Draft Notification

August 2019

Contents

Glossary of Terms

ACCC	Australian Competition and Consumer Commission
APC Act	Australian Postal Corporation Act, 1989
APSS	Australia Post Superannuation Scheme
BPR	Basic Postage Rate
CPI	Consumer Price Index
CSO	Community Service Obligations
DCR	Delivery Cost Review
D/D+E	Debt over Debt plus Equity
EEP	Enterprise Efficiency Program
EPM	Enterprise Profit Model
FTE	Full Time Equivalent
GBE	Government Business Enterprise
GFC	Global Financial Crisis
GRIA	General Retail Industry Award
GST	Goods and Services Tax
LPO	Licensed Post Office
MIWG	Mail Industry Working Group
MRP	Market Risk Premium
NDM	National Delivery Model
NPS	Net Promotor Score
OECD	Organisation for Economic Co-operation and Development
Q1, 2, 3, 4	Quarter 1, 2, 3, 4
PTRM	Post Tax Revenue Model
RoLS	Reform our Letter Service
TFP	Total Factor Productivity
VBI	Vested Benefit Index
VAA	Value Adviser Associates
VECM	Vector Error Correction Model
WACC	Weighted Average Cost of Capital
WPI	Wage Price Index

1. Executive summary

This draft notification (**notification**) proposes price increases to Australia Post's reserved ordinary letter service (including a 10c increase to the basic postage rate (**BPR**) from $1.00 to $1.10), effective January 2020.

The proposed increases are the first change to ordinary letter service prices since January 2016, when the choice of delivery speed was extended to all Australians.

The January 2016 product and price changes ('**Reform'**) were an essential re-calibration designed to provide closer alignment between the revenue raised from the letters service and the efficient cost of delivering the service. Reform has been a key factor in Australia Post returning to profit over the past three financial years.

Notwithstanding the benefit from Reform, the combination of ongoing volume decline and an ever-increasing delivery footprint requires a continuing focus on cost efficiency as well as regular price increases to ensure a sustainable letter service. Since the previous increase to the BPR (January 2016), the number of new delivery addresses has increased by around 700,000, yet the volume of letters that Australia Post is delivering has declined by around 820 million.

To address this ongoing challenge, Australia Post is implementing a range of strategies to manage network costs and slow the rate of letter decline. We have achieved substantial productivity benefits from the Reform our Letter Service (**RoLS**) program and will continue to realise productivity benefits through the One Network Program (including initiatives that enable posties to deliver a growing proportion of parcel volume).

As part of the proposed January 2020 price increases, Australia Post will maintain the existing price of concession stamps (at 60 cents), seasonal greeting card stamps (at 65 cents) and the priority label (at 50 cents).

Australia Post believes the proposed prices are appropriate, justified and necessary to allow Australia Post to generate sufficient revenue to align more closely with the efficient forward-looking economic costs of its notified service (reserved ordinary letter service).

This notification sets out Australia Post's evidence and supporting arguments, demonstrating that:

- Australia Post's costs are efficient and cost movements over the period of this notification reflect an aggressive and sustained pursuit of efficiency and productivity opportunities;
- although the revenue from the proposed price changes will not fully recover the sum of efficient costs of providing the domestic reserved letter service, plus an appropriate rate of return, the price changes are reasonable given the current circumstances of the Australian letters market; and
- the proposed changes balance Australia Post's obligations to operate in a manner consistent with sound commercial practice while meeting the prescribed performance standards associated with the community service obligations.

This notification is supported by information on Australia Post's letter volumes, revenues and costs, and modelled over the same period as the Corporate Plan (2018/19 to 2021/22).

The key pricing assumption to support the financial modelling contained in, and supporting, this notification is those prices proposed to be effective January 2020. Those proposed prices include the notifiable and other domestic letter prices. They are the only proposed price changes to reserved letters in 2019/20.

Under the post-tax revenue model (**PTRM**) used by the Australian Competition and Consumer Commission (**ACCC**) in Australia Post's previous price notifications, even with the proposed price changes, by 2020/21 Australia Post's:

- reserved ordinary letter service is forecast to under recover by $118m; and
- domestic letter service is forecast to under recover by $354m.

Although, Australia Post is only required to notify the ACCC of proposed changes to its notified service i.e. the reserved ordinary letter service, and the notified service only comprises around 8% of reserved letter volume, this notification includes detail on other domestic letter price changes, to provide context of the broader letters market and assist the ACCC in its assessment of the notification.

2. Introduction

Under the provisions of the Australian Postal Corporation Act, 1989, (**APC Act**) Australia Post's principal function is the supply of postal services within Australia and between Australia and places outside Australia.

In performing its legislated functions, Australia Post has a number of obligations summarised as follows:

- Commercial Obligation – to perform its functions, as far as practicable, in a manner consistent with sound commercial practice;
- Community Service Obligations (**CSO**) – to supply a letter service that is 'reasonably accessible' to all Australians; and
- General Governmental Obligations – to perform its functions consistent with general governmental policies of which the directors are notified; directions given by the Minister under section 49; and Australia's obligations under any convention.

Australia Post, as the designated operator for Australia has been nominated to fulfil the Australian Government's obligations under the Universal Postal Union Acts and associated regulations. Fulfilling these obligations align with Australia Post's CSO.

A CSO is a government requirement for a service provider to engage in non-commercial activities to meet affordability and access objectives. The commonly agreed definition of a CSO[1] adopted by Australian governments is:

> 'A community service obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other business in the public or private sectors to generally undertake, or which it would only do commercially at higher prices.'

Australia Post's CSO detailed in section 27 of the APC Act requires Australia Post to supply a letter service:

- Within Australia; and
- Between Australia and places outside of Australia.

In supplying the letter service, the APC Act also prescribes:

- The service must be available at a single uniform rate for standard letters carried within Australia by ordinary post; and
- The performance standards (including delivery times) for the letter service reasonably meet the social, industrial and commercial needs of the Australian community.

[1] Steering Committee on the National Performance Monitoring of Government Trading Enterprises 1994, page xi

The cost of Australia Post's CSO has traditionally been funded by an internal cross-subsidy from within Australia Post's reserved letter service[2] however, since circa 2008, with the increased level of decline driven by digital substitution, this has been challenging. The challenge for Australia Post is balancing the need to earn a commercial rate of return, working towards an agreed financial target and dividend policy while continuing to meet the requirements of its CSO and providing an affordable BPR.

2.1. Commercial rate of return

As described in the *Commonwealth Government Business Enterprise Governance and Oversight Guidelines* (January 2018), Government Business Enterprises (**GBE**), such as Australia Post, are expected to operate and price efficiently.

A principal objective for each GBE is that it adds to its shareholder value and earns at least a commercial rate of return, which contemplates recovery of the full cost of the resources employed, including the cost of capital.

Principal financial targets are set in advance with Shareholder Ministers and are premised on the basis that each GBE is expected to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and to pay commercial dividends from those returns according to an agreed dividend policy.

2.2. Regulatory environment

To avoid breaching section 95Z of the Competition and Consumer Act, 2010, Australia Post must notify the ACCC if it proposes to:

- Increase the price of a reserved ordinary letter service; or
- Introduce a new service that would fall within the definition of a reserved ordinary letter service; or
- Provide the reserved ordinary letter service under terms and conditions that are not the same, or substantially similar to, the existing terms and conditions of that service.

Additionally, Australia Post is required to notify the ACCC if the price of a 'stamped' priority reserved letter is proposed to be greater than 150% of the equivalent reserved ordinary letter price.

2.3. Ordinary letter service

Ordinary letters are letter services offered by Australia Post that do not include the provision of a special service for which a special charge or additional fee is payable. A special service will generally include special requirements or conditions that need to be met to qualify for the price charged.

There are two main groups of special services; those supplied at a lower rate than the ordinary letter rate (e.g. PreSort or Charity Mail) and those supplied at a higher rate than the ordinary letter rate (e.g. prepaid envelopes).

Postage for ordinary letters is predominantly paid for using postage stamps or postage labels, but in certain circumstances postage can be paid for by cash and Australia Post applies a 'Postage Paid' postmark.

[2] Under the APC Act, Australia Post has the exclusive right to collect, carry and deliver letters within Australia that (subject to exceptions) weigh not more than 250 grams. This statutory monopoly service, along with the right to issue postage stamps, are termed Australia Post's 'reserved services'.

Ordinary letters include reserved (up to 250 grams) and non-reserved letters (over 250 grams and up to 500 grams). Reserved ordinary letters represent around 8% of the reserved letter service and just 6% of the domestic letter service volume. They are the foundation upon which Australia Post's letter service is based and performance of 'ordinary' reserved letters (delivered to regular delivery timetable) are included within the delivery performance monitoring of the Prescribed Performance Standards. Reserved ordinary letters include:

- Small letters (the BPR – standard postal article carried by ordinary post), which represent the majority of ordinary reserved letters;
- Large letters up to 125 grams; and
- Large letters over 125 grams up to 250 grams.

3. Proposed prices

This section details:

- The proposed prices.
- The impact of the proposed prices.
- How the proposed prices remain affordable.
- How the proposed prices compare to other OECD countries.

3.1. Proposed prices – January 2020

The prices proposed in this notification demonstrate a holistic approach to domestic letter pricing that provides greater pricing certainty (amount and timing) to all letter customers while ensuring the ordinary letter service remains accessible to, and affordable by, all Australians.

While the scope of this notification is proposed changes to Australia Post's reserved ordinary letter service[3], there will also be price changes to other domestic letter products from January 2020. These price changes are included in the financial modelling to assist the ACCC.

Table 1 details the proposed change to reserved ordinary letter prices. Changes to other domestic letter products (including business letter services) is provided at Appendix 1. The financial impact of all proposed prices is provided at Appendix 2.

Table 1 – Proposed prices – Reserved ordinary letters

	Current Price	**Proposed Price**	**Increase %**
Ordinary small letter	$1.00	$1.10	10.0%
Ordinary large letter			
Up to 125g	$2.00	$2.20	10.0%
Over 125g up to 250g	$3.00	$3.30	10.0%

In setting the proposed prices, Australia Post applies pricing principles[4]. Key principles are:

- The Regular letter service is a 'safety net' service priced to recover the efficient cost of providing the service.
- The Priority letter service is a commercial product and is priced accordingly.
- Prices will be set to enable Australia Post to meet its statutory requirements to provide an adequate commercial return to fund its CSO.

