
SHAREHOLDER EXECUTIVE

Annual Review 2011/12

OCTOBER 2012

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Shareholder Executive Annual Review 2011-12

Chief Executive's Report for 2012

In 2011-12 the Shareholder Executive once again played an important role in supporting the Government's key commercial objectives. We continued to represent Government as a value-focused shareholder across a broad range of state-owned and partially state-owned businesses, and also worked with Ministers and Departments to provide financial, analytical and negotiation support in a number of their dealings with companies – especially those in complex situations, and often when they have been facing severe financial pressures.

Our activities and achievements particularly reflect the ongoing relevance of the Shareholder Executive to the Government's efficiency and growth agenda. 2012-13 will continue to present challenges, however I am confident that the momentum we have established means that the Shareholder Executive remains ideally positioned to support Government and drive long term value for taxpayers.

Shareholder Executive

This year has seen some changes to the scope of the role of the Shareholder Executive, with the UK Green Investment Bank ("UKGIB") and Information Economy Directorate teams transferring to the Shareholder Executive during the year. There have also been a number of changes to our portfolio of businesses, where we have a formal shareholder mandate.

In the first quarter of 2012 Patrick O'Sullivan joined the Shareholder Executive as our non-executive Chairman. Patrick, who is also Chairman of Old Mutual and Deputy Governor of the Bank of Ireland, succeeds Philip Remnant, who had been in the post since June 2007. Patrick brings with him a breadth of commercial experience which will be invaluable to the Shareholder Executive during the term of his appointment, providing us with high level strategic direction and also supporting us in our work with our portfolio businesses.

I would like to take this opportunity to thank Philip Remnant for the support he has provided to the Shareholder Executive since 2007. The challenges over the last five years have been many and varied, and Philip has been a source of wise counsel throughout. I look forward to working with Patrick to build on this strong foundation in the future.

UK Green Investment Bank

In January 2012 the Shareholder Executive took over responsibility for setting up the UKGIB, a flagship Government policy. UKGIB, which will operate at arm's length from Government and will be managed as a portfolio company by the Shareholder Executive, will accelerate investment in the UK's green infrastructure. It has been provided with £3bn funds for investment by 2015.

Paving the way for the UKGIB, a team of finance professionals – UK Green Investments ("UKGI") – has been recruited within the Shareholder Executive to make direct investments on behalf of the Secretary of State, on fully commercial terms, prior to state aid approval for the Bank. UKGI's first transaction was in April and to date it has committed £180m to specialist fund managers to co-invest equity into waste and non-domestic energy efficiency infrastructure projects. Eligible UKGI assets will be transferred to the UKGIB in time.

Information Economy

In May 2012 the Information Economy Directorate became part of the Shareholder Executive. With policy responsibility within BIS for cyber security, telecoms and resilience – both in the UK and internationally – and for the digital sector in the UK, the work of the Information Economy Directorate complements many of the activities in which the Shareholder Executive is already involved.

The Information Economy Directorate has important roles in a number of areas that are critical to the future of the UK economy, by supporting economic prosperity, protecting national security, safeguarding the public's way of life and making a significant and valued contribution to the Government's growth agenda.

We welcome this move, and the Shareholder Executive looks forward to tackling the challenges presented by these issues and delivering on this high-profile and important agenda.

Portfolio of Businesses

At the end of this year the Shareholder Executive portfolio comprised 19 businesses where we have a formal shareholder mandate. This represents a net decrease of 5 from 2010/11 and reflects:

- the addition of Companies House, following the Autumn Statement which established the Public Data Group ("PDG"). The PDG replaced the Public Data Corporation ("PDC"), which had been established in 2011 by bringing HM Land Registry, the Met Office and Ordnance Survey – three data-rich Government bodies – into BIS and under the sponsorship of

the Shareholder Executive. Companies House now also forms part of PDG;

- the sale of the Government's residual 40 per cent. stake in Actis Capital ("Actis"), to Actis's management team for an initial cash payment of US\$13 million as well as a share in the future profitability of Actis's funds;
- the transfers of the Covent Garden Market Authority and The Queen Elizabeth II Conference Centre to the Cabinet Office, as part of the transfer of the Government Property Unit to the Cabinet Office in June 2011;
- the transfer of the UK Atomic Energy Authority from the Shareholder Executive, to the Science Directorate in BIS;
- the decision taken by the Home Office to wind-down the activities of the Forensic Science Service, and the transition of its commercial activities to alternative accredited suppliers; and
- the completion of the wind-down of British Nuclear Fuels, which no longer had any operating functions.

