

# Post Office Limited

## Strategic Review – Strategic Transformation Plan

*Summary for DBT/UKGI*





21<sup>st</sup> October 2024



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Exec summary

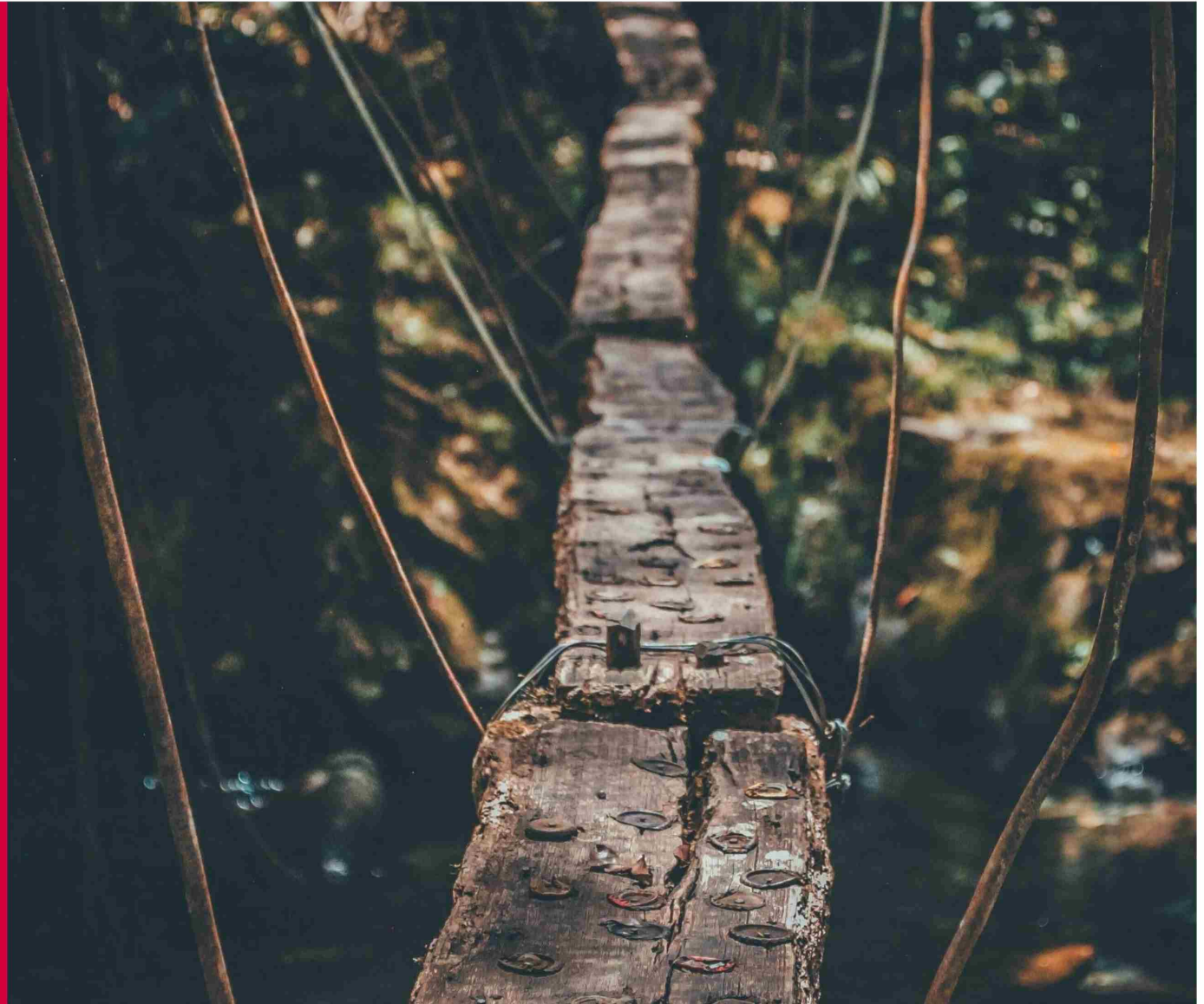
# The Post Office faces multiple headwinds, with an unviable business model and likely requirement of c. £1.8bn of government funding over the next five years to stay in operation

 <p><b>Challenge</b></p>	<ul style="list-style-type: none"> <li>The Post Office faces <b>multiple headwinds</b>, with an <b>unviable business model</b> that <b>depends on significant public funding</b> to cover operating costs and ongoing 'keep the lights on' investment</li> <li>PO's <b>business model is expected to come under increasing pressure</b> given exposure to structurally declining markets, historic underfunding and its high cost base</li> </ul>
 <p><b>Continuation of 'as is' scenario ('counterfactual')</b></p>	<ul style="list-style-type: none"> <li>We forecast a <b>growing trading loss</b> (£[GRO] by end of FY29/30; excl. inflation) and that POL will require additional funding to maintain minimum Security Headroom and cover 'minimum acceptable' investment (above funding to support remediation/inquiry, Horizon replacement and the uncommercial network)</li> <li>We expect an indicative <b>£1.8bn government funding requirement over the next five years</b> to keep PO in operation, without delivering transformational change (outside of Horizon replacement) and with a FY30 go-forward business still heavily reliant on government</li> </ul>
 <p><b>Strategic Plan</b></p>	<ul style="list-style-type: none"> <li>The Plan encompasses an extensive set of initiatives across six core pillars of activity (Proposition, Network, Postmaster/SP relations, Operating Model, Technology/Data, Other considerations)</li> <li>The Strategic Plan will <b>transform Post Office's operations, finances, relationship with PMs and customer experience</b>, delivering a <b>viable business model</b> and proactive steps to counter challenges Post Office is facing, alongside positive steps to address market shifts</li> <li>The Plan is sequenced across three phases, with delivery of a sustainable Post Office largely complete by Year 4</li> </ul>
 <p><b>Plan financials</b></p>	<ul style="list-style-type: none"> <li>Initiatives in the Strategic Plan deliver change across both the top-line (+£112m) and cost elements (-£178m); the net impact enables POL to <b>increase Postmaster remuneration to 65% of total revenue</b>, as well as maintain a positive EBITDA</li> <li>The five-year <b>investment requirement for Strategic Plan initiatives is c.£[GRO]</b> (combining CapEx and Exceptional spend), or c.£[GRO] inclusive of contingency; when combined with other asks of government, the <b>total five-year estimated Government funding requirement</b> (incl. all NBIT contingencies) is £[GRO] (incl. Plan contingencies); £[GRO] <b>less vs. counterfactual</b></li> </ul>

