

Royal Mail Holdings plc

Interim Report for the half year ended 25 September 2011



Financial performance beginning to improve. But core Universal Service activities remain loss-making

Key financial highlights	Half year to 25 September 2011	Half year to 26 September 2010
	£m	£m
Group revenue	4,606	4,402
Operating profit including modernisation costs *	67	22
Free cash inflow/(outflow)	309	(52)

* - Operating profit after modernisation costs, before other operating exceptional items

- Our financial performance, including our cash flow, is beginning to improve. We have a great deal to do still to return Royal Mail to sustained financial viability;
- Revenue grew by 5% and costs before modernisation increased by 1%;
- The business unit that provides the core Universal Service to the UK's 29 million addresses remains loss-making. But as a result of tight cost control and price increases introduced last spring, the loss at the half year was £41 million - not as great as the £55 million loss a year ago;
- Were it not for profits from GLS (£58 million) and Post Office Limited (£55 million), the Group overall would have made a loss;
- UK letter volumes fell 6% compared to a year ago. UK packet volumes rose 5% in tough market conditions;
- Modernisation is painful for our people as working practices are changing and there are continuing job losses - over 5,000 people left over the last 12 months, with almost 2,000 of them in Head Office or other managerial roles;
- EU approval for the Government's State Aid application remains vital;
- Our strategy to achieve our goal of a financially sustainable Royal Mail and to attract private capital investment remains the same:
 - Modernise Royal Mail,
 - Respond better to customers' needs and grow our business,
 - Work with Ofcom to secure a new, appropriate regulatory framework.

Moya Greene, Chief Executive Officer of Royal Mail Group, said: "Our financial performance at the Group level in the first half of our financial year, including our cash flow, shows some improvement on the same period a year ago. The necessary measures we implemented earlier in the year - increasing our prices and tight cost control - are a key part of our strategy to return Royal Mail to sustained financial viability. They are beginning to deliver results. But, we have a great deal to do.

"We are half way through our financial year and are operating within a difficult and challenging business environment. The economic downturn is proving to be prolonged and, like many other predominantly UK and European-based companies, our trading conditions are challenging. Our focus therefore remains on returning to sustained financial viability. We will continue to reduce our costs wherever possible without compromising the six-days-a-week service.

"We look forward to working with Ofcom to secure a new regulatory approach as the need to do so is pressing. Furthermore, it will be essential for Royal Mail that the European Commission approves the Government's State Aid application to relieve the Company of its historic pension liability and allow restructuring of the Royal Mail balance sheet".

Royal Mail Group ('the Group') is unique in reaching everyone in the UK through its mails, Post Office and parcels businesses. The Group is a key component of the UK's economic and social infrastructure, providing services to private individuals, companies and communities.

The Group is the sole provider of the UK's Universal Service. Every working day, the business processes and delivers around 59 million items covering almost 29 million UK addresses.

Each year, our European and UK express parcels businesses – General Logistics Systems (GLS) and Parcelforce Worldwide – handle over 400 million parcels. In 11,785 Post Office branches, we serve around 20 million customers every week.

The business is changing fast. The Group is modernising its core letters business to make it more efficient, effective and customer responsive. The Post Office is transforming its branch network in response to changing customer needs and the demands of a modern and dynamic business.

This process of change is about ensuring a sound, secure and sustainable Royal Mail. The mails market is in significant decline in the developed world. Royal Mail is no different. It faces significant financial challenges which are being urgently addressed. The Postal Services Act and Regulatory Reform are an important part of the process.

Financial Performance

Profit of the Group is reported after costs associated with modernising the business. This provides a better understanding of our performance against our strategic aims. Our focus is on Operating profit after modernisation costs, before other operating exceptional items.

Operating profit after modernisation costs before other operating exceptional items of £67m has improved by £45m from £22m at September 2010. This is due to improved performances in all three of the Group's main operating segments, UKLPI, GLS and Post Office Limited. This has more than offset the substantial increase in modernisation costs.

	External revenue		Operating (loss)/profit after modernisation costs	
	September 2011 £m	September 2010 £m	September 2011 £m	September 2010 £m
UK Letters & Parcels and International (UKLPI)	3,414	3,277	(41)	(55)
General Logistics Systems (GLS)	778	707	58	51
Post Office Limited	406	398	55	18
Other businesses	8	20	(5)	8
Group	4,606	4,402	67	22

Financial Review

Profit and loss summary

	September 2011 £m	September 2010 £m
External revenue	4,606	4,402
Operating costs	(4,427)	(4,369)
Modernisation exceptional costs	(133)	(30)
Share of profits in joint ventures and associates	21	19
Operating profit after modernisation costs before other operating exceptional items	67	22
Other operating exceptional costs	(26)	(24)
Non-operating exceptional profits	146	52
Profit before financing and taxation	187	50
Net finance costs and pension interest	(16)	(105)
Taxation credit/(charge)	5	(91)
Profit/(loss) for the financial half year	176	(146)

- Group external revenue increased by £204m, from £4,402m in 2010 to £4,606m in 2011, mainly due to mail price increases, offsetting letter volume declines;
- Modernisation exceptional costs have increased from £30m to £133m mainly due to £58m higher redundancy costs and £23m higher Business Transformation payments;
- Operating profit after modernisation costs before other operating exceptional items of £67m is £45m higher than the £22m last year, mainly due to the increase in revenues, offset in particular by modernisation costs;
- Non-operating exceptional profits of £146m (2010 £52m) mainly comprise profits on the sales of property of £118m (2010 £10m) and the profit on disposal of business of £28m (2010 £42m) mainly Romec Services Limited;
- Net finance and pension interest costs of £16m (2010 £105m) have reduced by £89m mainly due to a £13m notional pension interest credit (2010 £84m charge); and
- The taxation credit of £5m (2010 £91m charge) relates to UK operations, partly offset by a charge on overseas operations. Last year's charge mainly related to the write off of deferred tax assets.

Balance sheet summary

	As at 25 September 2011 £m	As at 27 March 2011 £m
Net assets before pension deficit	1,592	1,394
Pension deficit	(4,647)	(4,501)
Net liabilities	(3,055)	(3,107)

- Net assets before the pension deficit of £1.6bn are £0.2bn higher in the first half year, mainly due to an increase in cash and financial assets due to cash flow generation;
- The accounting pension deficit has increased from £4.5bn to £4.6bn in the first half year; and
- Net debt of £0.7bn (March 2011 £0.9bn) is lower principally due to the positive cash flow described below.

Free cash flow summary

	September 2011 £m	September 2010 £m
EBITDA pre pension costs	533	401
Working capital	163	(88)
Pensions payments*	(236)	(237)
Modernisation investment in UKLPI	(250)	(198)
Other exceptional items	(29)	(11)
Other capital expenditure	(45)	(117)
Other (dividends, tax, interest)	(17)	7
Cash inflow/(outflow) before disposal of assets	119	(243)
Disposal of assets	190	191
Free cash inflow/(outflow)	309	(52)

*Includes pension payments relating to redundancy of £19m (2010 £8m), of which £16m (2010 £7m) relates to modernisation.