We also continue to work closely with a number of non-portfolio assets, as well as continuing to support other Departments with our traditional corporate finance and project work.

The Shareholder Executive Team

Staff numbers in the Shareholder Executive's Portfolio and Corporate Finance teams have remained broadly stable during the past year. We currently have a core staff of approximately 60, which is evenly split between Civil Servants and private sector corporate finance specialists, most of whom are recruited on fixed term contracts.

In 2011-12 the total number of staff in the Shareholder Executive did increase, reflecting the transfers of the Information Economy Directorate team, which numbers approximately 20 staff, and the UKGIB team, which numbers approximately 30 staff. As the UKGIB approaches operational launch towards the end of this year, we expect the number of people working in the Shareholder Executive's UKGIB team to reduce, as we switch to a more conventional portfolio role.

2011 – 2012 Achievements

Since the last Annual Review, published in September 2011, the Shareholder Executive has successfully delivered a number of important and challenging achievements. These include:

- **Establishment of the UK Green Investment Bank:** In March 2012 it was announced that the UKGIB's headquarters will be based in Edinburgh, with the major transactions team based in London. The decision followed a rigorous process in which 32 locations submitted detailed self assessments against a set of common criteria. In May, the UKGIB was established as a Companies Act company called UK Green Investment Bank plc, with Lord Smith of Kelvin appointed as the Bank's Chair, Sir Adrian Montague as Deputy Chair and Senior Independent Director, and Anthony Odgers as the Government Representative Director. Legislation relating to the UKGIB was introduced in May as part of the Enterprise and Regulatory Reform Bill, with the UKGIB clauses setting the Bank's green purpose, facilitating its independence, and providing funding powers;
- **Addressing the c.£10bn Royal Mail Pension Deficit:** In March 2012 the Shareholder Executive received approval from the European Commission for the transfer of the majority of the historic pension liabilities and assets from Royal Mail to Government, in addition to approval to restructure the debt on Royal Mail's balance sheet if required. These developments, which were enabled by the Postal Services Act 2011 – the implementation of which also involved a considerable Shareholder Executive role – help to pave the way for the introduction of private capital into Royal Mail, in order to secure the future of the company and the sustainability of the Universal Service Obligation;
- **Separation of Post Office:** In April 2012, Post Office separated from Royal Mail and was established as a newly independent business with its own Board and commercial strategy. This separation will enable Post Office to remain in public ownership (subject to the possibility of transferring ownership to a mutual in the future) as Royal Mail seeks to attract private capital. The Shareholder Executive also played a key role in helping Post Office and Royal Mail agree to a ten-year commercial contract that ensures the vital commercial relationship between the two companies can be maintained;
- **Post Office Mutualisation:** In July 2012 the Shareholder Executive published the Government's response to the "Building a Mutual Post Office" consultation, marking a key milestone in the Government's plans to make clear progress towards mutualisation – a theme central to the Government's Open Public Services agenda – by the end of this Parliament. By bringing together the responses from across the Post

Office's wide range of stakeholders the Government, supported by the Shareholder Executive, has been able to set parameters within which a Post Office mutual could be developed, and identify the next steps that would need to be taken to mutualise;

