



**Royal Mail Group Ltd**

**Regulatory Financial Statements  
2009-10**

**Part 2: Unaudited financial information**

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## **Introduction**

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This is Part 2 of the regulatory financial statements and is supplementary to the audited financial information presented in Part 1.

Whilst the information in this document is not audited, it has been reviewed by the Auditor for consistency with Part 1 of the regulatory financial statements.

## **Regulatory accounting principles and basis of preparation**

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Supplementary information has been included as agreed with Postcomm, and this is detailed below.

### **(i) Costs by pipeline activity**

The analysis in Note 1 details the costs by pipeline area for 2009-10 and 2008-09 by:

- Fully allocated cost (FAC) - the full activity cost including a share of the overhead costs; and
- Long run marginal costs (LRMC) - the element of the FAC that is assessed as being variable with volume over the long run. A separate assessment of this is carried out for each activity within each pipeline area.

The pipeline areas are groupings of activities identified by Royal Mail, which define the operational and non-operational processes from which products attract costs.

### **(ii) Property, plant, vehicles and equipment information by pipeline**

Note 2 shows the property, plant, vehicles and equipment analysis by pipeline segment, which is based on the historic net book values of the property, plant, vehicles and equipment for Royal Mail Group Ltd.

The majority of property assets are no longer included within Royal Mail Group Ltd figures, as they are now owned by a separate company, Royal Mail Estates Limited. The properties are leased at market rates to the business units that deliver the regulatory Services.

Property fit out costs are those incurred in order to bring properties into full operational use and are recorded within the relevant individual operating business units' books.

The attribution of the remaining property, plant, vehicles and equipment across the pipeline areas is based on the costs incurred in operating and maintaining the assets within each pipeline area.

## **Regulatory accounting principles and basis of preparation**

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### **(iii) Property, plant, vehicles and equipment – asset lives**

Property, plant, vehicles and equipment is recognised at cost, including directly attributable costs in bringing the asset into working condition for its intended use.

Depreciation of property, plant, vehicles 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 lives assigned to major categories of property, plant, vehicles, consistent with the Royal Mail Group Ltd statutory accounts, are:

	Range of 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

### **(iv) Supplementary disclosure of specific products**

Postcomm has agreed that certain products may be exempted from the requirements of Condition 7 of the Licence provided that Royal Mail publishes details of their performance in the regulatory financial statements. Accordingly note 3 provides details of International Bulk Mail, Relay, and Special Delivery account.

### **(v) Postcode Address File income statement**

Note 4 sets out a proforma income statement for the Postcode Address File (PAF), the disclosure of which was agreed as part of Postcomm's review into the future management of PAF.

### **(vi) Cash Flow Analysis**

Note 5 sets out a proforma Cash Flow statement for both the USO products and for Royal Mail Letters.

The Royal Mail Letters totals shown in the proforma cash flow statement use the Letters management accounts as a starting point, adjusted to include Group items that relate to the regulated business such as capital work in progress.

Given the shared network nature of Royal Mail's business, it is difficult to attribute cash flows to the individual regulatory services, hence the USO cash flows are estimated only. Known income or charges allocated to the USO in the regulatory income statement (such

## **Regulatory accounting principles and basis of preparation**

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as operating profit and pension charges) are brought directly into the cash flow statement, with other cash flows such as capital expenditure and pension payments estimated based upon apportionment rules. For example pension payments have been allocated to the USO in proportion to the people costs in the income statement.

### **(vii) Performance against the Price Control**

Note 6 sets out a comparison of regulated cash flows in Postcomm's Final Proposals with actual Royal Mail results for the last four years.