Letter prices have been set to ensure a sustainable letter service. As shown in Table 31, the proposed prices (effective January 2020) do not exceed the efficient cost (including a reasonable rate of return) of providing the service.

[3] Stamped letters delivered to the Priority delivery timetable would also be notifiable if the rate proposed exceeded 150% of the ordinary rate.

[4] Appendix 3 details Australia Post's Letter Pricing Principles.

Furthermore, as part of the overall January 2020 proposed pricing package:

- The concession stamp will continue to be offered to eligible Australians at the 2014 rate ($3 for a booklet of five stamps). This means that users of the concession stamp have enjoyed the same small letter rate since 28 June 2010.
- The seasonal greeting card rate[5] will also continue to be offered at the 2014 rate (65 cents for a small letter).
- While there will be increases to the price of letters covered by the priority delivery timetable, the price of the priority label will remain at 50c.

3.2. Impact of the proposed prices

Australia Post estimates the average household sends between 10 and 20 letters per year. Within this estimate, for eligible households that have taken up the concession stamp offer, the price changes have no impact as the concession stamp rate does not change.

If a household is not eligible for, or has not taken up the concession stamp offer, the impact, within this estimate, will be between zero and $2 depending on the proportion of letters the household sends that are seasonal greeting cards.

3.3. Pricing for business letter services

Business and Government customers have been very clear they want more transparency and predictability around price changes. Providing notice, or at a minimum guidance, of future price changes allows customers to plan for changes financially and minimise disruption.

To address this issue Australia Post has committed to the following approach:

- Single increases each financial year (1 July – 30 June).
- Provide major customers and industry three months' notice of planned price changes.
- Provide pricing guidance for the following year to large customers and industry as soon as is practicably possible.

3.4. The BPR remains affordable

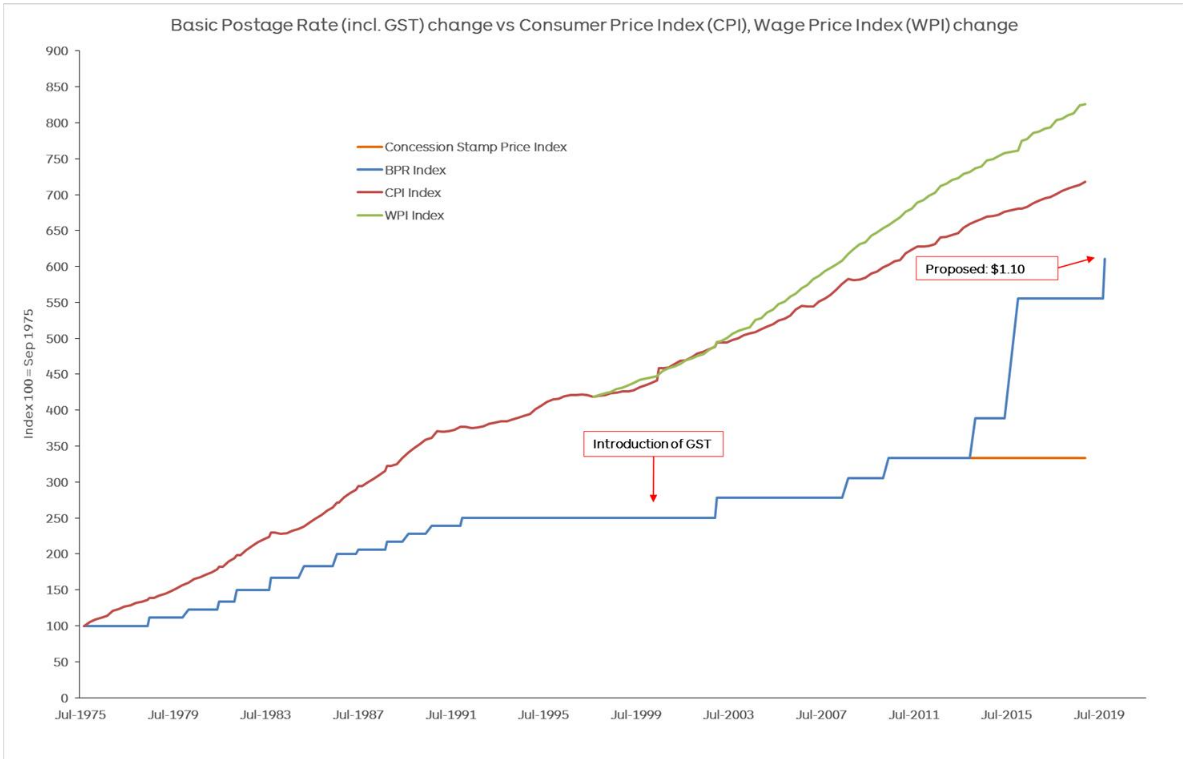
As noted in section 2, the challenge for Australia Post is balancing the need to earn a commercial rate of return and working towards an agreed financial target and dividend policy while continuing to meet the requirements of its CSO and providing an affordable BPR.

[5] Available November and December only

At $1.10, the BPR continues to see Australian domestic letter prices remain one of the most affordable in the world as shown Chart 1 which compares the change in stamp prices (postage rate including GST) to the change in the Consumer Price Index[6] (**CPI**) since 1975[7] and the change in the Wage Price Index[8] (**WPI**) since 1997[9].

The analysis shows the changes to the BPR since 1975 have been well below the changes to the CPI and WPI since 1975. Furthermore, as shown in Chart 1, the concession stamp rate index is significantly below the BPR Index, CPI and the WPI.

Chart 1 – Affordability of the BPR



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[6] Consumer Price Index; All groups; Quarterly; Publication Date: 30 January 2019; Australian Bureau of Statistics / Reserve Bank of Australia; ABS Cat No. 6401.0.

[7] The Postmaster General's Department was separated into the Australian Telecommunications Commission (trading as Telecom Australia) and the Australian Postal Commission (trading as Australia Post) in mid-1975 and hence was taken as a starting point for comparison

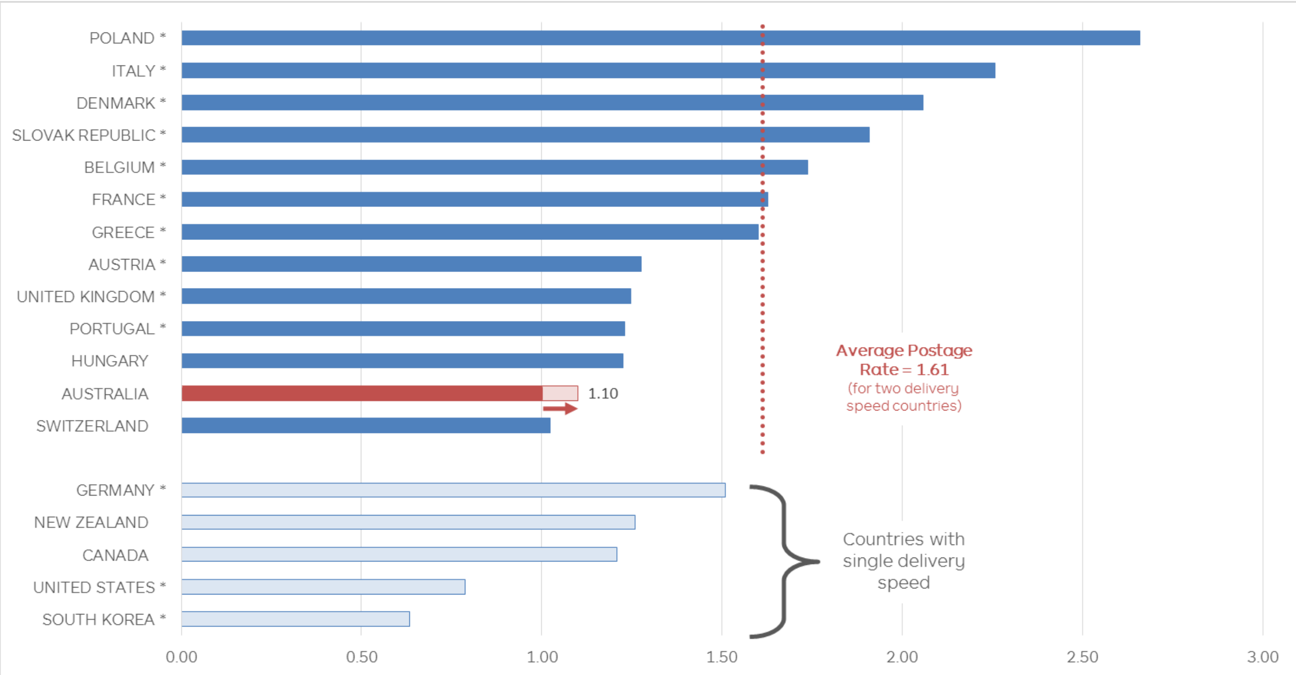
[8] Wage Price Index; Quarterly, Total hourly rates of pay excluding bonuses, All Australia, Private and Public, All industries; Publication Date: 20 February 2019; Australian Bureau of Statistics; ABS Cat No. 6345.0.

[9] As Wage Price Index data is only available from September 1997 it has been indexed from the level of CPI in September 1997.

3.5. BPR comparison to other OECD countries

As shown in **Chart** 2, when compared to other OECD countries, at $1.10, Australia's BPR is the second lowest where choice of delivery speed for letters is offered and is fourth lowest overall.

Chart 2 – Domestic postage rates, Regular[10]



*countries where basic postage rate is tax exempt

[10] Purchasing Power Parity (PPP) of basic letter price in A$ - source OECD and Australia Post, prices in other countries as at 1 July 2019.

4. Consumer insight

Australia Post continually monitors the perceptions of Australians via a quantitative, online survey among 1,000 people. The survey is designed to be representative of the 18 years+ community (sample proportions in accordance with 2016 Census data); and is 10 minutes in length.

4.1. Consumer satisfaction with letters

One of the areas monitored is consumer satisfaction with sending and receiving letters. In the period since November 2017, consumer satisfaction with sending letters has significantly increased, up 10% pts in February 2019 (Figure 1). Consumer satisfaction with receiving letters remains consistently high since January 2016 (Figure 2).

Figure 1 – Consumer satisfaction with sending letters

Source: Consumer Net Promotor Score (NPS) survey; those who have sent letters – January 2016 (n=444), November 2017 (n=1,009), September 2018 (n=745), February 2019 (n=728). Based on a response of 8 or higher to the questions: 'How would you rate your overall level of satisfaction with sending letters through Australia Post, on a scale of 0 to 10 where 0 is 'Not at all satisfied' and 10 is 'Extremely satisfied' and 5 is 'Average'."