- **Development of Public Data Group:** The Shareholder Executive is supporting PDG in its strategy to develop collaborative ways of working between its members, HM Land Registry, the Met Office, Ordnance Survey and Companies House. This includes PDG's members looking at ways to make data more accessible, and since the end of the last year a number of data releases have been made freely available by PDG's members for the first time. Progress has also been made in areas which will significantly contribute to Government's agenda to drive data access, efficiencies and economic growth. The Shareholder Executive has been helping to drive greater collaboration and sharing of best practice between the PDG members, and five workstreams around data sharing and cost efficiencies have now been identified as priority areas. Shorter term operational opportunities are also being considered, such as Companies House and Land Registry sharing intelligence to combat company impersonation and mortgage fraud. We are also pleased to have been able to announce the appointment of Claudia Arney as Chairperson of PDG. Claudia brings with her a wealth of knowledge of the public data agenda, and a depth of commercial experience, which will be crucial in pushing forward PDG's joint-working strategy in the future, further improving public access to data;
- **Management of Overseas Owned Plutonium in the UK:** The Shareholder Executive worked closely alongside the Nuclear Decommissioning Authority ("NDA") and the Department of Energy and Climate Change ("DECC") to develop a commercial agreement, announced to Parliament by DECC in July 2012, that results in the NDA taking ownership of approximately four tonnes of plutonium stored in the UK previously owned by certain German utilities. The transaction enables a reduction in the amount of separated plutonium stored in Europe, allows MOX fuel to be provided to the German utilities ahead of the German national reactor shut down programme and is commercially advantageous for the UK;
- **Releasing Public Spectrum:** Following the release of the "Enabling UK Growth: Releasing Public Sector Spectrum" consultation document in March 2011, the Shareholder Executive has continued to play a central role in developing a detailed plan that sets out how Government could meet its target of releasing 500 MHz of public spectrum by 2020. An update to the consultation was published in December 2011, setting out the works being undertaken across Government to release public spectrum and providing a shortlist of bands being examined and the next steps for release. The Shareholder Executive has also been working

closely with the Ministry of Defence and Ofcom to develop an approach to potentially sharing a number of bands that have been identified by the Ministry of Defence, and for which there has been significant expressions of interest for a number of innovative applications;

- **Cyber Security Advice:** In September 2012 the Government launched the Cyber Security Guidance Booklet for Business at an event attended by more than one hundred FTSE 100 Chief Executives, Chairs and Chairs of Audit Committees. The booklet contains important cyber security information which is applicable to all sectors of the economy, and we will now work with partners across Government and the private sector to promote and disseminate this guidance to businesses of all sizes. The Shareholder Executive made a significant contribution to the booklet and led the launch event. This represents an excellent example of co-operative working between BIS, GCHQ and the Centre for the Protection of National Infrastructure;
- **Corporate Finance Practice:** The Shareholder Executive advised Ministers and Departments on a wide range of issues this year, across industries including healthcare, aerospace, transportation and defence. The work has varied widely in scope, and includes taking a leading role in the Regional Development Agencies closure programme, as well as in a number of cases where large companies that were in distress approached Government for assistance. The most high-profile of these was the collapse of Southern Cross, in respect of which the Shareholder Executive worked closely alongside the Department for Health to promote a consensual and landlord-led restructuring that ensured virtually all the Southern Cross care homes remained open and continuity of care was maintained for all residents;
- **Government Corporate Finance Profession:** The Shareholder Executive has continued to lead the work to develop a cross-Government Corporate Finance Profession, and this year we successfully put in place a governance structure to support the Profession's launch. By bringing together the Heads of corporate finance practices across Government, this initiative will help to ensure a joined-up and strategic approach to corporate finance resourcing and the sharing of expertise. This, together with our work with Ministers and Departments across Government, was identified in the June 2012 Civil Service Reform Plan as an example of how policy and analytical services can be provided effectively across Departments on a shared basis, and it will continue to be a focus area for us over the coming months.

Outlook

In the coming year we expect that the Shareholder Executive will continue to deliver valued advice to state-owned and partially state-owned businesses, including both those where we have a direct shareholder mandate and those where we do not, to ensure that Government maximises value and protects the taxpayer in the long term. In addition, we will also continue to provide support to Ministers and Departments in their dealings with these businesses.

