



Shareholder Executive Annual Review 2010-11

Chief Executive's Report for 2011

This year has again seen the Shareholder Executive play a significant role in helping Government be an effective and value-orientated shareholder in a broad range of state owned or part-owned businesses. Against a changing political and economic environment, we have continued to focus on improving the performance of public sector owned businesses in often complex situations. We have provided a wide range of corporate finance advice to Government, including a number of financial interventions in UK businesses, and supported the Public Expenditure Committee (Assets), the key ministerial forum for taking forward asset realisations.

This report follows the concise format introduced last year. In the Portfolio Analysis Report we review performance across our portfolio of businesses. This represents published data which is accessible from the respective businesses website, where further performance information can be found if desired.

Achievements

Looking back over the year there have again been a number of significant milestones achieved in challenging times. Some of the highlights include:

- Sale of the Tote – the disposal of the Tote to Betfred for £265m was completed in July 2011. The sale came less than a year after the Chancellor announced the Government's intention to resolve the future of the Tote, and followed numerous failed attempts to do so in the past. The transaction was achieved in line with the Government's declared objectives of recognising the support the Tote provided to the racing industry whilst also securing value to the taxpayer. The Shareholder Executive led the sale process on behalf of the Department for Culture, Media and Sport.
- Postal Services Act 2011 – the Postal Services Act received Royal Assent in June 2011 and allows the Government to implement the recommendations of the independent Hooper Review of the postal sector, including introducing private capital into Royal Mail in order to secure the

future of the company and the sustainability of the Universal Service Obligation – the delivery of letters and parcels to all 29m addresses in the UK, six days a week, at uniform one-price-goes-anywhere tariff. The Act also enables Government to relieve Royal Mail of its historic and crippling pension deficit (subject to EU state aid approval), makes fundamental changes to the regulatory framework for the postal market and maintains the Post Office in public ownership while allowing it to move to a mutual ownership model in the future. The Shareholder Executive led the process of taking the Postal Services Bill through Parliament as part of its role managing the Royal Mail shareholding.

- Financing the Post Office – in late 2010 we finalised a Government financing package of £1.3bn for the Post Office covering the four year Spending Review period, the culmination of intensive work to establish a coherent and sustainable vision for the network. This package includes a significant element of investment which will, amongst other things, establish the Post Office as the “front office of government” allowing it to play a pivotal part in the transformation of government services, and guarantees for its duration a minimum network of 11,500 outlets, representing more branches than all of the high street banks combined.
- Establishing a new Public Data Group – the Shareholder Executive is playing a leading role in shaping the proposals to develop a new grouping of data-rich government bodies, provisionally named the Public Data Group, which will bring together and coordinate their services more effectively to increase the amount of freely available government information. A key step towards the achievement of this objective was facilitating the transfer of HM Land Registry, the Met Office and Ordnance Survey to the Department for Business, Innovation and Skills (BIS). We have also launched a consultation on data issues which will enable Government to develop an appropriate policy framework before decisions on the structure of a Public Data Group are taken later in the year.
- Releasing public spectrum – the Government has announced that 500 MHz of spectrum currently used by the public sector will be released to the commercial sector by 2020. The Shareholder Executive has been central in leading the cross-government project team. In March 2011 we published a high level plan setting out Government’s approach to achieving this target along with a public consultation. We expect the first substantial release of spectrum in 2013.



- Corporate Finance Practice – the Shareholder Executive has advised BIS on a wide range of issues in the aerospace, automotive and defence industries this year including financial support for UK helicopter production, research and development and Jaguar Land Rover’s new UK engine plant. We have also advised BIS on its aerospace launch investment portfolio and the potential monetisation of its student loan book. Other projects included working with the Department of Health on Southern Cross and HM Treasury on Partnerships UK.
- Government property management – the Government Property Unit (GPU) developed an innovative strategy to deliver substantial savings across the Government’s estate. In the first year of Government new controls on property acquisitions and lease renewals reduced estate costs by over £90m. Other gains have been achieved by consolidating the Government’s office estate through exiting leasehold offices that are non-core as quickly as possible, moving staff into core buildings, consolidating facilities management contracts, as well as improving density, efficiency and flexibility of the retained estate.

Shareholder Executive team

Having incubated GPU in the Shareholder Executive for a year, GPU transferred to the Cabinet Office in June 2011. This move reflects strong links between management of the Government property estate and the Cabinet Office’s wider work on Civil Service efficiency and reform, and we look forward to continuing to work with them as they move into developing property structures and transactions.