Figure 2 - Consumer satisfaction with receiving letters

Source: Consumer NPS survey; those who have received letters – January 2016 (n=507), November 2017 (n=958), September 2018 (n=942), February 2019 (n=946). Based on a response of 8 or higher to the questions: 'How would you rate your overall level of satisfaction with receiving letters through Australia Post, on a scale of 0 to 10 where 0 is 'Not at all satisfied' and 10 is 'Extremely satisfied' and 5 is 'Average'."

The survey of customers in February 2019 also showed that when asked a different question (to those supporting the above Figures), around nine in ten customers (91%) believe that Australia Post exceeds or meets expectations when it comes to sending and receiving letters. This represents a significant increase of 10% pts compared to November 2017.

When thinking about our letters service among senders, almost three in four (74%) are satisfied with the ease of sending a letter, 64% with the range of sending options, and 45% with the cost of sending a letter. Compared to November 2017, satisfaction in each of these areas saw a slight increase of about 6% pts.

From a letter delivery perspective, 62% of customers continue to be satisfied with the timeliness of delivery, and three in four (73%) are satisfied with the condition it was received in. Around 7 in 10 consumers (69%) are satisfied with the accuracy of delivery and 69% with the friendliness and professionalism of the postie.

4.2. Consumer and Business satisfaction ratings – Australia Post as a whole

NPS is calculated subtracting the proportion of Promoters (indicated 9 or 10) from Detractors (indicated 0 to 6).

When asked the question below, we continue to see strong advocacy for the Australia Post brand with a combined June monthly score of +19.1 NPS points. Year to date, the combined score is +20.5 NPS points. This represents a +3.4 point increase from the end of year FY17 score (+17.1 points).

> '*Taking everything you know about Australia Post into consideration how likely would you be to recommend Australia Post to a friend or colleague, using a scale of 0 to 10 where 0 is 'Not at all likely' and 10 is 'Extremely likely'?'*

The Business NPS for the month of June 2019 was +19.0 points.

The Consumer NPS for the month of June 2019 was +19.3 points, our fifth highest ever Consumer score whilst running this program (the highest score reached was 20.2 points in December 2018). Since November 2017, we have seen an improvement in NPS across nearly all customer segments, with Golden Years (Roy Morgan's Helix consumer segment for retirees) seeing the biggest increase (from 17.2 to +27.9 points).

4.3. Attitude to price changes

In November 2018, we also sought independent research (quantitative survey of 2,000 people) to understand community reactions to a potential stamp price increase.

The online survey was conducted between 22 November and 27 November 2018. The survey was designed to be comprehensive (15 minutes in length), robust (N=2,000 sample), and representative of the views of the Australian 16 years+ community (sample proportions are in accordance with 2016 Census data). Key outcomes from the survey:

4.3.1. Reaction to a potential stamp increase

The majority of the community (64%) expects the price of a single stamp to increase in the next 12 months. Of those who did not think the price would increase; over half were 16 – 25 years old, half were students and 45% spoke a language other than English at home.

4.3.2. Community differences in level of support

A segmented approach based on demographic and socioeconomic status showed no cohort would be significantly more or less likely to support or oppose an increase.

Those slightly more likely to oppose an increase are aged over 55 and pre-retirees or retirees.

4.3.3. Reasons for support versus opposition

The key reasons for supporting an increase included; business economics, value of the service provided, price satisfaction and maintaining a business model signal a level of commercial pragmatism.

The key reasons for opposing an increase included; perception of being profit driven, poor service quality, no longer send letters and cost of living is too high.

We then showed a variety of positioning statements which noted the increase was around ensuring a sustainable letter service (maintaining the postal network and delivery standards) or not profit driven. After seeing these statements, 80% of the community were supportive or neutral towards an increase.

5. Letter volumes

In this section:

- The approach to volume forecasting – baseline projections for each of the key letter segments are derived from an econometric model which are then finalised by including insights based upon most recent industry and market intelligence.
- Continuing pressure – the rate of volume decline continues and is primarily driven by digital substitution.
- Price elasticity – estimates reveal an inelastic set of price elasticities on letter volume demand and this provides a quantification of the historical impact of price changes.

5.1. Overview

The global financial crisis (**GFC**) of 2007/08 marked a fundamental change in letter volume demand for Australia Post. Since that period, electronic alternatives to physical mail have driven down letter volumes at a rate far greater than that of the proceeding period.

Globally, digital connectivity continues to rise. According to the International Telecommunications Union, the number of internet users grew to 3.6bn in 2017, representing 48.0% of the world's population (up from 20.5% a decade ago).

As the expansion of faster broadband networks has brought more people online, data use across the globe has grown exponentially. Mobile devices are fast becoming the preferred way for consumers to access digital content, with the number of devices and connections per user increasing each year.

Since Australia's peak mail volume year (2007/08), the volume of addressed letters sent in Australia has fallen by 48.6% as shown in Table 2.

Table 2 – Letter volumes – a history of decline[11]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	FY09-18 CAGR	FY09-18 Total
Total addressed%	(4.1)	(5.5)	(3.7)	(4.9)	(6.3)	(4.0)	(7.0)	(9.7)	(11.8)	(10.9)	(7.1)	(48.6)
Reserved%	(3.9)	(5.5)	(3.6)	(5.2)	(6.8)	(4.0)	(7.3)	(9.7)	(11.9)	(11.0)	(7.3)	(49.3)
Reserved Ordinary/Other%	(4.8)	(6.4)	(5.8)	(5.7)	(9.9)	(5.8)	(10.5)	(13.8)	(17.7)	(11.3)	(9.7)	(60.2)

In recent times, the landscape of the Australian postal industry has been characterised by increasing declines in letter volumes and an expansion in the number of delivery points that Australia Post is required to service. It is against this backdrop that in January 2016 Australia Post introduced the most significant regulatory reform to its letters business in over 20 years to ensure the future sustainability of the letters business.

Australia Post has made significant cost savings associated with the introduction of the January 2016 product and price changes and will continue to pursue cost efficiencies. However, to ensure the ongoing sustainability of the letters service a balance of price changes with cost efficiencies is required.

[11] 2017/18 reserved volume has been adjusted to exclude Print Post <250g to provide comparability with historical information.

5.2. Approach to letter volume projections

The prices proposed by Australia Post are embedded within the most recent modelling work undertaken by Diversified Specifics Pty Ltd (an external consultancy engaged by Australia Post for independent analysis) in its preparation of the '*Australia Post Domestic Letter Volume Demand Update', July 2019* report.[12]

There has been a change in notation from previous documentation developed by Diversified Specifics to more accurately reflect the Diversified Specifics process, (the term '*projection*' rather than '*forecast*' is used to emphasise the methodology projects forward historical trends econometrically). However, the approach to letter volume forecasts is consistent with Australia Post's price notifications since 2010. That is the modelling work applied by Diversified Specifics to Australia Post's revenue-based volumes acts as the baseline for the letter volume forecasts presented in this notification and as such, letter volume forecasts incorporate off model market and industry-based intelligence on recently emerging trends or future events that the econometric process does not completely recognize.

The techniques used are premised upon best practice econometric methods in line with internationally accepted approaches to letter volume projecting.

In establishing a set of baseline projections for each of the letter volume segments, which has now extended the scope to include the Print Post segment, Diversified Specifics:

- employed several advanced econometric techniques including tests for structural breaks[13], co-integration, optimal lag structures vector error correction and dynamic ordinary least squares modelling; and
- imposed a Clements-Hendry adjustment factor to ensure projection robustness. The adjustment is designed to capture any momentum effects of additional falls in letter volumes from potentially increasing substitution effects beyond the impact captured by the substitution variable in the estimated model.

These projected baselines represent logical and statistically valid advances on previous projection efforts that have also acted as the foundation for prior price notifications submitted to the ACCC.

However, in a time of rapid technological change, baseline projections derived from empirical data are likely to become obsolete relatively quickly. This is due to an underlying assumption of the empirical models that any existing trends will continue at a similar pace to those observed historically.

Furthermore, there is no single variable that precisely measures the phenomena of electronic substitution away from the traditional letter item. Rather, multiple electronic communication channels emerge at different times each at varying stages of development and penetration. As such, the econometric process generates baseline projections only. Indeed, there will always be a need for these projections to be supplemented with current market and management insights to recognize emerging trends whilst also acknowledging the very real threats that are likely to impact letter volumes in future years.

[12] The findings of this section are largely based upon the Diversified Specifics report: 'Australia Post Domestic Letter Volume Demand Update', July 2019. The reader is advised to consult the source documentation for greater detail where required.

[13] Excluding Print Post due to limitations on data availabilities.

Diversified Specifics' econometric models project future letter volume fluctuations under two scenarios – with and without the proposed price increases applied. Importantly, the difference between the projections across the two scenarios are not qualitatively large suggesting most of the anticipated letter volume reductions are attributed to a sustained movement towards electronic alternatives to the letter. This, in addition to the estimation of a largely inelastic set of price elasticities, suggest the forces of electronic substitution are presently, and will continue to be, the dominant driver of letter volume demand for some time to come.

5.3. Forecasting process

The econometric projections are intended to represent a baseline upon which further intelligence may be overlaid to counter a lack of tractable empirical data on the emerging threats to letter volumes.

This includes trends identified within Australia Post's internal charge account data, which show that industries are in differing stages of developing alternative communication portals, the more advanced of which will result in letter volume declines in excess of those predicted by any econometric process.

As a result, Australia Post's volume forecasts are derived by generating a baseline projection using Diversified Specifics model and then finalised by incorporating recent market intelligence by Australia Post to account for 'off-model' impacts.

This approach is consistent with that adopted by Australia Post in prior notifications and accepted by the ACCC:

> *'These forecasts, which are also reflected in Australia Post's 2013 Corporate Plan, are broadly consistent with recent trends in letter volumes.*[14]*'*

In summary, the dynamic statistical methodologies and augmentation approach that support the letter volume forecasts outlined within this notification are consistent with those previously accepted by ACCC.

The following sections delineate Australia Post's key letter volume categories of Ordinary / Other and PreSort into its small and large letter components.

This facilitates a discussion of the diversity in how these trends have evolved and how they are subsequently modelled to generate letter volume forecasts.

5.4. Forecast letter volumes

The volume forecasts in this notification assume an average annual reserved letter volume decline of 9.4% per annum out to 2021/22.