The UKGIB team will continue to prepare for the UKGIB to be fully operational later this year, subject to the receipt of state aid approval from the European Commission. The UKGIB Board is currently recruiting the Chief Executive Officer and other key members of the executive team, developing the Bank's processes and systems, and finalising its premises in Edinburgh and London. We are also continuing to oversee the activities of the UK Green Investments team.

Following the passing of the Postal Services Act 2011, and the receipt of state aid approval from the European Commission for Royal Mail's proposed pension and, if required, balance sheet restructuring and Post Office's funding package, the Shareholder Executive will continue to work closely with both businesses. This includes supporting management to develop approaches to attract private capital into Royal Mail, and to explore potential options for the mutualisation of Post Office. Both of these activities are ongoing and we look forward to working with Royal Mail, Post Office, and their respective stakeholders in the coming months to make significant further progress in these areas.

Government, led by DECC and the Shareholder Executive, is also continuing to explore the potential sale of its shareholding in Urenco. Departments have been working closely to develop and assess options for realising value from this shareholding, with the aim that any transaction would deliver value for money for Government, while at the same time underpinning the future success of the company and safeguarding the UK's non-proliferation, security and defence interests.

The Shareholder Executive is also continuing its work to examine options for monetising parts of the Income Contingent and Mortgage Style Student Loan books. To support this work we are preparing feasibility assessments that look at the sale of existing loans, in order to reduce Government's risk exposure while delivering value for money for taxpayers and ensuring that borrowers are no better or worse off as a result of any sale. Following the completion of this feasibility work, the Government will decide whether and how to monetise these assets.

The Shareholder Executive will also continue to work closely with a number of Ministers and Departments to provide advice and support in relation to complex corporate finance matters. These activities include:

- supporting DECC in helping it to secure attractive low-cost financing solutions for the Green Deal, an initiative which will enable consumers to install a wide range of energy efficiency measures in their homes. Consumers will not have to pay the upfront costs of installation, rather payments will be made through their electricity bills which should be offset by energy efficiency savings. The Green Deal will also enable the Government to make progress on meeting its carbon reduction targets, while at the same time creating a significant number of “green jobs” in the energy efficiency industry;
- working with DECC, following the publication in May 2012 of the draft Energy Bill, to support its work in developing and negotiating commercial agreements with developers aimed at attracting new sources of capital into the UK power sector;
- providing support to BIS in its work to increase and diversify the supply of credit to small and medium sized enterprises in the UK, through non-bank lending channels;
- working with the Ministry of Defence on assets identified for possible sale, such as the Government Pipeline and Storage System, an aviation fuel pipeline, Marchwood Sea Mounting Centre, a military Sea Port of Embarkation located within the Port of Southampton and Defence Support Group, the vehicle maintenance, repair and overhaul provider to the British Military; and
- playing a central role as Government moves from planning, to implementing, the 500MHz spectrum release plan. As part of the programme of works, the Shareholder Executive together with the Department for Culture, Media and Sport have procured an economic study to assess the contribution that radio spectrum makes to the UK economy, including factors that influence future demand for public spectrum. This work, which is due to complete in Autumn 2012, is intended to provide a key input to the decisions that the Government will take in relation to releasing public spectrum. The Government remains on target for the first substantial release of spectrum to take place in 2013.

As this last year has demonstrated, the demand for corporate finance advice across Government remains high. The Shareholder Executive will continue to support its portfolio businesses, while also providing valued advice to Ministers and Departments across Government. At the same time we will actively support the Government’s ambitions to promote the sharing of

services across the public sector. This includes in corporate finance, through the cross-Government Corporate Finance Profession – having established its governance structure, we expect to launch it for members before the end of this calendar year – and in other areas, through our work with the Efficiency and Reform Group in the Cabinet Office and with other areas of Government expertise.

None of what we have achieved this year would have been possible without the hard work, commitment and professionalism of the Shareholder Executive team. I would like to extend my thanks to the team for their work, and am confident that we can look forward to a rewarding and successful 2012/13.