## Unaudited notes to the financial statements

### 1. Analysis of Costs by Pipeline

Costs by pipeline	FAC					LRMC				
	Processing £m	Delivery £m	Other operational costs £m	Overheads £m	Total £m	Processing £m	Delivery £m	Other operational costs £m	Overheads £m	Total £m
2009-10										
Bulk	(461)	(1,781)	(455)	(314)	<b>(3,011)</b>	(341)	(1,019)	(177)	(112)	<b>(1,649)</b>
Non-bulk	(1,047)	(1,104)	(687)	(560)	<b>(3,398)</b>	(856)	(657)	(276)	(209)	<b>(1,998)</b>
<b>Total</b>	<b>(1,508)</b>	<b>(2,885)</b>	<b>(1,142)</b>	<b>(874)</b>	<b>(6,409)</b>	<b>(1,197)</b>	<b>(1,676)</b>	<b>(453)</b>	<b>(321)</b>	<b>(3,647)</b>
2008-09										
Bulk	(438)	(1,816)	(450)	(330)	<b>(3,034)</b>	(335)	(1,065)	(174)	(114)	<b>(1,688)</b>
Non-bulk	(1,123)	(1,151)	(727)	(581)	<b>(3,582)</b>	(917)	(697)	(295)	(218)	<b>(2,127)</b>
<b>Total</b>	<b>(1,561)</b>	<b>(2,967)</b>	<b>(1,177)</b>	<b>(911)</b>	<b>(6,616)</b>	<b>(1,252)</b>	<b>(1,762)</b>	<b>(469)</b>	<b>(332)</b>	<b>(3,815)</b>

Bulk products defined as Mailsort, Cleanmail, PPI, Response Services, Presstream, Packetpost, Packetsort, Walksort and Access (i.e. Basket B as per Licence Condition 21, but excluding Special Delivery and including Access.)

Royal Mail operations manage a pipeline of activities, whereby letters are collected from the customer, Post Office or from pillar boxes, processed (sorted), then delivered to the receiving customer. These can be shown as either fully allocated costs (FAC or all inclusive costs), or as long run marginal costs (LRMC).

## Unaudited notes to the financial statements

### 2. Property, Plant, Vehicles and Equipment - information by pipeline

2009-10

	Processing £m	Access, National and Local Distribution £m	Delivery £m	Other £m	Total Mails £m	Non Mails assets £m	Total Royal Mail Group Limited £m
Property	-	-	-	-	-	65	65
Property fit out	150	38	190	4	382	11	393
Vehicles	1	109	73	2	185	27	212
Plant and machinery	360	19	21	1	401	3	404
Fixtures and equipment	30	9	40	1	80	3	83
<b>Total</b>	<b>541</b>	<b>175</b>	<b>324</b>	<b>8</b>	<b>1,048</b>	<b>109</b>	<b>1,157</b>

2008-09

	Processing £m	Access, National and Local Distribution £m	Delivery £m	Other £m	Total Mails £m	Non Mails assets £m	Total Royal Mail Group Limited £m
Property	-	-	-	-	-	60	60
Property fit out	148	35	184	3	370	9	379
Vehicles	1	98	67	1	167	11	178
Plant and machinery	355	20	21	1	397	2	399
Fixtures and equipment	29	9	39	1	78	3	81
<b>Total</b>	<b>533</b>	<b>162</b>	<b>311</b>	<b>6</b>	<b>1,012</b>	<b>85</b>	<b>1,097</b>

Most of the property assets are not included within Royal Mail Group Ltd figures, as they are now owned by a separate company, Royal Mail Estates Limited. The properties are leased at market rates to the business units that deliver the regulatory Services. Property fit out costs are those incurred in order to bring properties into full operational use and are recorded within the relevant individual operating business units' books. The attribution of the remaining property, plant and equipment across the pipeline areas is based on the costs incurred in operating and maintaining the assets within each pipeline area. The 2009-10 property, plant, vehicles and equipment profiles across pipeline areas have been applied to both 2008-09 and 2009-10, and as such the comparative values have been restated.

