with the respective business units that form part of the segments.

There are no differences in the measurement of the respective segments' profit/loss and assets and the consolidated financial statements prepared under IFRS.

Accounting standards and interpretations not applied

The International Accounting Standards Board (IASB) has issued accounting standards relevant to the Group with an effective date for accounting periods beginning after the commencement date of the period to which these financial statements relate. The Group has considered the impact of these below:

International Accounting Standards (IFRSs/IAS)		Effective date
IFRS 3	Business Combinations (revised January 2008)	1 July 2009
IAS 24	Related Party Disclosures (revised November 2009)	1 January 2011
IAS 27	Consolidated and Separate Financial Statements (revised January 2008)	1 July 2009

IFRS 3 Business Combinations

The Group has not early adopted the revised IFRS 3 and so will apply it prospectively to all business combinations on or after 29 March 2010. The key features of the revised IFRS 3 include a requirement for acquisition-related costs to be expensed and not included in the purchase price; and for contingent consideration to be recognised at fair value on the acquisition date (with subsequent changes recognised in the income statement and not as a change to goodwill). The standard also changes the treatment of non-controlling interest (formerly minority interest) with an option to recognise these at full fair value as at the acquisition date and for previously held non-controlling interest to be fair valued as at the date control is obtained, with gains and losses recognised in the income statement. It is expected that the revision to this standard will not have a material impact on the financial position or performance of the Group.

IAS 24 Related Party Disclosures

This revised standard provides an exemption from disclosure requirements for transactions between entities controlled, jointly controlled or significantly influenced by the same government and between such entities and the government itself, unless they are individually or collectively significant. The standard also amends the definition of a related party to remove some inconsistencies. This standard which will be adopted with a commencement date of 28 March 2011 will not have a material impact on the financial position or performance of the Group.

2. Accounting policies (continued)

IAS 27 Consolidated and Separate Financial Statements

IAS 27 revised is effective for annual periods beginning on or after 1 July 2009, with earlier application only permitted when the revised IFRS 3 is applied. The revised standard applies retrospectively with some exceptions. IAS 27 revised no longer restricts the allocation to minority interest of losses incurred by a subsidiary to the amount of the non-controlling equity investment in the subsidiary. A partial disposal of equity interest in a subsidiary that does not result in a loss of control will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to any gain or loss. Where there is loss of control of a subsidiary, any retained interest will have to be re-measured to fair value, which will impact the gain or loss recognised on disposal. This standard will be adopted with a commencement date of 29 March 2010 and will have no material impact on the financial position or performance of the Group.

The Directors do not anticipate that the adoption of these standards will have a material impact on the Group's primary financial statements. Certain of the above standards may require amendment to disclosures in the period of initial application.

Improvements to IFRSs not yet adopted

In May 2008 and April 2009 the IASB issued amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The Group has adopted the relevant 2008 amendments as detailed on page 52.

The Group has not yet adopted the following relevant 2009 amendments which will be reviewed to understand the possible impact on the financial position or performance of the Group. The improvements can be summarised as follows:

- *IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations:* When a subsidiary is held for sale, all of its assets and liabilities will be classified as held for sale under IFRS 5, even when the entity retains a non-controlling interest in the subsidiary after the sale. Disclosures required in respect of non-current assets disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5.
- *IFRS 8 Operating Segments:* Segment assets and liabilities need only be reported when those assets and liabilities are included in the measures used by the chief operating decision maker.
- *IAS 17 Leases:* The specific guidance on classifying land as a lease has been removed so that only general guidance remains.
- *IAS 36 Impairment of Assets:* The largest unit permitted for allocating goodwill acquired in a business combination is the operating segment defined in IFRS 8 before aggregation for reporting purposes.
- *IAS 38 Intangible Assets:* If an intangible asset acquired in a business combination is identifiable only with another intangible asset, the acquirer may recognise the group of intangibles as a single asset provided the individual assets have similar useful lives. The valuation techniques presented for determining the fair value of intangible assets acquired in a business combination are only examples and are not restrictive on the methods that can be used.

Royal Mail Holdings plc

3. Segment information

28 March 2010	UK operations					Other European operations	Elimination adjustment	Total
	Royal Mail Letters	Parcelforce Worldwide	Post Office Limited	Other	Total	General Logistics Systems		
	£m	£m	£m	£m	£m	£m		
External revenue	6,564	399	838	61 ¹	7,862	1,487	-	9,349
Revenue between segments	95	3	343	152	593	-	-	593
Total revenue	6,659	402	1,181	213	8,455	1,487	-	9,942
Operating profit before exceptional items	121	17	72	82	292	112	-	404
Operating exceptional items - ColleagueShare	(40)	(1)	(3)	-	(44)	-	-	(44)
- impairments	-	-	(72)	(4)	(76)	-	-	(76)
- other	(141)	(1)	(36)	7	(171)	-	-	(171)
Profit on disposal of property, plant and equipment	-	-	3	2	5	-	-	5
Interest expense	(15)	(1)	(6)	(106)	(128)	(1)	31 ²	(98)
Interest revenue	28	-	1	44	73	5	(31) ²	47
Net pensions interest	(286)	(20)	(23)	-	(329)	-	-	(329)
(Loss)/profit before tax	(333)	(6)	(64)	25	(378)	116	-	(262)

¹ The 'Other' segments' external revenue comprises £45m (2009 £36m) relating to the provision of facilities management services by Romec Limited, £12m (2009 £10m) for print services provided by iRed Partnership Limited, £1m (2009 £1m) for building engineering services provided by NDC 2000 Limited and £3m (2009 £4m) from other miscellaneous business activities.

² The elimination adjustment (2009 £40m) relates to interest charged between segments.

There is no single customer for which revenues from transactions amount to 10 per cent or more of the total revenues earned in the current period or in the prior period.

29 March 2009	UK operations					Other European operations	Elimination adjustment	Total
	Royal Mail Letters	Parcelforce Worldwide	Post Office Limited	Other	Total	General Logistics Systems		
	£m	£m	£m	£m	£m	£m		
External revenue	6,707	399	908	51	8,065	1,495	-	9,560
Revenue between segments	102	3	353	159	617	-	-	617
Total revenue	6,809	402	1,261	210	8,682	1,495	-	10,177
Operating profit before exceptional items	58	12	41	86	197	124	-	321
Operating exceptional items - Government grant	-	-	152	-	152	-	-	152
- ColleagueShare	(72)	(2)	(10)	-	(84)	-	-	(84)
- impairments	-	-	(77)	-	(77)	-	-	(77)
- other	(112)	-	(9)	(19)	(140)	-	-	(140)
Profit on disposal of property, plant and equipment	-	-	8	3	11	-	-	11
Interest expense	(14)	(3)	(11)	(66)	(94)	(2)	40	(56)
Interest revenue	39	-	5	24	68	8	(40)	36
Net pensions interest	(99)	(7)	(8)	-	(114)	-	-	(114)
(Loss)/profit before tax	(200)	-	91	28	(81)	130	-	49

Royal Mail Holdings plc

3. Segment information (continued)

The following amounts are included within operating profit before exceptional items:

28 March 2010	UK operations					Other European operations	Total £m
	Royal Mail Letters £m	Parcelforce Worldwide £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	
Depreciation	187 ¹	3	-	27	217	29	246
Amortisation	24	1	-	-	25	7	32
Share of post tax profit from joint ventures and associates	3	-	27	11	41	-	41

¹ Royal Mail Letters' depreciation includes £2m (2009 £3m) allocated from the Group Property business unit (part of 'Other' segments). The property, plant and equipment assets to which the depreciation relates have not been allocated to Royal Mail Letters by Group Property.

29 March 2009	UK operations					Other European operations	Total £m
	Royal Mail Letters £m	Parcelforce Worldwide £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	
Depreciation	173	2	1	27	203	26	229
Amortisation	20	-	-	-	20	8	28
Share of post tax profit from joint ventures and associates	1	-	34	12	47	-	47

28 March 2010	UK operations					Other European operations	Total £m
	Royal Mail Letters £m	Parcelforce Worldwide £m	Post Office Limited £m	Other £m	Total £m	General Logistics Systems £m	
Segment assets	1,725	101	1,156 ¹	2,088 ²	5,070	823 ³	5,893
Non-current assets	1,175	17	114	588	1,894	489	2,383 ⁴
Other information:							
Investments in joint ventures and associates	9	-	101	37	147	-	147
Property, plant and equipment additions	242	6	58	16	322	48	370 ⁵
Intangible assets additions	50	2	15	1	68	3	71 ⁵

¹ Post Office Limited segment assets include:

- income tax receivable of £13m (2009 £13m) for which the corresponding income does not form part of segment profit/loss; and
- 'non-current assets held for sale' of £1m (2009 £3m).

² 'Other' segments' assets include £4m (2009 £nil) relating to 'non-current assets held for sale' in the Group Property business unit.

³ GLS segment assets include £1m (2009 £4m) income tax receivable for which the corresponding income does not form part of segment profit/loss.

⁴ Non-current assets which form part of total segment assets, for this purpose exclude financial assets £1,241m (2009 £1,128m) and deferred tax assets £95m (2009 £154m). Segment profit/loss includes interest revenue earned from financial assets but does not include tax income/expense and consequently, the impact of deferred tax.

⁵ Total capital additions include £0.2m (2009 £nil) borrowing costs capitalised in relation to specific qualifying assets.

Royal Mail Holdings plc

3. Segment information (continued)

29 March 2009	UK operations					Other European operations	Total
	Royal Mail Letters	Parcelforce Worldwide	Post Office Limited	Other	Total	General Logistics Systems	
	£m	£m	£m	£m	£m	£m	£m
Segment assets	1,641	100	1,226	2,120	5,087	828	5,915
Non-current assets	1,093	13	115	599	1,820	496	2,316
Other information:							
Investments in joint ventures and associates	6	-	103	32	141	-	141
Property, plant and equipment additions	334	6	38	27	405	52	457
Intangible assets additions	31	-	39	2	72	2	74

4. People information

(a) People costs excluding ColleagueShare and restructuring costs

	2010 £000	2009 £000
Wages and salaries	4,439	4,605
Pensions	441	496
Social security	300	317
Subpostmasters	480	510
Temporary resource	86	84
	5,746	6,012

(b) Headcount

The number of people employed, calculated on a headcount basis, were:

	Period end employees		Average employees	
	2010	2009	2010	2009
Royal Mail Letters	155,312	162,310	157,893	164,435
Parcelforce Worldwide	4,434	4,489	4,478	4,531
Post Office Limited	8,209	8,760	8,576	8,899
Corporate and Group Property	545	597	536	565
UK wholly owned subsidiaries	168,500	176,156	171,483	178,430
UK partially owned subsidiaries	4,217	4,438	4,199	4,504
General Logistics Systems	12,885	13,059	12,917	12,871
Group total	185,602	193,653	188,599	195,805

The number of subpostmasters employed at the period end were:

	2010	2009
Total	8,448	8,682

Royal Mail Holdings plc

4. People information (continued)

(c) Directors' emoluments

	2010	2009
	£000	£000
Directors' emoluments	3,035	3,024
Amounts earned under Long-Term Incentive Plans	2,626	1,136

Number of Directors accruing benefits under defined benefit schemes	2	2
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The Directors' Remuneration Report discloses full details of Directors' emoluments and can be found on pages 38 to 43.