Stephen Lovegrove

Chief Executive

30 September 2012

Portfolio Analysis Report for 2011/12

The analysis detailed on the following pages sets out a summary of the combined results of the 19 businesses that make up the Shareholder Executive portfolio. As explained in the Chief Executive's report, there have been a number of changes to the portfolio in the past year and as such comparisons with results from previous years should be made with caution. The portfolio is currently made up of (ownership percentages in brackets if below 100 per cent.):

- Companies House
- CDC
- Channel 4
- Eurostar (40 per cent.)¹
- Export Credits Guarantee Department (operating as UK Export Finance)
- Land Registry
- LCR¹
- Met Office
- NATS (49 per cent.)
- National Nuclear Laboratory ("NNL")
- NDA
- Nuclear Liabilities Fund ("NLF")
- Ordnance Survey
- Post Office
- Royal Mail
- Royal Mint
- UK Hydrographic Office
- Urenco (33 per cent.)
- Working Links (33 per cent.)¹

Performance is reviewed across the Shareholder Executive portfolio through a structured Investment Review process, which incorporates quarterly and annual reviews of our businesses, supplemented by rigorous day-to-day monitoring against a set of performance targets specific to each business.

¹ Due to the lack of comparable financial information for the 2010/11 and 2011/12 periods, Eurostar, LCR and Working Links have been excluded from the Portfolio Analysis.

Portfolio Analysis Methodology

The basic methodology adopted in the Portfolio Analysis 2011/12 is the same as the Portfolio Analysis 2010/11.

Businesses where Government has a controlling interest are fully consolidated, and businesses where Government holds a non-controlling interest are proportionally consolidated (e.g. NATS and Urenco).

The majority of the businesses in the portfolio report in pounds sterling and to a March year end. Where companies report in a different currency, average exchange rates have been applied to the income statement and year-end exchange rates have been applied to the balance sheet. Where companies report to a different year end no adjustment has been made.

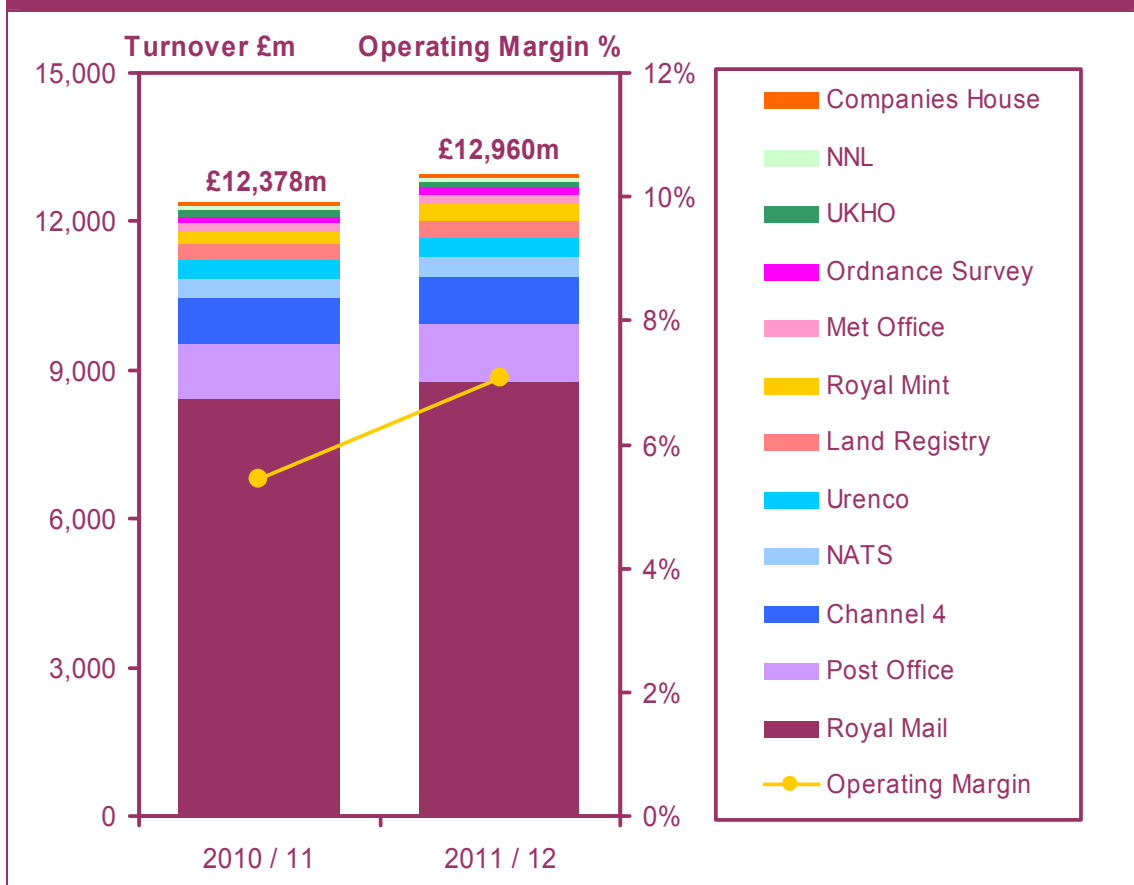
To reflect the separation of Royal Mail in April 2012, Royal Mail and Post Office are reported in the Portfolio Analysis Report for 2012 as separate businesses. In last year's report they were both grouped together as Royal Mail.