*The Post Office faces multiple headwinds, with an unviable business model set to come under intensifying pressure.*

*This is expected to drive a growing trading loss and material dependency on government subsidy.*

*A high-level counterfactual outlook suggests a £1.8bn investment requirement over the next five years (excl. inflation) to 'keep the lights on'.*





Counterfactual build up

# The Situation Assessment determined that Post Office is at a critical juncture and faces multiple challenges...

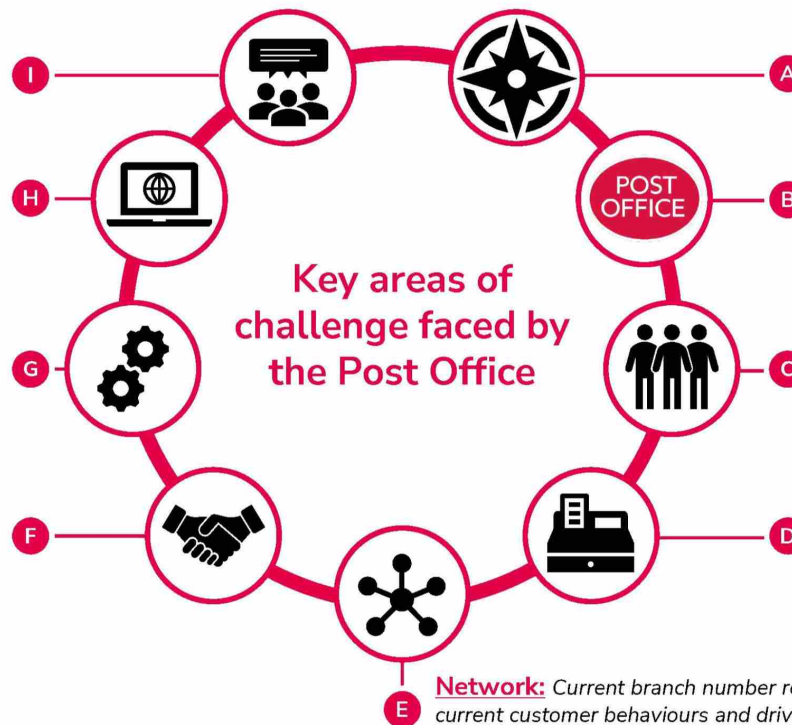
## Summary of key areas of challenges faced by POL

**Shareholder relationship:** Opportunity to reset by providing a strategic plan with transparency around long-term investment required and future financially independent state this would achieve

**Technology strategy:** NBIT involves high risk 'big band' deployment with uncertain but high expected costs; critical juncture to consider alternatives. Limited focus on transformational in-store technology

**Central operations:** Comprehensive review required to simplify the organisation, reduce costs, structure operations and instigate cultural change to foster clear-sighted ambition and better support the Post Office of the future

**Postmasters:** Evident need to reconsider current remuneration model, further professionalise franchisee model and take material steps to redress PO/PM relationships



**Purpose:** Unclear 'purpose' to date has hampered clear direction – critical for PO to develop a strategy that all stakeholders can align on (& opportunity for PO leadership to drive this)

**Brand:** Under pressure from the Horizon IT scandal and Inquiry. Whilst damaging, brand trust has been relatively resilient – nevertheless, vital to work to rebuild trust; good brand awareness but close association with Mails/passports anchor 'right to play'; many customers unaware of PO's diverse product set

**Customers:** Falling retail customer volumes. PO needs to enhance its digital offering to draw customers to branches and better use automation to improve in-branch customer experience

**Commercial portfolio:** Growing headwinds in core Mails/Retail; while BF4 will help to partially offset, this is unlikely to be a long-term solution and there are likely no 'big bang' new products that could be immediately rolled out

**Network:** Current branch number requirements are outdated for current customer behaviours and driving an inefficient network, leading to a significant number of unprofitable branches



Counterfactual build up

## ... with a business model that depends on significant public funding to cover operating costs and ongoing investment

### Historical context

#### Revenue stagnation



- POL revenues have grown at 2% p.a. across the past six years to £911.6m in FY23/24, driven by a c.£70m contraction in Mails, Retail, Government Services & ID services

#### Service mix shift



- Product mix has shifted considerably to greater focus on banking
  - Banking & ATMs are the main contributors to growth, with a revenue increase of c.£140m

#### Falling real PM rem



- Overall Postmaster rem has grown by just 3% p.a. from FY18/19
  - FY23/24, lagging significantly behind inflation
  - Growing Postmaster costs have further driven down their profitability and viability

#### Reliance on gov't



- POL is reliant on government investment for 'keep the lights on' investment and to cover 'one-time' costs associated with Horizon/remediation/Inquiry, with no provision for development

### Outlook



- The market outlook is one of further decline in the short term; casting PO as a financially unsustainable business primarily operating in increasingly less attractive markets
- PO revenue is forecast to decline further, with maintenance of PM rem at its current rate (47% of overall revenue) resulting in a  $\frac{\text{GRO}}{\text{GRO}}$  % reduction in average revenue per branch and a deepening of trading loss across the period to (£GRO)
  - This does not quantify total impact on PMs; inflationary rises in their own costs will likely worsen the picture

PO's business model is expected to come under increasing pressure given exposure to structurally declining markets, historic underfunding and its high cost base

Counterfactual build up

# Our high-level counterfactual outlook suggests a trading loss of £GRO by the end of FY29/30 (excl. inflation)

## Counterfactual forecast financials

### Background context

- High-level counterfactual modelling outlines a 'do nothing' scenario. Key assumptions:
  - INFLATION: All numbers shown excluding inflation and Horizon-related contingency /optimism bias (though the latter is captured 'below the line')
  - REVENUE: Follows historic five-year CAGRs, with adjustments based on PO FY24/25 business plan, PO strategy and wider market trends – **excludes BF4**
  - COSTS: Scaled with revenue/ remained flat depending on cost category (with specific adjustments for some line items)
  - POSTMASTER REM: Fixed at 47% across the period (FY23/24 was 45% and FY24/25 is expected to be 46% of revenue)
  - INTEREST PAYMENT: Rises from £14m to £48m FY25/26 and subsequent years (captured 'below the line')
  - INVESTMENT LOAN REPAYMENT: Rises from £7m to £31m in FY26/27 and then nil (captured 'below the line')
- As outlined on the following pages, this outturn coupled with various funding requirements implies an **ask of Government for £1.8bn over the next five years**:
  - This does not include Banking Framework 4 (which will improve Post Office's revenue situation but is not enough to change the narrative)
  - POL is expected to continue to require 'keep the lights on' funding of at least a similar quantum beyond the plan period