5. Operating costs

Operating profit before exceptional items is stated after charging:

	2010	2009
	£m	£m
(a)		
Pensions charge (note 25):	441	496
Cash	526	551
Non-cash	(85)	(55)

(b)		
Distribution and conveyance operating costs:	1,579	1,577
Operating lease charges on vehicles	30	37
Other distribution and conveyance	1,549	1,540

(c)		
Depreciation and amortisation:	278	257
Depreciation of owned property, plant and equipment	210	206
Depreciation of property, plant and equipment under finance lease and hire purchase contracts	36	23
Total depreciation (note 10)	246	229
Amortisation of intangible assets (note 13)	32	28

Property, facilities and maintenance costs	308	290
Computers and telephones costs	247	274
Consultancy, marketing and legal fees	178	177
Operating lease charges on property, plant and equipment (excluding vehicles)	220	203
Foreign currency exchange gains	-	(3)

Regulatory body costs:	14	14
Postcomm	11	9
Postwatch	-	3
Consumer Focus	3	2

Royal Mail Holdings plc

6. Auditor's remuneration

	2010 £000	2009 £000
Audit of statutory financial statements	597	712
Other fees to the auditor:		
Statutory audits for subsidiaries	1,427	1,504
Other services supplied pursuant to such legislation	329	383
Taxation services	121	162
Corporate finance services	-	63
Litigation services	-	9
Other services	46	31
Total	2,520	2,864

The Group paid an additional £199,000 in 2010 in respect of the 2009 audit (£221,000 in 2009 in respect of the 2008 audit).

7. Operating exceptional items

The results for the year include a number of non-recurring or restructuring costs which fall outside of the Group's normal trading activity. These are items which, in management's judgement, need to be disclosed by virtue of their size or incidence in order to provide greater visibility of the underlying results of the business, which the Board believes to be a more meaningful indication of ongoing operational performance. An analysis of the exceptional items included within the income statement is as follows:

	2010		2009	
	£m	£m	£m	£m
Government grant income		-		152
ColleagueShare - phantom share scheme	28		(14)	
- stakeholder dividend	(72)		(70)	
		(44)		(84)
Other restructuring costs:				
Provision for restructuring (note 20)	(178)		(113)	
Other exceptional items	7		(27)	
Impairment of property, plant and equipment (note 10)	(58)		(38)	
Impairment of intangible assets (note 13)	(18)		(39)	
		(247)		(217)
Total operating exceptional items		(291)		(149)

There was no corresponding Government grant received by the Group during the year under the Industrial Development Act (IDA) 1982 (2009 £152m). The 2008-09 amount was used to compensate Post Office Limited for providing certain specified "services of general economic interest".

The £28m release (2009 £14m charge) for the phantom share scheme (note 20) and £72m (2009 £70m) stakeholder dividend costs are the estimated amounts relating to the Company ColleagueShare plan this year. The Board has agreed to replace the third and final issue of notional shares with an additional stakeholder dividend, the payment of which will be directly linked to the achievement of key modernisation milestones in the future. The stakeholder dividend earned will be paid to qualifying employees in 2010-11 whilst the costs of the phantom share scheme are discounted and the shares are to be redeemed by the Group by 2012-13.

The £178m (2009 £113m) restructuring charge is in respect of employee related redundancy costs of £167m (2009 £113m) resulting mainly from operational efficiency initiatives in Royal Mail Letters and in Post Office Limited. Other Group restructuring exceptional charges of £11m (2009 £4m) were incurred during the year. There were no material exceptional charges or releases relating to property this year (2009 £4m write-back).

Impairments of £76m (2009 £77m) relate to Post Office Limited comprising £57m (2009 £38m) property, plant and equipment and £15m (2009 £39m) intangible assets and iRed Partnership Limited (iRed) comprising £1m (2009 £nil) property, plant and equipment and £3m (2009 £nil) intangible assets. Due to ongoing losses, the carrying values of asset purchases made by Post Office Limited and iRed during the year have been impaired to their recoverable amount.

Other exceptional items include a £7m net credit (2009 £27m charge) comprising the release of an accrual for professional fees of £10m (2009 £18m charge) in connection with Government funding, offset by a charge of £3m (2009 £9m) for other restructuring items charged in the current year.

Royal Mail Holdings plc

8. Net finance costs

The following analysis excludes net pensions interest.

	2010 £m	2009 £m
Unwinding of discount relating to ColleagueShare scheme	(9)	(8)
Interest payable on financial liabilities carried at amortised cost	(89)	(48)
Finance costs	(98)	(56)
Interest received on available for sale financial assets	42	17
Interest received on loans and receivables financial assets	5	19
Finance income	47	36
Net finance costs (excluding net pensions interest)	(51)	(20)

The finance costs of £98m (2009 £56m) include £7m (2009 £5m) in respect of finance charges payable under finance lease and hire purchase contracts.

No gains/losses on available for sale financial assets were released from equity and recognised in the income statement for the year.

9. Income tax

The major components of the income tax charge for the years ended 28 March 2010 and 29 March 2009 are:

	2010 £m	2009 £m
Tax charged to the income statement		
Current income tax:		
Current UK income tax (credit)/charge	(24)	3
Foreign tax	31	35
Adjustments in respect of current income tax of previous years	(3)	(2)
	4	36
Deferred income tax:		
Relating to origination and reversal of temporary differences	54	242
Income tax charge reported in the income statement	58	278
Tax charged to equity		
Income tax related to items charged or credited directly to equity:		
Deferred income tax charge related to actuarial movements in the pension deficit	4	209
Deferred income tax charge related to movements in hedging reserve	5	-
Current income tax relief for pension deficit recovery payment	-	(21)
Current income tax charge for fair value adjustments on financial assets investments	10	4
Income tax charge reported in equity	19	192
Total taxation charge		
Current income tax charge	14	19
Deferred income tax charge	63	451
Total income tax charge reported	77	470

Royal Mail Holdings plc

9. Income tax (continued)

A reconciliation between the tax charges and the product of accounting (loss)/profit multiplied by the UK rate of Corporation Tax for the years ended 28 March 2010 and 29 March 2009 is as follows:

	2010 £m	2009 £m
(Loss)/profit before taxation	(262)	49
At UK standard rate of Corporation Tax of 28%	(73)	14
Overseas current tax rates	(2)	(1)
Tax over-provided in prior years	(3)	(2)
Non-taxable income	(6)	(43)
Non-deductible expenses	16	16
Associates'/joint ventures' profit after tax charge included in Group pre-tax profit	(11)	(13)
Net increase in tax charge resulting from derecognition of deferred tax assets	149	197
Effect of withdrawal of Industrial Buildings Allowances on deferred tax	-	108
Profit from asset disposals eligible for relief	(2)	(3)
Other	(10)	5
Tax charge in the income statement	58	278
Effective income tax rate	-	567%

Deferred tax relates to the following:

	Balance sheet		Income statement	
	2010 £m	2009 £m	2010 £m	2009 £m
Liabilities				
Accelerated capital allowances	(1)	(1)	-	2
Goodwill qualifying for tax allowances	(4)	-	(4)	2
Gross deferred tax liabilities	(5)	(1)		
Assets				
Deferred capital allowances	1	104	(103)	42
Provisions and other	30	36	(6)	10
Pensions temporary differences	2	8	(2)	(253)
Losses available for offset against future taxable income	68	3	65	(38)
Hedging derivatives temporary differences	(6)	-	(1)	-
Goodwill qualifying for tax allowances	-	3	(3)	(7)
Gross deferred tax assets	95	154		
Net deferred tax asset	90	153		
Consolidated income statement			(54)	(242)

The Group has unrecognised deferred tax assets of £2,847m (2009 £2,373m), comprising £2,253m (2009 £1,892m) relating to the retirement benefit obligation, £360m (2009 £228m) relating mainly to fixed asset timing differences, and £234m (2009 £253m) relating to tax losses in subsidiaries that are available to offset against future taxable profits. The Group has capital losses carried forward, the tax effect of which is £24m (2009 £22m) and temporary differences related to capital losses of £107m (2009 £108m). The Group has rolled over capital gains of £73m (2009 £72m); no tax liability would be expected to crystallise should the assets into which the gains have been rolled be sold at their residual value, as it is anticipated that a capital loss would arise. The adverse tax effect of the phased abolition of Industrial Buildings Allowances resulted in a reduction of the Group's deferred tax asset by £108m in 2009 and was recorded within that year's income statement tax charge.

The taxation of foreign profits rules were enacted in Finance Act 2009. Under the foreign profits rules, a dividend exemption was introduced which largely exempts dividends received on or after 1 July 2009 from UK corporation tax. The Group has applied this legislation in arriving at its UK tax results for the accounting period ended 28 March 2010.

At 28 March 2010, there was no recognised or unrecognised deferred income tax liability (2009 £nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, associates or joint ventures, as the Group has no liability to additional taxation should such amounts be remitted due to the availability of exemptions and other reliefs, including the UK dividend exemption.

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10. Property, plant and equipment

	Land and buildings			Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m				
Cost							
At 30 March 2009	1,669	263	549	1,104	390	947	4,922
Exchange movements	(6)	-	-	(5)	(1)	(3)	(15)
Reclassification	(12)	1	11	(11)	13	(2)	-
Additions	93	4	55	71	101	46	370
Acquisition of businesses	1	-	-	-	-	-	1
Disposals	(8)	(1)	(14)	(16)	(43)	(24)	(106)
Reclassification to non-current assets held for sale (note 15)	(18)	-	-	-	-	-	(18)
At 28 March 2010	1,719	267	601	1,143	460	964	5,154
Depreciation and impairment							
At 30 March 2009	851	158	338	642	205	842	3,036
Exchange movements	(2)	-	-	(3)	(1)	(2)	(8)
Reclassification	-	-	-	(6)	6	-	-
Depreciation (note 5)	52	7	35	63	57	32	246
Impairment (note 7)	11	2	28	1	5	11	58
Disposals	(7)	(1)	(14)	(15)	(39)	(23)	(99)
Reclassification to non-current assets held for sale (note 15)	(14)	-	-	-	-	-	(14)
At 28 March 2010	891	166	387	682	233	860	3,219
Net book value							
At 28 March 2010	828	101	214	461	227	104	1,935
At 30 March 2009	818	105	211	462	185	105	1,886

Depreciation rates are disclosed within accounting policies (note 2). No depreciation is provided on freehold land, which represents £205m (2009 £197m) of the total cost of properties. The net book value of the Group's property, plant and equipment held under hire purchase contracts and finance leases amounts to £176m (2009 £124m) comprising £157m vehicles (2009 £100m), £13m (2009 £17m) plant and machinery and £6m (2009 £7m) land and buildings. The net book value of the Group's property, plant and equipment includes £197m (2009 £180m) in respect of assets in the course of construction. The net book value of the Group's land and buildings includes £409m (2009 £427m) in respect of building fit-out.

