International Post Corporation

Trading update for the first quarter April to June 2022

22-07-2022

Revenue down 11.5% year on year in the first quarter, reflecting weakening retail trends, lower test kit volumes and a return to structural decline in letters Adjusted operating loss of £92 million, reflecting inflexibility in the cost base to adjust to lower volumes and disappointing performance on delivery of further efficiencies.

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Progress on Pathway to Change stalled, creating £100 million risk to £350 million of benefits identified for FY 2022-23; other cost saving programmes on track, albeit with headwinds from recent increases in absence due to COVID-19

Q1 performance emphasises the need to act now to make the most of our new infrastructure, find more flexible ways of matching resource to workload and ensure we have a more agile and sustainable relationship with the CWU

Now moving ahead with actions where we do not need further union agreement, notably revisions and Scan-in Scan-out (SISO) in Delivery

Outlook for FY 2022-23: weaker parcels market and lower than anticipated efficiency savings in-year. Provided progress can be made on above actions, now likely to be around breakeven at adjusted operating profit level, excluding any impact from industrial action.

GLS:

Volume declined 3% year on year in the first quarter; revenue growth of 7.8% in Sterling, (9.8% in Euros), including acquisitions2, benefitted from better pricing and higher freight revenues

Given current inflationary environment and COVID-19 restrictions in place during Q1 2021-22, some margin compression year on year, as expected

Operating profit of £94 million (€112 million), broadly in line with prior year

Maintaining FY 2022-23 outlook: revenue growth year on year of high single digit % in Euros and operating profit in the range of €370 to €410 million

Group:

Holding company Royal Mail plc to be renamed International Distributions Services plc to reflect the group structure of two separate companies (Royal Mail and GLS). Our intention is to have clearer financial separation with no cross subsidy, reflecting the increased importance of GLS to the group and our position in the wider logistics and distribution markets

No impact on Royal Mail and GLS brands

In the event that significant operational change within Royal Mail in the UK is not achieved, the Board will consider all options to protect the value and prospects of the Group, including separation of the two companies.

Keith Williams, Chair, commented: “Whilst GLS delivered a solid performance in the first quarter, the performance of Royal Mail was disappointing with an adjusted operating loss of £92 million resulting from of a decline in parcel volumes post the pandemic and a lack of progress in delivering efficiencies.”

"The pandemic boom in parcel volumes bolstered by the delivery of test kits and parcels is over. Royal Mail is currently losing one million pounds per day and the efficiency improvements which are needed for long term success have stalled."

'We can however be a long-term success story. We have advantages in scale and reach and a strong balance sheet and asset base which are the foundations for a successful future. We need to act now in moving to that future in the interests of all stakeholders, employing those advantages to the maximum."

Simon Thompson, CEO Royal Mail, commented: "We have made progress building the infrastructure we need for Royal Mail to compete, especially given the growing demand for more larger parcels, delivering the next day – including Sundays – and in a more environmentally friendly way. But building the infrastructure is not enough. We have to transform the way we work too. We need to change – and change now. This is how we can give our team the job security that they deserve for tomorrow and not just for today. I am ready to talk about pay and change at any time. But it has to be both."

Martin Seidenberg, CEO GLS, commented: "GLS continues to deliver a good performance, with weaker B2C volumes partly offset by growth in B2B. Pricing actions have mitigated volume declines and revenue grew by 9.8% year on year in Euro terms. Given inflationary pressures, operating profit margin contracted, as expected. Whilst we anticipate further cost pressures in the second half, we are maintaining our full year outlook."

Group

With the financial benefits from parcel growth during the pandemic now dissipating, the difference in performance between our two businesses is re-emerging. GLS continues to make positive progress, but results at Royal Mail have worsened significantly.

The Group has increasingly become reliant on GLS for returns. Over the last three years more than two thirds of reported Group operating profit has come from GLS. It is a growing business with a great future.

Royal Mail showed it can be profitable during the pandemic due to the combination of a surge in parcels and the delivery of test kits. It is still well positioned to take advantage of the opportunities presented by a changing market. It has around £8 billion of assets as at March 2022, including around £1.5 billion in property, net assets of just over £4 billion, and has an estimated domestic parcel market revenue share of around 40%7 in the UK, as well as being the provider of the Universal Service. It also has a strong and trusted brand and unparalleled scale and reach in the UK. These give Royal Mail the potential to succeed and to grow.

