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## CITY LINK

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■ 18.8% Group Revenue 2007

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**PRINCIPAL ACTIVITIES:**  
Premium express  
delivery of parcels

**PRINCIPAL GEOGRAPHIES:**  
UK

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**OUR OBJECTIVE:**

To become the UK's leading timed, next-day premium parcel delivery company with scale and operational control to maximise leadership position

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**STRATEGIC PRIORITIES:**

- › Restore business to profitability
  - › Transition from franchise plus hub and trunker to end-to-end operator
  - › Delivery of Target Express integration benefits
  - › Drive top line
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## CITY LINK

### MARKET CONDITIONS

The UK market saw growth above GDP in 2007. The overall express parcels delivery sector continues to consolidate. City Link’s purchase of Target Express and the purchase of ANC by Fedex at a similar time are illustrative of this trend. The gradual industry decline in revenue per consignment has continued however within our own business this decline was somewhat further than expected.

### KEY PERFORMANCE INDICATORS

	£m	Change vs 2006
Revenue	417.1	+ 95.5%
Organic revenue		-5.2%
Operating profit	19.4	-44.3%
Adjusted operating profit	44.8	+ 24.1%
Net adjusted margin	10.7%	-6.2%
No. of consignments (m)	51.8	+4.4%
Revenue per consignment (£)	8.24	-2.3%

### 2007 REVIEW

Revenue from City Link increased by 95.5% during 2007 delivering a 24.1% increase in adjusted operating profit before tax, reflecting the impact of the acquisitions of the former City Link franchises and Target Express business. Network turnover grew only by a modest 1.9% during the year, depressed as a result of poor volumes in the fourth quarter when the expected surge of volumes in the approach to Christmas did not occur.

Until October, City Link’s performance tracked budget month-by-month and the business exited the third quarter with network growth up 4.7%. However, in December we issued a trading statement stating that fourth quarter profits were

likely to be up to £10 million below our expectations as a result of a further volume decline in the business-to-consumer segment in the ten weeks before Christmas. We attributed this slowdown to weaker consumer spending in a challenging retail environment.

Since then we have conducted a detailed analysis into the trends in City Link’s revenue base. We have concluded that although there was an impact from downtrading in the business to consumer segment of the business, this played only a part in a downturn that can essentially be attributed to the fact that the integration programme tried to do too much too quickly without establishing a sound base. This had the effect of impacting service. In addition, some of the actions we undertook, most notably with the former City Link franchises, were in the wrong direction.

The fourth quarter profit shortfall anticipated at the time of the December trading statement can be explained as follows. Revenues during the period fell well short of expectation as a result of down trading by existing customers, a modest increase in customer attrition and the fact that this lost revenue was not replaced by sales generated from new business. In addition, the UK parcels industry has over the years experienced a gradual decline in revenue per consignment (RPC) – our measure of average price. Historically, this has not had a detrimental effect on City Link profits because strong volume growth and the benefits from operational leverage on our fixed cost base have offset price erosion. However, in 2007 City Link’s network RPC fell somewhat further than expected and this combination of lower volumes at cheaper RPC is the principal reason for the Q4 profit shortfall. This was further compounded by the



### SMARTER DRIVING

City Link has introduced a new HGV fleet of vehicles with the latest Euro 5 engines which produce even lower CO2 emissions whilst continuing to be highly efficient operationally. In addition, City Link is trialling electric vehicles in its West London depot and aims to introduce at least 20 such vehicles into the low emission zones around the Capital. City Link has introduced Driver Assessors who train its HGV drivers to drive more efficiently, leading to more fuel-efficient driving techniques which include effective gear changing.

fact that City Link carried excess cost in the fourth quarter in anticipation of the pre-Christmas surge in volumes which failed to materialise.

The business's foundation for integration was not solid enough to cope with the degree of changes being put through the combined networks and the depot integration programme had a temporary negative impact on service levels, most notably around the time of the introduction of cage handling into the Target Express network and the integration pilot in the late summer. As a result we have lost some customers, unsettled others causing them to down trade with us and issued an increased number of service credits as compensation for poor service. These service credits exacerbated the fall in RPC. A hiatus in sales management during the first half of the year also led to an inadequate new business pipeline.

In addition to the mid-year service issues described above, poor account management of the small to mid-size ex-franchise customers may be the principal reason for the lost business highlighted above. The move from a local to more centralised account management system unsettled customers who had formed strong relationships with former franchisees, most of whom left the business post acquisition. In addition, as we moved to integrate depots, relevant management positions were not appointed quickly enough to take effective ownership of their additional new customer base.

The issues outlined above became apparent very suddenly and with no obvious warning and have seriously impacted the financial performance of City Link. The business tracked budget until the beginning of October and was actually

forecasting an above-budget full year out-turn until August. Despite regular reviews and updates, nothing untoward came to light or was expected. The underlying issues were masked by increased volumes of business from our continuing customers. When that trend reversed in the fourth quarter this, combined with poor new business generation, caused a sudden and marked effect on revenue and profit.

We have taken immediate action to address these issues. Petar Cvetkovic, the former CEO of Target Express, replaced Michael Cooke as Managing Director on 18 February 2008 with a clear focus on restoring the profitability of the business. In order to ensure continuity of customer service we have taken the decision to pause the depot rationalisation programme until such time as our systems, processes and account management have been improved. We will however continue with Phase One of the integration, the roll out of mechanical handling equipment and handheld consignment scanners, as they are delivering service and operational benefits within the depots.

Other actions undertaken since December include the roll-out of a new account management structure which aims to build direct relationships between customers and their local depots. The account management team is being further strengthened by new appointments and CRM training programmes for both new and existing managers, are currently underway.

A new senior leadership team is in place within City Link's sales and marketing operation and has created a stronger pipeline of new business prospects than in 2007, converting several into new customers within the last eight weeks. Recruitment for field sales is on-going.

#### CUSTOMER SERVICE FOCUS

City Link is committed to offering "Best in Class" customer service and reliability rates continue to exceed 98%. Armando Sanchez, Operations Director at ebuyer.com, one of City Link's major customers, said: "We have been exceptionally pleased with the performance of City Link. We're a fast growing business and City Link has continued to deliver great service. Their ability to cope with the volume increase has been impressive."