## Unaudited notes to the financial statements

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### 3. Disclosure of performance of specific products

	2009-10		
	Revenue £m	Fully Allocated Cost £m	Operating Profit/(loss) before exceptional Items £m
International Bulk Mail	138	(155)	(17)
Relay	9	(19)	(10)
Special Delivery Account	120	(76)	44

### 4. Postcode Address File Proforma Income Statement 2009-10

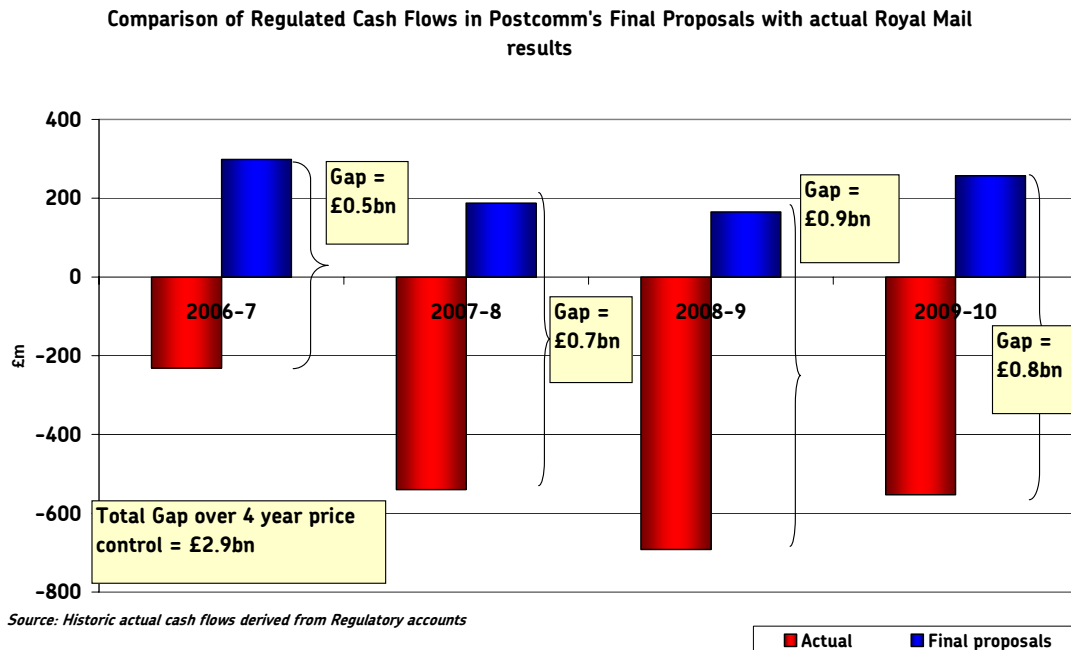
	£m
Revenue	24.9
Operating Costs	(22.3)
Operating Profit	<u>2.6</u>

**5. 2009-10 Proforma Cash Flow Statement**

	USO total £m	Royal Mail Letters total £m
<b>Operating profit before exceptional items</b>	68	121
<b>Add back non-cash costs</b>		
Depreciation, amortisation and impairment	84	211
Pension charge	161	386
Share of profit of Joint Ventures and associates	-	(3)
<b>Operating earnings before non-cash costs</b>	<u>313</u>	<u>715</u>
<b>Less cash outflows</b>		
Purchase of property, plant and equipment	(79)	(245)
Proceeds from disposal of property, plant and equipment	1	3
Purchase of intangibles and Fixed asset investments	(19)	(50)
Pension cash contributions		
Ongoing	(212)	(507)
Deficit	(107)	(258)
<b>Cash outflow from operating and investing activities</b>	<u>(103)</u>	<u>(342)</u>
Exceptional cash flow	(77)	(184)
<b>Cash outflow after exceptional items</b>	<u>(180)</u>	<u>(526)</u>

The changing customer demand side effect of increasing e substitution and product downtrading, coupled with the ongoing costs of business transformation and the historical pension deficit, meant that during 2009-10 the USO generated a cash outflow of £180m.

6. Performance against the Price Control



Postcomm had set a four year price control based on cash. The high level of downtrading, pace of competitor penetration, and market instability was not anticipated in the price control and the analysis above shows that a cumulative cash gap of some £2.9bn has arisen over the four years.