	Land and buildings			Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m				
Cost							
At 31 March 2008	1,538	263	530	928	322	888	4,469
Exchange movements	30	3	-	21	4	14	72
Reclassification	4	(8)	9	4	-	(9)	-
Additions	108	8	18	163	94	66	457
Disposals	(6)	(1)	(8)	(12)	(30)	(12)	(69)
Reclassification to non-current assets held for sale (note 15)	(5)	(2)	-	-	-	-	(7)
At 29 March 2009	1,669	263	549	1,104	390	947	4,922
Depreciation and impairment							
At 31 March 2008	780	154	308	580	161	815	2,798
Exchange movements	9	1	-	13	3	10	36
Reclassification	12	(3)	(3)	3	-	(9)	-
Depreciation (note 5)	48	6	32	57	58	28	229
Impairment (note 7)	10	1	9	-	8	10	38
Disposals	(5)	-	(8)	(11)	(25)	(12)	(61)
Reclassification to non-current assets held for sale (note 15)	(3)	(1)	-	-	-	-	(4)
At 29 March 2009	851	158	338	642	205	842	3,036
Net book value							
At 29 March 2009	818	105	211	462	185	105	1,886
At 31 March 2008	758	109	222	348	161	73	1,671

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11. Leasehold land payment

	2010 £m	2009 £m
Net book value		
At 30 March 2009 and 31 March 2008	4	-
Additions	-	4
Amortisation	-	-
Exchange movements	-	-
At 28 March 2010 and 29 March 2009	4	4

12. Goodwill

	2010 £m	2009 £m
Cost		
At 30 March 2009 and 31 March 2008	663	565
Exchange movements	(27)	96
Acquisition of businesses	-	2
At 28 March 2010 and 29 March 2009	636	663
Impairment		
At 30 March 2009 and 31 March 2008	457	392
Exchange movements	(18)	65
At 28 March 2010 and 29 March 2009	439	457
Net book value		
At 28 March 2010 and 29 March 2009	197	206
At 30 March 2009 and 31 March 2008	206	173

The carrying value of goodwill arising on business combinations of £197m (2009 £206m) at the balance sheet date includes £195m (2009 £205m) relating to the General Logistics Systems (GLS) business segment. In line with the accounting policy (see note 2), this goodwill has been reviewed for impairment. An impairment loss is recognised for the amount by which the carrying value of an asset or cash generating unit exceeds the recoverable amount. The recoverable amount is the higher of net realisable value and value in use. The carrying value of GLS, excluding interest bearing and tax related assets and liabilities, is £456m (2009 £471m) at year end and the operating profit before exceptional items is £112m (2009 £124m) for the year (note 3). The carrying value represents a multiple of 4.1 (2009 3.8) on operating profit before exceptional items. The net realisable value of GLS, for the purposes of the impairment review (i.e. the 'fair value less costs to sell'), has been assessed with reference to earnings multiples for quoted entities in a similar sector. On this basis, the net realisable value of GLS has been assessed to be in excess of the carrying value. No reasonable possible change in the earnings multiples referenced would reduce the net realisable value to below the carrying value.

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13. Intangible assets

	2010				2009			
	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m
	Cost							
At 30 March 2009 and 31 March 2008	25	28	255	308	22	21	183	226
Additions	-	-	71	71	-	-	74	74
Disposals	-	-	(1)	(1)	-	-	(2)	(2)
Acquisition of businesses	-	-	-	-	-	2	-	2
Exchange movements	(1)	(1)	-	(2)	3	5	-	8
At 28 March 2010 and 29 March 2009	24	27	325	376	25	28	255	308
Amortisation and impairment								
At 30 March 2009 and 31 March 2008	22	19	189	230	18	11	130	159
Impairment (note 7)	-	-	18	18	-	-	39	39
Amortisation	1	4	27	32	1	5	22	28
Disposals	-	-	(1)	(1)	-	-	(2)	(2)
Exchange movements	(1)	(1)	-	(2)	3	3	-	6
At 28 March 2010 and 29 March 2009	22	22	233	277	22	19	189	230
Net book value								
At 28 March 2010 and 29 March 2009	2	5	92	99	3	9	66	78
At 30 March 2009 and 31 March 2008	3	9	66	78	4	10	53	67

The intangible assets recognised in the Group's balance sheet, none of which have been internally generated, have finite lives and are being written down on a straight-line basis over their remaining economic lives as follows:

Intangible asset	Remaining economic life in years
Master franchise licences	up to 1
Customer listings	1 to 3
Software	1 to 6

The amortisation charge of £32m (2009 £28m) relating to intangible assets is aggregated within 'other operating costs' in the income statement and disclosed in note 5. Details of the impairment is disclosed in note 7.

Royal Mail Holdings plc

14. Investments in joint ventures and associates

Joint ventures

During 2009-10 and 2008-09, the Group's only joint venture investment was a 50% interest in First Rate Exchange Services Holdings Limited, whose principal activity is the provision of Bureau de Change.

Associates

Details of the Group's 2009-10 and 2008-09 associate investments are provided in note 28. The reporting dates for these investments is 31 March 2009 except for Quadrant Catering Limited (30 September 2009) and G3 Worldwide Mail N.V. (Spring) (31 December 2009). Estimates of the profits of Quadrant Catering Limited and G3 Worldwide Mail N.V. (Spring), from their reporting date to 28 March 2010 (and 29 March 2009 for the prior year), have been included to ensure that the reported share of profits of associates aligns with the Group's financial year. There are no significant restrictions on the ability of associates to transfer funds to the Group in the form of cash dividends, repayment of loans or advances.

On 25 March 2010, Royal Mail agreed to sell its 20% shareholding in Camelot Group plc. Completion of the transaction is conditional upon approval from Camelot's regulator, the National Lottery Commission.

	At 30 March 2009 £m	Share of post tax pre dividend profit £m	Reclassification £m	Dividend £m	At 28 March 2010 £m
Joint ventures					
Share of net assets	71	32	-	(29)	74
Goodwill	1	-	-	-	1
Net investments	72	32	-	(29)	75
Associates					
Share of net assets	60	9	(2)	(6)	61
Goodwill	9	-	2	-	11
Net investments	69	9	-	(6)	72
Total net investments in joint ventures/associates	141	41	-	(35)	147

The reclassification above relates to the increased shareholding in G3 Worldwide Mail N.V. (Spring).

	At 31 March 2008 £m	Share of post tax pre dividend profit £m	Dividend £m	At 29 March 2009 £m
Joint ventures				
Share of net assets	68	30	(27)	71
Goodwill	1	-	-	1
Net investments	69	30	(27)	72
Associates				
Share of net assets	58	17	(15)	60
Goodwill	9	-	-	9
Net investments	67	17	(15)	69
Total net investments in joint ventures/ associates	136	47	(42)	141

Royal Mail Holdings plc

14. Investments in joint ventures and associates (continued)

	2010			2009		
	Joint ventures £m	Associates £m	Total £m	Joint ventures £m	Associates £m	Total £m
Share of assets and liabilities:						
Current assets	172	123	295	170	138	308
Non-current assets	3	53	56	3	51	54
Share of gross assets	175	176	351	173	189	362
Current liabilities	(101)	(112)	(213)	(102)	(127)	(229)
Non-current liabilities	-	(3)	(3)	-	(2)	(2)
Share of gross liabilities	(101)	(115)	(216)	(102)	(129)	(231)
Share of net assets	74	61	135	71	60	131
Share of revenue and profit:						
Revenue	77	1,206	1,283	69	1,155	1,224
Profit after tax	32	9	41	30	17	47

15. Non-current assets held for sale

	Land and building assets		
	Freehold £m	Long leasehold £m	Total £m
Net book amount			
At 30 March 2009	2	1	3
Reclassification from property, plant and equipment	4	-	4
Disposals	(1)	(1)	(2)
At 28 March 2010	5	-	5

	Land and building assets		
	Freehold £m	Long leasehold £m	Total £m
Net book amount			
At 29 March 2008	1	-	1
Reclassification from property, plant and equipment	2	1	3
Disposals	(1)	-	(1)
At 29 March 2009	2	1	3

The expected disposal of these property assets is as a result of the rationalisation of the Group portfolio.

Non-current assets held for sale are shown in the relevant business segment in note 3.

During the year a gain of £2m (2009 £7m) was recognised in the income statement in relation to the disposal of assets held for sale.

16. Inventories

	2010 £m	2009 £m
Supplies and materials (uniforms, fuel, printing and stationery, mailbags, engineering spares)	30	26
Merchandise (retail, lottery products and stamps)	8	6
Total	38	32

During the year £1m (2009 £4m) of inventory items were written off. Engineering spares items are included net of a provision for impairment of £4m (2009 £5m). The cost of inventories recognised as an expense in the income statement is £106m (2009 £106m).

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17. Current trade and other receivables

	2010 £m	2009 £m
Trade receivables	855	869
Prepayments and accrued income	151	151
	1,006	1,020
Client receivables	149	135
Total	1,155	1,155

Movements in the provision for bad and doubtful debts were as follows:

	2010 £m	2009 £m
At 30 March 2009 and 31 March 2008	29	33
Foreign exchange rate adjustment	-	3
Receivables provided for during the year	17	13
Release of provision	(7)	(10)
Utilisation of provision	(7)	(10)
At 28 March 2010 and 29 March 2009	32	29

The amount of trade receivables that were past due but not impaired are as follows:

	2010 £m	2009 £m
Past due not more than one month	90	55
Past due more than one month and not more than two months	7	10
Past due more than two months	14	20
Total past due but not impaired	111	85
Provided for or not yet overdue	776	813
Provision for bad and doubtful debts	(32)	(29)
Total trade receivables	855	869

18. Cash and cash equivalents

	2010 £m	2009 £m
Cash in the Post Office Limited network	708	720
Cash at bank and in hand	145	107
Total cash at bank, in hand or in the Post Office Limited network	853	827
Cash equivalent investments: Short-term deposits	84	233
Total cash and cash equivalents	937	1,060

Cash and cash equivalents comprise amounts held physically in cash, bank balances available on demand and deposits for three months or less, dependent on the immediate cash requirements of the Group. Where interest is earned, this is either at floating or short-term fixed rates based upon bank deposit rates. The fair value of cash and cash equivalent investments is not materially different from the carrying value of £937m (2009 £1,060m).

The £937m total cash and cash equivalents does not include a £3m (2009 £nil) overdrawn bank balance relating to the General Logistics Systems (GLS) subsidiary. This £3m is included in the Financial liabilities – interest bearing loans and borrowings (current) balance of £388m in the balance sheet.

Royal Mail Holdings plc

19. Financial liabilities

2010

	Loans and borrowings £m	Finance lease/hire purchase contracts £m	Derivative liabilities £m	Total £m
Amounts falling due in:				
One year or less or on demand (current)	388	61	17	466
More than one year (non-current)	1,138	120	1	1,259
More than one year but not more than two years	-	45	1	46
More than two years but not more than five years	301	73	-	374
More than five years	837	2	-	839
Total	1,526	181	18	1,725

Included within the £388m loans and borrowings due within one year is an overdrawn bank balance of £3m (2009 £nil).

2009

	Loans and borrowings £m	Finance lease/hire purchase contracts £m	Derivative liabilities £m	Total £m
Amounts falling due in:				
One year or less or on demand (current)	234	29	56	319
More than one year (non-current)	803	81	5	889
More than one year but not more than two years	2	30	5	37
More than two years but not more than five years	1	47	-	48
More than five years	800	4	-	804
Total	1,037	110	61	1,208

2010

	Loans and borrowings £m	Further committed facility £m	Total facility £m	Average interest rate of loan drawn down %	Average maturity date of loan drawn down year
BIS loans to Royal Mail Group Ltd	1,177	560	1,737	6.6	2018
BIS loans to Post Office Limited	343	807	1,150	0.8	2010
Committed facilities	1,520	1,367	2,887		
Miscellaneous loans and borrowings in subsidiaries	6	-	6	2.2	2011
Total	1,526	1,367	2,893		

2009

	Loans and borrowings £m	Further committed facility £m	Total facility £m	Average interest rate of loan drawn down %	Average maturity date of loan drawn down year
BIS loans to Royal Mail Group Ltd	800	900	1,700	8.1	2020
BIS loans to Post Office Limited	232	918	1,150	0.9	2009
Committed facilities	1,032	1,818	2,850		
Miscellaneous loans and borrowings in subsidiaries	5	-	5	3.6	2011
Total	1,037	1,818	2,855		

Royal Mail Holdings plc

19. Financial liabilities (continued)

The miscellaneous loans and borrowings in subsidiaries are either unsecured or secured on various assets (mainly property) of the overseas subsidiaries. The loans are repayable in variable and fixed amounts over their maturity periods.

The obligations under finance leases and hire purchase contracts are either unsecured or secured on the leased assets. These are repayable in variable and fixed amounts over their maturity periods. The average interest rate is 5% (2009 6%). The average maturity date is within two to three years (2009 within two to three years).