### High-level estimate; excl. inflation & BF4

P&L metrics		FY23/24	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	FY29/30 vs 24/25
Income		£987m	£917m	GRO					
Revenue		£912m	£844m	GRO					
FRES		£25m	£23m	GRO					
Expenditure <sup>1</sup>		(£492m)	(£493m)	GRO					
Network Subsidy		£50m	£50m	GRO					
PM rev. share (incl NSP)	£	£413m	£390m	GRO					
	% of revenue	45%	46%	GRO					
	Avg rev. p/branch	£35k	£33k	GRO					
Trading profit <sup>2</sup>		£32m	(£16m)	GRO					

With a growing trading loss in the coming years, POL will have a greater need for Government funding support (see build-up in next few slides)


Sources: POL input; Teneo research & analysis  
Notes: 1. CoS, OpEx and Merchant Commission; 2. Equals Revenue + FRES – Expenditure – PM revenue share

Counterfactual build up

# In the next five years, POL will require ongoing funding to support the network, remediation and inquiry activities and to replace Horizon

Estimate; based on current known inputs

Estimated known Government funding ask, FY25/26-FY29/30

	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	Total	Rationale
<b>Network Subsidy</b> +	GRO						Amidst rising cost pressures in <b>supporting the uncommercial network</b> , POL continues to require Network Subsidy from the Government
<b>Remediation &amp; Inquiry</b> +	£14m	-	-	-	-	£14m	In addition, <b>DBT is funding remediation and inquiry costs</b> , with the remainder estimated at c.£14m for FY25/26, as public inquiry comes to an end ...
<b>Horizon replacement</b> (excl. contingency & Optimism Bias) 	GRO						... as well as <b>Horizon replacement costs</b> (including NBIT program, activities to maintain Horizon in parallel, and further technology workstreams)
 <b>Known funding requirement</b>	GRO						The total covers losses on the uncommercial network and ongoing Horizon IT and remediation & inquiry costs <i>Excludes live liabilities/risks</i>

The known funding ask amounts to a total of £ GRO over the next five years (excl. Horizon contingency & “optimism bias”)

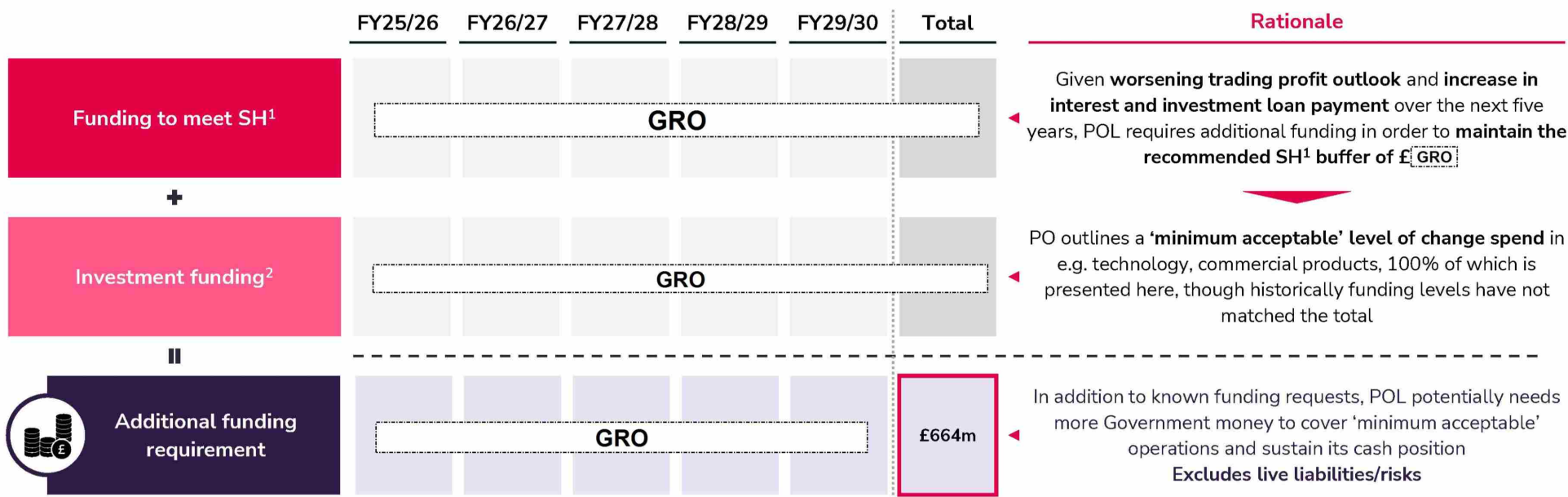


Counterfactual build up

# In addition, POL will need further funding to maintain minimum Security Headroom and to cover 'minimum acceptable' investment

Estimate; based on current known inputs

Estimated incremental Government funding ask, FY25/26-FY29/30



**An incremental funding requirement of £664m is anticipated over FY25/26-FY29/30 to maintain security headroom and support tactical investment**

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Sources: POL input; Teneo research & analysis  
Notes: 1. Security Headroom; 2. Includes 'keep the lights on', 'minimum acceptable' and Teneo contingency as mitigation for diminishing visibility (20% for FY26/27-FY27/28, 30% for FY28/29 and 40% for FY29/30)

Counterfactual build up

# In total, our high-level counterfactual outlook projects a £1.8bn investment requirement over the next five years (excl. inflation)