Table 3 – Total reserved letter volumes

	2017/18 Final	2018/19 Forecast	2019/20 Forecast	2020/21 Forecast	2021/22 Forecast	CAGR
Volume (m)	2,231	2,032	1,828	1,657	1,511	
Change (%)		(8.9)	(10.0)	(9.4)	(8.8)	(9.4)

The following Tables show that domestic letter volume (addressed and total) also continue to decline resulting in an average annual volume decline of 9.5% and 9.0% respectively per annum.

[14] Australia Post Price Notification Final Decision, February 2014, page 26

Table 4 – Total domestic addressed letter volume

	2017/18 Final	2018/19 Forecast	2019/20 Forecast	2020/21 Forecast	2021/22 Forecast	CAGR
Volume (m)	2,274	2,071	1,863	1,687	1,537	
Change (%)		(8.9)	(10.0)	(9.4)	(8.9)	(9.5)

Table 5 – Total domestic letter volume

	2017/18 Final	2018/19 Forecast	2019/20 Forecast	2020/21 Forecast	2021/22 Forecast	CAGR
Volume (m)	2,856	2,678	2,407	2,199	2,018	
Change (%)		(6.2)	(10.1)	(8.6)	(8.2)	(9.0)

Although letter volumes are declining, the nationwide delivery network that Australia Post is required to service continues to grow. Over the last two decades the delivery footprint has increased by circa 1.6% per annum.

With domestic addressed letter volumes forecast to be 1,537m by 2021/22, the number of addressed letters per delivery point continues to decrease. By 2021/22 the volume of addressed letters per delivery point is forecast to have decreased by 8.8% per annum since 2007/08 (or 72% overall).

Table 6 – Addressed letter volume per delivery point per annum

	2007/08 Actual	2017/18 Actual	2018/19 Forecast	2021/22 Forecast	2007/08 - 2021/22 CAGR	2018/19 - 2021/22 CAGR
Number of delivery points (m)	10.5	11.9	12.1	12.6	1.4%	1.6%
Letter volume (b)	4.6	2.3	2.1	1.5	(7.5)%	(9.5)%
Volume per delivery point	441	192	172	122	(8.8)%	(10.9)%

5.5. Ordinary / Other letters

The Ordinary / Other letter classifications consist of:

- Non-bulk business-to-business and business-to-household mailings; and
- Individual mailings from household-to-business and household-to-household.

Some specific attributes of Ordinary / Other letters are that they:

- Generally consist of letters that are produced or mailed on an ad hoc or daily basis.
- Can consist of mailings in response to a one-on-one interaction.
- Have lodgement sizes that are well below the threshold required to access the PreSort letter service.

As a result, these segments have traditionally been more susceptible to substitutive pressures over a longer period.

In the recent past these letter segments have experienced an accelerated rate of decline as a greater array of alternatives continue to gain a wider level of acceptance amongst senders and receivers. For example, direct debit payments within Australia grew by an average of 7.5% per annum over the 2007/08 to 2017/18 period.

5.5.1. Ordinary / Other small letter volume

The Ordinary / Other small letter segment category consists of full rate business mail, cheque payments and other consumer correspondence that satisfy the relevant small letter category size and weight requirements as set by Australia Post.

Declines in this type of mail are well documented underpinned by a behavioural shift towards phone, internet and direct debit payment channels to settle a bill or invoice. Consequently, cheque volumes have diminished (down 21.0% and 19.6% in 2016/17 and 2017/18 respectively).

This leads to a segment now containing a larger proportion of small and medium enterprise bill presentment type mail which will continue to be impacted by substitution, consolidation and rationalisation as individual senders seek to minimise their transaction costs by reducing their usage of the physical mail item.

5.5.2. Ordinary / Other small letter volume drivers

Using a vector error correction modelling (VECM) framework the statistically significant volume drivers over the June 2002 to June 2018 timeframe are:

- Substitution – bill payments type substitution away from the traditional mail item is proxied by cheque volume as broadly representative of declines in all traditional modes of bill payment and inversely the growth in popularity of direct debit payment options. Within the projection process the rate of substitution for this letter segment broadly reflects the trended cheque volume decline; and
- Real Price – a combination of inflationary real price declines and nominal price increases. Consumer Price Index (**CPI**) projections for average changes in consumer prices were given by the Commonwealth Budget projections whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.

The error correction component of the VECM is augmented with two dichotomous variables to capture the effects of the GFC and the relatively large increase in the basic postage rate price occurring in the March quarter of 2016.

5.5.3. Ordinary / Other large letter volume

This segment consists of full rate large letters up to a maximum size, weight and thickness of 360x260mm, 500g, and 20mm respectively.

Traditionally an effective channel for larger document transmission, this segment is directly impacted by technological change factors and the willingness of the wider population to embrace such advancements as they communicate with each other. As the number of households and businesses with online connections in Australia has increased so too has the popularity of flash drive usage, cloud storage facilities and file sharing services such as Dropbox, iCloud and OneDrive. These technologies have permitted an instantaneous and cost-effective medium for larger document transmission that greatly reduces the need for such documents to be sent via the postal network.

5.5.4. Ordinary / Other large letter volume drivers

Using a VECM framework the statistically significant volume drivers over the June 2002 to June 2018 timeframe are:

- Substitution – substitution away from the traditional mail item is captured by a measure of mobile broadband traffic growth in the Asia Pacific region to proxy growth in EDI technology, transmission of larger documents via email and other cloud-based platforms in addition to online form facilities. These impacts are captured within the Other large letter projection process via the interpolation of annual projections on global mobile traffic in the Asia Pacific region as generated by Cisco.[15]
- Real Price – a combination of inflationary real price declines and nominal price increases. CPI projections for average changes in consumer prices were given by the Commonwealth Budget projections whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.

The error correction component of the VECM is augmented with two dichotomous variables to capture the effects of the GFC and the relatively large increase in the ordinary / other large letter prices occurring in the March quarter of 2016.

5.6. PreSort

This segment consists of bulk (300+) lodgements that typically consist of:

- Business transactional letter volume commonly generated by business and government enterprises who service large customer bases. These organisations are typically quite structured in their planning and mailings tend to be an outcome of a business process linked to servicing customers; and
- Promotional or trans-promotional material such as brochures or other addressed material that satisfies the relevant letter category, conditions, size and weight requirements.

5.6.1. PreSort small letter volume

This segment consists of the following items that satisfy the relevant small letter category size and weight requirements:

- Business transactional presentment letter volumes such as bills, statements, share notices and letters advising customers of price increases, policy changes, etc.; and
- Promotional mail including direct mail, brochures and other addressed promotional material.

The dominant product category within this segment is business transactional letters. Pre GFC, letter volume movements reflected a positive association with growth in Australian non-farm gross domestic product. However, post GFC the situation altered as businesses were impacted by a slowdown in sales and began to shift their focus towards cost containment practices to maintain their profit margins.

Two options that could be enacted immediately were:

- Rationalisation – reducing the frequency that invoices and statements were provided to the recipient; and

[15] Cisco (2012), 'Cisco Visual Networking Index: Global Mobile Data Traffic Forecast Update', 2011–2016, Asia Pacific Mobile Data Traffic, p.24; & Cisco (2016), "Cisco Visual Networking Index: Global Mobile Data Traffic Forecast Update, 2015–2020", Asia Pacific Mobile Data Traffic, 3 February 2016, p.36. The methodology employed involves interpolating the series from annual to quarterly and extrapolating the projections to correspond with the forecast horizon.

- Consolidation – integrating multiple messages (e.g. a transactional message and a promotional message) within a single letter item rather than the sending of two separate letters.

Although these practices had the ability to reduce the demand for PreSort small letters, another factor has also emerged that had the potential to eliminate that demand altogether:

- *Sender sponsored electronic substitution* – businesses themselves began investigating, developing and promoting a widespread acceptance of alternative electronic bill presentment channels to the traditional letter.

Multi-country cross sectional surveys have indicated recipients' preferences for the physical letter item remains strong despite a wider range of alternatives. As a result, private senders of bill presentments appear to fall into two categories:

- Those fundamentally motivated by reductions in transaction costs. These senders have tended to engage in a range of push and pull tactics aimed at changing recipient behaviours to facilitate a wider acceptance of new substitutive platforms;[16] and
- Those who might forego the possible cost advantages of pursuing an electronic alternative to instead retain a relationship with the recipient by remaining loyal to the letter due to its effective reach and promotional attributes. These senders do not formulate their decisions about mail based upon cost or incremental changes in price. Rather, they form their communication decisions based upon technological availabilities, the effectiveness of each platform, the behaviour of the recipient, etc.

This discussion is relevant when the sender and recipient retain the power to choose their own communication channel.

Unfortunately, these two categories are not clear cut (rather a sender may adopt either approach based upon the communication type and customer base) nor stable. In recent years there has been an increasing trend of businesses pursing the cost reduction initiative and either removing the option for letter-based communication altogether or imposing penalties upon a potential recipient in the form of higher prices and transaction charges.

5.6.2. PreSort small letter volume drivers

Using a dynamic ordinary least squares (DOLS) framework the statistically significant PreSort small letter volume drivers over the timeframe of December 2007 to June 2018 are:[17]

- Substitution – the widespread use of tablets and smartphones facilitated by wireless broadband technology. These impacts are captured within the projection process via the interpolation of projections on global mobile traffic in the Asia Pacific region by Cisco. To account for the increased propensity to substitute away from the traditional PreSort small letter item, forward projections on the substitution variable are augmented by similar statistics on machine to machine technological advances that are likely to gain momentum in future years; and

[16] Examples include the imposition of a surcharge for the provision of a paper-based bill or the compulsory use of a direct debit arrangement as a condition of a new service agreement or product offering. For a more detailed discussion see Paterson C.J. Nikali H. & Elkela K. (2014), *"Digitalization of Consumer Invoices - A Comparative Study"* The Role of Postal Service in a Digital Age, M.A. Crew and T.J. Brennan (eds), Edward Elgar Publishing Ltd, p.283.

[17] The PreSort small letter volume model is developed using a dynamic ordinary least squares technique consistent with Diversified Specifics 2015, Australia Post: Domestic Letter Volume Demand Update – August 2015, produced on behalf of Australia Post.

- Real Price – a combination of inflationary real price declines and nominal price increases. CPI projections for average changes in consumer prices were given by the Commonwealth Budget projections whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.