Otherwise the composition of the Shareholder Executive team has remained stable with a core staff of 60, broadly split between civil servants and private sector corporate finance specialists, most of whom are on short fixed term contracts.

Outlook

The coming months will be no less challenging than those that have gone before but there continues to be a number of opportunities where the Shareholder Executive can support Government in maximising value and protecting the taxpayer in the long term.

For example, taking forward the developments from the Postal Services Act 2011 will be an important stage for preparing the Royal Mail for sale and



putting the Post Office into a sustainable position. With the Royal Mail the focus for the Shareholder Executive will be on securing state aid approval from the EU for the proposed pension and balance sheet restructuring, and delivering proposals to transfer the Royal Mail pension's historic liabilities to government. On the Post Office side we will be working on securing state aid approval from the EU for the £1.3bn funding package and reviewing whether the Post Office could mutualise once it has separated from Royal Mail. Part of this work has started with a public consultation, launched in September 2011, on what a future Post Office mutual might look like.

Developing the structure around public data assets and how it supports the Government's growth agenda will be another key focus in the coming year. Giving better access to valuable government data to business and members of the public will provide more opportunities to develop innovative products and services, delivering benefits for the wider economy. The challenge is to provide a more consistent approach towards accessing public sector information, and balancing the desire for more free data whilst ensuring affordability and value for taxpayers.

As economic conditions remain difficult we expect the demand for corporate finance advice across Whitehall to increase. The Shareholder Executive will continue to advise Government where large companies are in distress. We will also be working with the Efficiency and Reform Group in the Cabinet Office on a variety of projects including the sharing of back office services across government and the development of new ownership models such as the proposed mutualisation programme.

Another new and positive development under way is the creation of a Government Corporate Finance Profession. This body will aim to promote the more effective use of corporate finance resource across Government departments through improved networking, prioritisation, training and best practice sharing events. It will be led from the Shareholder Executive and I look forward to developing this new community of professionals in the coming year.

The Shareholder Executive is continuing to share knowledge and best practice with foreign governments as they set up similar organisations to manage state owned assets. I am keen that the Shareholder Executive continues to extend its international reach and for it to be recognised as a centre of expertise in good shareholder governance across the international community.



This has been a very full and active year. None of this would be possible without the dedication and professionalism of the Shareholder Executive team. I would like to take the opportunity to thank the team for their commitment, expertise and flexibility. I particularly wish to thank Philip Remnant, whose last full year this is, for his invaluable contribution to the organisation over the last four years as Chairman. We also look forward to welcoming Patrick O'Sullivan who will be taking over the Chairman role early next year.

Stephen Lovegrove
Chief Executive

30 September 2011



Portfolio Analysis Report for 2011

This report sets out an analysis of the combined results of the 20 businesses within the Shareholder Executive's portfolio for the year ended 31 March 2011. Given the wide diversity of businesses, and the degree to which the Royal Mail influences the portfolio (78% of portfolio turnover and 36% of operating profit), some caution should be taken when comparing results from previous years.

Performance is actively reviewed across the Shareholder Executive portfolio through a formal annual Investment Review cycle as well as ongoing day-to-day monitoring. For each business we monitor against a set of bespoke performance targets and an agreed dividend policy. We update valuations for the portfolio at least every two years.

Scope of reporting and methodology

The scope of the report covers 20 businesses in the Shareholder Executive portfolio after the removal of three businesses included in last year's analysis; Defence Support Group, Defence Science and Technology Laboratory, and Scottish Water have been taken out of the portfolio as our role has transitioned to a purely corporate finance remit.

Although within the scope of the portfolio, we have not included: Working Links as the company has changed its year end and has yet to publish final accounts; and BNFL as the company no longer has ongoing operating functions and is in the final stages of being wound down.

To improve the clarity and transparency of the report, we have changed the way we have presented the results for 2011 and restated 2010 using the same methodology. We have fully consolidated businesses where Government has a controlling interest (in previous reports we fully consolidated all the portfolio businesses irrespective of the percentage of Government ownership) and proportionally consolidated the results where Government holds a non-controlling interest (namely 40% stake in Actis, 49% stake in NATS and 33% stake in Urenco). Taking only a share of the revenues, profits, dividends and asset base for non-controlling stakes reflects the degree to which Government can benefit from changes in the performance of these businesses.