The undrawn committed facilities, in respect of which all conditions precedent had been met at the balance sheet date, expire as follows:

	2010	2009
	£m	£m
Expiring in one year or less	-	-
Expiring in more than one year, but not more than two years	807	-
Expiring in more than two years	560	1,818
Total	1,367	1,818

The following securities apply to the Group's committed facilities:

	2010	2009	
	£m	£m	Security
Royal Mail Group Ltd senior debt facility	900	900	Fixed charges over Royal Mail Holdings plc's shares in Royal Mail Group Ltd and Royal Mail Group Ltd's shares in Royal Mail Estates Limited. Floating charges over all assets of Royal Mail Holdings plc, Royal Mail Group Ltd and Royal Mail Estates Limited
Royal Mail Group Ltd shareholder loan facility	337	300	None
Royal Mail Group Ltd other drawn down loans	500	500	Fixed charges over any Royal Mail Group Ltd loans to General Logistics Systems B.V., any Royal Mail Group Ltd loans to subsidiaries of General Logistics Systems B.V. and Royal Mail Investments Limited's shares in General Logistics Systems B.V. Floating charge over non-regulated assets of Royal Mail Group Ltd
	1,737	1,700	
Post Office Limited facility	1,150	1,150	Floating charge over all assets of Post Office Limited and a negative pledge* over cash and near cash items
Total	2,887	2,850	

*The negative pledge is an agreement not to grant security over these assets or to set up a vehicle that has the same effect.

The Royal Mail Group Ltd shareholder loan increased by £37m (2009 £nil) as a result of accrued interest added to the loan balance.

The Post Office Limited facility of £1,150m is currently restricted to funding the cash and near cash items held within the Post Office Limited network.

The BIS loans to Post Office Limited under the facility are short dated on a programme of liquidity management and mature on average 1 day after the year end (2009 1 day). On maturity it is expected that further loans will be drawn down under this facility, which expires in 2011.

The security in place in the previous year was as disclosed above.

The BIS loans to Royal Mail Group Ltd and Post Office Limited become repayable immediately on the occurrence of an event of default under the loan agreements. These events of default include non-payment, insolvency and breach of covenant relating to interest and total indebtedness. It is not anticipated that the Company is at risk of breaching any of these obligations, except as discussed in note 2.

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20. Provisions for liabilities and charges

	Restructuring £m	Employee Costs £m	Other £m	Total £m
At 29 March 2009	139	134	37	310
Arising during the year:				
- charged in operating exceptional items	181	37	-	218
- charged in other operating costs	-	-	35	35
Reclassification	(4)	-	4	-
Unused amounts reversed	(3)	(65)	(17)	(85)
Utilised in the year	(199)	(7)	(5)	(211)
Discount rate adjustment	-	9	-	9
At 28 March 2010	114	108	54	276
Disclosed as:				
Current at 28 March 2010	88	-	42	130
Non-current at 28 March 2010	26	108	12	146
	114	108	54	276
Current at 29 March 2009	108	-	28	136
Non-current at 29 March 2009	31	134	9	174
	139	134	37	310

Restructuring

The provision for restructuring principally comprises redundancy schemes of £97m (2009 £108m). The remainder relates to onerous property and commercial contracts associated with restructuring projects.

The timing of cash flows for such provisions is by its nature uncertain and dependent upon the outcome of related events.

Employee Costs

Royal Mail operates a phantom share scheme referred to as ColleagueShare. This is a five-year scheme running to March 2012. The provision at 28 March of £108m (2009 £134m) represents the potential liability for the financial years up to 2011-12 and has been discounted to recognise the long-term nature of the scheme.

Other

Other provisions of £54m (2009 £37m) include expected liabilities arising from property exits in the normal course of business. These principally comprise onerous lease obligations and decommissioning costs. Other amounts arise from estimated exposures resulting from legal claims.

All provision amounts are expected to be utilised in 2010-11, except for £143m (including ColleagueShare) expected to be utilised within 2 to 3 years, £1m of onerous property contracts expected to be utilised within 3 to 5 years, and a further £2m expected to be utilised over a period greater than 5 years.

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21. Current trade and other payables

	2010 £m	2009 £m
Trade payables and accruals	1,179	1,223
Advance customer payments	299	300
Social security	95	123
	1,573	1,646
Deferred consideration on business combinations	-	7
Client payables	313	376
Amounts due to pension schemes relating to redundancies	6	8
Interest	2	2
Capital payables	108	115
ColleagueShare accrual	74	77
Total	2,076	2,231

The Group, through Post Office Limited, receives and disburses cash on behalf of Government agencies and other clients to customers through its Post Office branch network. Amounts owed to these parties are separately shown as client payables above. The level of cash held and the related payables can vary significantly at each balance sheet date.

The change in the carrying value of the discounted element of the payable balance due to the passage of time is not material.

Capital payables represent liabilities outstanding in relation to the acquisition of property, plant and equipment and intangible assets.

22. Non-current other payables

	2010 £m	2009 £m
Lease incentives	22	8
Other payables	21	18
Capital payables	-	6
Total	43	32

23. Financial risk management objectives and policies

The Group's principal financial instruments, other than derivatives, comprise short-term deposits, money market liquidity investments, Government gilt edged securities, loans, finance leases and hire purchase contracts and cash. The main purposes of these financial instruments are to raise finance and manage the liquidity needs of the business operations. The Group has various other financial instruments such as trade receivables and trade payables, which arise directly from operations.

The Group enters into derivative transactions, principally commodity swaps and forward currency contracts. The purpose is to manage the commodity and currency risks arising from the Group's operations.

It is, and has been throughout the year under review, the Group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk, commodity price and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The Group's exposure to market risk for changes in interest rates relates to the Group's debt obligations and interest bearing financial assets. The BIS loans to Royal Mail Group Ltd of £1,177m (2009 £800m) are at a fixed interest rate to maturity with an average maturity date of 2018 (2009 – average date of 2020). The BIS loans to Post Office Limited of £343m (2009 £232m) are at short-dated fixed interest rates with average maturity 1 day (2009 average 1 day). The total interest bearing financial assets of the group (excluding the non-current investments) of £191m (2009 £336m) are at short-dated fixed or variable interest rates with average maturity 3 days (2009 average 9 days). These short-dated financial instruments are maturity managed to obtain the best value out of the interest yield curve.

The Group's policy is to manage its net interest expense using an appropriate mix of fixed and variable rate financial instruments. No external hedging of interest rate risk is undertaken.

The following table demonstrates the sensitivity to reasonably possible changes in interest rates, with all other variables held constant, of the Group's profit before taxation and equity based upon the financial instruments held at the balance sheet date.

The effect from available for sale (whether floating or fixed rate) financial assets is calculated as the change in fair value at the balance sheet date and impacts equity.

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23. Financial risk management objectives and policies (continued)

The effect from other floating rate financial instruments is calculated as the balance of the instruments multiplied by the change in interest rates and impacts profit before taxation.

There is no effect on either profit before taxation or equity from other financial instruments.

	2010		2009	
	Effect on profit before taxation gains/(losses) £m	Effect on equity gains/(losses) £m	Effect on profit before taxation gains/(losses) £m	Effect on equity gains/(losses) £m
Effect of an increase in sterling interest rates of 100 basis points (1%)	(1)	(149)	2	(142)
Effect of a decrease in sterling interest rates of 50 basis points (0.5%)	1	90	(1)	86

Foreign currency risk

The Group is exposed to foreign currency risk due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, the balances held to operate the Bureau de Change services within Post Office Limited and various purchase contracts denominated in foreign currency. These risks are mitigated by hedging programmes managed by Group Treasury. Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts. Hedging will not normally be considered for exposures of less than £1m and hedging is normally confined to 80% of the forecast exposure where forecast cash flows are highly probable.

The Group's obligation to settle with overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprising of US dollar (US\$), Japanese yen, sterling and euro. Group Treasury operates a rolling 18-month hedge programme, which is subsequently reviewed on a quarterly basis. There has been no external SDR hedge in place throughout the financial year 2009-10.

For the Bureau de Change business, balances of major currency holdings are hedged along with minor currencies showing a closely correlated movement.

The Group's obligations to settle conveyance charges in US\$ has been partially hedged (to April 2011).

The Group has three active hedge programmes covering obligations to settle euro invoices on automation projects.

The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries. However it does hedge the transactional exposure created by inter-company loans with these subsidiaries.

The following table demonstrates the sensitivity to reasonably possible changes in exchange rates, with all other variables held constant, of the Group's profit before taxation and equity based upon the financial instruments held at the balance sheet date.

The effect from financial instruments owned by GLS denominated in foreign currency and held at amortised cost in the balance sheet is calculated as the balance of the instruments multiplied by the change in exchange rates and impacts equity.

The effect from other financial instruments denominated in foreign currency and held at amortised cost in the balance sheet is calculated as the balance of the instruments multiplied by the change in exchange rates and impacts profit.

The effect from derivative assets and liabilities is calculated as the change in fair value at the balance sheet date and impacts equity (for derivatives within an effective hedging relationship) or profit before taxation (for ineffective hedges and derivatives not designated in hedging relationships).

There is no effect on either profit before taxation or equity from other financial instruments.

	2010		2009	
	Effect on profit before taxation gains/(losses) £m	Effect on equity gains/(losses) £m	Effect on profit before taxation gains/(losses) £m	Effect on equity gains/(losses) £m
Effect of an increase in US\$/sterling exchange rates of 20 cents	4	(9)	2	(12)
Effect of a decrease in US\$/sterling exchange rates of 20 cents	(5)	12	(2)	16
Effect of an increase in sterling/euro exchange rates of 10 pence	(5)	13	(3)	16
Effect of a decrease in sterling/euro exchange rates of 10 pence	5	(13)	3	(16)

Royal Mail Holdings plc

23. Financial risk management objectives and policies (continued)

Commodity price risk

The Group is exposed to fuel price risk arising from operating one of the largest vehicle fleets in Europe, which consumes over 120 million litres of fuel per year, and a jet fuel price risk arising from the purchasing of air freight services. The Group's fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy uses over-the-counter derivative products (in both US\$ commodity price and US\$/sterling exchange rate) to manage these exposures.

In addition, the Group is exposed to the commodity price risk of purchasing electricity and gas. The Group's risk management strategy aims to reduce uncertainty created by the movements in the electricity and gas markets. These exposures are managed by locking into fixed rate price contracts with suppliers and using over-the-counter derivative products to manage these exposures.

The following table demonstrates the sensitivity to reasonably possible changes in commodity prices, with all other variables held constant, of the Group's profit before taxation and equity based upon the financial instruments held at the balance sheet date.

The effect from derivative assets and liabilities is calculated as the change in fair value at the balance sheet date and impacts equity (for derivatives within an effective hedging relationship) or profit before taxation (for ineffective hedges and derivatives not designated in hedging relationships).

There is no effect on either profit before taxation or equity from other financial instruments.

	2010		2009	
	Effect on profit before taxation gains/(losses)	Effect on equity gains/(losses)	Effect on profit before taxation gains/(losses)	Effect on equity gains/(losses)
	£m	£m	£m	£m
Effect of an increase in diesel fuel prices of 10 US cents per litre	-	11	-	13
Effect of a decrease in diesel fuel prices of 10 US cents per litre	-	(11)	-	(13)
Effect of an increase in jet fuel prices of 10 US cents per litre	3	-	3	-
Effect of a decrease in jet fuel prices of 10 US cents per litre	(3)	-	(3)	-

Credit risk

Royal Mail operates a credit policy, which provides a fair and equitable arrangement for all its account customers. The level of credit granted is based on a customer's risk profile assessed by an independent credit referencing agent. The credit policy is applied rigidly within the regulated products area so as to ensure that Royal Mail is not in breach of compliance legislation. Assessment of credit for the non-regulated products is based on commercial factors, which are commensurate with the Group's appetite for risk.

Royal Mail has a dedicated credit management team, which sets and monitors credit limits, and takes corrective action as and when appropriate. Credit controls in place have limited the level of bad debt incurred to around 0.1% (2009 0.1%) of turnover.