The model also contains two dichotomous variables that capture the effects of the GFC and the relatively large increase in the PreSort small letter prices occurring in the March quarter of 2016. Although each is statistically insignificant, they are included for their economic significance, for consistency with the model's philosophies adopted in this research task and due to their requirements in satisfying the tests on cointegration.

5.6.3. PreSort large letter volume

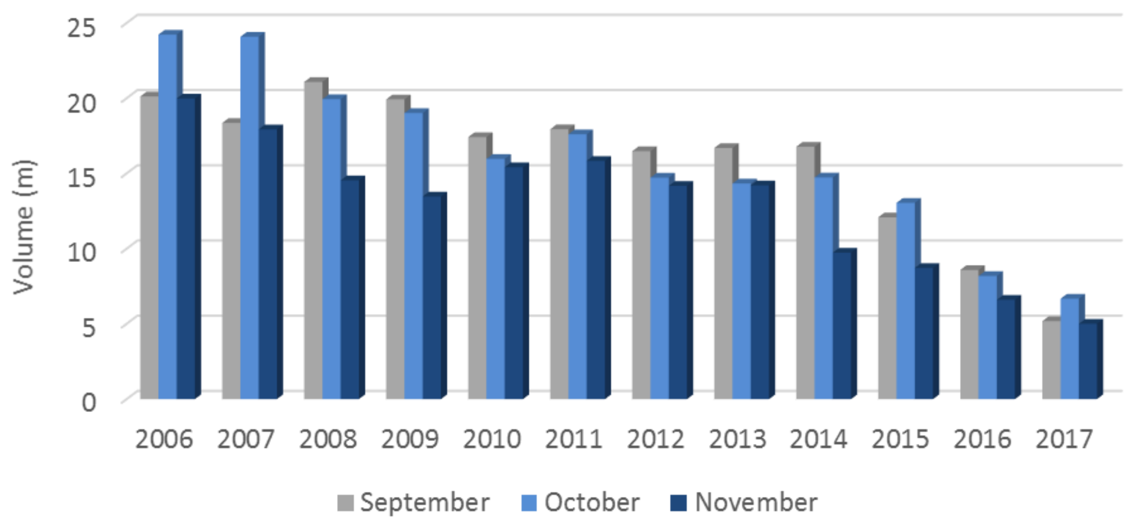
This segment consists of bulk (300+) lodgements of large letter mail typically sent by business and the public sectors. It includes items such as prospectuses, annual reports and promotional material.

Letter volume fluctuations of this non-standard sized category of business mail correlated highly with movements in the level of economic activity pre GFC. This association largely explained an average annual growth rate of 2.2% for PreSort large letter volumes over the 2000/01 to 2007/08 period.

However, in the post GFC climate, as business strategies progressively moved towards an engagement of cost containment activities, the bulk distribution of large publications became a target for potential savings.

Coupled with legislative changes to the Corporation Amendments Act of 2007, which required companies to mail a hard copy annual report on an opt-in basis only, a divergence in the long run association between the health of the Australian economy and PreSort large letter volume movements was reinforced (see refer Chart 3).

Chart 3 – PreSort large volumes (typical annual report months)



5.6.4. PreSort large letter volume drivers

Using a VECM framework the PreSort large letter volume drivers over the timeframe of September 2009 to June 2018 are:

- Substitution – mobile wireless broadband traffic is employed as a proxy for alternative electronic channels that enable the receipt of nonstandard sized documents. These impacts are captured within the projection process via the interpolation of projections on global mobile traffic in the Asia Pacific region by Cisco; and
- The error correction component of the VECM is augmented with two dichotomous variables to capture the effects of the closure of the Medium letter product service and the relatively large increase in the PreSort large letter prices occurring in the March quarter of 2016.

5.7. Print Post

This segment consists of lodgements that satisfy the relevant Print Post category size and weight requirements.

Volumes in this segment consist of publications such as magazines and catalogues. The dominant product in this segment is Print Post Large < 500g. Given the relationship to membership, the econometric analysis does exclude those magazines published by large (volume) member associations.

Since 2007/08 volumes[18] have declined at an average annual rate of 5.8% however, in 2016/17 volumes declined by 10.6% and by 9.9% in 2017/18.

These declines reflect the general trends within the magazine and publication industries where magazine and publication subscription (and circulation) rates have declined worldwide.

5.7.1. Print Post volume drivers

Using a VECM framework the Print Post volume drivers over the timeframe of September 2014 to June 2018 are:[19]

- Substitution – mobile wireless broadband traffic is employed as a proxy for electronic alternatives to print based magazines. These impacts are captured within the projection process via the interpolation of projections on global mobile traffic in the Asia Pacific region by Cisco; and
- Real Price – a combination of inflationary real price declines and nominal price increases. CPI projections for average changes in consumer prices were given by the Commonwealth Budget projections whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.

5.8. Summary of econometric forecasts

The econometric projections as derived by Diversified Specifics suggest declining letter volumes in every year for each letter segment. Contrasting the 'with' and 'without' price increase scenarios clearly identifies the importance of electronic substitution as the dominant statistical letter volume driver.

When recent trends are combined with the inferences generated by the projection scenarios, the extent and magnitude of the threat to Australia Post's letters business over the short run time horizon are readily observable.

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[18] Excluding large (volume) member associations

[19] Given the small sample size and the possibility of latent effects, interpretations of the Print Post drivers and parameters should be treated as indicative only.

5.9. Estimating a reliable set of price elasticities

In the years following 2007/08 and in contrast to any period previous, each letter volume segment has been characterised by an increasing number of price changes as Australia Post responds to very real threats to its core letters business.

In acknowledgment of the challenging landscape Australia Post operates in, it is important to estimate any letter volume effects associated with this overt change in pricing policy.

For each letter volume segment, the econometric modelling process estimates a price elasticity that is relevant to the historical postal environment and can provide a guide as to how volumes might respond to any future changes in postage rates.

Diversified Specifics most recent econometric analysis highlights that all price elasticities of demand are inelastic.[20] For the PreSort large letter segment, real price did not display statistical significance and is therefore assumed to be perfectly price inelastic.

Table 7 – Price elasticities of demand (Diversified Specifics models)

Price elasticity by segment	
Small Letter Volumes	
Ordinary / Other	-0.42
PreSort	-0.24
Large Letter Volumes	
Ordinary / Other	-0.60
PreSort	N/A [21]
Print Post Volumes	-0.34

Previous studies have also indicated that price is either inelastic or fails to register as a statistically significant driver (assumed to be perfectly price inelastic).

The findings of the Diversified Specifics study project declining letter volumes in every year to 2021/22 for every letter segment and that the leading statistical and economic driver of volume remains electronic substitution.

These findings emphasize the significant role substitutive pressures (dependent upon the extent that senders and receivers are willing to accept the alternative mode of communication) has on Australia Post's letters business.

Diversified Specifics research also suggests that in an environment characterised by rapid technological change, projections generated from econometric models based on empirical data can quickly become obsolete. It then becomes essential that letter volume projections be augmented with industry / market-based intelligence and institutional insights to enable a view of the future that is increasingly accurate and robust.

An explanation of Australia Post's volume forecasts, illustrating the augmentation of the econometric baseline projections is provided at Appendix 4.

[20] Econometric modelling at Australia Post for all segments except for Print Post has spanned a 17-year period. Over that time each model has benefited by numerous updates and revisions that have generated a significant knowledge base regarding the factors that drive letter volume demand for any one segment. The modelling of Print Post mail volumes however remains in its infancy and when combined with the relatively small sample size employed, its associated elasticity estimates should be treated with all due caution given the possible presence of latent effects.

[21] For the PreSort large letter segment, price was not statistically significant (statistically insignificant parameter was 0.4)

5.9.1. Promoting and sustaining mail

In October 2015, a Postal Industry Consultative Forum meeting was held with representatives from the printing industry, direct marketing industry, charity / fundraising industry, envelope industry, postage meter vendors, the licensed post office network, small business and relevant unions.

The Forum provided a way for all stakeholders with interests in the postal sector to share their ideas and issues in an open and transparent way.

An action from the Forum was for Australia Post to work with industry representatives, industry associations and suppliers to establish a working group.

In March 2016, the Mail Industry Working Group (**MIWG**) was formed and continues to meet regularly. The MIWG comprises representatives from the printing industry, direct marketing and fundraising industry associations, envelope suppliers and postage meter suppliers.

The primary objective of the MIWG is to focus on initiatives to sustain mail volumes and maintain the relevance of addressed mail. The meetings also provide a forum for consultation and idea sharing on areas of mutual interest across the mailing industry including industry promotion and innovation, mail product developments/changes and supply chain efficiencies.

The MIWG has become a well-established forum and continues to provide attendees a forum in which to share their issues and ideas with one-another in an open and transparent way.

The MIWG also provides attendees with the opportunity to gain a broader perspective of the many factors influencing the postal sector, cost efficiency programs, and upcoming mail developments and initiatives.

In forming the MIWG, it was also recognised that the industry associations and supplier groups would continue to meet with Australia Post on a one-on-one basis to pursue initiatives specific to their sector or organisation.

Australia Post continues to meet with the following groups to work together on initiatives to promote the value of mail and / or specific development or productivity opportunities:

- Printing Industries Association of Australia;
- Fundraising Institute of Australia;
- The Real Media Collective (**TRMC**)
- Envelope suppliers;
- Postage meter suppliers; and
- Mailhouses.

TRMC was formed through the merger of two former industry associations: the Australasian Catalogue Association (**ACA**) and Two Sides Australia Limited (**TSA**). Australia Post, which had representation on the boards of both TSA Ltd and the ACA, is on the board of TRMC.

Australia Post promotes and supports the mail channel at an industry and customer level through sponsorship of industry campaigns, undertaking our own promotion activity and providing tools to maximise use of the channel. This includes:

- Campaign Targeter – developed and launched by Australia Post in October 2017, Campaign Targeter is a free online tool for customers to better plan and target their promotional mail campaigns. The tool provides invaluable customer insights including access to Roy Morgan Research's Helix Personas and many mapping options.

    - Since launched, over 4000 users have registered, enabling them to better target either unaddressed or addressed mail campaigns.