A reconciliation of the £304m 'net cash inflow/(outflow) before financing activities' in the Interim consolidated statement of cash flows and the £309m Free cash inflow/(outflow) above is shown on page 12.

- EBITDA pre pension costs of £533m is higher than £401m last year mainly due to the increase in revenues of £204m, offset by an increase in operating costs;
- Working capital inflows of £163m include strong working capital management and timing differences, including a VAT benefit of £40m;
- Modernisation investment in UKLPI mainly comprises £80m (2010 £26m) severance related costs, £28m (2010 £74m) Business Transformation payments and £120m (2010 £94m) capex;
- Other capital expenditure of £45m (2010 £117m) is £72m lower mainly due to £22m lower property, plant and equipment spend, £15m lower IT spend and a £32m movement in capital payables; and
- Disposal of assets of £190m comprises property sales of £161m and the sale of the Group's investment in Romec Services Limited of £29m.

Group Chief Executive Officer's Review

Moya Greene – Chief Executive Officer

Overview

Our financial performance at the Group level in the first half of our financial year, including our cash flow, shows some improvement on the same period a year ago. The necessary measures we implemented earlier in the year – increasing our prices and tight cost control – are a key part of our strategy to return Royal Mail to sustained financial viability. They are beginning to deliver results. But, we have a great deal to do.

The business unit providing our core Universal Service activities continues to be loss-making. Our volumes are declining and we are now handling 6% fewer letters than this time last year. We expect annual declines for the foreseeable future. Our Group margin on sales, after modernisation charges, which has improved somewhat (up from 0.5% to 1.5%) over the last twelve months, remains very modest compared with many other European postal operators.

We are a key part of the UK's economic and social infrastructure providing a comprehensive, six-days-a-week service with overnight delivery. Our industry is in decline with letters now accounting for a very modest share of daily social messaging. Against this difficult backdrop, our strategic priority remains the same – to return the Group to financial viability and attract private capital. The period of maximum change is now as we aim to:

- successfully modernise our operations for a more efficient and effective Royal Mail
- respond better to our customers' needs and deliver growth
- work with Ofcom to secure an appropriate regulatory framework

Our financial performance

The Group delivered an operating profit of £67 million, up from £22 million in 2010. An increase in overall revenues up £204 million to £4,606 million, tight cost control and good contributions from GLS and POL were the main drivers of the modest increase in overall profitability. Losses in the business unit providing our core Universal Service activities reduced from £55 million to £41 million. Our profits were also boosted by one-off property and business disposals of £190 million, the bulk of the proceeds arising from the sale of Rathbone Place, London. We maintained our strong focus on tight cost control. Overall, our net operating costs excluding exceptional costs increased significantly less than the annual rate of inflation at September 2011, 5.6% RPI. We delivered this solid cost performance despite increases in conveyance and distribution costs, including payments to other postal operators and fuel. People costs were lower. The necessary but difficult process of ensuring we are more efficient continues.

We reported a net reduction of over 5,000 in the number of people we employ in the UK over the last twelve

months. Almost 2,000 of the people who left our business in the last twelve months were previously in Head Office or managerial roles.

Improving our free cash flow position is a vital focus for the Group. We are now reporting, for the first time in more than 3 years, a free cash inflow of £309 million compared to a £52 million outflow last year. This improved position can be attributed to the revenue increases and disposals I mentioned earlier and our focus on improving our working capital – though the working capital improvement is unlikely to be sustained in full for the whole year. It is imperative that we continue to improve the Group's cash position.

Our improved free cash flow position does not include any cash payments to fund the historic pension deficit, although the regular pension contribution by the Group was more than £200 million. Royal Mail Group assumes that the Government will relieve the Group of the bulk of its pension deficit, subject to EU State Aid clearance. Were the Government not able to provide the deficit relief, the Group would need to make a pension deficit payment of £307 million by 31 March 2012.

Despite volatile markets the balance sheet pension deficit has seen a relatively small increase from £4,501 million in March 2011 to £4,647 million at the half year.

Business unit performance

The Group is organised into three main businesses: UK Letters & Parcels and International (UKLPI), Post Office Limited (POL) and General Logistics Systems B.V (GLS).

UK Letters & Parcels and International (UKLPI) processes and delivers letters and packets in line with Royal Mail's unique Universal Service Obligation (USO). It is also a leading provider of collection and delivery services for express packages and parcels through Parcelforce Worldwide, providing both businesses and consumers with a range of timed delivery options.

Losses at UKLPI reduced from £55 million twelve months ago to £41 million. The necessary price increases we put in place earlier in the year to offset the impact of volume declines, along with mix changes, generated a net increase in revenues of £137 million. We are now handling around 59 million items a day down from around 80 million in 2005-06. The ongoing decline in letters volumes (down 6%) continued; packet volumes, however, were up 5% as online shopping activity continues to grow at pace.

Group Chief Executive Officer's Review (continued)

We continued our vital programme to modernise Royal Mail. This is one of the largest change programmes of its kind currently underway in the UK. While the programme has made significant progress, it has taken longer to start fully delivering results than we had planned. A great deal more remains to be achieved. Modernisation is about generating cost savings in our core Universal Service activities faster than the decline in volumes we are experiencing. It is also about a more innovative and customer responsive Royal Mail. Fundamentally, it is about putting our core Universal Service activities on a sound, secure and sustainable basis. This is a tough and demanding agenda. It requires painful changes for our people as modernisation involves changes to working practices to improve efficiency.

The deployment of new equipment and technology, along with the upgrading of existing automated sorting machinery, is reducing costs. More than half the mail is now sequenced to the route of the delivery walk. Almost 40,000 hand-held devices to record electronically the safe arrival of mail requiring a signature on delivery have been deployed. Nearly 6,500 new, smaller delivery vans are in use. Four years ago, we had 600 old or obsolete sorting machines while today we have more than 800 new or upgraded machines in operation. However, the toughest part of the drive to reduce costs is in mail delivery. Nearly 300 delivery office revisions to improve efficiency through a computer-enabled redesign of walks and deployment of new delivery equipment, including smaller vans, have now been completed out of nearly 1,400. This programme will continue for the rest of this financial year and 2012-13.

It will also, unfortunately, mean continuing job losses in addition to the 50,000 full time equivalent employees who have left Royal Mail over the last decade or so.

GLS is one of the biggest ground based parcel service providers in Europe today. GLS provides a network coverage of 42 countries through wholly owned and partner companies and is globally connected via contractual agreements.

GLS, our major European ground based parcel service provider, grew its reported revenues – ignoring the impact of currency exchange rate movements of £30m – by £41 million or 6%. GLS delivered growth in virtually every country in which it operates in and parcel volumes increased by 4%. Costs increased due to volume growth and, as in UKLPI, due to increased conveyance and distribution costs. Economic uncertainty in Continental Europe means the outlook in the second half is more challenging.