With respect to credit risk arising from other financial assets of the Group, which comprise cash, cash equivalent investments, available for sale financial assets, held to maturity financial assets, held for trading financial assets, loans and receivables financial assets and certain derivative instruments, the Group invests/trades only with high quality financial institutions. The Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

There are no significant concentrations of credit risk within the Group.

Liquidity risk

The Group's primary objective is to ensure that the Group has sufficient funds available to meet its financial obligations as they fall due. This is achieved by aligning short-term investments and borrowing facilities with forecast cash flows. Typical short-term investments include money market funds, time deposits with approved counterparties, UK Government gilts and Treasury bills. Borrowing facilities are regularly reviewed to ensure continuity of funding.

The unused facilities for Royal Mail Group Ltd of £560m expire in 2014 (2009 £900m expiring in 2014). The unused facility for Post Office Limited of £807m expires in 2011 (2009 £918m expiring in 2011). Additionally, the Group has £200m (2009 £200m) of uncommitted lines of credit which are reviewed annually.

Capital management

Royal Mail Holdings plc is a public limited company whose shares are not traded and the Group regards its capital as share capital, share premium, retained earnings and debt provided by the UK Government. The sole shareholder and the provider of the majority of debt to the Group is the UK Government. The management of capital is closely linked to the Group's relationship with its shareholder. The Group maintains its liquidity requirements by the management of its internal funds and by the drawing down of equity and debt from its shareholder as well as drawing on limited external debt facilities. The Group's debt to equity ratio is determined by its shareholder.

Financial assets - pension escrow investments

On 23 March 2007, Royal Mail Holdings plc and Royal Mail Group Ltd established £1bn of investments in escrow. These investments are held as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006. At 28 March 2010, Royal Mail Holdings plc had £1,011m (2009 £940m) of investments in the pension escrow and Royal Mail Group Ltd had £178m (2009 £166m). Charges over these assets have been registered. Further details on the Royal Mail Pension Plan, including the latest full actuarial valuation, are contained in note 25.

Royal Mail Holdings plc

24. Financial instruments

Carrying amounts and fair values

Set out below is a summary by category of the carrying amounts of all the Group's financial instruments. Trade receivables, payables, prepayments, accruals and client payables have been omitted from this analysis on the basis that carrying value is a reasonable approximation for fair value. Pension scheme assets and liabilities are also excluded. Fair values have been calculated using current market prices (forward exchange rates/commodity prices) and discounted using appropriate discount rates. There are no material differences between the fair value (transaction price) of all financial instruments at initial recognition and the fair value calculated using these valuation techniques. The fair value of the BIS loans to Royal Mail Group Ltd (non-current) is £1,197m at 28 March 2010 (2009 £875m). The fair value of 'Obligations under finance leases and hire purchase contracts' is £184m (2009 £116m). For all other financial instruments fair value is equal to the carrying amount.

The tables below also set out the carrying amount of the currency of the Group's financial instruments:

	Level	Classification	Sterling £m	US\$ £m	euro £m	Other £m	2010 Total £m
Financial assets							
Cash at bank, in hand or in Post Office Limited network			700	14	116	23	853
Cash equivalent investments			84	-	-	-	84
- Money market funds		Loans and receivables	38	-	-	-	38
- Short-term deposits – bank		Loans and receivables	46	-	-	-	46
Cash and cash equivalents			784	14	116	23	937
Financial assets – investments (current)							
- Short-term deposits – Government/local government		Loans and receivables	1	-	-	-	1
Financial assets – investments (non-current)							
- Bank deposits		Loans and receivables	-	49	-	-	49
Financial assets – pension escrow investments (non-current)							
- Cash at bank			2	-	-	-	2
- Treasury bills	1	Available for sale	269	-	-	-	269
- Gilt edged securities (conventional)	1	Available for sale	137	-	-	-	137
- Gilt edged securities (index linked)	1	Available for sale	781	-	-	-	781
Derivative assets – current	2		-	15	9	-	24
- non-current	2		-	2	1	-	3
Total financial assets			1,974	80	126	23	2,203
Financial liabilities							
Financial liabilities – loans and borrowings (current)							
- BIS loans to Royal Mail Group Ltd		Amortised cost	(40)	-	-	-	(40)
- BIS loans to Post Office Limited		Amortised cost	(343)	-	-	-	(343)
- Miscellaneous loans in subsidiaries (current)		Amortised cost	-	-	(5)	-	(5)
Obligations under finance leases and hire purchase contracts (current)		Amortised cost	(60)	-	(1)	-	(61)
Financial liabilities – loans and borrowings (non-current)							
- BIS loans to Royal Mail Group Ltd		Amortised cost	(1,137)	-	-	-	(1,137)
- Miscellaneous loans in subsidiaries (non-current)		Amortised cost	-	-	(1)	-	(1)
Obligations under finance leases and hire purchase contracts (non-current)		Amortised cost	(120)	-	-	-	(120)
Derivative liabilities – current	2		(7)	(7)	(3)	-	(17)
- non-current	2		(1)	-	-	-	(1)
Total financial liabilities			(1,708)	(7)	(10)	-	(1,725)
Net total financial assets			266	73	116	23	478

Royal Mail Holdings plc

24. Financial instruments (continued)

There are no financial assets or liabilities designated at fair value through the income statement on initial recognition.

The criteria for codification of 'Level' in the above table is described in the accounting policy 'Fair value measurement of financial instruments' on page 58.

The financial assets – investments (non-current) – bank deposits of £49m (2009 £nil) are pledged as collateral to a counterparty bank which has provided a letter of credit in support of a lease payable obligation.

Derivative assets £24m current, £3m non-current (2009 current £43m, non-current £22m) and liabilities £17m current, £1m non-current (2009 £56m current, £5m non-current) are valued at fair value. Effective changes in the fair value of derivatives, which are part of a designated cash flow hedge under IAS 39, are deferred into equity. All other changes in derivative fair value are taken straight to the income statement.

None of the financial assets listed above are either past due or considered to be impaired.

The movements in pension escrow investments of £83m (2009 £36m) consists of £41m (2009 £19m) interest on the investments and £42m (2009 £17m) movement in fair value deferred into the Financial Assets Reserve.

	Level	Classification	Sterling £m	US\$ £m	euro £m	Other £m	2009 Total £m
Financial assets							
Cash at bank, in hand or in Post Office Limited network			680	14	106	27	827
Cash equivalent investments			233	-	-	-	233
- Money market funds		Loans and receivables	176	-	-	-	176
- Short-term deposits – Government/local government		Loans and receivables	7	-	-	-	7
- Short-term deposits – bank		Loans and receivables	50	-	-	-	50
Cash and cash equivalents			913	14	106	27	1,060
Financial assets – investments (current)							
- Short-term deposits – bank		Loans and receivables	6	-	-	-	6
- Short-term deposits – Government/local government		Loans and receivables	1	-	-	-	1
Financial assets – pension escrow investments (non-current)							
- Treasury bills	1	Available for sale	255	-	-	-	255
- Gilt edged securities (conventional)	1	Available for sale	144	-	-	-	144
- Gilt edged securities (index linked)	1	Available for sale	707	-	-	-	707
Derivative assets – current	2		-	32	11	-	43
- non-current	2		-	13	9	-	22
Total financial assets			2,026	59	126	27	2,238
Financial liabilities							
Financial liabilities – loans and borrowings (current)							
- BIS loans to Post Office Limited		Amortised cost	(232)	-	-	-	(232)
- Miscellaneous loans in subsidiaries (current)		Amortised cost	(2)	-	-	-	(2)
Obligations under finance leases and hire purchase contracts (current)		Amortised cost	(28)	-	(1)	-	(29)
Financial liabilities – loans and borrowings (non-current)							
- BIS loans to Royal Mail Group Ltd		Amortised cost	(800)	-	-	-	(800)
- Miscellaneous loans in subsidiaries (non-current)		Amortised cost	-	-	(3)	-	(3)
Obligations under finance leases and hire purchase contracts (non-current)		Amortised cost	(81)	-	-	-	(81)
Derivative liabilities – current	2		(1)	(54)	(1)	-	(56)
- non-current	2		-	(5)	-	-	(5)
Total financial liabilities			(1,144)	(59)	(5)	-	(1,208)
Net total financial assets			882	-	121	27	1,030

Royal Mail Holdings plc

24. Financial instruments (continued)

Interest rate risk

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

The table below sets out the carrying amount by maturity of the Group's financial instruments that are exposed to interest rate risk. The pension escrow investments mature between 1 day and 46 years but have been disclosed as maturing in greater than 5 years as the investments have been provided as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006. The floating rate BIS loans to Royal Mail Group Ltd mature in 2014 and interest rates on these loans are set for periods between 7 days and 6 months as selected by the Group.

Financial year ended 28 March 2010

	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Cash at bank	3.2	5	-	-	-	5
Financial assets – investments (current)						
- Short-term deposits – Government/local government	7.7	1	-	-	-	1
Financial assets – investments (non-current)						
- Bank deposits	1.1	-	-	49	-	49
Financial assets – pension escrow investments (non-current)						
- Gilt edged securities (conventional)	4.8	-	-	-	137	137
BIS loans to Post Office Limited	0.8	(343)	-	-	-	(343)
BIS loans to Royal Mail Group Ltd	8.0	(40)	-	-	(837)	(877)
Obligations under finance lease and hire purchase contracts	4.8	(61)	(45)	(73)	(2)	(181)
Miscellaneous loans in subsidiaries	4.5	(1)	-	(1)	-	(2)
Total		(439)	(45)	(25)	(702)	(1,211)
Floating rate						
Cash at bank	0.4	101	-	-	-	101
Cash equivalent investments:						
- Money market funds	0.4	38	-	-	-	38
- Short-term deposits – bank	0.8	46	-	-	-	46
Financial assets – pension escrow investments (non-current)						
- Cash at bank	0.4	-	-	-	2	2
- Treasury bills	0.4	-	-	-	269	269
- Gilt edged securities (index linked)	4.9	-	-	-	781	781
BIS loans to Royal Mail Group Ltd	2.3	-	-	(300)	-	(300)
Miscellaneous loans in subsidiaries	1.5	(4)	-	-	-	(4)
Total		181	-	(300)	1,052	933
Non-interest bearing						
Cash at bank, in hand or in Post Office Limited network		747	-	-	-	747
Derivative assets		24	3	-	-	27
Derivative liabilities		(17)	(1)	-	-	(18)
Total		754	2	-	-	756
Net total financial assets/(liabilities)		496	(43)	(325)	350	478

Royal Mail Holdings plc

24. Financial instruments (continued)

Financial year ended 29 March 2009

	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Cash at bank	7.6	7	-	-	-	7
Cash equivalent investments:						
- Short-term deposits – Government/local government	0.5	7	-	-	-	7
Financial assets – investments (current)						
- Short-term deposits – bank	6.0	6	-	-	-	6
- Short-term deposits – Government/local government	7.7	1	-	-	-	1
Financial assets – pension escrow investments (non-current)						
- Gilt edged securities (conventional)	4.8	-	-	-	144	144
BIS loans to Post Office Limited	0.9	(232)	-	-	-	(232)
BIS loans to Royal Mail Group Ltd	8.1	-	-	-	(800)	(800)
Obligations under finance lease and hire purchase contracts	5.7	(29)	(30)	(47)	(4)	(110)
Miscellaneous loans in subsidiaries	3.9	(2)	(1)	-	-	(3)
Total		(242)	(31)	(47)	(660)	(980)
Floating rate						
Cash at bank	0.9	89	-	-	-	89
Cash equivalent investments:						
- Money market funds	1.0	176	-	-	-	176
- Short-term deposits – bank	0.8	50	-	-	-	50
Financial assets – pension escrow investments (non-current)						
- Treasury bills	0.4	-	-	-	255	255
- Gilt edged securities (index linked)	5.0	-	-	-	707	707
Miscellaneous loans in subsidiaries	2.8	-	(1)	(1)	-	(2)
Total		315	(1)	(1)	962	1,275
Non-interest bearing						
Cash at bank, in hand or in Post Office Limited network		731	-	-	-	731
Derivative assets		43	21	1	-	65
Derivative liabilities		(56)	(5)	-	-	(61)
Total		718	16	1	-	735
Net total financial assets/(liabilities)		791	(16)	(47)	302	1,030

Royal Mail Holdings plc

24. Financial instruments (continued)

Contractual maturity analysis for gross financial liabilities

The table below sets out the gross (undiscounted) contractual cash flows of the Group's financial liabilities. For overdrafts, loans and finance leases/hire purchase contracts, these cash flows represent the undiscounted total amounts payable including interest. For derivatives which are settled gross, these cash flows represent the undiscounted gross payment due and do not reflect the accompanying inflow. For derivatives which are settled net, these cash flows represent the undiscounted forecast outflow.