- Print Post personalisation – launched in January 2017, this enhancement to content provisions allows senders to incorporate content specific to the addressee and increase the value and effectiveness of the publication being sent.
- Promo Post – launched 1 June 2015. Promo Post is a service specifically for addressed promotional mail delivered to the Regular delivery timetable, which provides lower prices than PreSort.
    - It has been widely used across all major sectors and in the 2017/18 financial year, represented 12.9% of total PreSort volume and 9.6% of total PreSort revenue.
- Support of TRMC: Australia Post is a major sponsor of TRMC, an industry association that develops and runs campaigns that promote and protect the use of print, paper and mail. There are four major campaigns:
    - Keep Me Posted – advocates for consumers to receive bills by their preferred channel (including though the mail) without being charged a fee;
    - Value of Paper and Print – develops and distributes research, case studies and articles that show the effectiveness of businesses using paper based media including mail for their marketing and communication activity;
    - Two Sides – challenges greenwashing by providing relevant evidence and requesting organisations correct any incorrect claims they make about the environmental impacts of paper and mail; and
    - Open Up To Mail: provides case studies, research and runs seminars to demonstrate to marketers and advertising agencies the effectiveness of including direct mail in multi-channel marketing campaigns

Supporting industry events such as the TRMC Annual Awards to ensure catalogues remain part of the multi-channel marketing conversation.

Customer Engagement – Australia Post’s:

- Sales teams work with clients across industry sectors to ensure that the benefits of physical mail and our mail products are understood and also to reinforce that mail remains a relevant channel for promotional and transactional communications; and
- Mail house briefings – provide a regular interface between mail houses and Australia Post, to brief them on upcoming changes and initiatives as well as assisting in the coordination of information on how to prepare and lodge mail into the network.

6. Costs

In this section:

- An overview of Australia Post's costs by major category.
- Detail on any material structural changes to these costs e.g. licensed post office (**LPO**) mail and delivery payments.
- Detail on how these costs change by price, volume or other impacts.
- Detail on how management of Australia Post's defined benefit superannuation scheme has historically materially reduced Australia Post's superannuation expense.

Table 8 – Financial overview

	Forecast	**Forecast**	**Forecast**	**Forecast**
$million	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Trading Revenue				
Letters[22]	2,260	2,105	2,013	1,915
Non-Letters	4,603	4,938	5,291	5,668
Total trading revenue	**6,863**	**7,043**	**7,304**	**7,583**
Trading Expenses (Cost)				
Labour and Oncosts	3,533	3,601	3,680	3,781
Goods / Services for Sale	189	201	209	217
Accommodation	363	364	364	365
Depreciation	287	273	288	324
Other Non-Labour	2,469	2,528	2,619	2,712
Total trading expenses	**6,841**	**6,968**	**7,160**	**7,399**
Trading profit	**22**	**75**	**144**	**184**

[22] Includes total domestic letters, inbound letters, inbound packets <2kg and outbound letters

6.1. Change to LPO mail and delivery payments

The payments licensees receive for mail and delivery related activities are either a percentage of postage value or dollar-rate fees, such as the post office box service fee and per delivery point mail management fee.

Historically LPO mail and delivery payments were indexed to movements in the BPR, however, in January 2018 this indexation was varied by agreement. This change was made to provide licensees more consistency and certainty around the timing and value of changes to these payments, to an annual adjustment in line with movement in the General Retail Industry Award (**GRIA**). With this change, cost forecasts for delivery payments are determined based on in the indexation to the GRIA.

As part of the consultation with the LPO representative groups on the change in indexation arrangement it was agreed that a review of overall LPO payment scheme would be undertaken.

A commitment was given that in the event of the next BPR event occurring prior to the completion of the review Australia Post would provide as an additional increase in payments to licensees any difference that might exist between the then BPR increase and any GRIA increases received in the period since the change in indexation arrangement.

The review of the LPO payment scheme commenced in February 2018 and was concluded in February 2019 (Appendix 5) with the revised LPO Payment Scheme: and will take effect from 1 July 2019. The benefits of the new payment rates will be applied retrospectively to licensees from 1 January 2019.

The new LPO payment scheme provides for an increase in payment to LPOs of circa $34m. As noted above, the indexation of delivery payments to the GRIA is included in the costs forecasts in our Corporate Plan. However, as other changes were agreed to after the Corporate Plan was finalised, that impact is not included in the financial data supporting this notification. Irrespective of this, those changes to payments do not have a material impact on the costs of the domestic reserved letter service.

6.2. FTE usage

As evidenced below, total FTEs at a corporate, domestic letter service and reserved letter service are forecast to decline.

Table 9 – Australia Post total FTEs by function

Activity / Area	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**31,746**	**31,474**	**31,477**	**31,530**

A breakdown of Table 9 by full time, overtime and part time / casual is shown at Table 10.

Table 10 – Australia Post total FTEs by type

Type	Forecast	Forecast	Forecast	Forecast
	2018/19	**2019/20**	**2020/21**	**2021/22**
Full time	24,128	23,793	23,780	23,805
Overtime	2,445	2,478	2,491	2,499
Part time / casual	5,173	5,203	5,206	5,226
Total	**31,746**	**31,474**	**31,477**	**31,530**

The following two tables detail domestic and reserved letter service FTEs by function.

Table 11 - Domestic letter service FTEs by function

Activity / Area	Forecast	Forecast	Forecast	Forecast
	2018/19	**2019/20**	**2020/21**	**2021/22**
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**14,907**	**14,003**	**13,346**	**12,682**

Table 12 – Reserved letter service FTEs by function

Activity / Area	Forecast	Forecast	Forecast	Forecast
	2018/19	**2019/20**	**2020/21**	**2021/22**
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**13,072**	**12,211**	**11,588**	**10,971**

6.3. Domestic letter service

This section details domestic, reserved and reserved ordinary / other letter forecast data to 2021/22.

Table 13 – Domestic letter service

	Forecast	Forecast	Forecast	Forecast
	2018/19	**2019/20**	**2020/21**	**2021/22**
Volume (m)	2,678	2,407	2,199	2,018
Revenue ($m)	2,027	1,873	1,776	1,669
Cost ($m)	✂	✂	✂	✂
Profit ($m)	✂	✂	✂	✂

Table 14 – Reserved letter service

	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Volume (m)	2,032	1,828	1,657	1,511
Revenue ($m)	1,835	1,690	1,599	1,499
Cost ($m)	1,814	1,708	1,653	1,588
Profit ($m)	**21**	**(18)**	**(53)**	**(90)**

Table 15 – Reserved letter service costs by function

$m	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other	✂	✂	✂	✂
Total Costs	**1,814**	**1,708**	**1,653**	**1,588**

Table 16 – Reserved Ordinary / Other letter service

	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Volume (m)	653	590	533	485
Revenue ($m)	671	623	585	547
Cost ($m)	738	701	680	656
Profit ($m)	**(67)**	**(79)**	**(95)**	**(109)**

Table 17 – Reserved Ordinary / Other letter service costs by function

$m	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other	✂	✂	✂	✂
Total Costs	**738**	**701**	**680**	**656**

6.4. Superannuation

This section outlines the two types of superannuation benefits available to employees of Australia Post:

- A defined benefit fund, the Australia Post Superannuation Scheme (APSS). This Scheme was closed in 2012 and at the time comprised nearly 100% of the Australia Post workforce. Currently 60% of the workforce are members of the APSS; and

- An employer sponsored default Accumulation fund, Australia Post Superannuation Plan (or any other complying accumulation fund at the employee's choice). There are currently in excess of 13,000 AP employees either in the Australia Post default Accumulation fund or that have exercised choice in the selection of their Superannuation fund. This accumulation membership base will continue to grow with membership forecast to surpass that of the APSS in 2020.

6.4.1. APSS defined benefit scheme

Since 1990, Australia Post has provided employee members of the APSS with retirement benefits. The current benefit for permanent employees is 14.3% of their final average salary for each year of service, and 9.5% for fixed-term and casual employees.

At 30 June 2018, the APSS defined benefit component held $4,198m in assets, representing a $528m surplus over the $3,670m of vested employee liabilities (114.4% VBI as at 30 June 2018).

These benefits are largely funded from the returns on existing APSS investments as well as company contributions to the Scheme.

6.4.2. APSS liability management

To actively manage the volatility of the defined benefit expense and cash contributions, the Scheme was closed to new members in July 2012. Even though accumulation arrangements can be higher for the employer than defined benefit, Australia Post determined that the investment risk and associated financial volatility to the Corporation was no longer an acceptable risk. As the surplus grows, the likelihood of an additional cash injection due to a market correction declines.

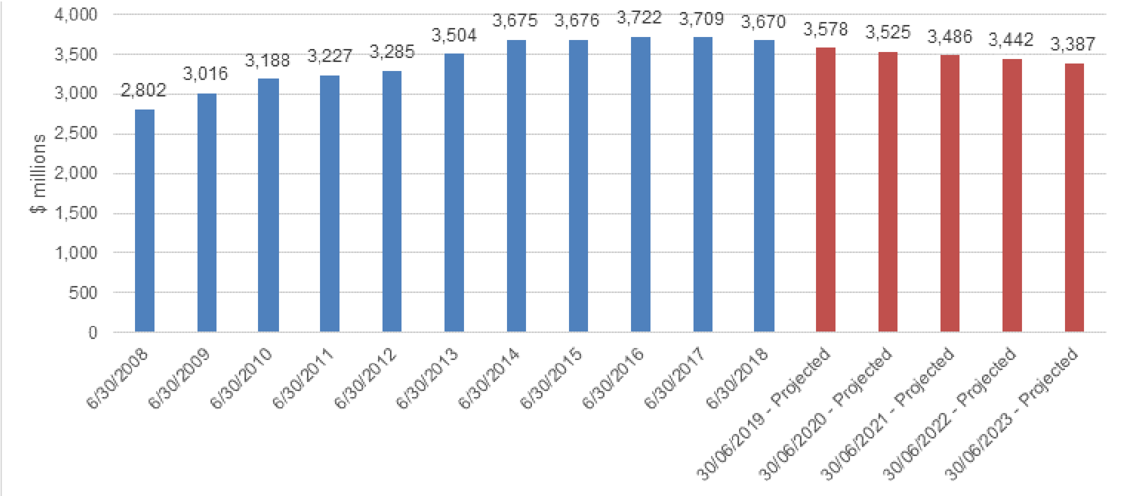
Indexation of superannuation salaries that do not grow, or grow by less than the Enterprise Bargaining Agreement rate for that year, between birthdays, with Average Weekly Ordinary Time Earnings (AWOTE) was ceased on 1 July 2014. In doing so, it not only assists the financial viability of the APSS but also provides greater certainty around Superannuation salary inflation and the associated liabilities.

At the same time, superannuation accruals during periods of leave without pay was modified from 12 months, to 28 consecutive days.