The Post Office is part of everyday life in communities throughout the UK. Around 20 million customers visit the 11,785 Post Office branches per week.

It provides many different services and products spanning financial services (including savings, mortgages and credit cards), Government services; telephony; foreign currency; travel insurance and mail services.

The Post Office's challenge is similar to that of the Royal Mail: to generate new revenue streams and manage costs tightly as traditional business lines decline. Good progress was made by POL on both fronts. The Post Office's operating profit grew from £18 million to £55 million following an increase in the Network Subsidy and good growth in financial services and identity services, a developing area for POL. The Post Office delivered tight cost control with costs down £19 million from last half year. Within the branch network, by far the largest of its kind in the UK, piloting of the new Post Office trading models is underway to extend opening hours and to enable more sustainable and profitable branches for operators to run in the future.

Outlook

We are half way through our financial year and are operating within a difficult and challenging business environment. The economic downturn is proving to be prolonged and, like many other predominantly UK and European-based companies, our trading conditions are challenging. Our focus therefore remains on returning to sustained financial viability. We will continue to reduce our costs wherever possible without compromising the six-days-a-week service.

At the same time, we continue on our drive to modernise Royal Mail and to identify and deliver profitable new areas of growth.

We also look forward to working with Ofcom to secure a new regulatory approach as the need to do so is pressing. Furthermore, it will be essential for Royal Mail that the European Commission approves the Government's State Aid application to lift the burden from the Company of the historic pension liability and significantly reduce the level of debt on the Royal Mail balance sheet.



Moya Greene – Chief Executive Officer

Interim consolidated income statement

		Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
	Notes			
Continuing operations				
Turnover		4,516	4,327	9,006
Network Subsidy Payment		90	75	150
Revenue		4,606	4,402	9,156
People costs		(2,769)	(2,814)	(5,717)
Distribution and conveyance operating costs		(825)	(764)	(1,619)
Other operating costs		(833)	(791)	(1,602)
Share of post tax profit from associates and joint ventures		21	19	28
Operating profit before exceptional items		200	52	246
Modernisation costs – operating exceptional items	4	(133)	(30)	(207)
ColleagueShare – ‘share’ scheme value		-	-	109
- dividend		-	-	1
Business Transformation		(28)	(5)	(41)
Restructuring costs		(105)	(25)	(264)
Impairments		-	-	(12)
Operating profit after modernisation costs before other operating exceptional items		67	22	39
Other operating exceptional items	4	(26)	(24)	(88)
Operating profit/(loss)		41	(2)	(49)
Profit on disposal of property, plant and equipment	6	118	10	65
Profit on disposal of business		28	42	44
Profit before financing and taxation		187	50	60
Finance costs		(60)	(50)	(114)
Finance income		31	29	69
Net pension interest	8	13	(84)	(167)
Profit/(loss) before taxation		171	(55)	(152)
Taxation credit/(charge)	5	5	(91)	(106)
Profit/(loss) for the period from continuing operations		176	(146)	(258)
Profit/(loss) attributable to:				
Equity holder of the parent company		176	(146)	(259)
Non-controlling interest		-	-	1

Interim consolidated statement of comprehensive income

	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Profit/(loss) for the financial year from continuing operations	176	(146)	(258)
Other comprehensive (expense)/income for the period	(124)	(371)	3,432
Translation differences on foreign currency net investments	(8)	(38)	(11)
Actuarial (losses)/gains on defined benefit schemes	(164)	(344)	3,424
(Losses)/gains on cash flow hedges deferred into equity	(9)	(4)	24
Gains on cash flow hedges released from equity to income	(9)	(4)	(7)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	(2)	(2)	(3)
Gains on financial assets deferred into equity	89	32	20
Gains on financial assets released from equity to income	-	-	(6)
Taxation on assets taken directly to equity	(21)	(11)	(9)
Total comprehensive income/(expense) for the period	52	(517)	3,174
Total comprehensive income/(expense) for the period attributable to:			
Equity holder of the parent company	52	(517)	3,173
Non-controlling interest	-	-	1

Interim consolidated balance sheet

	Notes	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Non-current assets				
Property, plant and equipment		1,809	1,834	1,832
Leasehold land payment		3	4	3
Goodwill		197	189	197
Intangible assets		131	119	126
Investments in joint ventures and associates		123	131	105
Financial assets – pension escrow investment		1,320	1,249	1,161
- investments		-	49	44
- derivatives		3	1	6
Other receivables		8	1	-
Deferred tax assets		4	7	8
		3,598	3,584	3,482
Non-current assets held for sale				
		1	1	4
Current assets				
Inventories		39	37	38
Trade and other receivables		1,058	1,060	1,135
Financial assets – investments		61	4	1
- derivatives		16	12	36
Cash and cash equivalents		1,362	1,148	1,101
		2,536	2,261	2,311
Total assets				
		6,135	5,846	5,797
Current liabilities				
Trade and other payables		(2,059)	(1,808)	(1,961)
Financial liabilities – interest bearing loans and borrowings		(325)	(343)	(375)
- obligations under finance lease and hire purchase contracts		(73)	(60)	(65)
- derivatives		(5)	(12)	(3)
Income tax payable		(10)	(10)	(6)
Provisions	7	(153)	(109)	(181)
		(2,625)	(2,342)	(2,591)
Non-current liabilities				
Financial liabilities – interest bearing loans and borrowings		(1,478)	(1,418)	(1,478)
- obligations under finance lease and hire purchase contracts		(241)	(168)	(193)
- derivatives		(5)	(2)	-
Provisions	7	(124)	(147)	(97)
Retirement benefit obligation	8	(4,647)	(8,473)	(4,501)
Other payables		(60)	(89)	(34)
Deferred tax liabilities		(10)	(5)	(10)
		(6,565)	(10,302)	(6,313)
Total liabilities				
		(9,190)	(12,644)	(8,904)
Net liabilities				
		(3,055)	(6,798)	(3,107)
Equity				
Share capital		-	-	-
Share premium		430	430	430
Retained earnings		(3,791)	(7,458)	(3,803)
Reserves		298	223	258
Equity attributable to equity holder of parent company		(3,063)	(6,805)	(3,115)
Non-controlling interest		8	7	8
Total equity				
		(3,055)	(6,798)	(3,107)

The condensed consolidated Interim financial statements, including accompanying notes, were approved by the Board on 21 November 2011 and were signed on its behalf by:



Moya Greene



Matthew Lester

Interim consolidated statement of changes in equity

	Share premium £m	Retained earnings £m	Financial Assets Reserve £m	Foreign Currency Translation Reserve £m	Hedging Reserve £m	Other Reserves £m	Equity holder of the parent £m	Non-controlling interest £m	Total equity £m
At 29 March 2010	430	(6,968)	55	136	12	47	(6,288)	7	(6,281)
Loss for the period	-	(146)	-	-	-	-	(146)	-	(146)
Other comprehensive (expense)/income for the period	-	(344)	24	(38)	(13)	-	(371)	-	(371)
Translation differences on foreign currency net investments	-	-	-	(38)	-	-	(38)	-	(38)
Actuarial losses on defined benefit schemes	-	(344)	-	-	-	-	(344)	-	(344)
Losses on cash flow hedges deferred into equity	-	-	-	-	(4)	-	(4)	-	(4)
Gains on cash flow hedges released from equity to income	-	-	-	-	(4)	-	(4)	-	(4)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	-	-	-	-	(2)	-	(2)	-	(2)
Gains on financial assets deferred into equity	-	-	32	-	-	-	32	-	32
Taxation on items taken directly to equity	-	-	(8)	-	(3)	-	(11)	-	(11)
Total comprehensive (expense)/income for the period	-	(490)	24	(38)	(13)	-	(517)	-	(517)
At 26 September 2010	430	(7,458)	79	98	(1)	47	(6,805)	7	(6,798)
Loss for the period	-	(113)	-	-	-	-	(113)	1	(112)
Other comprehensive income/(expense) for the period	-	3,768	(15)	27	23	-	3,803	-	3,803
Translation differences on foreign currency net investments	-	-	-	27	-	-	27	-	27
Actuarial gain on defined benefit schemes	-	3,768	-	-	-	-	3,768	-	3,768
Gains on cash flow hedges deferred into equity	-	-	-	-	28	-	28	-	28
Gains on cash flow hedges released from equity to income	-	-	-	-	(3)	-	(3)	-	(3)
Gains on cash flow hedges released from equity to the carrying amount of non-financial assets	-	-	-	-	(1)	-	(1)	-	(1)
Losses on financial assets deferred into equity	-	-	(12)	-	-	-	(12)	-	(12)
Gains on financial assets released from equity to income	-	-	(6)	-	-	-	(6)	-	(6)
Taxation on items taken directly to equity	-	-	3	-	(1)	-	2	-	2
Total comprehensive income/(expense) for the period	-	3,655	(15)	27	23	-	3,690	1	3,691
At 27 March 2011	430	(3,803)	64	125	22	47	(3,115)	8	(3,107)
Profit for the period	-	176	-	-	-	-	176	-	176
Other comprehensive (expense)/income for the period	-	(164)	68	(8)	(20)	-	(124)	-	(124)
Translation differences on foreign currency net investments	-	-	-	(8)	-	-	(8)	-	(8)
Actuarial losses on defined benefit schemes	-	(164)	-	-	-	-	(164)	-	(164)
Losses on cash flow hedges deferred into equity	-	-	-	-	(9)	-	(9)	-	(9)
Gains 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	-	-	-	-	(2)	-	(2)	-	(2)
Gains on financial assets deferred into equity	-	-	89	-	-	-	89	-	89
Taxation on items taken directly to equity	-	-	(21)	-	-	-	(21)	-	(21)
Total comprehensive income/(expense) for the period	-	12	68	(8)	(20)	-	52	-	52
At 25 September 2011	430	(3,791)	132	117	2	47	(3,063)	8	(3,055)

Interim consolidated statement of cash flows

	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Cash flow from operating activities			
Operating profit before exceptional items	200	52	246
Adjustment for:			
Depreciation and amortisation	141	133	286
Share of post tax profits from joint ventures and associates	(21)	(19)	(28)
Working capital and other non-cash movements	209	(90)	(49)
(Increase)/decrease in inventories	(1)	1	-
Decrease in trade and other receivables	76	69	14
Increase/(decrease) in trade and other payables	83	(107)	(44)
Increase in client receivables	-	(5)	(9)
Increase/(decrease) in client payables	45	(43)	1
Net decrease/(increase) in derivative assets	9	(7)	(12)
(Decrease)/increase in non-exceptional provisions	(3)	2	1
Cash paid in respect of retirement benefit obligations in excess of that charged in operating profit	(5)	6	(283)
Cash payments in respect of operating exceptional items	(178)	(124)	(272)
ColleagueShare – 'share' scheme and dividend	(2)	(76)	(77)
Business Transformation payments	(36)	(5)	(25)
Other	(140)	(43)	(170)
Cash inflow/(outflow) operations	346	(42)	(100)
Income tax (paid)/received	(15)	2	(22)
Net cash inflow/(outflow) from operating activities	331	(40)	(122)
Cash flows from investing activities			
Dividends received from associates and joint ventures	3	6	39
Finance income received	31	29	69
Proceeds from sale of property, plant and equipment	161	120	164
Proceeds from disposal of Group business	29	71	73
Purchase of property plant and equipment	(135)	(164)	(292)
Acquisition of businesses	-	(1)	(2)
Purchase of intangible assets	(30)	(45)	(82)
Net (purchase)/sale of financial assets investments (non-current)	(26)	(28)	42
Net purchase of financial asset investments (current)	(60)	(3)	-
Net cash (outflow)/inflow from investing activities	(27)	(15)	11
Net cash inflow/(outflow) before financing activities	304	(55)	(111)
Cash flows from financing activities			
Finance costs paid	(36)	(30)	(60)
Payment of capital element of obligations under finance lease contracts	(28)	(36)	(65)
Cash received on sale and leasebacks	73	103	115
New Loans	-	280	332
Repayment of borrowings	(50)	(43)	(42)
Net cash (outflow)/inflow from financing activities	(41)	274	280
Net increase in cash and cash equivalents	263	219	169
Effect of foreign currency exchange rates on cash and cash equivalents	(2)	(6)	(2)
Cash and cash equivalents at the beginning of the period	1,101	934	934
Cash and cash equivalents at the end of the period	1,362	1,147	1,101

The £1,147m cash and cash equivalents balance at the half year ended 26 September 2010 is net of a £1m overdrawn bank balance relating to the General Logistics Systems (GLS) subsidiary.

Free cash flow in Royal Mail

Free cash flow in Royal Mail is defined as the net increase in cash and cash equivalents less; the increase/decrease in cash held pending payment to POL clients; cash flows from financing activities (except interest paid); and the net cash purchase/sale of financial asset investments (current and non-current).

Free cash flow is not a measure defined under IFRS but is a key indicator used by management to assess performance.

A reconciliation of 'net cash inflow before financing activities' in the Interim consolidated statement of cash flows to Free cash flow is shown below.

	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m
Net cash inflow/(outflow) before financing activities	304	(55)
(Increase)/decrease in cash held pending payment to POL clients	(43)	8
Net purchase of financial asset investments (non-current)	26	28
Net purchase of financial asset investments (current)	60	3
Finance costs paid	(36)	(30)
Effect of foreign currency exchange rates on cash*	(2)	(6)
Free cash flow	309	(52)

*The impact of foreign currency exchange rates are presented as an adjustment to the 'net increase in cash and cash equivalents' in the Interim consolidated statement of cash flows

Notes to the financial statements for the half year ended 25 September 2011

1. Authorisation of financial statements

The condensed consolidated Interim financial statements of the Group for the half year ended 25 September 2011 were authorised for issue by the Board on 21 November 2011 and the balance sheet was signed on the Board's behalf by Moya Greene and Matthew Lester. Royal Mail Holdings plc is a public limited company owned by HM Government, domiciled in the United Kingdom.