	2010					
	Gross loans and borrowings commitments £m	Gross finance lease/hire purchase instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	424	68	492	345	10	847
More than one year (non-current)	1,860	129	1,989	3	1	1,993
More than one year but not more than two years	38	49	87	3	1	91
More than two years but not more than five years	416	76	492	-	-	492
More than five years	1,406	4	1,410	-	-	1,410
Total	2,284	197	2,481	348	11	2,840
						2009
	Gross loans and borrowings commitments £m	Gross finance lease/hire purchase instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	264	33	297	225	55	577
More than one year (non-current)	1,555	91	1,646	46	5	1,697
More than one year but not more than two years	31	34	65	43	5	113
More than two years but not more than five years	89	50	139	3	-	142
More than five years	1,435	7	1,442	-	-	1,442
Total	1,819	124	1,943	271	60	2,274

Hedging Activities

The Group had the following designated cash flow hedge programmes during the current and previous financial year:

- i) The diesel fuel hedge programme uses forward commodity price swaps and forward currency purchase contracts to hedge the exposure arising from commodity price and US\$/sterling exchange rates for forecast diesel fuel purchases.
- ii) The air conveyance hedge programme uses US\$ and euro forward currency purchase contracts to hedge the exposure arising from US\$/sterling and sterling/euro exchange rates for forecast air conveyance purchases.
- iii) Four capital programmes using euro forward currency purchase contracts to hedge the exposure arising from sterling/euro exchange rates for contracted capital expenditure on automation projects.
- iv) The electricity hedge programme uses forward commodity price swaps to hedge the exposure arising from electricity prices.
- v) The gas hedge programme uses forward commodity price swaps to hedge the exposure arising from gas prices.

Royal Mail Holdings plc

24. Financial instruments (continued)

The following table shows the movements on the hedging reserve for each of these hedge programmes:

	Gains/(losses) deferred into equity during year £m	(Gains)/losses released from equity to income during year £m	Gains released from equity to the carrying value of non- financial assets during year £m
2010			
Diesel fuel	3	21	-
Air conveyance	(2)	(4)	-
Capital programmes	(3)	-	(4)
Electricity	(6)	4	-
Gas	(4)	-	-
Total	(12)	21	(4)
2009			
Diesel fuel	(19)	(7)	-
Air conveyance	10	(2)	-
Capital programmes	19	-	(14)
Electricity	(2)	-	-
Total	8	(9)	(14)

The £21m losses released from equity to income during year (2009 gains of £9m) are included within the distribution and conveyance operating costs in the income statement.

There is no material ineffectiveness recognised in the income statement relating to cash flow hedges.

For all the above cash flow hedge programmes, the underlying cash flows being hedged are expected to occur at the same dates as the hedge instruments (derivatives) mature. For the non-capital programmes (diesel, electricity and air conveyance), the profit or loss will be taken on maturity. For capital programmes, the impact on the income statement will be through the depreciation charge over the life of the asset being hedged.

The following table shows the derivatives outstanding at the year end:

	Commodity/ currency	Nominal amount	Maturity date	Average contracted commodity price/ exchange rate	Derivative asset non-current fair value £m	Derivative asset current fair value £m	Derivative Liability non-current fair value £m	Derivative Liability current fair value £m
2010								
Diesel fuel	Diesel fuel	141k tonnes	Apr 10 – Jan 12	US\$703/tonne	1	2	-	(2)
Diesel fuel	US\$	\$99m	Apr 10 – Jan 12	US\$1.75/£	1	8	-	-
Air conveyance	US\$	\$18m	Apr 10 – Apr 11	US\$1.96/£	-	3	-	-
Capital programmes	euro	€82m	Apr 10 – Apr 11	£0.80/€	1	8	-	-
Electricity	Electricity	448k MWH	Apr 10 – Feb 12	£47/MWH	-	-	(1)	(4)
Gas	Gas	20m therms	May 10 – Jan 12	£0.55/therm	-	-	-	(3)
Cash flow hedges					3	21	(1)	(9)
Other derivatives					-	3	-	(8)
Total					3	24	(1)	(17)
2009								
Diesel fuel	Diesel fuel	159k tonnes	Apr 09-Jan 11	US\$983/tonne	-	-	(3)	(45)
Diesel fuel	US \$	\$172m	Apr 09-Apr 11	US\$1.93/£	8	22	-	-
Air conveyance	US \$	\$45m	Apr 09-Apr 11	US\$1.97/£	3	5	-	-
Capital programmes	euro	€113m	Apr 09-Apr 11	£0.76/€	9	10	-	-
Electricity	Electricity	271k MWH	Oct 09-Feb 11	£53/MWH	-	-	(1)	(1)
Cash flow hedges					20	37	(4)	(46)
Other derivatives					2	6	(1)	(10)
Total					22	43	(5)	(56)

Royal Mail Holdings plc

24. Financial instruments (continued)

Other derivatives represent hedges by the Group of other foreign exchange and commodity price exposures, which are not designated as hedges under IAS 39 (including the hedge of jet fuel costs arising from the purchasing of air freight services, the hedge of the Bureau de Change currency holdings within Post Office Limited, the hedge of the US\$ bank deposits and the hedge of inter-company loans with overseas subsidiaries).

The Group had outstanding, forward transactions to hedge foreign currency and fuel purchases at contracted rates as follows:

	In currency (millions)		Sterling equivalents (millions)	
	2010	2009	2010	2009
Maturing within one year				
Euro	293	218	258	191
US\$	206	204	121	111
Australian dollars (AU\$)	4	4	2	2
Diesel and jet fuel (US\$)	88	150	48	78
Electricity and gas (sterling)	-	-	23	7
Maturing after one year				
Euro	4	50	3	37
US\$	37	73	23	37
Diesel and jet fuel (US\$)	36	38	22	20
Electricity and gas (sterling)	-	-	9	10

The Group's fuel hedges, which fix the sterling cost of purchasing fuel, consist of two elements which may be hedged jointly or separately:

- a commodity forward transaction fixing the cost in US\$ of purchasing fuel; and
- a currency forward transaction fixing the sterling cost of these US\$.

The table above contains both of these transactions. The commodity forward transactions are shown under the heading 'Diesel and jet fuel (US\$)' - US\$88m (2009 US\$150m) maturing within one year and US\$36m (2009 US\$38m) maturing after one year. The related currency forward transactions are contained within the total of US\$ - US\$206m (2009 US\$204m) maturing within one year and US\$37m (2009 US\$73m) maturing after one year.

25. Employee benefits - pensions

The Group operates pension schemes as detailed below.

Scheme	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives	Defined benefit
Royal Mail Retirement Savings Plan (RMRSP)	UK employees	Defined contribution
Royal Mail Defined Contribution Plan (RMDCP)	UK employees	Defined contribution
Various other small-scale schemes operated by overseas subsidiaries	Overseas subsidiary employees	Defined contribution

Defined Contribution

A charge for the defined contribution schemes of £5m (2009 £2m) was recognised in operating profit before exceptional items within the income statement. The Company contributions to these schemes was £5m (2009 £2m). A new defined contribution plan (RMDCP) was launched in April 2009. New recruits joining from 31 March 2008 are able to begin paying contributions to the new plan after they have worked for the Company for a year.

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. The latest full actuarial valuations of both schemes have been carried out as at 31 March 2006 using the projected unit method. For RMPP, this valuation was concluded at £3.4bn deficit. For RMSEPP, the valuation was concluded at £43m deficit. A series of changes to RMPP and RMSEPP began to take effect on 1 April 2008.

The changes encompass:

- the Plan closed to new members from 31 March 2008;
- all pensions and benefits earned before 1 April 2008 are still linked to final salary at the time of retirement;
- from 1 April 2008, defined benefits building up for employee members of the Plan are earned on a career salary basis;
- employees can continue to take their pension on reaching 60 but the normal retirement age will increase to 65 for benefits earned from 1 April 2010; and
- from 1 April 2010 it will be possible to draw pension earned before the change to normal retirement age at 60, and continue working while still contributing to the Pension Plan until the maximum level of benefits has been reached.

Royal Mail Holdings plc

25. Employee benefits – pensions (continued)

Payment of £521m (2009 £549m) was made during the year in respect of regular future service contributions, with £516m (2009 £543m) relating to RMPP. The regular future service contributions charge for RMPP, expressed as a percentage of pensionable pay, has remained at 20.0%, effective from April 2006. This rate is not expected to change materially during 2010-11. For RMSEPP, these contributions have remained at 48.2% (2009 48.2%).

Payment of £291m (2009 £290m) was made during the year to fund the deficit in the schemes, with £286m (2009 £285m) relating to RMPP. Deficit recovery payments are planned for RMPP over the 17 years from the date of the latest full actuarial valuation. These payments will be made before each 31 March, and may therefore span across the Group's year end (the last Sunday in March). Over the 16 years from 31 March 2007, planned deficit payments are £260m per annum, increasing in line with RPI (base year is 2006-07). For RMSEPP, deficit recovery payments will be £5m per annum from 1 April 2007 to 31 December 2015.

A current liability of £6m (2009 £8m) has been recognised for payments to the pension schemes relating to redundancy (note 21). During the year, payments of £50m (2009 £32m) relating to redundancy were made.

A liability of £1m (2009 £1m) has been recognised for future payment of pension benefits to a past Director (see page 43 Directors' Remuneration Report).

On 23 March 2007, the Group established £1bn of investments in escrow as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period.

The following disclosures relate to the gains/losses and deficit in the schemes recognised for the RMPP and RMSEPP defined benefit plans in the financial statements of the Group:

a) Major assumptions

The size of the pension deficit, which is large in the context of the Group and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the deficit and overall income statement charge. The major assumptions were:

	At 28 March 2010 % pa	At 29 March 2009 % pa
Rate of increase in salaries	4.6	4.2
Rate of increase in pensions and deferred pensions	3.6	3.2
Discount rate	5.6	6.4
Inflation assumption	3.6	3.2
Expected average rate of return on assets	6.7	6.9

The above assumptions relate to both defined benefit plans with the exception of the expected average rate of return on assets which is computed for the combined assets of the plans. The expected average rate of return on assets is a weighted average of the long-term expected rate of return of each principal asset class (see section b). The expected average rate of return is computed at each balance sheet date based on the market values and long-term rate of return of each principal asset class as at that date.