Both shareholders and employees are an important part of that future. Our employees at Royal Mail in the UK are important stakeholders. 1 in 175 employed people in the UK work for Royal Mail. Our overall package pays up to 40% more than our competitors. We want to do all we can to protect Royal Mail's position as the leading employer in the industry, and to offer long term job security.

We are confident that if our people work with us to make the changes we are asking for, we can offer jobs to all that want them on terms which will continue to be industry leading. Our current pay offer is made against the backdrop of post-lockdown losses, and more challenging economic prospects for the UK.

The ability to make good on that offer largely depends on being able to make the changes that will fund it.

We note with regret the result of the CWU ballot yesterday. Action on the part of the CWU to delay necessary changes or engage in industrial action will only damage our ability to continue to offer everyone at Royal Mail a job and is an abdication of their responsibility for the future security of their members. In the long term, the interests of shareholders and employees are aligned. Success for both depends on being able to create a more competitive business.

We are announcing today that we are changing the name of the holding company to International Distributions Services plc. This reflects the increased importance of GLS to the group, our strength in markets outside the UK, the shape and performance of the group today, and our position in the wider logistics and distribution markets. It will not have any impact on the brands Royal Mail and GLS.

The Board has always maintained that there should be no cross subsidy in the Group and recognises the need to address improvements in Royal Mail's performance quickly. In the event that significant change within Royal Mail is not achieved, the Board will consider all options to protect the value and prospects of the Group, including separation of the two companies.

Royal Mail

We are seeing the impact of macro-economic trends on Q1 performance - high inflation and increased cost of living for consumers – plus the unwinding of the exceptionally high volumes of parcels we saw during COVID-19 restrictions.

Total parcel volume was down 15%1 and revenue was down 15.1%1 compared to the prior year. Compared to pre-pandemic (Q1 2019-20) total parcel volume grew by 1% and revenue by 15.6%.

Domestic parcel volumes were 15% lower year on year, which reflected: recent wider trends in retail and the impact of cost of living increases; reduced test kit volumes, following the end of free universal COVID-19 tests; and lockdown restrictions during the prior year which resulted in elevated volumes. Domestic parcel revenue was 13.9% lower, reflecting price increases and mix.

Compared to pre-pandemic (Q1 2019-20), domestic parcel volumes were up 14% and revenue up 26.1%, reflecting strong positive price/mix.

International volumes were down 16% year on year, an improvement on recent trends but reflecting ongoing challenges in the cross border parcel market, as previously outlined. Volumes were down 44% when compared to Q1 2019-20, with revenue down 18.4%, due to price increases and import/export mix.

Letter performance was slightly ahead of our expectations: total letter revenue was down 6.7%1 year on year, with addressed letter volume (ex. elections) down 6%1, reflecting a return to the long-term structural decline in letters. Compared to Q1 2019-20, total letter revenue was 12.9% lower, which also reflected the benefit of local and EU elections in May 2019.

Overall, total revenue declined by 11.5% year on year in the first quarter and was broadly flat compared to Q1 2019-20.

Cost performance was disappointing. Although we have taken action focused on variable labour costs, including reducing reliance on temporary resources and overtime, we were unable to reduce costs quickly enough in line with lower parcel and letter volumes.

In addition, whilst other elements of our cost programmes are on track (albeit with some pressure from a recent rise in COVID-19 absence), progress on transformation has stalled due to the current industrial relations environment and lack of CWU support. Whilst we are seeing flow-through benefits from Pathway to Change savings last year, there has been no progress on planned annual revisions in the operation and ways of working, to deliver additional benefits this year. As a result, we are not achieving our agreed productivity trajectory, which creates a £100 million risk around delivery of our £350 million targeted benefits for FY 2022-23. Overall productivity was 1.8% lower year on year in Q1, with an improvement in Processing offset by declines in Delivery.

As a result of the above, Q1 financial performance was materially impacted, resulting in an adjusted operating loss of £92 million.

Outside of Pathway to Change, we made progress in a number of areas. We opened our first Super Hub in Warrington in June, and are on track to hit our target of 70% of parcels automated by year end. We are moving ahead with plans to roll out dedicated parcel routes from around 350 parcel depots across the country, to meet the growing demand for next day and larger parcels, with our first depot planned to go live in October.

We have also recently launched Royal Mail Health, which will address the growing healthcare at home industry and continue to grow our Sunday delivery volumes.

The new Royal Mail Academy launched in June and is delivering best-in-class training to develop the next generation of leadership talent in our business and support a culture of continuous learning.