As with previous years, four portfolio businesses operate in areas that have sector-specific performance metrics and as such these have been reported separately. This applies to: CDC; UKEF; the NDA; and the NLF.

Turnover and Operating Margin

The turnover of the Shareholder Executive's portfolio increased from £12,378m to £12,960m in the year to March 2012, representing an increase of 4.7 per cent. on the previous year. A £349m increase in Royal Mail's turnover accounts for approximately 60 per cent. of this change, however strong performances were also recorded by Post Office, NATS and Royal Mint. In particular, Royal Mint increased its turnover by 45.9 per cent. during the year, mainly due to a strong performance in its Commemorative Coin division.

Figure 1 – Portfolio Turnover and Operating Margin 2010/11 – 2011/12



Note: Chart excludes CDC, UKEF, NDA, NLF, Eurostar, LCR and Working Links

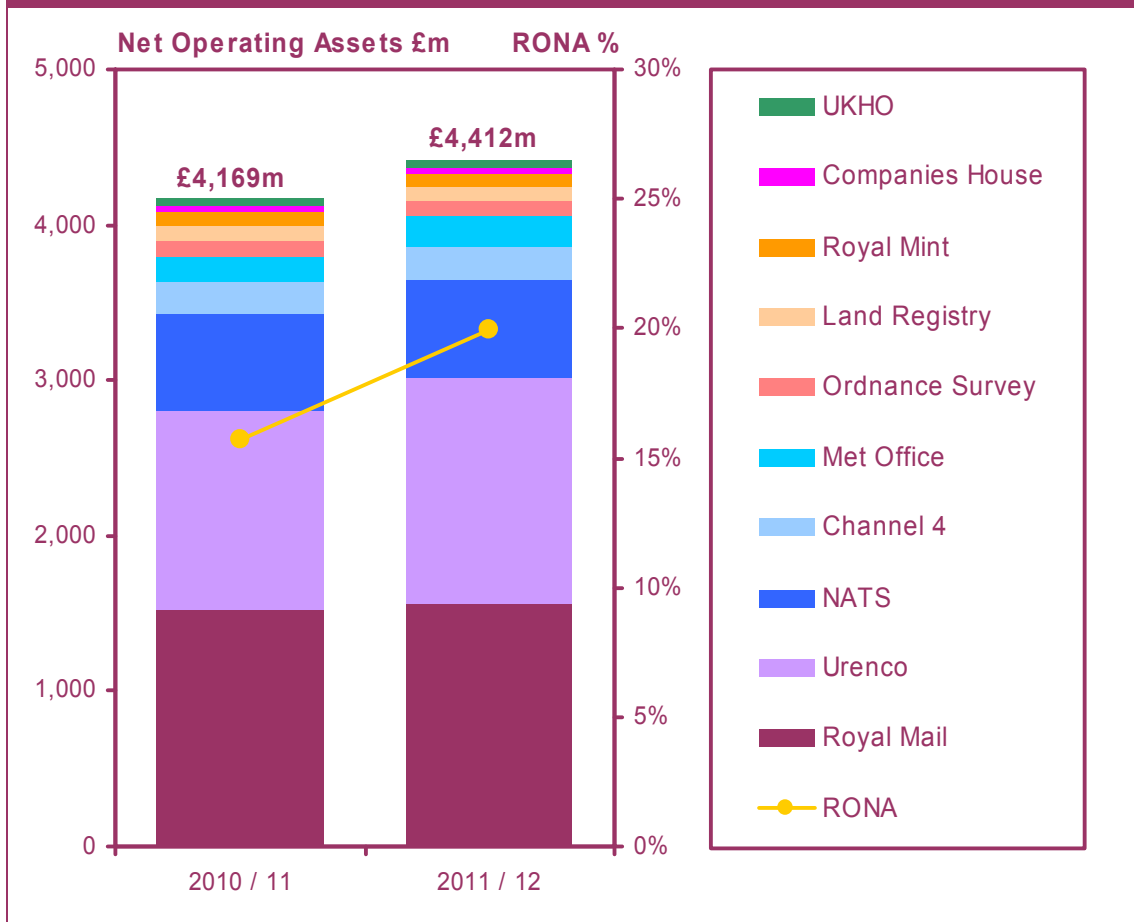
Operating profits before exceptional items increased by 36.5 per cent. to £918m, resulting in an increase in the blended portfolio operating margin to 7.1 per cent., from 5.4 per cent. in the previous year. This margin expansion was mainly driven by increased profitability at Royal Mail, where profits grew by 83.6 per cent., however a number of other assets, including HM Land Registry, Ordnance Survey, NATS and Royal Mint, also performed well.

Net Operating Assets and Return on Net Operating Assets (“RONA”)

During the year to March 2012, net operating assets increased by 5.8 per cent. to £4,412m. This growth reflects increases in net operating assets for Channel 4, Met Office, Ordnance Survey, NATS, Royal Mail and Urenco, which were partially offset by declines at Companies House, Land Registry, Royal Mint and the UK Hydrographic Office.

Due to strong operating profit performances across much of the portfolio, RONA increased to 19.9 per cent., up from 15.7 per cent. in the previous year.