These changes have significantly de-risked the APSS by reducing liabilities and therefore the risk of additional funding requirements.

Whilst membership numbers have declined in recent years, Vested Benefits continued to increase after the APSS closure in 2012 however they have now started to stabilise and reduce as outlined in Chart 4.

Chart 4 – APSS Vested defined benefit liabilities

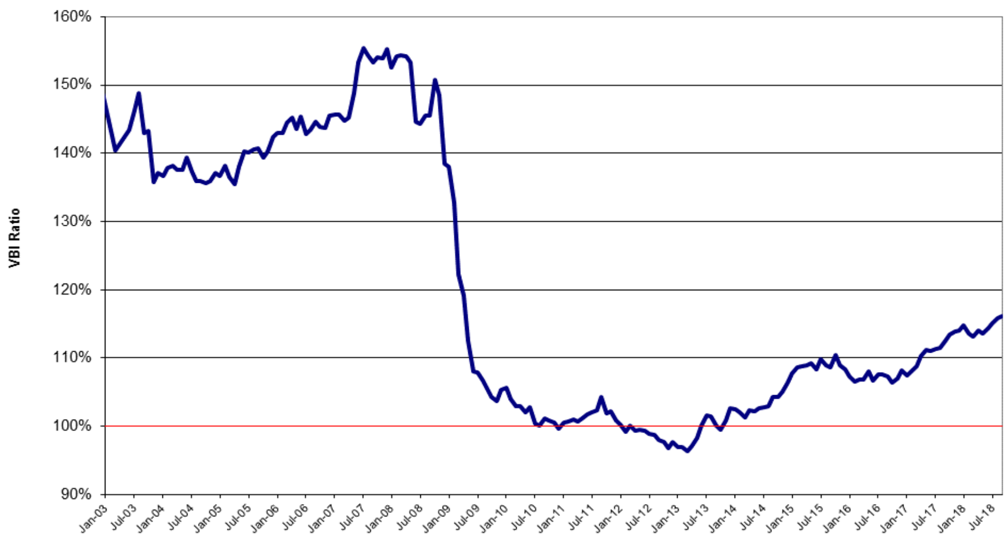


6.4.3. APSS Funding Risk

The funding position of the APSS has varied significantly over time, largely due to volatility in global financial markets. The funding position is most commonly measured as the ratio of the Australia Post financed assets to the Vested Benefits, known as the Vested Benefits Index (VBI). A ratio of 100% indicates that benefit obligations are fully funded.

As a result of carefully managing the liabilities and investments, the Vested Benefits Index has grown as illustrated in Chart 5 (114.4% at 30 June 2018, from 102.7% in June 2014). As the surplus grows, the likelihood of an additional cash injection due to a market correction declines.

Chart 5 – APSS Vested defined benefit index



The Australia Post Superannuation Scheme (APSS) is subject to actuarial review every three years required under the Trust Deed and APRA Superannuation Prudential Standards. The latest triennial actuarial valuation process commenced in June 2018 with the final report handed down to the APSS Trustee and Australia Post in December 2018.

Since the actuarial review in 2015, the funding of the defined benefit obligations of all existing APSS members has required annual employer cash contributions equal to 9.5% of employee superannuation salaries. The 2018 actuarial investigation tested this contribution rate with reference to projected liabilities and investment returns and assumptions.

Given the strong funding position of the plan at the time of the review, it was recommended that Australia Post works with the APSS Trustee to reduce the exposure to investment risk through a reduced investment target and reduces the rate of cash contributions in to the APSS**.**

Following the review, the Australia Post Board has agreed that the normal contribution rate is set at 7.5% of the Superannuation Salaries of Australia Post employees, effective from financial year 2018/19.

This revised contribution rate is based on the advice of the APSS Actuary. The APSS Actuary has confirmed that this level of contribution is expected to be sufficient to meet the Company's defined benefit obligations over the long term.

The defined benefit superannuation expense shown on the income statement will use assumptions prescribed under accounting standards and as such will differ from the cash contributions as shown Table 18.

Table 18 – APSS Defined Benefit

APSS Defined Benefit	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Cash Contributions ($m)	204.9	158.9	159.1	150.0	145.0	134.3
Defined Benefit Expense ($m)	115.1	271[23]	125.2[24]	186.5	197.2	162.6
Defined Contribution Expense ($m)	24.0	45.3	57.4	65.2	79.3	92.4

[23] Increase driven by accounting change during that period

[24] The one-off decrease was due to the removal of AWOTE indexation.

6.5. Depreciation

The following Tables show the depreciation expense for letter products over the next three years.

Table 19 – Depreciation expense, domestic letter service

$m	Forecast	Forecast	Forecast	Forecast
	2018/19	2019/20	2020/21	2021/22
Buildings & Fitout	21	19	20	21
Plant & equipment	28	31	34	34
Computer software	35	31	33	34
Motor vehicles	11	10	9	9
Total	**95**	**91**	**96**	**98**

Table 20 – Depreciation expense, reserved letter service

$m	Forecast	Forecast	Forecast	Forecast
	2018/19	2019/20	2020/21	2021/22
Buildings & Fitout	19	17	18	18
Plant & equipment	25	28	30	29
Computer software	33	29	30	30
Motor vehicles	9	8	7	8
Other Depreciation	0	0	0	0
Total	**86**	**82**	**85**	**86**

Table 21 – Depreciation expense, reserved ordinary / other letter service

$m	Forecast	Forecast	Forecast	Forecast
	2018/19	2019/20	2020/21	2021/22
Buildings & Fitout	8	8	8	8
Plant & equipment	11	11	12	12
Computer software	14	12	13	13
Motor vehicles	3	3	3	3
Total	**36**	**34**	**36**	**36**

7. Cost allocation

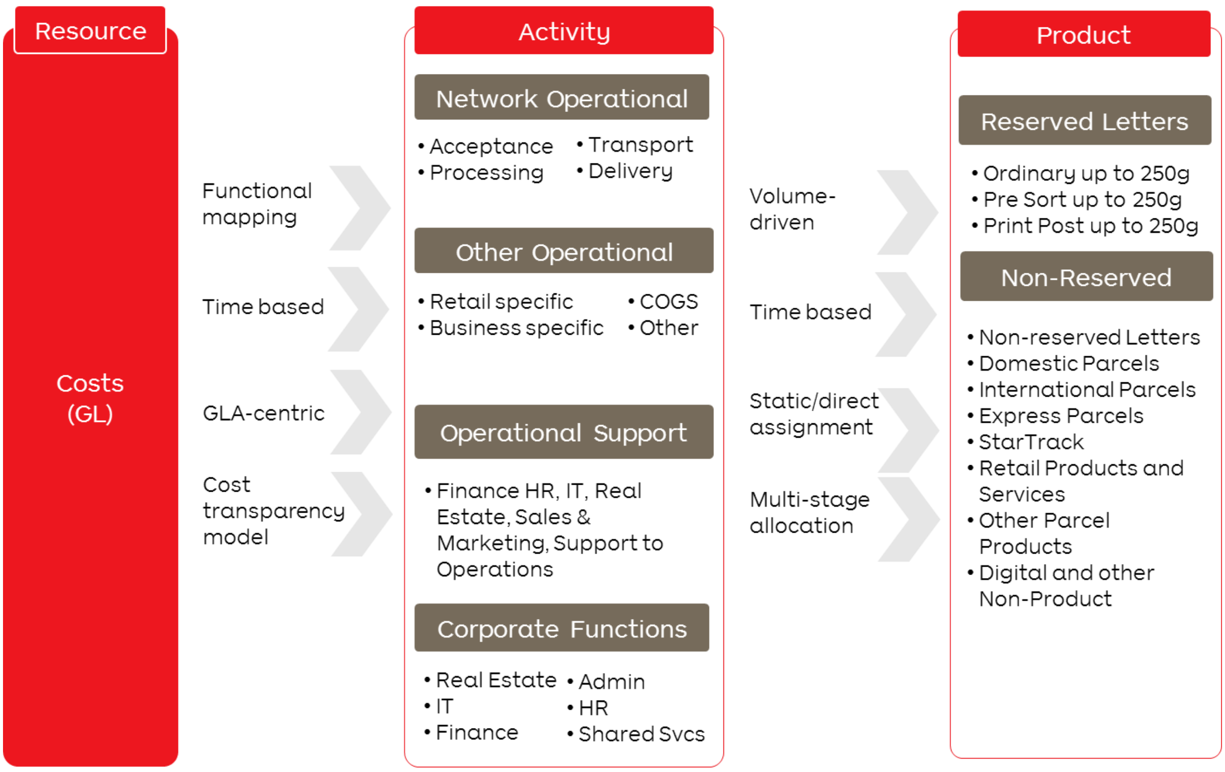
- An overview of Australia Post's cost allocation model and methodology.
- The changes Australia Post has implemented in response to ACCC / WIK recommendations (Delivery Cost Review) and how they result in a more transparent cost allocation.
- Detail on the need to review the current treatment of Unaddressed Mail costs.
- An overview on the allocation of costs between 'Priority' and 'Regular'.

7.1. Australia Post's cost allocation model

Australia Post uses an Enterprise Profit Model (**EPM**) to calculate the operational cost of 'Reserved' and 'Non-Reserved' services provided by Australia Post. The model is a fully absorbed costing model and allocates costs to products and services via the following guiding principles:

- All products and services are to be charged appropriately with the costs of the enterprise;
- Activity Based Costing is used as the appropriate cost allocation methodology;
- The Activity Based Costing model identifies resources costs from the general ledger and assigns these costs to activities, these activities are then assigned to products and services primarily according to consumption.
- Direct attribution of costs to products is conducted, wherever possible; and
- Miscellaneous revenues, unrelated to a product or service, are treated as miscellaneous, with any associated costs allocated to them.

Figure 3 – Enterprise Profit Model



EPM is used as a key internal reporting tool providing financial metrics to ensure a sharp focus is maintained on costs and product profitability.

EPM also supports external reporting requirements including:

- Regulatory Accounting Procedure Manual and the Record Keeping Rules schedules;
- Quarterly shareholder reports;
- Letters / Non-Letters services (Annual Reports);
- Key input into the CSO Model to calculate the CSO cost estimate; and
- Price notifications.

7.2. Methodology

Australia Post's cost allocation methodology is robust and relevant:

- Product volume is the dominant cost driver in the model.
- Product volume is measured in each activity (providing activity specific volume) and in each geographic state (state originating and terminating volumes).
- Products do not receive activity cost if there is no volume of product in the activity.