High-level estimate; excl. inflation & BF4

Estimated total Government funding ask<sup>2</sup>

	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	Change <sup>1</sup>	Total <sup>1</sup>
Network subsidy	GRO						GRO
Funding to meet SH <sup>3</sup>	GRO						
Investment funding <sup>4</sup>	GRO						
Remediation & Inquiry <sup>4</sup>	£14m	-	-	-	-		£14m
Horizon replacement <sup>5</sup>	GRO						GRO
<b>Total funding ask</b>	GRO						<b>GRO</b>
<i>Horizon – DBT Optimism Bias &amp; contingency</i>							GRO
<b>Total ask incl Horizon Optimism Bias &amp; contingency</b>							<b>£1.8bn</b>

This indicative £1.8bn ask over the next five years simply keeps Post Office in operation, without delivering transformational change (outside of Horizon replacement) and with the business in FY30 still heavily reliant on government

Sources: POL input; Teneo research & analysis  
 Notes: 1. FY25/26 -> FY29/30; 2. Excludes live liabilities and risks. Note that the basis of the numbers presented (e.g. timeframe, inflation) is different to those presented in the Situation Assessment report; 3. Security Headroom. Funding number is a function of trading profit; 4. Data from Jun-2024; 5. Data from Sept-24

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*Post Office has developed a Strategic Plan that will ensure Post Office can remain viable, transforming to a new model where POL operates fully as a franchisor, with a lean cost base that supports PMs in delivering high-quality in-branch digital services to their communities*

*The Plan delivers a business fundamentally different in financial health, operational efficiency, digital sophistication and attractiveness (to both PMs and customers) – for a smaller investment quantum vs the Counterfactual*





## Plan overview

# Background and aims

## Context

- The Post Office faces multiple headwinds, including: declining relevance of its commercial proposition; significant breakdown in Postmaster relations; poorer public sentiment and government 'trust' following the Horizon scandal and Inquiry
- A change in POL leadership has brought appetite for transformational change and precipitated a Strategic Review
- Teneo was asked to support POL to consider:
  - How does the Post Office need to change in the (near-term) future, to best serve its customers, Postmasters and other key stakeholders?
  - What is the Plan needed to achieve this?
  - What is the funding requirement required to achieve the Plan?

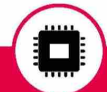
## Strategic Review aims



Significant increase in  
PM remuneration



Streamlined, fit-for-  
purpose central  
organisation



Critically assess  
approach to Horizon  
replacement



Re-evaluate network,  
incl. segmentation &  
formats



Modernise proposition  
and in-store experience

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# Future vision for the Post Office


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Future vision for the Post Office

# The future PO must reflect its core purpose, serving communities with essential services via a physical branch network and digital channels

## Core purpose of the Post Office

 Help citizens manage their daily lives, supporting local communities and businesses to thrive by providing access to essential cash, banking, mails and public services

 Provide access for digitally excluded and vulnerable groups (i.e. those who either cannot, or prefer not to, use online/digital platforms)

 Provide an interface between physical and digital services, particularly where identity and security are critical

## Strategic imperatives

### New Deal for PMs

- Create a sustainable, fair and attractive proposition for Postmasters, that reflects their vital role in delivering Post Office services



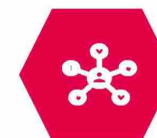
### Lasting financial stability

- Achieve financial independence, enabling the Post Office to be sustainable in the long-term



### Improved community service

- Become a platform of choice for businesses and Government to serve and support local communities

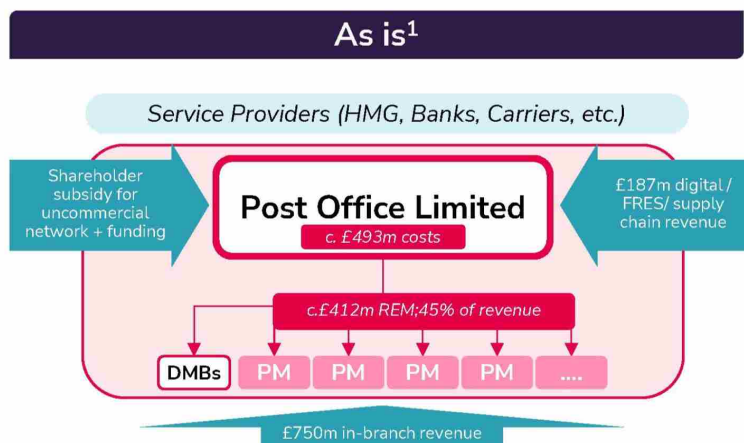


The Strategic Plan will ensure Post Office can (i) remain viable and (ii) fulfil its purpose and the key outlined strategic imperatives; 'mission and values' will be subject to further iteration in the early stages of Plan enactment



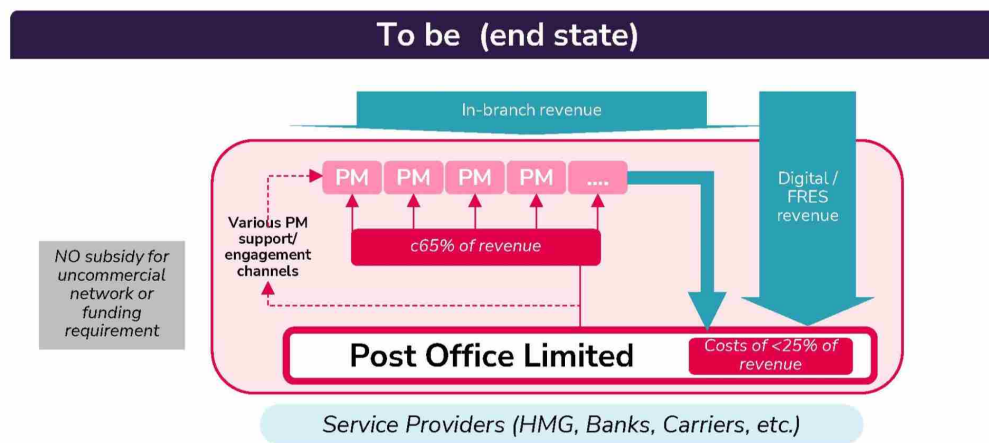
Future vision for the Post Office

# The Post Office is a broad 'system' of customer-facing Post Office branches, the Postmasters who run them and the central POL organisation



**POL's role**

- Characterised by **unclear and blurred responsibilities**, at times leading to uncommercial decisions
- Directly manages Post Office branches as well as via Postmasters
- Treats **PM remuneration as a cost item**
- Limited incentive to **control central costs**