Mortality

The mortality assumptions for the larger scheme are based on the latest self administered pension scheme (SAPS) mortality tables (S1PMA for male pensioners and S1DFA for female pensioners) with appropriate scaling factors (106% for male pensioners and 101% for female pensioners), allowing for 'medium cohort' projections with a 1.25% floor. These are detailed below:

Average expected life expectancy from age 60:	2010	2009
For a current 60 year old male RMPP member	26 years	26 years
For a current 60 year old female RMPP member	29 years	29 years
For a current 40 year old male RMPP member	28 years	28 years
For a current 40 year old female RMPP member	31 years	31 years

Royal Mail Holdings plc

25. Employee benefits – pensions (continued)

b) Plans' assets and expected rates of return

The assets in the plans and the expected rates of return were:

At 28 March 2010

	Market value		Long-term expected rate of return	
	2010 £m	2009 £m	2010 % pa	2009 % pa
Equities	5,999	5,864	8.4	8.4
Bonds	17,652	12,311	6.2	6.3
Property	1,677	1,631	6.6	6.8
Other assets	486	265	4.6	4.2
Fair value of plans' assets	25,814	20,071		
Present value of plans' liabilities	(33,855)	(26,847)		
Deficit in schemes	(8,041)	(6,776)		

There is no element of the above present value of liabilities that arises from plans that are wholly unfunded.

Certain of the above investments relate to properties occupied by the Group, but the contribution of these properties to the fair value of plans' assets is not material. The pension plans have not invested in any other assets used by the Group or in the Group's own financial instruments.

c) Recognised charges

An analysis of the separate components of the amounts recognised in the income statement and statement of comprehensive income is as follows:

	2010 £m	2009 £m
Analysis of amounts recognised in the income statement:		
Analysis of amounts charged to operating profit before exceptional items:		
- Current service cost	436	494
- Past service cost	-	-
Total charge to operating profit before exceptional items	436	494
Analysis of amounts charged to operating exceptional items:		
- Loss due to curtailments (within provision for restructuring charge – note 20)	42	31
Total charge to operating profit	478	525
Analysis of amounts charged/(credited) to financing:		
- Interest on plans' liabilities	1,701	1,734
- Expected return on plans' assets	(1,372)	(1,620)
Total net charge to financing	329	114
Net charge to income statement before deduction for tax	807	639
Analysis of amounts recognised in the statement of comprehensive income:		
- Actual return on plans' assets	5,841	(3,861)
- Less: expected return on plans' assets	(1,372)	(1,620)
Actuarial gains/(losses) on assets (all experience adjustments)	4,469	(5,481)
- Experience adjustments on liabilities	673	(10)
- Effects of changes in actuarial assumption on liabilities	(6,454)	1,407
Actuarial (losses)/gains on liabilities	(5,781)	1,397
Total actuarial losses recognised in the statement of comprehensive income before deduction for tax	(1,312)	(4,084)

Royal Mail Holdings plc

25. Employee benefits – pensions (continued)

d) Movement in plans' assets and liabilities

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	2010 £m	2009 £m
Plans' liabilities at beginning of period	(26,847)	(26,846)
Current service cost	(436)	(494)
Curtailment costs*	(48)	(33)
Finance cost	(1,701)	(1,734)
Employee contributions	(158)	(166)
Actuarial (losses)/gains (recognised in statement of comprehensive income)	(5,781)	1,397
Benefits paid	1,116	1,029
Plans' liabilities at end of period	(33,855)	(26,847)

*The curtailment costs in the income statement are recognised on a consistent basis with the associated compensation costs. Estimates of both are included, for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy during the accounting period. Such payments may occur in an accounting period subsequent to the recognition of costs in the income statement.

Changes in the fair value of the plans' assets are analysed as follows:

	2010 £m	2009 £m
Plans' assets at beginning of period	20,071	23,923
Company contributions paid	862	821
Movement in company contributions accrued	(2)	1
Company contributions prepaid in 2008 for 2009	-	50
Employee contributions	158	166
Finance income	1,372	1,620
Actuarial gains/(losses) (recognised in statement of comprehensive income)	4,469	(5,481)
Benefits paid	(1,116)	(1,029)
Plans' assets at end of period	25,814	20,071

e) History of experience gains and losses

The cumulative amount of actuarial gains and losses recognised since transition to IFRSs at 29 March 2004 in the statement of comprehensive income is £4,506m loss (2009 £3,194m loss). The Directors are unable to determine how much of the pension scheme deficit recognised in transition to IFRSs is attributable to actuarial gains and losses since inception of the pension schemes. Consequently, the Directors are unable to determine the cumulative amount of actuarial gains and losses that would have been recognised in the statement of comprehensive income between inception of the pension schemes and transition to IFRSs.

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Fair value of assets	25,814	20,071	23,923	23,578	21,847
Present value of liabilities	(33,855)	(26,847)	(26,846)	(28,563)	(27,435)
Deficit in schemes	(8,041)	(6,776)	(2,923)	(4,985)	(5,588)
	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Experience adjustment on assets	4,469	(5,481)	(1,327)	172	3,421
Experience adjustment on liabilities	673	(10)	(169)	(122)	(161)

Royal Mail Holdings plc

26. Issued share capital and reserves

Authorised share capital	2010	2009
	£	£
Ordinary shares of £1 each	100,000	100,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	100,001	100,001

Issued and called up share capital	2010	2009
	£	£
Ordinary shares of £1 each	50,005	50,005
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	50,006	50,006

The Special Share can be redeemed at any time by its holder (the Secretary of State for Business, Innovation and Skills), subject to such redemption being compliant with the Companies Act 2006. The Company cannot redeem the Special Share without the prior consent of its holder. No premium is payable on redemption.

On distribution in a winding up of the Company, the holder of the Special Share is entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member. The Special Share does not carry any rights to vote.

Under section 63(7) of the Postal Services Act 2000, for the purposes of the Companies Act 2006, certain shares issued shall be treated as if their nominal value had been fully paid up.

Under sections 72 and 74 of the Postal Services Act 2000, the Secretary of State for Business, Innovation and Skills may issue directions to the Company which, depending on the direction issued, could result in the recognition of a distribution.

Reserves identified in the consolidated statement of changes in equity

Financial Assets Reserve

The Financial Assets Reserve is used to record fair value changes on available for sale financial assets.

Foreign Currency Translation Reserve

The Foreign Currency Translation Reserve is used to record the gains and losses arising from 29 March 2004 on translation of assets and liabilities of subsidiaries denominated in currencies other than the reporting currency.

Hedging Reserve

The Hedging Reserve is used to record gains and losses arising from cash flow hedges since 28 March 2005.

Other Reserves

Other Reserves of £47m (2009 £47m) comprise £2m (2009 £2m) unrealised gain on First Rate Exchange Services Holdings Limited, a joint venture entity, and £45m (2009 £45m) relating to unrealised gains on Midasgrange Limited, an associate company.

Rural Network Reserve

The Rural Network Reserve was created by Post Office Limited, following directions issued by the Secretary of State under section 72 of the Postal Services Act 2000 (the Act). The amounts allocated to this Reserve are applied as if they were profits available for distribution. The purposes for which the Rural Network Reserve may be utilised are stated in the directions issued, and principally relate to the maintenance of a rural network of post offices. A total of £816m has been used from this Reserve towards the maintenance of a rural network between March 2003 and the end of the 2008-09 financial year. There will be no further amounts allocated to this Reserve which has now therefore, been fully utilised.

Royal Mail Holdings plc

27. Commitments

Operating lease commitments

The Group is committed to the following future minimum lease payments under non-cancellable operating leases as at 28 March 2010:

	Land and Buildings		Vehicles and equipment		IT equipment		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Within one year	138	140	20	22	32	26	190	188
Between one and five years	436	443	18	26	33	34	487	503
Beyond five years	602	583	1	3	-	-	603	586
Total	1,176	1,166	39	51	65	60	1,280	1,277

Existing leases for UK land and buildings have an average term of 12 years and any new leases entered into generally have a 15-year term with a 10-year break clause. Existing land and buildings leased overseas by the GLS subsidiary have an average lease term of 9 years. Vehicle leases generally have a term of between 2 and 8 years, depending on the asset class, with the average term being 3 years. The existing leases have an average term remaining of 1 year. There is one IT contract with a lease term of 10 years with 3 years remaining at the balance sheet date.

Finance lease and hire purchase commitments

	2010		2009	
	Minimum lease payments £m	Present value of minimum lease payments £m	Minimum lease payments £m	Present value of minimum lease payments £m
Within one year	68	61	33	29
Between one and five years	125	118	84	77
Beyond five years	4	2	7	4
Total minimum lease payments	197	181	124	110
Less amounts representing finance charges	(16)	-	(14)	-
Present value of minimum lease payments	181	181	110	110

The Group has finance lease contracts for vehicles, land and buildings and equipment. The leases have no terms of renewal, purchase options or escalation clauses and there are no restrictions concerning dividends, borrowings or additional leases. Vehicle leases have a term of between 3 and 8 years, depending on the class of vehicle, with the average term being 3 years. The land and buildings lease is for a 15 year term and the equipment leases for an average term of 7 years.

Capital commitments

The Group has commitments of £129m at 28 March 2010 (29 March 2009 £193m), which are contracted for but not provided for in the financial statements.

Royal Mail Holdings plc

28. Related party disclosures

The ultimate parent (the Company) and principal subsidiaries

Royal Mail Holdings plc is the ultimate parent company of the Group. The consolidated financial statements include the financial statements of Royal Mail Holdings plc and the principal subsidiaries listed in the following table:

Company	Principal activities	Country of incorporation	% equity interest	
			2010	2009
Royal Mail Group Ltd	Mails and parcels services	United Kingdom	100	100
Post Office Limited	Counter and retail services	United Kingdom	100	100
Royal Mail Investments Limited	Holding company	United Kingdom	100	100
General Logistics Systems B.V.	Parcel services	Netherlands	100	100
Royal Mail Estates Limited	Property holdings	United Kingdom	100	100
Romec Limited	Facilities management	United Kingdom	51	51
iRed Partnership Limited	Document management services	United Kingdom	100	100

Royal Mail Holdings plc is the immediate parent company of the Royal Mail Group Ltd subsidiary company. The remaining subsidiary companies listed above have Royal Mail Group Ltd as their immediate parent company.

Joint venture

The Group's 50% interest in First Rate Exchange Services Holdings Limited, a company registered in the United Kingdom, is held by Post Office Limited. The company's principal activity is the provision of Bureau de Change.

Associates

The following companies are the principal associates of the Group:

Company	Principal activities	Country of incorporation	% Ownership	
			2010	2009
Quadrant Catering Limited	Catering services	United Kingdom	51	51
Camelot Group plc	National lottery	United Kingdom	20	20
G3 Worldwide Mail N.V. (Spring)	Mail services	Netherlands	32.45	24.5
Midasgrange Limited	Financial services	United Kingdom	50	50

The majority of the Board and voting power in Quadrant Catering Limited is held by the Group's partner, hence it is not a subsidiary.

Management control lies with the Bank of Ireland partner in the operation of the Midasgrange Limited company and therefore the company is not a joint venture.

With the exception of Midasgrange Limited, for whom the Group's investment is held by Post Office Limited, the investment in the associate companies listed above is held by Royal Mail Group Ltd.

During the year the Group increased its shareholding in G3 Worldwide Mail N.V. (Spring) from 24.5% to 32.45% (note 14).

Royal Mail Holdings plc

28. Related party disclosures (continued)

Related party transactions

During the year the Group entered into transactions with related parties. The transactions were in the ordinary course of business and included administration and investment services recharged to the Group's pension plan by Royal Mail Pensions Trustees Limited. The transactions entered into and the balances outstanding at the financial year end were as follows:

	Sales/recharges to related party		Purchases/recharges from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2010	2009	2010	2009	2010	2009	2010	2009
	£m	£m	£m	£m	£m	£m	£m	£m
Royal Mail Pension Plan	10	10	-	-	-	-	-	-
Quadrant Catering Limited	-	-	35	36	-	-	3	3
Camelot Group plc	37	46	-	-	-	-	-	-
G3 Worldwide Mail N.V. (Spring)	-	-	7	8	3	9	1	2
Midasgrange Limited	33	41	1	-	10	15	-	-
First Rate Exchange Services Holdings Limited Group	30	40	134	145	14	14	2	1

The companies listed above are joint ventures and associates of the Group with the exception of Royal Mail Pension Plan.