Figure 2 – Net Operating Assets and RONA 2010/11 – 2011/12

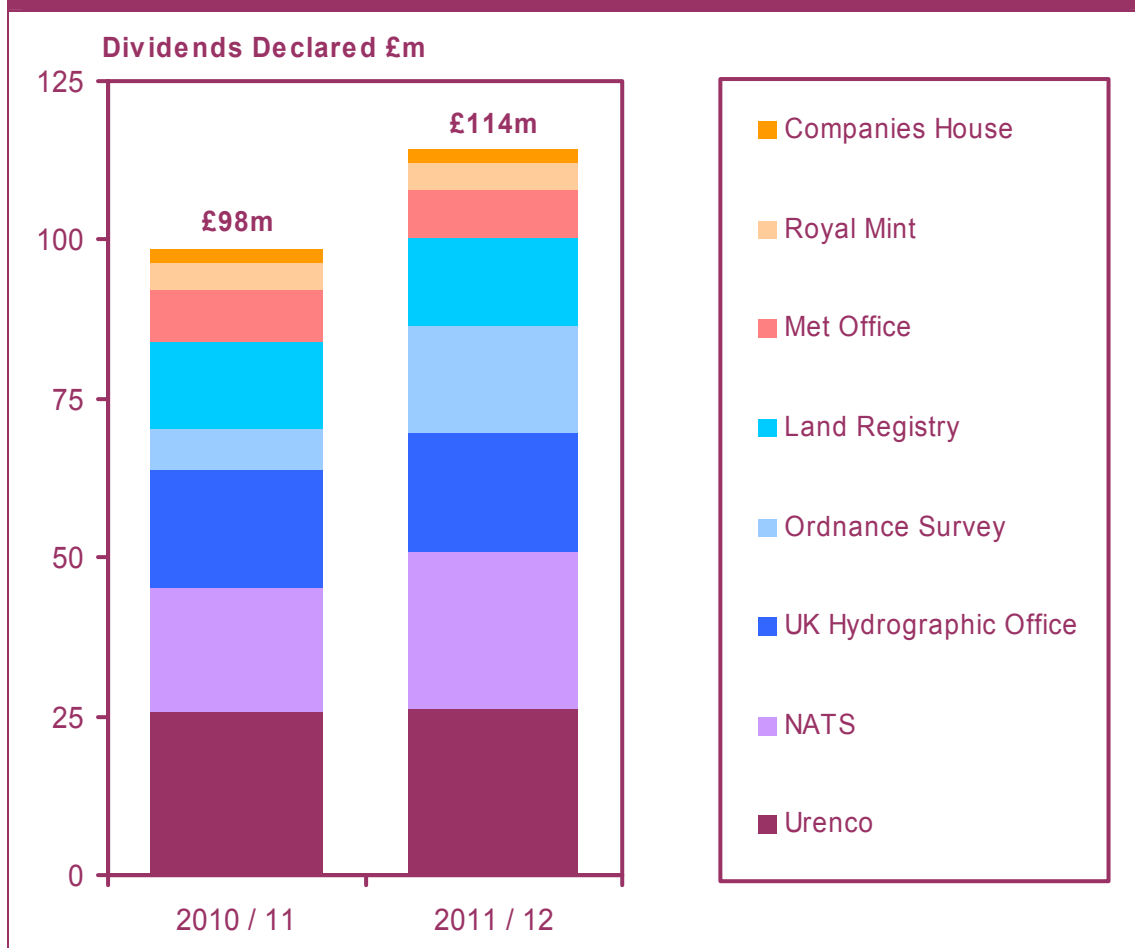


Note: Chart excludes CDC, UKEF, NDA, NLF, Eurostar, LCR, NNL, Post Office and Working Links

Dividends Declared

Only eight businesses in our portfolio declared dividends in the year to March 2012, with Government's share of these payouts totaling £114m. This compares to £98m in the prior year, and represents an increase of 16.2 per cent. Almost 70 per cent. of this growth was driven by Ordnance Survey, which increased its dividend by 171 per cent. from £6m to £17m. Much of the remaining increase was driven by NATS, which increased its dividend by 26.8 per cent. to £51m (of which the Government's share was £25m).

Figure 3 – Dividends Declared 2010/11 – 2011/12



Note: Chart excludes CDC, UKEF, NDA, NLF, Channel 4, Eurostar, LCR, NNL, Post Office, Royal Mail and Working Links

Performance of Other Portfolio Businesses

- CDC's total net assets on a valuation basis declined to £2,608m in the year to December 2011, from £2,680m in the previous year. This was due to decreases in both the value of CDC's portfolio, and lower cash and short-term deposits being held by the business.
- In the year to March 2012, UKEF supported £2.3bn of business by way of issuing guarantees and insurance policies to banks and exporters,

down from £2.9bn in the previous year. This decrease contributed to a 25.5 per cent. fall in net income over the period to £139m. Over the year net assets also decreased, by £40m or 7.5 per cent., to £501m.

- NDA's commercial income decreased from £1,036m to £1,004m in the year to March 2012, while at the same time its net liabilities rose from £50,600m to £54,816m 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 0.7 per cent. to £8,630m at the end of March 2011.

For detailed description of the businesses and a summary of their financial accounts please refer to information on the [Shareholder Executive website](#).

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