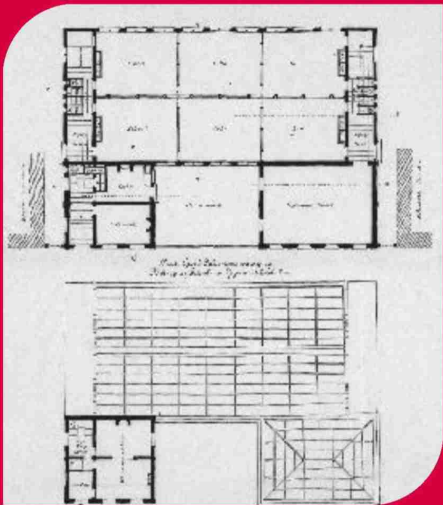


**POL's role**

- **Enabling the network of expert Postmasters** serving their local communities and compensating them appropriately
- **Franchisor** providing a range of vital services (e.g. brand, commercial partnerships, propositions, marketing, central administrative services, tech/systems, training, stakeholder engagement, etc.)
- **Providing digital services** that drive margin, bolster brand, and/or enable omni-channel services

**The proposed Strategic Plan will transform Post Office to a new model where POL operates fully as a franchisor, with a lean cost base that supports Postmasters in delivering high-quality in-branch and digital services to their communities**

Sources: POL input; Teneo research & analysis  
Notes: 1. # Represent FY23/24



# Strategic plan

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Strategic plan

# The plan encompasses an extensive series of initiatives across six core pillars of activity...

Proposition	Network	Postmaster/SP relations	Operating Model	Technology & Data	Other considerations
<ul style="list-style-type: none"> <li>Capitalise on the Banking opportunity (both PO-delivered banking services and Banking Hubs)</li> <li>Range of new product/service propositions</li> <li>Increase marketing spend to drive awareness/consideration</li> <li>Development of enhanced digital/omni-channel customer proposition</li> </ul>	<ul style="list-style-type: none"> <li>'no regrets' right-sizing of network</li> </ul> <div style="border: 1px dashed black; padding: 5px; text-align: center; font-size: 2em; font-weight: bold;">GRO</div> <ul style="list-style-type: none"> <li>Deploy segmented branch strategy by format and ongoing footprint management approach</li> <li>Material increase in Banking Hubs to c.500 by end FY29/30</li> </ul>	<ul style="list-style-type: none"> <li>Material increase in 'revenue share' and a structural embedding of this within these arrangements</li> <li>Whole 'lifecycle' enhanced package of engagement, support and agency</li> <li>Performance support &amp; incentives</li> <li>Strategic partner strategy</li> </ul>	<ul style="list-style-type: none"> <li>Streamline POL via 'zero-based' principles and org. design best practice ('no regrets'), including creation of new centres of excellence</li> <li>Plan enablers: culture-change programme; capability/ talent-build programme</li> </ul> <div style="border: 1px dashed black; padding: 5px; text-align: center; font-size: 1.5em; font-weight: bold;">GRO</div> <ul style="list-style-type: none"> <li>ESG strategy</li> </ul>	<ul style="list-style-type: none"> <li>'no regrets' pursuit of alternative, lower-cost and lower-risk Horizon replacement programme</li> <li>Segmented in-branch technology and automation strategy</li> <li>Core systems refresh</li> <li>Management information enhancement</li> <li>Customer data platform development</li> </ul>	<ul style="list-style-type: none"> <li>Brand rebuild programme</li> <li>Master brand architecture re-launch</li> <li>Stakeholder &amp; shareholder engagement programme</li> <li>Financing and investment</li> <li>Wind-down of Inquiry/related programmes</li> </ul>

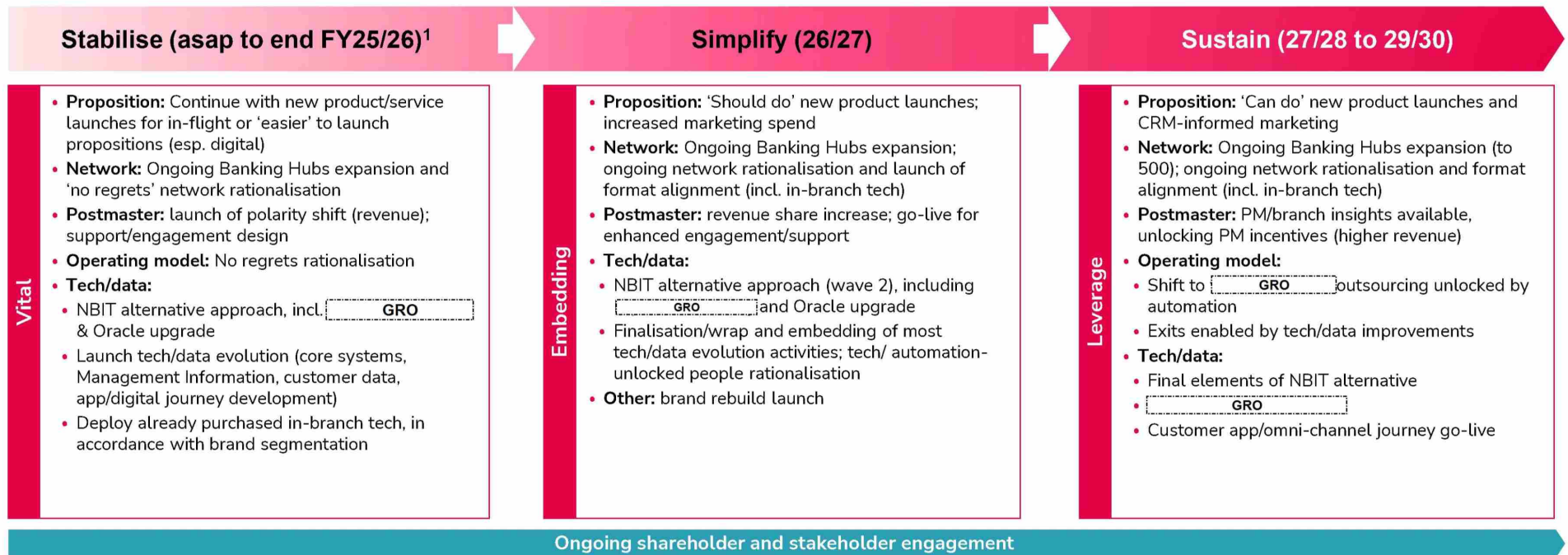
Clear Strategic Plan vision relating to:





## Strategic plan

# The Plan is sequenced across three phases, with the delivery of a sustainable Post Office largely complete by Year 4

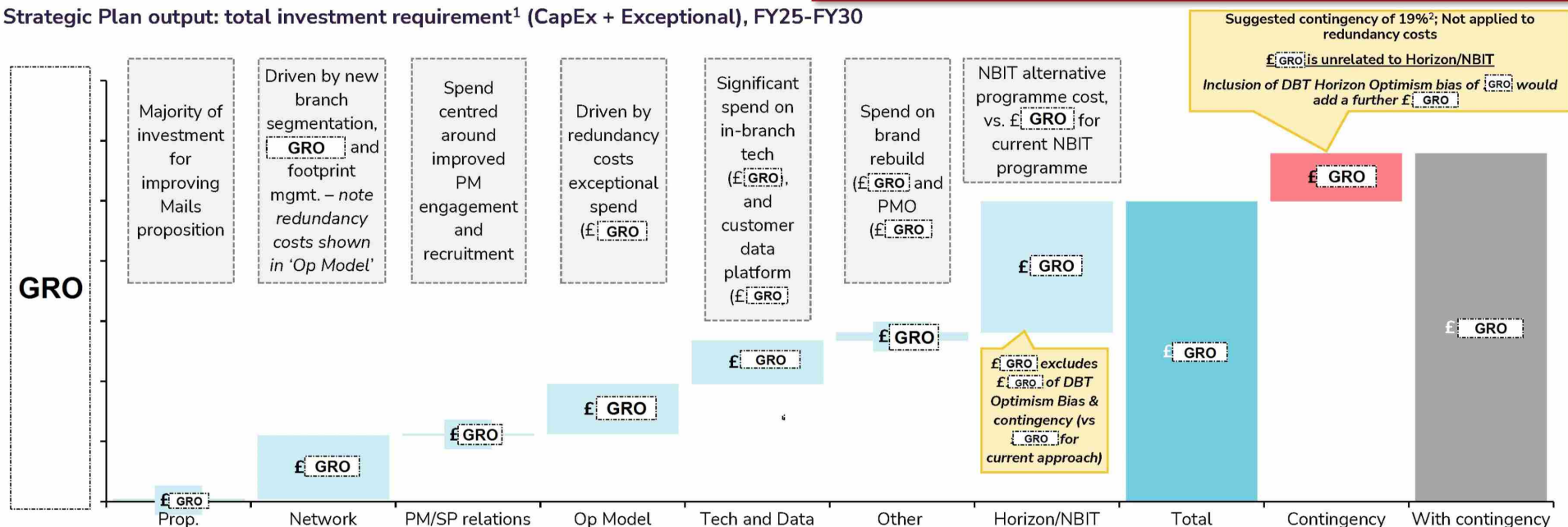


Strategic plan

# The five-year investment requirement for Strategic Plan initiatives is c.£ GRO (combining CapEx and Exceptional spend), or c.£ GRO inclusive of contingency

Forecast represents best estimates from available data; excludes inflation

Strategic Plan output: total investment requirement<sup>1</sup> (CapEx + Exceptional), FY25-FY30



Spend on the Horizon/NBIT programme constitutes c.43% of the total five-year Strategic Plan investment requirement

Sources: POL input; Teneo research & analysis

Notes: 1. Excludes existing change spend items for FY25/26 which overlap with Strategic Plan initiatives (see later slide for holistic view); 2. Excludes Horizon/NBIT optimism bias (but includes contingency). Contingency not applied to redundancy costs given these represent 'worst case' scenario already; 3. Figure does not include optimism bias or contingency, includes removal of £ GRO SPM Indexation Adjustment

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Strategic plan

Est. funding requirement (incl. all NBIT contingencies) is £ **GRO** (incl. Plan contingencies); £ **GRO** less vs. counterfactual

Estimate; excludes inflation

PO metrics	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	Change <sup>1</sup>	Total <sup>1</sup>
Revenue	<b>GRO</b>							
Cost excl. merchant comm.								
PM rev. incl. NSP								
% of total rev.								
Total (£)								
Avg. rev. p/branch								
Trading profit								<b>GRO</b>
<b>Estimated total Government funding ask<sup>2</sup></b>								
Network subsidy								£ <b>GRO</b>
Funding to meet SH	-	-	-	-	-	-	-	-
Investment funding <sup>3</sup>								£ <b>GRO</b>
Remediation & Inquiry	£ <b>GRO</b>	£14m	-	-	-	-	-	£14m
Horizon replacement	£ <b>GRO</b>							£ <b>GRO</b>
Strategic Plan (excl NBIT)	-							£562m
<b>Total funding req.</b>	£ <b>GRO</b>							<b>GRO</b>
NBIT alternative - DBT Optimism Bias & contingency								
<b>Total ask incl Horizon Optimism Bias &amp; contingency</b>								<b>GRO</b>
Overall Strategic Plan contingencies (incl. revenue/costs/investment)								
<b>Total ask incl Strategic Plan contingency</b>								<b>GRO</b>

Commentary on delta vs counterfactual

- The initiatives in the Strategic Plan deliver change across both the top-line (+£112m) and cost elements (-£178m)
- The net impact enables POL to increase Postmaster remuneration to 65% of total revenue, as well as maintain a positive EBITDA
- The total five-year estimated Government funding ask post NBIT optimism bias and overall contingency is c. **GRO** vs. the counterfactual).