2. Accounting policies

Basis of preparation and accounting

The condensed consolidated Interim financial statements for the half year ended 25 September 2011 (2010 half year ended 26 September 2010) do not constitute statutory financial information as defined in section 434 of the Companies Act 2006. The condensed consolidated Interim financial statements are unaudited but have been reviewed by the auditor, Ernst & Young LLP, and their report is set out at the end of this document. The Annual Report for the year ended 27 March 2011 has been filed with the Registrar of Companies. The report of the auditor on those accounts was unqualified, and did not contain any statement under section 498 of the Companies Act 2006. Although not qualified the opinion did include an emphasis of matter in relation to material uncertainties surrounding the going concern assumption.

The condensed consolidated Interim financial statements for the half year ended 25 September 2011 have been prepared in accordance with the Disclosure and Transparency Rules (DTR) of the Financial Services Authority and with IAS34 "Interim Financial Reporting" as adopted by the European Union (EU). These condensed consolidated Interim financial statements should be read in conjunction with the Annual Report for the year ended 27 March 2011 which was prepared in accordance with IFRS as adopted by the EU.

The accounting policies applied in the preparation of the condensed consolidated Interim financial statements are consistent with the Annual Report for the year ended 27 March 2011 except for the adoption of the amended accounting standard and Improvements to IFRSs with effect from 28 March 2011 as noted below:

IAS 24 *Related Party Disclosures (Amendment)*

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.

The May 2010 *Improvements to IFRSs* relating to IFRS 3 *Business Combinations*, IFRS 7 *Financial Instruments: Disclosures*, IAS 27 *Consolidated and Separate Financial Statements* and IAS 34 *Interim Financial Reporting* have also been applied from 28 March 2011.

The changes outlined above are not expected to have a material impact on the financial position or performance of the Group.

Significant accounting judgements, estimates and assumptions

The preparation of the condensed consolidated Interim financial statements requires the Group to make various estimates and assumptions when determining the carrying value of certain assets and liabilities. The significant judgements and estimates applied by the Group in these condensed consolidated Interim financial statements have been applied on a consistent basis with the Annual Report for the year ended 27 March 2011.

Notes to the financial statements continued

2. Accounting policies (continued)

Funding

Material Uncertainty in the Financing of Royal Mail Group excluding Post Office Limited ('RMG')

Background

The postal market in the UK is both open to full competition and in structural decline due to the emergence of alternative digital communication media. Over the past 5 years inland addressed postal volumes have declined by over 20% and are expected to continue to decline by some 5% per annum over the next five years. In addition, the actuarial pension deficit agreed formally with the Pension Trustee in 2010 is some £10bn as at 31 March 2009 for Royal Mail Group excluding Post Office Limited ('RMG') - to be repaid over a 38 year period - and RMG is required to make pension deficit repayments of c.£300m per annum rising to around £410m per annum by 2016.

Balance sheet and cash flow solvency

As at 25 September 2011 RMG is balance sheet insolvent with net liabilities of £2.8bn (27 March 2011 £2.8bn), brought about by the recognition of the pension deficit on the balance sheet in March 2006. The pension deficit currently stands at £4.6bn (27 March 2011 £4.5bn) and has remained broadly consistent with that reported at the year end. The discount rate has remained unchanged from March 2011 at 2.0% pa.

The pension deficit recognised in the RMG financial statements is calculated based on the requirements of IAS 19 and on different assumptions to the actuarial deficit agreed periodically with the Pension Trustee. It is the actuarial deficit that is used to determine the cash payments to repair the deficit.

At 25 September 2011 RMG had £825m of cash headroom (including cash on hand, short term deposits and unutilised loan facilities) available.

There are severe pressures and risks on RMG's cash flow and headroom position, brought about by a number of factors, including:

- recent and forecast declines in inland addressed postal volumes caused by the current economic climate and the emergence of alternative digital communications media causing a material reduction in the proportion of communications carried out using the mail;
- the significant investment required to modernise RMG so as to achieve the cost reductions necessary to keep pace with the reduction in volumes; and
- the costs of meeting RMG's obligations to fund the pension scheme, including both ongoing pension contributions and pension deficit payments.

As a result of this pressure on cash flow and the fact that RMG is balance sheet insolvent, the Board has been carefully monitoring, on a regular basis, whether RMG has sufficient cash flow to meet its liabilities as they fall due over the foreseeable future. This has involved reviews of projected cash headroom until March 2013.

RMG has been taking a number of steps to preserve its financial flexibility, including property disposals, the disposal of its 20% investment in Camelot, the disposal of Romec Services Limited, sales and leasebacks, cost-cutting, supplier initiatives and other measures to reduce expenditure and to release cash. Nevertheless, the Board has concluded that without Government support RMG may not be able to meet its liabilities as they fall due, including future deficit contribution payments and the repayment of £900m Government loan facilities due in March 2014.

Government Policy for Royal Mail

In 2008 the Government commissioned a review of the postal sector - entitled "Modernise or Decline" - and its findings confirmed that the universal service "is part of our economic and social glue" and that it delivers significant economic value to the nation and its citizens. Royal Mail, the letters business of RMG, has been modernising its operations over the last five years and will continue to make further significant investment to reduce its cost base.

The Government made the restructuring and privatisation of RMG one of its first policies:

- The Postal Services Act - which provides a platform for the Government to relieve RMG of the majority of its historical pension deficit, to change the regulatory regime for RMG and allow the introduction of private capital - came into effect in October 2011;
- A formal State Aid application to the European Commission for restructuring aid (relieving RMG of the majority of its pension deficit and restructuring the balance sheet) as required by European Law, was made by the Government in June 2011;
- In July 2011 the European Commission opened an investigation into the Government's State Aid application and confirmed that "The Commission acknowledges the importance of the reform of the postal market in the UK. However, we must ensure that the state measures do not provide undue advantages to Royal Mail as this would distort the conditions of competition among postal operators in the Internal Market". This investigation is currently ongoing; and
- Regulation of postal services was transferred to Ofcom in October 2011 and Ofcom have commenced a consultation entitled "Securing the universal postal service - proposals for the future framework for economic regulation".

Notes to the financial statements

Continued

2. Accounting policies (continued)

Key Assumptions and Material Uncertainties for Going Concern

The RMG strategic plan ('the plan') projects a sustained return to profitability and cash generation as the benefits of modernisation are realised. The plan assumes that core letter volumes will continue to decline by 5% per annum and that a further £1.1bn will be invested into modernising the Royal Mail letters network to improve profitability and cash flow generation in 2011-12 and 2012-13. A key material assumption is that this modernisation programme will be successful in delivering World Class Mail and reducing costs in 2012-13 by £0.6bn in real terms compared to the cost base of 2010-11.