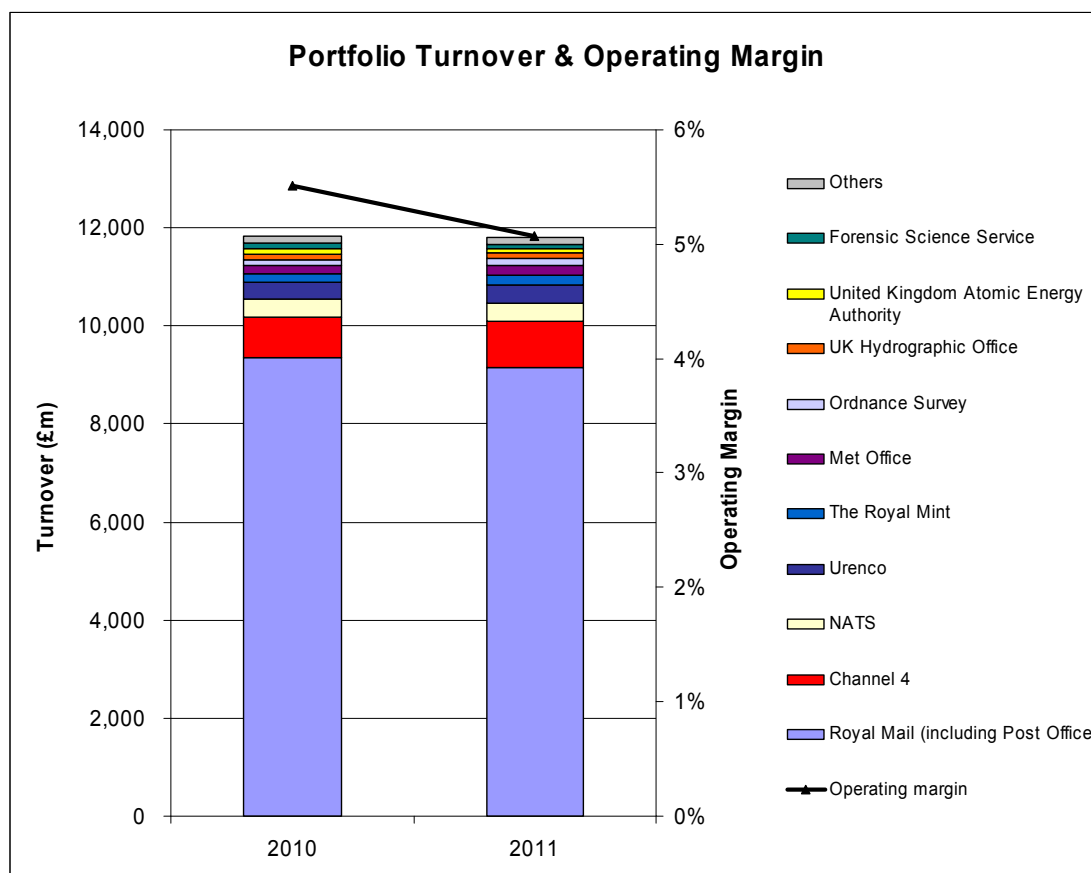
We have revised the definition we use for the dividend analysis to the amount declared rather than paid in the year. This allows underlying performance to be reviewed without the distortion of any timing issues in the dividend payment schedule.

In addition, four of the businesses which operate in sectors with specialist performance metrics have been reported separately rather than combined analysis. This applies to: CDC the UK's development finance institution; UK Export Finance (formerly known as the Exports Credit Guarantee Department) the UK's export credit agency; Nuclear Decommissioning Authority (NDA) which owns 19 sites and the associated civil nuclear liabilities and assets of the public sector; and Nuclear Liabilities Fund (NLF) which holds an investment portfolio to fund certain long-term waste fuel and decommissioning costs for 8 nuclear power stations.

As in previous years, where we have a relationship with both the parent and a subsidiary company (for example Royal Mail and Post Office) only the parent company's results have been included. No adjustment has been made for businesses whose financial year ends in December rather than March (Actis, CDC, Channel 4 and Urenco). Where the financials are reported in foreign currencies (Actis and Urenco) average exchange rates have been applied.

Turnover and operating margin

Turnover remained almost constant at £11,809m down from £11,827m in 2010. Royal Mail experienced a fall of 2.1% to £9,156m and the Forensic Science Service declined 22.7% to £87m. However, Channel 4 had a good year delivering 12.6% revenue growth to £935m, as did the Royal Mint up 24.5% from 2010 to £215m.