£ **GRO** smaller ask inclusive of Plan

£ **GRO** smaller ask inclusive of Plan contingency

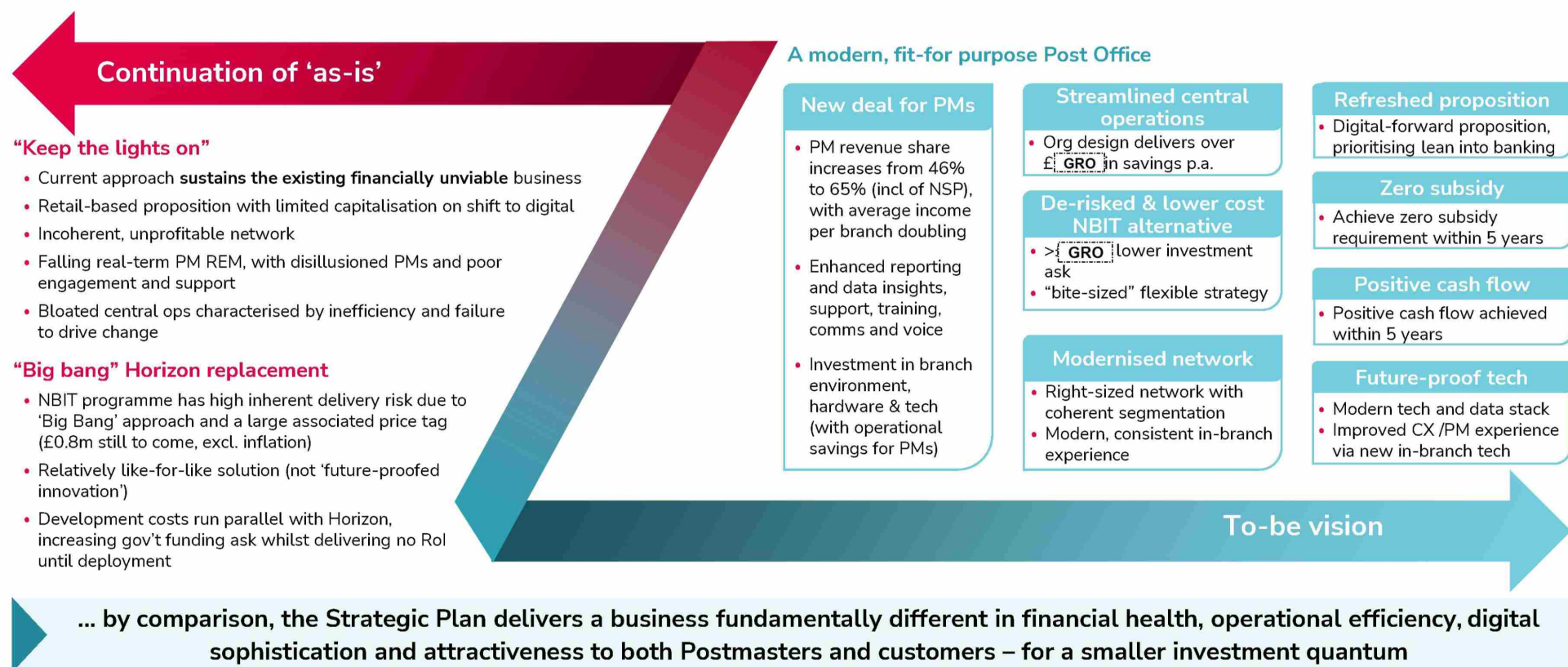
The incremental estimated funding ask represents a saving (vs counterfactual) and delivers transformational change that puts the business on a more viable footing (incl. significant enhancements to the P&L of the business and share of revenue available to PMs)

Sources: POL input; Teneo research & analysis  
Notes: 1. FY25/26 -> FY29/30; 2. Core methodology as described in counterfactual version; 3. Investment funding lower than counterfactual due to removal of items covered by Strategic Plan investment



Strategic plan

# The counterfactual scenario, whilst delivering a 'replacement' for Horizon, requires significant ongoing subsidy to sustain the network ...





*The Plan requires £562m of new investment, offset by other investment 'savings' (vs Counterfactual) enabled by the Plan*

*The funding requirement (incl. all NBIT contingencies) is £ GRO £ GRO (incl. Plan contingencies); this is £ GRO less vs. counterfactual*

*Government enablement and funding is vital to Plan success*

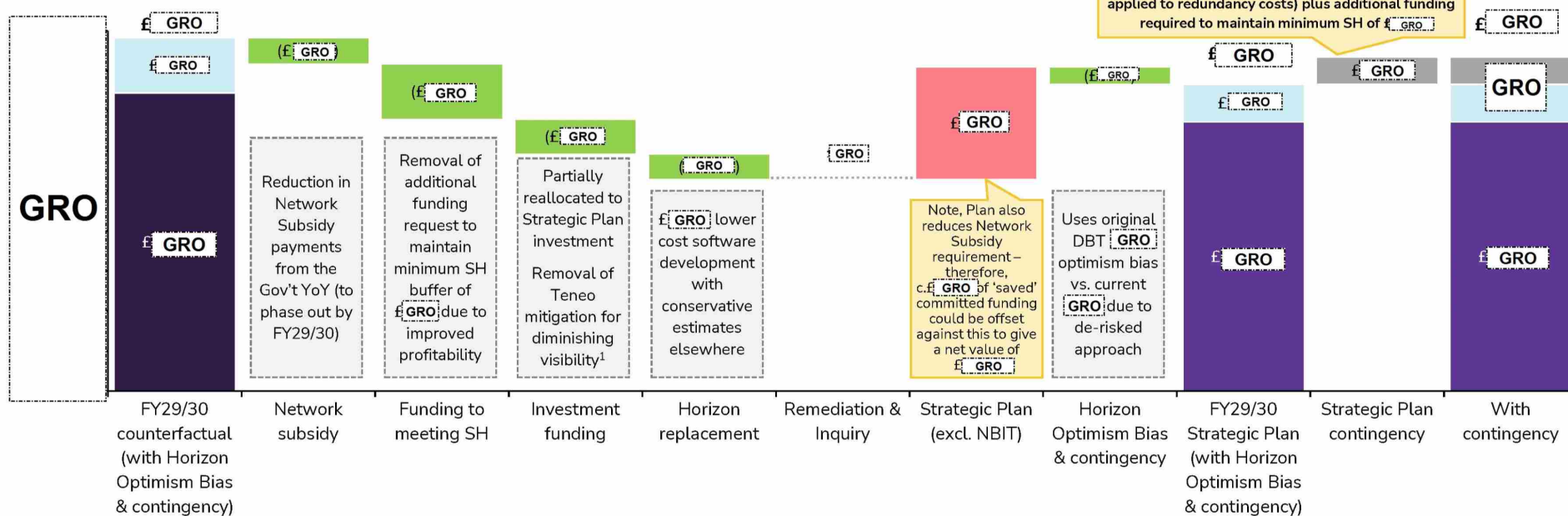


Strategic plan

# Plan requires £562m of new investment, which represents c. £GRO of investment 'savings' vs Counterfactual (net of contingencies)