The plan also assumes that Government will relieve RMG of the majority of its pension deficit, restructure the balance sheet, reset covenants from March 2012 onwards and that a more appropriate postal regulatory regime will be introduced.

In forming their view regarding RMG's going concern status, the Directors have identified two material uncertainties that cast significant doubt upon RMG's ability to continue as a going concern:

First, the relief of the majority of the pension deficit and the balance sheet restructure are conditional on the obtaining of State Aid approval from the European Commission.

As highlighted above, the Government submitted a formal State Aid application in July 2011 and the resulting EC investigation is underway.

The Directors cannot be certain that State Aid approval will be given for the full package of measures or that it will be given by March 2012 (when the next pension deficit payment would otherwise be due).

The second material uncertainty is whether Government would provide alternative financing in the event of a delayed or rejected application for restructuring aid on suitable terms as described above.

The Directors believe that the Government would continue to provide adequate financing to RMG. This is based on a number of factors including the prior experience of the Government financing Post Office Limited from 2006-7 onwards.

Going Concern Basis in the Financial Statements

On this basis and after careful consideration of the cash flow and headroom projections the Directors consider it appropriate to prepare the financial statements on a going concern basis, which assumes that RMG will continue in operational existence for the foreseeable future.

Should the State Aid application fail and Government not provide alternative debt financing arrangements to relieve the future pension deficit obligations, the going concern basis could be invalid and adjustments may have to be made to reduce the value of the assets to their realisable amount, to provide for any further liabilities that might arise and to reclassify fixed assets and long-term liabilities as current assets and current liabilities. The financial statements presented for the six months ended 25 September 2011 do not contain any adjustment that may be required if it was concluded that RMG was unable to continue as a going concern.

Post Office Limited Funding

Post Office Limited had net liabilities as at 25 September 2011 but has continued to operate at a profit before exceptional items in the half year.

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 period, Post Office Limited has embarked upon the implementation of a number of programmes set out within its 2011-15 plan which are designed to improve the profitability of the company. 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 modernising the branch office network.

On 24 March 2010 a 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 of £1.15bn to 31 March 2012. These arrangements received State Aid approval on 23 March 2011.

A further funding agreement with Government was announced on 27 October 2010 which provided for:

- funding of £410m for 2012-13;
- funding of £415m for 2013-14;
- funding of £330m for 2014-15; and
- extension of the existing working capital facility of £1.15bn up to 31 March 2016.

All of the funding for 2012-13 to 2014-15 and extension of the working capital facility is subject to State Aid approval.

Notes to the financial statements

Continued

2. Accounting policies (continued)

Although Post Office Limited continues to face challenges, the Directors recognise that significant progress was made in delivering the 2005-11 plan, and that a plan for 2011-15 has been approved which is proceeding satisfactorily. Therefore, after careful consideration, the Directors 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 these financial statements have been prepared on a going concern basis.

Accounting standards issued but not yet 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:

<i>International Accounting Standards (IAS/IFRSs)</i>	<i>Effective date</i>
IAS 1 Financial Statements Presentation (Amendment)	1 July 2012
IAS 19 Employee Benefits (Amendment)	1 January 2013

IAS 1 Financial Statements Presentation (Amendment)

In June 2011, the IASB issued amendments to IAS 1 Financial Statement Presentation, which are intended to improve and align the presentation of items of other comprehensive income (OCI). This is effective for the year ending March 2014 and is not expected to have a significant impact on the Group.

IAS 19 Employee Benefits (Amendment)

In June 2011, the IASB issued amendments to IAS 19 Employee Benefits, which may result in changes to the net pension cost and may require additional disclosures relating to assets. The impact of this amendment on the Group, effective for the year ending March 2014, will be assessed in due course.

Principal risks and uncertainties

The Group uses a business-wide framework for the identification, assessment, treatment, monitoring and reporting of risk. The key risks facing the Group remain around:

- Revenues and costs – reflecting the consequences of continued volume decline;
- Government, regulation and legislation – including the restrictions that the Group faces in relation to its regulatory obligations; and
- Financial – including the funding of the pension deficit and modernisation of the business.

These risks are being actively managed to support the long-term sustainability of the Group.

3. 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. Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit/loss.

There is no aggregation of operating segments.

The operating segments comprise operations in both the UK and other parts of Europe, the latter being the GLS business segment. The UK operations include the remaining two 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 the consolidated financial statements prepared under IFRSs.

Notes to the financial statements

Continued

3. Segment information (continued)

Half year ended 25 September 2011

	UK operations				Other European operations	Total
	UK Letters & Parcels and International	Post Office Limited	Other	Total	General Logistics Systems	
	£m	£m	£m	£m	£m	£m
External revenue	3,414	406	8	3,828	778	4,606
Revenue between segments	12	169	55	236	-	236
Total segment revenue	3,426	575	63	4,064	778	4,842
Operating profit/(loss) before exceptional items	91	56	(5)	142	58	200
Modernisation costs – operating exceptional items	(132)	(1)	-	(133)	-	(133)
Operating (loss)/profit after modernisation costs before other operating exceptional items	(41)	55	(5)	9	58	67
Other operating exceptional items	(14)	(8)	-	(22)	(4)	(26)
Operating (loss)/profit	(55)	47	(5)	(13)	54	41
Profit on disposal of property, plant and equipment	118	-	-	118	-	118
Profit on disposal of business	-	-	28	28	-	28
Profit before financing and taxation	63	47	23	133	54	187

Finance costs of £60m (2010 £50m), finance income of £31m (2010 £29m) and net pension interest credit of £13m (2010 £84m charge) when added to the profit before financing and taxation of £187m (2010 £50m) reconciles to the Group profit before taxation of £171m (2010 £55m loss).

Half year ended 26 September 2010 – Restated for the internal organisation structure change in the second half of 2010-11

	UK operations				Other European operations	Total
	UK Letters & Parcels and International	Post Office Limited	Other	Total	General Logistics Systems	
	£m	£m	£m	£m	£m	£m
External revenue	3,277	398	20	3,695	707	4,402
Revenue between segments	15	164	68	247	-	247
Total segment revenue	3,292	562	88	3,942	707	4,649
Operating (loss)/profit before exceptional items	(27)	20	8	1	51	52
Modernisation costs – operating exceptional items	(28)	(2)	-	(30)	-	(30)
Operating (loss)/profit after modernisation costs before other operating exceptional items	(55)	18	8	(29)	51	22
Other operating exceptional items	-	(24)	-	(24)	-	(24)
Operating (loss)/profit	(55)	(6)	8	(53)	51	(2)
Profit on disposal of property, plant and equipment	7	3	-	10	-	10
Profit on disposal of associate company	-	-	42	42	-	42
(Loss)/profit before financing and taxation	(48)	(3)	50	(1)	51	50

Notes to the financial statements

continued

3. Segment information (continued)

Year ended 27 March 2011 – Restated for the internal organisation structure change in the second half of 2010-11