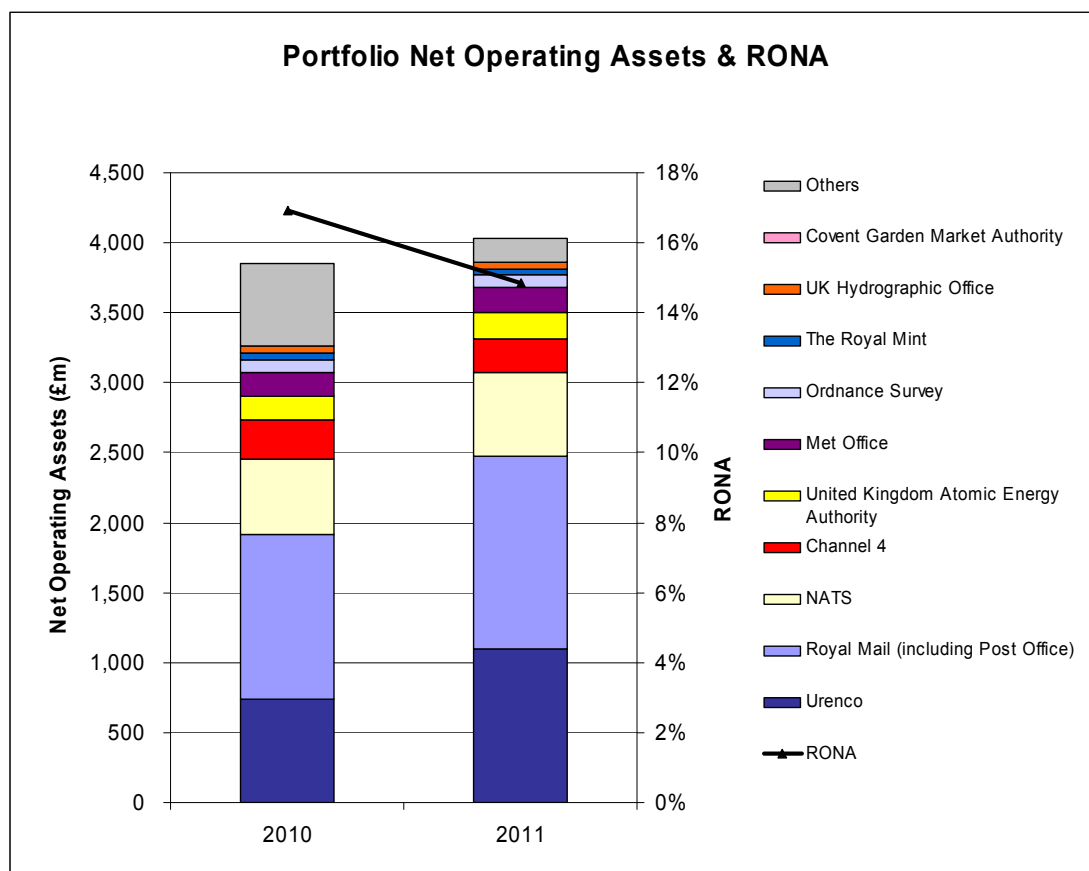
Note: chart excludes Working Links, BNFL, CDC, UK Export Finance, NDA and NLF

Consolidated operating profits before exceptional items fell by 8.2% to £598m. This was predominantly driven by lower profitability at Royal Mail, where profits fell 39.9% to £218m. Despite the overall fall, profits improved in many of businesses notably Channel 4 which increased to £49m from £4m in the previous year and the UK Hydrographic Office which grew to £38m from £28m in 2010.

As a result of lower operating profits, operating margin also fell slightly to 5.1% from 5.5% in 2010.

Net operating assets and return on net assets (RONA)

Comparing results on a consistent basis, during the year total net operating assets went up by 4.6% to £4,031m. This step up was driven by an increase in Ureco's property, plant and equipment. As operating profits fell, RONA also declined to 14.8% down from 16.9% in 2010.