However, as our Q1 performance demonstrates, we are at a crossroads. The need to reach agreement with CWU on the changes that are essential to grow our business and ensure long term job security for our team is becoming ever more urgent.

We need to deliver changes to our ways of working to ensure that Royal Mail can deliver more of what our customers want and compete effectively in the market. This includes making the most of our new infrastructure, finding more flexible ways of matching resource to workload and ensuring we have a more agile and sustainable relationship with the CWU so that we can adapt quickly to changing dynamics in the market.

On 19 July members of the CWU voted in favour of industrial action. We have offered a package worth up to 5.5% for CWU grade colleagues, the biggest increase for many years. The pay offer includes a 2% unconditional pay increase (which has now been applied and backdated to April 2022), a further 1.5% which would be paid from the date upon which we implement the changes agreed and a new “above and beyond” bonus scheme worth up to 2% or £520 a year.

However, we can only fund this if we have agreement to implement change in the business, which will support growth, deliver efficiencies, and provide job security. This includes:

flexible working, meaning our core team might work around one hour a day less in the Summer and around one hour a day more in the Winter, whilst getting the same weekly pay all year round;

over the next three years some of our core team in Delivery working one Sunday every four weeks, although based on our current volumes one Sunday every 40 weeks;
changes to our absence policy to make sure that as many people as possible attend work every day;
moving to later start times over a number of years, with the majority of our team starting between one and two hours later.
We remain committed to reaching agreement with the CWU. Industrial action by the CWU will only serve to damage the future prospects of the business and undermine the long-term job security we want to offer our team.

We will now move ahead with change where we do not need further union agreement and make progress on the actions we have already agreed as part of Pathway to Change, notably revisions, Scan-in Scan-out (SISO) in Delivery and agreeing a business model for Parcelforce that guarantees long term profitability.

We were pleased to reach agreement with Unite/CMA, avoid industrial action and secure the benefits of our changes in operational management.

GLS

Volume declined 3% year on year in the first quarter. Most countries saw a decline in volumes vs. the prior year, although in Europe East we saw volume growth, despite lapping a period which included COVID-19 tailwinds in the prior year. Weaker B2C volumes were partly mitigated by growth in B2B volumes. The overall decline in B2C volumes reflected an unwinding of the positive effects from lockdown restrictions which benefitted Q1 2021-22.

Revenue growth was 9.8% in Euros, 7.8% in Sterling, compared to Q1 2021-22. This reflected price increases and fuel surcharges implemented at the start of the year, and included the impact from acquisitions.2 Foreign exchange movements adversely impacted revenue by c. £20 million.

Pricing actions across markets and higher freight revenues mitigated parcel volume declines. Revenue growth was achieved in almost all markets. However, cost pressures driven by inflationary effects, in particular higher subcontractor rates due to higher fuel costs, resulted in margin compression compared with Q1 2021-22, as expected.

GLS Canada continued to trade well, including a strong contribution from Rosenau. In Europe East, GLS Hungary also performed well, growing revenues double-digit percent year on year.

Outlook

Since May, the economic backdrop has continued to weaken. Q1 parcel volumes in Royal Mail were down 15% year on year and only 1% higher than pre-COVID levels. Mix is being negatively impacted by lower volumes of higher AUR (average unit revenue) test kits. We continue to review opportunities to adjust prices, though we must balance this with our requirement to maintain volumes in our largely fixed cost network and market dynamics.

The CWU dispute is already impacting negatively on our ability to deliver the urgently required change in Royal Mail. This has caused progress on Pathway to Change to stall resulting in a £100 million risk to £350 million of benefits identified for FY 2022-23. In addition, we have not been able to respond quickly enough to declining parcel volumes, with now also an increasing likelihood that material planned savings linked to a CWU pay deal will be not be realised in FY 2022-23.

The market outlook for parcels has weakened and we now anticipate a lower level of efficiency savings in FY 2022-23. Provided progress can be made on the change items highlighted where we do not need further union agreement, it is now likely Royal Mail will be around breakeven at the adjusted operating profit level for FY 2022-23, excluding the impact of industrial action.

GLS, like Royal Mail, is facing cost headwinds in all of its markets. Whilst we anticipate further cost pressure in the second half, absent any significant deterioration in the macro environment, the combination of specific pricing actions, service quality and targeted efficiency measures that are being undertaken should allow us to deliver our full year outlook of high single digit % revenue growth and operating profit in the range of €370 to €410 million.

Source: Royal Mail