	UK operations				Other European operations	Total
	UK Letters & Parcels and International	Post Office Limited	Other	Total	General Logistics Systems	
	£m	£m	£m	£m	£m	
External revenue	6,857	776	38	7,671	1,485	9,156
Revenue between segments	28	345	142	515	-	515
Total segment revenue	6,885	1,121	180	8,186	1,485	9,671
Operating profit before exceptional items	72	36	20	128	118	246
Modernisation costs – operating exceptional items	(192)	(15)	-	(207)	-	(207)
Operating (loss)/profit after modernisation costs before other operating exceptional items	(120)	21	20	(79)	118	39
Other operating exceptional items	(48)	(40)	-	(88)	-	(88)
Operating (loss)/profit	(168)	(19)	20	(167)	118	(49)
Profit on disposal of property, plant and equipment	60	5	-	65	-	65
Profit on disposal of associate company	-	-	44	44	-	44
(Loss)/profit before financing and taxation	(108)	(14)	64	(58)	118	60

4. Operating exceptional items

	Half year ended		Year ended 27 March 2011 £m
	25 September 2011 £m	26 September 2010 £m	
Modernisation costs:			
ColleagueShare – ‘share’ scheme and dividend	-	-	110
Business Transformation payments	(28)	(5)	(41)
Restructuring costs	(105)	(25)	(264)
Impairment of property, plant and equipment	-	-	(12)
Total modernisation costs	(133)	(30)	(207)
Other operating exceptional costs:			
Provision for potential industrial claims	-	-	(30)
Impairment of property, plant and equipment and intangible fixed assets	(11)	(24)	(41)
Impairment of investment in associate company	-	-	(2)
Other exceptional items	(15)	-	(15)
Total other operating exceptional costs	(26)	(24)	(88)
Total operating exceptional items	(159)	(54)	(295)

Modernisation costs comprise those amounts which mainly relate to the ongoing modernisation of the Royal Mail Letters network with UKLPI.

The £28m charge (2010 £5m) represents Business Transformation payments that are linked to the achievement of key modernisation milestones as part of the pay and modernisation agreement with the Communication Workers Union.

Restructuring costs of £105m include £83m (2010 £21m) restructuring charge in provisions, consisting of employee related redundancy costs of £74m (2010 £16m) resulting mainly from operational efficiency initiatives in UKLPI and other Group restructuring exceptional charges of £9m (2010 £5m) mainly in respect of onerous property lease obligations. Additional costs charged include £5m (2010 £4m) principally relating to excess travel expenses resulting from the restructure, with the balance of £17m (2010 £nil) incurred to support the Group’s programme of modernisation.

Notes to the financial statements continued

4. Operating exceptional items (continued)

Impairments of £11m (2010 £24m) comprise £2m (2010 £15m) property, plant and equipment and £6m (2010 £9m) intangible assets in Post Office Limited, and £3m (2010 £nil) intangible assets in UKLPI. The carrying values of asset purchases made by Post Office Limited during the half year have been impaired to their recoverable amount, consistent with prior years.

Other exceptional items comprise other costs of £11m (2010 £nil) relating to State Aid and the Postal Services Bill within trade and other payables and £4m (2010 £nil) other exceptional costs included in provisions.

5. Taxation

The overall taxation (credit)/charge in the income statement is calculated by applying the forecast effective tax rates to the reported interim profit after adjusting for exceptional items, and profit after tax on joint ventures and associates.

	Half year ended		Year ended
	25 September 2011 £m	26 September 2010 £m	27 March 2011 £m
Current income tax			
Current UK income tax credit	(27)	(8)	(16)
Foreign tax	17	15	35
Adjustments in respect of current income tax of previous years	-	-	(1)
	(10)	7	18
Deferred income tax			
Relating to origination and reversal of temporary differences	5	84	88
Income tax (credit)/charge reported in the consolidated income statement	(5)	91	106

	Half year ended		Year ended
	25 September 2011 £m	26 September 2010 £m	27 March 2011 £m
Tax charged to equity			
Income tax related to items charged or credited directly to equity:			
Current income tax charge for fair value adjustments on financial assets investments	21	8	5
Deferred income tax charge related to movements in hedging reserve	-	3	4
Income tax charge reported in equity	21	11	9
Total taxation charge			
Current income tax charge	11	15	23
Deferred income tax charge	5	87	92
Total income tax charge reported	16	102	115

6. Property, plant and equipment

During the half year ended 25 September 2011, the Group acquired assets with a cost of £151m (half year ended 26 September 2010 £121m, year ended 27 March 2011 £291m).

Assets with a net book value of £43m were disposed of by the Group during the half year ended 25 September 2011 (half year ended 26 September 2010 £71m, year ended 27 March 2011 £99m). This net book value includes £16m relating to the sale and leaseback of Rathbone Place, a central London property.

Of the £161m proceeds from the disposal of property, plant and equipment, £43m was transferred into pension escrow as part of the release of the mortgage over Rathbone Place (note 10 of the 2010-11 Annual Report and Financial Statements refers).

At 25 September 2011 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £97m (half year ended 26 September 2010 £47m, year ended 27 March 2011 £134m).

Notes to the financial statements

continued

7. Provisions for liabilities and charges

	Restructuring and other exceptional costs £m	ColleagueShare scheme £m	Other £m	Total £m
At 27 March 2011	221	2	55	278
Arising during the year:				
- Charged in operating exceptional items	92	-	-	92
- Charged in other operating costs	-	-	6	6
Unused amounts reversed	(2)	-	(3)	(5)
Utilised in the year	(88)	(2)	(6)	(96)
Discount rate adjustment	2	-	-	2
At 25 September 2011	225	-	52	277
Disclosed as:				
Current at 25 September 2011	118	-	35	153
Non-current at 25 September 2011	107	-	17	124
	225	-	52	277
Current at 26 September 2010	67	-	42	109
Non-current at 26 September 2010	37	106	4	147
	104	106	46	256
Current at 27 March 2011	141	2	38	181
Non-current at 27 March 2011	80	-	17	97
	221	2	55	278

Restructuring and other exceptional costs

The provision for restructuring principally comprises redundancy schemes of £151m (27 March 2011 £159m). A further £74m (27 March 2011 £62m) relates to onerous property and commercial contracts associated with restructuring projects and the costs of potential industrial claims.

ColleagueShare scheme

At March 2011 the ColleagueShare scheme had no value. The £2m which related to this scheme was for people eligible under the scheme rules leaving the business in 2010-11. At September 2011 the scheme still has no value (2010 £106m).

Other

Other provisions of £52m (27 March 2011 £55m) are those recognised principally for the expected liabilities arising from property exits in the normal course of business. These mainly comprise onerous lease obligations and decommissioning costs. Other provision amounts arise from estimated exposures resulting from legal claims.