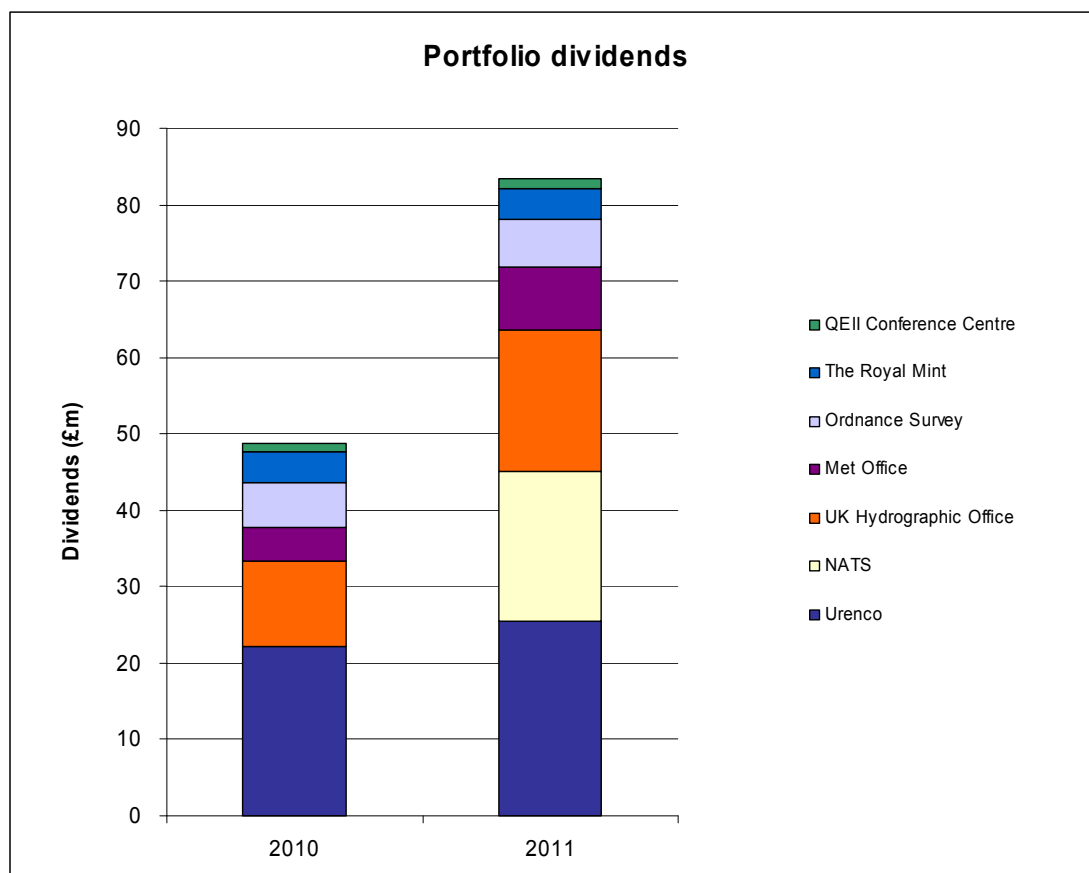


Note: chart excludes Working Links, BNFL, CDC, UK Export Finance, NDA and NLF

Dividends

Only seven businesses in our portfolio declared dividends in 2011. The Government's proportion of these dividends totalled £83.4m, compared to £48.8m in 2010. A large part of this uplift was due to NATS which historically has only been able to pay modest dividends and did not declare a dividend in 2010. The £19.6m due to Government in 2011 reflects the solid foundation of the company.

The dividend from Urenco, the largest contributor to the portfolio, rose 15.2% to £25.5m. Strong underlying performances at the UK Hydrographic Office and the Met Office also led to rises in dividend for this year.



Note: chart excludes Working Links, BNFL, CDC, UK Export Finance, NDA and NLF

Performance of other businesses

- CDC increased its total net assets on a valuation basis to £2,804m from £2,535m in the previous year. This represents a return of 11% in 2011.
- UK Export Finance reported a decrease in net income, as insurance liabilities increased, to £187m from £243m in 2010. Net assets fell by 7.3% to £383m at the end of March 2011.¹
- NDA's commercial income increased from £963m to £1,036m in 2011. However, its net liabilities rose from £45,204m to £50,600m as a result of the increase in nuclear provisions for future decommissioning activities.
- NLF's fund to meet future nuclear liabilities, excluding contributions from and payments to EDF Energy Nuclear Generation Group, grew by 1.2% to £8,574m at the end of March 2011.

For detailed description of the businesses and a summary of their financial accounts please refer to information on our website.

¹ Fixed Rate Export Finance has been excluded from the results as the scheme was closed on 31 March 2011.



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