The sales to and purchases from related parties are made at normal market prices. Balances outstanding at the year end are unsecured, interest free and settlement is made by cash.

The Group trades with numerous Government bodies on an arm's length basis. Transactions with these entities are not disclosed owing to the significant volume of transactions that are conducted.

Separately:

- the Group has certain loan facilities with Government (note 19); and
- the Group has received the Network Subsidy Payment from Government (note 2).

Key management compensation

	2010 £000	2009 £000
Short-term employee benefits	3,035	3,024
Post-employment benefits	307	(179)
Other long-term benefits	2,626	1,136
Total compensation earned by key management	5,968	3,981

Key management comprises executive and non-executive Directors of the Royal Mail Holdings plc Board.

HM Government is the Company's sole shareholder and, accordingly, the Directors have no interest in the shares of the Company.

29. Events after the balance sheet date

The Group has entered into sale and leaseback agreements relating to four property assets, after 28 March 2010. The total proceeds received amounted to £72m and the financial impact of these agreements in the context of the Group's profit or loss is not considered material.

Royal Mail Holdings plc

Group five-year summary (unaudited)

	2010	2009	2008	2007	2006
	£m	£m	£m	£m	£m
Income statement					
Revenue	9,349	9,560	9,388	9,179	9,056
Operating profit before exceptional items	404	321	162	233	355
Operating exceptional items	(291)	(149)	(441)	(243)	(210)
Operating profit/(loss)	113	172	(279)	(10)	145
Non-operating exceptional items	5	11	58	118	67
Profit/(loss) before financing and taxation	118	183	(221)	108	212
Finance income and costs, including net pensions interest	(380)	(134)	144	205	100
(Loss)/profit before tax	(262)	49	(77)	313	312
Taxation	(58)	(278)	212	(27)	83
(Loss)/profit after tax	(320)	(229)	135	286	395
Statement of cash flows					
Net increase/(decrease) in cash	24	(255)	224	1	(61)
Net (decrease)/increase in cash equivalents	(149)	(118)	(15)	34	(118)
Net (decrease)/increase in cash and cash equivalents	(125)	(373)	209	35	(179)
Balance sheet					
Goodwill and intangible assets	296	284	240	207	174
Property, plant and equipment	1,935	1,886	1,671	1,619	1,594
Other non-current assets, including those classified as held for sale	1,493	1,431	1,824	1,528	539
Net current (liabilities)/assets	(511)	(385)	(300)	(60)	535
Non-current liabilities	(9,494)	(7,872)	(3,676)	(5,558)	(6,181)
Net liabilities	(6,281)	(4,656)	(241)	(2,264)	(3,339)

Royal Mail Holdings plc

Parent Company financial statements

Statement of Directors' responsibilities in relation to the parent Company financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are not required under UK law to prepare a Remuneration Committee Report but, in accordance with the principles of good corporate governance, as outlined in the Combined Code, have chosen to do so. This Report has been prepared by the Remuneration Committee as if the Company was required to comply with both Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 of the United Kingdom and relevant Listing Rules of the Financial Services Authority and has been approved by the Board. The only exception is that a performance graph has not been included, since the Company is not quoted.

Donald Brydon

Ian Duncan

Royal Mail Holdings plc

Independent Auditor's report to the members of the Company, Royal Mail Holdings plc

We have audited the parent Company financial statements of Royal Mail Holdings plc for the year ended 28 March 2010 which comprise balance sheet and the related notes 1 to 10. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 96, the Directors are responsible for the preparation of the parent Company financial statements and for being satisfied that they give a true and fair view. The Directors are also responsible for the preparation of the Directors' Remuneration Report, which they have chosen to prepare as if the Company was required to comply with relevant requirements of both the UK Companies Act 2006 (and Regulations thereunder) and the Listing Rules of the Financial Services Authority. The only exception is that a performance graph has not been included, since the Company is not quoted. Our responsibility is to audit the parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. In addition, the Company has also instructed us to review whether the section of the Directors' Remuneration Report that has been described as audited has been properly prepared in accordance with the basis of preparation described therein.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 28 March 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of Royal Mail Holdings plc for the year ended 28 March 2010.

Alison Duncan (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor

London

28 May 2010

Royal Mail Holdings plc

Parent Company balance sheet

at 28 March 2010 and 29 March 2009

	Notes	2010 £m	2009 £m
Fixed assets			
Investments in subsidiaries	4	3,784	3,784
Investments in pension escrow	5	1,011	940
Total net assets		4,795	4,724
Capital and reserves			
Share capital	8	-	-
Share premium	9	430	430
Reserves	9	44	18
Profit and loss account	9	4,321	4,276
Shareholder's funds		4,795	4,724

The financial statements on pages 98 to 100 were approved by the Board of Directors on 28 May 2010 and signed on its behalf by:

Donald Brydon

Ian Duncan

Royal Mail Holdings plc

Notes to the parent Company financial statements

1. Parent Company accounting policies

The following accounting policies apply:

Financial year

The financial year ends on the last Sunday in March and, accordingly, these financial statements are made up to the year ended 28 March 2010 (2009 year ended 29 March).

Basis of preparation

The financial statements of the parent Company, Royal Mail Holdings plc (the Company) were authorised for issue by the Board on xx May 2010.

The financial statements on pages 98 to 100 have been prepared in accordance with applicable UK Accounting Standards and law, including the requirements of the Companies Act 2006. Unless otherwise stated in the accounting policies below, the financial statements have been prepared under the historic cost accounting convention.

In making an assessment on the Company's ability to continue as a going concern, the Directors have considered the assessments made by the subsidiaries Royal Mail Group Ltd and Post Office Limited. These are set out in note 2 to the Group financial statements. On this basis the Directors have concluded that it is appropriate that the Royal Mail Holdings plc Company financial statements have been prepared on a going concern basis.

The Company has not presented its own profit and loss account, as permitted by section 408 of the Companies Act 2006. However, the results of the Company for the year are disclosed in notes 6 and 9 to the financial statements.

The Company has taken advantage of paragraph 2D of *FRS 29 (IFRS 7) Financial Instruments: Disclosures* and has not disclosed information required by that standard, as the Group's consolidated financial statements in which the Company is included, provide equivalent disclosures for the Group under IFRS 7.

No new UK Accounting Standards, which affect the presentation of these financial statements, have been issued.

Impairment reviews

Unless otherwise disclosed in these accounting policies, fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Company assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the profit and loss account for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Investments in subsidiaries

Investments in subsidiaries within the Company's financial statements are stated at cost less any accumulated impairment losses. The opening and closing carrying value relates solely to the Company's investment in Royal Mail Group Ltd, a 100% subsidiary of the Company. Royal Mail Group Ltd is the only direct shareholding held by the Company.

Investments in pension escrow

Investments in pension escrow are financial assets within the scope of *FRS 26 Financial Instruments: Recognition and Measurement*.

The investments are a combination of short-term deposits and long-term investments which mature between 1 day and 46 years but have been included within fixed assets as the investments have been provided as security to the Royal Mail Pension Plan in support of the 17 year deficit recovery period from March 2006.

The investments comprise short-term deposits with a bank, Treasury bills and gilt edged securities.

The bank deposits are non-derivative assets that are neither held for trading nor quoted in an active market and therefore classified as 'loans and receivables' for measurement purposes under FRS 26. The investments are initially recognised at fair value, being the amount deposited. The investments accrue interest, thereby increasing the carrying value of the investments. This interest is included in the reported profit/(loss) for the year. The investments are derecognised when they mature.

Treasury bills, index-linked gilt edged securities and conventional gilt edged securities are classified as available for sale financial instruments on the basis that they are quoted investments that are not held for trading and may be disposed of prior to maturity. The investments are initially recognised at fair value, being the purchase price. After initial recognition, interest is included in the reported profit/(loss) for the year, using the effective interest rate method and the assets are measured at fair value with gains or losses being recognised in the Financial Assets Reserve until the investment is derecognised.

Contingent liabilities

Contingent liabilities are not disclosed if the possibility of losses occurring is considered to be remote.

2. Directors' emoluments

The Directors of the Company are not paid fees by the Company for their services as Directors of the Company. The Directors of the Company are paid fees by other companies of the Group. These emoluments are disclosed in the Group Annual Report and Financial Statements.

3. Auditor's remuneration

The auditor of the Company is not paid fees by the Company. The auditor of the Company is paid fees by the other companies of the Group. This remuneration is disclosed in the Group Annual Report and Financial Statements.

Royal Mail Holdings plc

4. Investments in subsidiaries

	Cost £m	Impairment £m	2010 £m	2009 £m
At 30 March 2009 and 31 March 2008	4,160	(376)	3,784	3,784
At 28 March 2010 and 29 March 2009	4,160	(376)	3,784	3,784

5. Investments in pension escrow

	2010 Average effective rate %	2010 £m	2009 Average effective rate %	2009 £m
Cash at bank	0.4	1	-	-
Treasury bills	0.4	229	0.4	217
Gilt edged securities (index linked)	4.9	664	4.2	601
Gilt edged securities (conventional)	4.8	117	4.8	122
Investments in pension escrow		1,011		940

6. Profit and loss account

The Company is a non-trading company. The profit for the period relates to income from the investments in pension escrow of £35m (2009 £17m) and a tax credit of £10m (2009 £7m).

7. Taxation

A tax charge of £10m (2009 £7m) has been taken to the Financial Assets Reserve, reflecting the tax liability on the fair value changes on available for sale financial assets. A tax credit of £10m (2009 £7m) has been taken to the profit and loss account, reflecting the sheltering of that tax liability by losses of other Group companies.

8. Share capital

Details of the share capital are disclosed in the Group Annual Report and Financial Statements in note 26.

9. Shareholder's funds

	Share premium £m	Profit and loss account £m	Financial Assets Reserve £m	2010 Total £m	2009 Total £m
At 30 March 2009 and 31 March 2008	430	4,276	18	4,724	4,693
Profit for the year	-	45	-	45	24
Taxation on items taken directly to reserves	-	-	(10)	(10)	(7)
Gains on financial asset investments	-	-	36	36	14
At 28 March 2010 and 29 March 2009	430	4,321	44	4,795	4,724

Financial Assets Reserve

The Financial Assets Reserve is used to record fair value changes on available for sale financial assets.

10. Charges

Details of charges registered over the assets of the Company are contained in the Group financial statements in notes 19 and 24.

Royal Mail Holdings plc

Forward looking statements

This document contains statements concerning the Group's business, financial condition, results of operations and certain of the Group's plans, objectives, assumptions, projections, expectations or beliefs with respect to these items.

The Company cautions that any forward looking statements in this document may and often do vary from actual results and the differences between these statements and actual results can be material. Accordingly, readers are cautioned not to place undue reliance on forward looking statements. The Company undertakes no obligation to release publicly the result of any revisions to these forward looking statements that may be made to reflect events or circumstances after the date of this document, including, without limitation, changes in the Group's strategy, or to reflect the occurrence of unanticipated events.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Such forward looking statements should, therefore, be considered in light of various important factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements. These factors include, among other things: the impact of competitive products and pricing; the occurrence of major operational problems; the loss of major customers; limitations imposed by the Group's indebtedness; undertakings and guarantees relating to pension funds; contingent liabilities; risks of litigation and risks associated with the Group's overseas operations.

Corporate information

Registered Office and Group Head Office

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Registered No: 4074919

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Corporate website

Additional corporate and other information can be accessed on the following website www.royalmailgroup.com. Information made available on the website is not intended to be, and should not be regarded as being, part of the financial statements.

The maintenance and integrity of the Group's websites is the responsibility of the Directors; the work carried out by the auditor does not involve consideration of these matters and, accordingly, the auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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