Strategic Plan output: incremental government funding ask impact, FY25-FY30

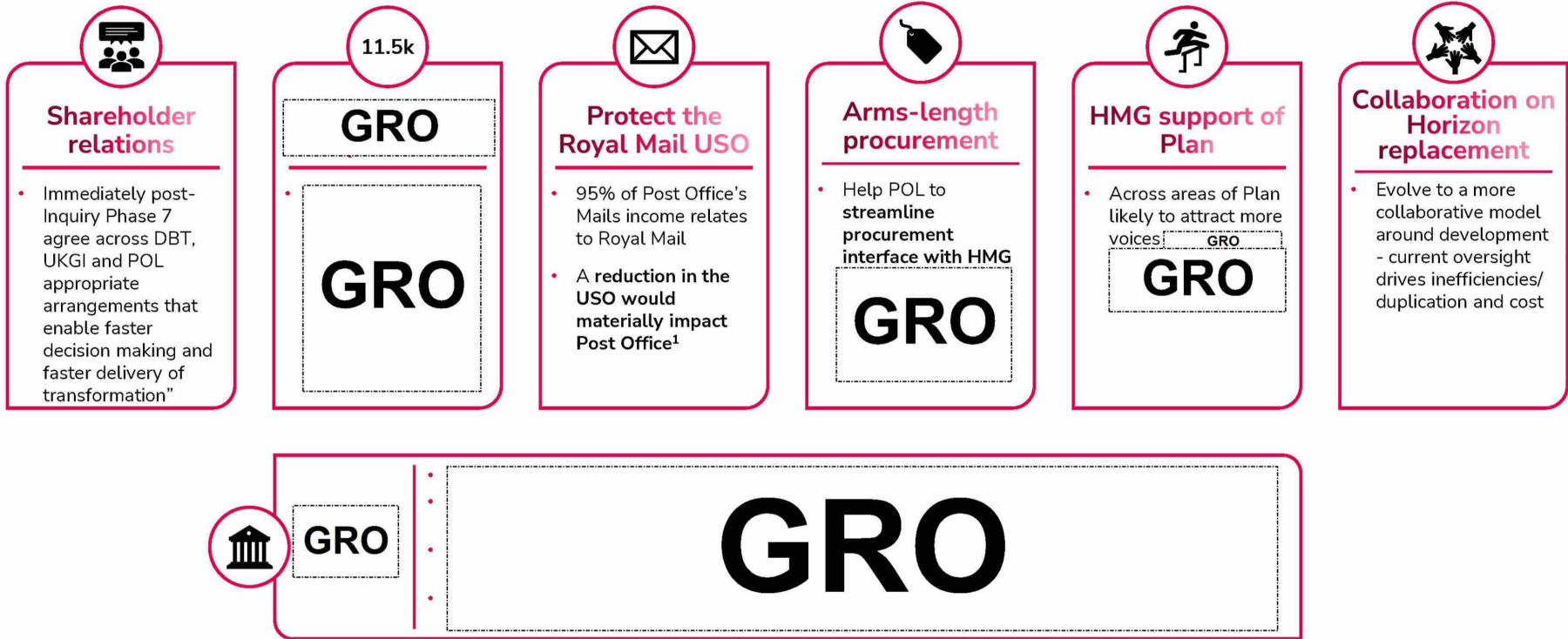


The investment 'savings' outlined are enabled by the Strategic Plan, with the similar overall requirement delivering a manifestly different outcome ('sustainment of an unviable as is' vs 'transformational change for Postmasters, customers and Government')

Sources: POL input; Teneo research & analysis  
Notes: 1. Included in change spend assumptions for counterfactual

Plan funding

# Successful delivery of the Plan will require significant support from and a further set of 'enablement' asks of government



Notes:

GRO Sources: POL input; Teneo research & analysis

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## Plan funding

## There are further longer-term considerations outside the core focus of the Plan that will need to be revisited



### Ownership model

- The Strategic Review actively took the view that questions of ownership would be best explored after remedial work to safeguard the future of the Post Office
  - Given Post Office's financial outlook, as per the Counterfactual, and scale of investment required
- We note material interest from Postmasters in a mutualisation/similar model
- Once the Plan has been substantively 'achieved' it would be appropriate to explore this further (post Y3)



### Further commercial initiatives

- During the Strategic Planning exercise, several commercial initiatives were considered but, ultimately, de-prioritised due to bandwidth during the Plan period
- Key 'tier two' initiatives include:

**GRO**



### Longer-term evolution

- The Strategic Review provides a 5-year plan to Stabilise, Simplify and Sustain Post Office
- The Plan does not actively consider longer-term evolution that may be required to continue to evolve the Post Office to meet shifting market demand or partner requirements

**GRO**

These questions should be revisited as the core plan progresses



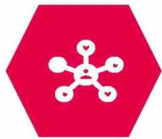
*Plan summary*



Strategic plan

# Various strands of the Plan come together to deliver against the three underpinning strategic imperatives

## Strategic imperatives



### Improved community service

- Become a platform of choice for businesses and Government to serve and support local communities



### Lasting financial stability

- Achieve financial independence, enabling the Post Office to be sustainable in the long-term



### New Deal for PMs

- Create a sustainable, fair and attractive proposition for Postmasters, that reflects their vital role in delivering Post Office services

## How the Plan delivers against these

- Compelling products/service, incl. more comprehensive **GRO**
- New App and omni-channel propositions and digitally enabled customer journeys
- Enhanced online and in-store experience
- Brand repair to restore trust in PO and better awareness of its range of valuable services

- Positive EBITDA position
- NSP switched off
- Programme of transformation investment that will overhaul PO and negate long-term reliance on Government funding

- Material increase in 'revenue share' (+ c.40% increase in revenue share and a doubling of average branch revenue)
- Whole 'lifecycle' enhanced package of engagement, support and agency
- Performance support & incentives
- Strategic Partner strategy
- Fit-for-purpose central franchise organisation providing cost effective value

**The Plan aligns well with Labour's policy ambitions relating to Post Office (strengthen PO), safeguarding provision of vital banking services, refocusing historical Government overspending, and reinvigorating UK high streets**