Notes to the financial statements continued

8. Employee benefits – pensions

Defined Benefit

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 long-term assumptions

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

	At 25 September 2011	At 26 September 2010	At 27 March 2011
	% pa	% pa	% pa
Rate of increase in salaries*	4.1	4.2	4.5
RPI	3.1	3.2	3.5
CPI	2.4	n/a	2.8
Discount rate	5.1	5.1	5.5

*The rate of increase in salaries for 2011-12 and 2012-13 reflects the Business Transformation 2010 and Beyond agreement. From 2013-14 the rate of increase in salaries assumption is RPI + 1%.

The real discount rate has remained unchanged from March 2011 at 2.0%. However, following a change to the construction of the RPI and CPI indices in 2010, it is now expected that there will be a wider gap between RPI inflation and CPI inflation in the future with current expectations being a 1.0% pa gap (0.7% pa at March 2011). If this wider gap between RPI and CPI inflation had been used in the half year key assumptions, the deficit at the half year would have reduced by £0.9bn to £3.6bn. The recent change in expectations has not been taken into account in the calculation of the pension deficit at the half year as this is a new factor where data on future expectations is emerging. Accordingly, the position will be revisited at year end when there is more information as to the volatility in this assumption.

Demographic assumptions, for example mortality, remain unchanged from those made in March 2011.

b) Plans' assets and liabilities

The plans' assets and liabilities were:

	Market value		
	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Fair value of plans' assets	28,129	26,688	27,685
Present value of plans' liabilities	(32,776)	(35,161)	(32,186)
Deficit in schemes	(4,647)	(8,473)	(4,501)

The fair value of plans' assets at September 2011 comprises equities £3.718m (March 2011 £4,268m), bonds £23,036m (March 2011 £21,291m), property £1,551m (March 2011 £1,590m), other assets £279m (March 2011 £418m) and derivative contracts £(455)m (March 2011 £118m). Ninety nine percent of the assets above are held by RMPP.

The RMPP Trustee has elected to use derivatives (such as swaps and futures) to deliver the investment strategy as described below. Derivatives generate an economic exposure value of £19.4bn (March 2011 £17.3bn). This has two effects – firstly to retain the effective economic exposure to equities whilst de-risking the Plan, and secondly to reduce its exposure to movements in interest rates and inflation. The exposure to equity type assets totals £10.8bn (March 2011 £11.7bn). The exposure to bond type assets (liability hedging) totals £35.1bn (March 2011 £31.0bn).

The investment strategy of the RMPP Trustee aims to safeguard the assets of the Plan and to provide, together with contributions, the financial resource from which benefits are paid. Investment is inevitably exposed to risks. The investment risks inherent in the investment markets are partially mitigated by pursuing a widely diversified approach across asset classes and investment managers. The Plan uses derivatives (such as swaps and futures) to reduce risks whilst maintaining expected investment returns. The Plan Trustee recognises that there is a natural conflict between improving the potential for positive return and limiting the potential for poor return. The Trustee has specified objectives for the investment policy that balance these requirements. More details of the RMPP investment strategy, principles and objectives can be found in the RMPP Report and Financial Statements 2010/11 at <http://www.royalmailpensionplan.co.uk/56/plan-report-and-accounts>.

Notes to the financial statements

continued

c) Movement in plans' assets and liabilities

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

	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Opening net retirement benefit deficit	(4,501)	(8,041)	(8,041)
Current service cost	(207)	(230)	(448)
Pay accrual included in pension costs	-	2	-
Curtailement costs	(15)	(9)	(36)
Net financing credit/(charge)	13	(84)	(167)
Employers contributions	227	233	767
Actuarial (losses)/gains (recognised in statement of comprehensive income)	(164)	(344)	3,424
Closing net retirement benefit deficit	(4,647)	(8,473)	(4,501)

Defined Contribution

A charge for the defined contribution schemes of £6m (2010 £5m) was recognised in operating profit before exceptional items within the income statement. The Company contribution to these schemes was £5m (2010 £5m).

9. Financial assets – pension escrow investments

Pension escrow investments have increased at the half year by £159m as a result of an £89m fair value adjustment, £27m interest and a £43m cash transfer replacing the mortgage on the Rathbone Place property sold in the first half of the year.

10. Related party transactions

During the period the Group entered into the following transactions with related parties:

	Half year ended 25 September 2011 £m	Half year ended 26 September 2010 £m	Year ended 27 March 2011 £m
Sales/recharges to:			
- Royal Mail Pension Plan	4	4	9
- Associates	18	24	40
- Joint Ventures	17	22	30
Purchases/recharges from:			
- Associates	20	19	43
- Joint Ventures	83	83	132
Amounts owed from:			
- Associates	19	10	13
- Joint Ventures	6	19	9
Amounts owed to:			
- Associates	8	7	4
- Joint Ventures	4	1	1

The Group has taken advantage of the exemption conferred by IAS 24 *Related Party Disclosures*, whereby transactions between the Group and other HM Government owned entities and with HM Government itself are not disclosed unless they are individually or collectively significant.

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.

Key management compensation

The basis of remuneration of key management personnel remains consistent with that disclosed in the Annual Report and Financial Statements for the year ended 27 March 2011.

11. Events after the balance sheet date

In November 2011 it was announced that the Group is to close its iRed Partnership Ltd business. This may result in the crystallisation of a number of liabilities which are currently being assessed.

Statement of Directors' responsibilities

The Directors confirm that this condensed consolidated Interim financial information has been prepared in accordance with IAS 34 as adopted by the European Union and that the Interim management report gives a true and fair view of the assets and liabilities, financial position and profit of the Group, including:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year, and
- material related-party transactions in the first six months and any material changes in the related party transactions described in the last Annual Report.

The Directors of Royal Mail Holdings plc are listed in the Group's Annual Report and Financial Statements for the year ended 27 March 2011. Since that date Richard Handover retired from the Board on 30 March 2011 and David Smith resigned from the Board on 13 June 2011. A list of current Directors is maintained on the Royal Mail Holdings plc website www.royalmailgroup.com.

By order of the Board



Moya Greene



Matthew Lester

21 November 2011

Independent Review Report to Royal Mail Holdings plc

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the interim report for the six months ended 25 September 2011 which comprises the Interim consolidated income statement, Interim consolidated statement of comprehensive income, Interim consolidated statement of changes in equity, Interim consolidated balance sheet, Interim statement of consolidated cash flows and the related notes 1 to 11. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with guidance contained in International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

Directors' responsibilities

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this interim report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the interim report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim report for the six months ended 25 September 2011 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union.

Emphasis of matter

In forming our opinion, which is not qualified we have also considered the adequacy of the disclosures made in note 2 to the condensed set of financial statements concerning the Company's ability to continue as a going concern. The conditions described in note 2 indicate the existence of material uncertainties which may cast significant doubt about the Company's ability to continue as a going concern. The condensed set of financial statements does not include the adjustments that would result if the Company was unable to continue as a going concern.

Ernst & Young LLP,

London

21 November 2011

Corporate Information

Registered Office and Group Head Office

Royal Mail Holdings plc
100 Victoria Embankment
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Telephone 020 7250 2888
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 accounts.

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.

Auditor

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