The use of volume as a key driver means the methodology employed by Australia Post inherently increases the cost burden for products experiencing volume growth and lessens the burden for products in structural decline.

This methodology reflects a 'dual till' approach and as demand for reserved letter service products declines, an increasing proportion of Australia Post's total cost base is borne by non reserved products.

While the principles underpinning our cost allocation model are unchanged, we continue to refine and improve the model and ensure it is updated to reflect changes in the business.

7.3. Safeguards

The cost allocation model has safeguards to avoid over-costing declining products and under-costing growing products.

The model achieves this as all activity cost is volume variable, regardless of whether the underlying resource used in the activity is fixed or variable.

In multi-product activities, product volume and the product consumption rate of activity resources, determine the cost allocation to each product. If consumption rates remain relatively stable over time, then cost allocation is predominantly volume dependent.

Products experiencing volume growth are deemed to be placing greater demand on shared activity resources than products that are declining. All products consuming a shared activity bear the same proportional change in activity cost per unit, however, products experiencing volume growth will absorb a greater share of the total activity cost pool, and products in decline a lower share.

7.4. Influence of cost driver changes

Product volumes are captured monthly and updated in the model. Activity drivers are typically assessed annually, however the model is updated if there is a material changes in mail flows across the network.

Consumption rates (time, weight, repetitions) are reviewed when activity costs deviate from expected tolerances (i.e. activity unit costs increase / decrease sharply).

7.5. EPM updates

Australia Post continually reviews its EPM in line with business changes to ensure it reflects the fundamentals of the business. This includes the allocation of non-operational (e.g. support) costs to the appropriate operational functional areas, allocation of operational costs reflective of operational procedures change (e.g. as manual labour is replaced by an automated process) and the annual Network Cost Allocation Update.

7.5.1. Delivery Cost Review

Australia Post undertook the Delivery Cost Review (**DCR**) which encompassed over $2b of Australia Post's almost $7b cost base. In undertaking this review we also sought to address the following areas of concern raised by WIK-Consult in its *Review of Australia Post Cost Allocation Methodology,* November 2015*:*

- Activity, processes and factors have not been updated to reflect changes in the processes (including the material delivery activities of Outdoor Delivery Staff and Set up and Sequencing).
- Factor values remain largely unchanged since being raised as an issue in WIK's prior review in 2008.
- Some activities are highly aggregated, where a more granular representation of the sub-activities performed is recommended.
- Documentation surrounding the definition of EPM activities, elements included, attributes and derivation of the factor values is extremely short and does not appear sufficiently informative.

DCR in part looked to address these concerns by:

- Establishing and documenting a Delivery Model that accurately reflects the material processes and activities performed in Delivery Indoor and Delivery Outdoor; and
- Leveraging operational data (time based and volume based), as well as revenue based volumes to establish more granular process and activity costings.
- Creating detailed process maps that tie back to both the Delivery Indoor and Delivery Outdoor activities in the Delivery Model.

Allocating processes and activities to products either through:

- Product volume x required # of delivery days; or
- Volume directly related to product; or
- Non-mail direct driver.

The following Table shows the impact of DCR for the 2016/17 financial year[25].

Table 22 – DCR impact 2016/17

2016/17 cost ($m)	Pre-DCR	Post-DCR	Change
Ordinary Stamped	✂	✂	✂
PreSort	✂	✂	✂
Print Post	✂	✂	✂
Ordinary / Other	✂	✂	✂
Total Reserved Letters	**2,033**	**2,019**	**(14)**
Non-Reserved Letters	✂	✂	✂
Total Domestic Letters	✂	✂	✂

At a meeting in December 2017, Australia Post presented a detailed overview of DCR to the ACCC. The presentation covered:

- Insight and understanding as to how cost allocation in EPM works;
- The evolution of our costing approach; and
- A detailed step through of enhancements made to EPM in response to the recommendations made by WIK-Consult.

7.5.2. Processing Cost Update

With the introduction of new mail processing equipment, the Culler Facer Canceller Preparation and Flat Sorting Machine, we undertook an evaluation of the associated operational processes at two mail centres (Dandenong Letter Centre and Bendigo Mail Centre) to ensure the costs of the new activities were allocated to the correct products in an appropriate manner.

As expected the impact of the update was a change in cost mix within reserved letters (from PreSort and Ordinary to Print Post) however, the impact to the total reserved letters cost was immaterial.

Table 23 – PCU impact 2018/19 Updated

2018/19 cost ($m) Forecast	Pre-PCU	Post-PCU	Change
Ordinary Stamped	✂	✂	✂
PreSort	✂	✂	✂
Print Post	✂	✂	✂
Ordinary Other	✂	✂	✂
Total Reserved Letters	**1,812**	**1,813**	**1**
Non-reserved Letters	✂	✂	✂
Total Domestic Letters	✂	✂	✂

7.6. Allocation of costs Priority v Regular

Effective January 2016 Australia Post introduced changes that provided all customers with a choice of delivery speed when sending a letter.

[25] For consistency in this section, Print Post items up to 250 grams are included as reserved for the full 2016/17 year

These changes enabled significant operational changes primarily within the Processing and Delivery functions which have been reflected in the EPM.

As network programs of work continue to be implemented, Australia Post will review activities and their cost factors / drivers to ensure activities are allocated to the right product.

Australia Post adopted a top down approach to estimate the operational unit cost difference between a small stamped Regular letter and a small stamped Priority letter. In 2017/18 the operational unit cost difference between a small stamped Regular letter and small stamped Priority letter is estimated to be ✂cents.

8. Productivity

In this section:

- Detail on the total factor productivity (**TFP**) results for Australia Post, covering both recent history and projections for the pricing period;
- Shows that while TFP growth in Australia Post has been impressive, the forecast negative impact of declining mail volumes will impact TFP growth within the period of this notification; and
- Australia Post's cost containment and efficiency initiatives.

8.1. Total factor productivity

Productivity growth is basically output growth less input growth, with both output and input measured on a real rather than nominal basis.

Some versions of productivity growth employ a partial factor measure, which compares output growth with the change in just one factor of production. The most common version of this is labour productivity.

Single factor productivity measures provide relevant and useful information, but they can be affected by changes in other production factors, for example in capital or labour substitution or outsourcing previously staffed work to contractors.

Total factor productivity measures output growth compared with the change in all inputs. It overcomes the issues of interpretation that arise with single (i.e. partial) factor productivity results.

This section of the notification presents the results of a TFP study commissioned by Australia Post.

8.1.1. Total factor productivity – Australia Post – background

As part of Australia Post's 2008 price notification Australia Post commissioned Meyrick and Associates to undertake a TFP assessment of Australia Post. This assessment resulted in the *Australia Post's Aggregate and Reserved Service Productivity Performance* report. For Australia Post's price notification of 2009, Australia Post commissioned Economic Insights Pty Ltd to update the report (*Australia Post's Aggregate and Reserved Service Productivity – 2009 Update)*.

In support of this price notification, Australia Post has again commissioned Economic Insights Pty Ltd to review the methodology used in measuring its TFP at the enterprise and reserved service levels and to provide updated estimates of TFP growth.

A summary of the report Australia Post's Corporate and Reserved Service Total Factor Productivity 28 May 2019 follows.

8.1.2. Australia Post's Total Factor Productivity

As noted above, the previous study of Australia Post's TFP growth was in 2009. This and earlier studies used historical data relating to a period of increasing postal volumes and used the traditional 'billed' outputs specification which is based on competitive market assumptions. Under this approach output is measured purely based on what the business sells.

Since around 2009, however, the throughput volumes of a number of Australia's key infrastructure networks, including postal services, have started to decline due to technological change and other factors. At the same time, however, these service providers have been required to make their networks available to an ever–increasing number of geographically dispersed customers. To more accurately capture the outputs being provided by networks, recent studies of network productivity have moved to measuring output on a 'functional' basis which recognises the services the network business is required to provide and not just those it directly charges customers for.

Over the last several years the fall in postal volumes has accelerated with the number of domestic reserved letters falling by around 10 per cent annually. At the same time, however, Australia Post has been required to service more delivery points, the number of which has increased broadly in line with population growth.

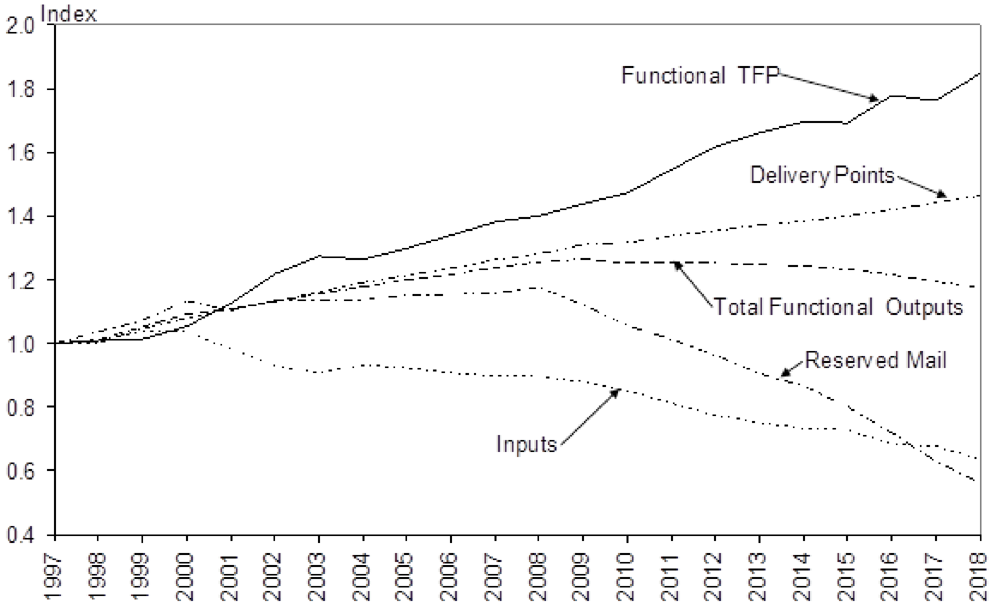
This report develops functional outputs frameworks for measuring Australia Post's aggregate and reserved services TFP. Productivity growth based on these frameworks is calculated at the aggregate level for 1992 to 2018 and at the reserved services level for 1997 to 2018.

At the corporate level, we include three functional outputs: mail billed output, non–mail billed output and delivery points. Mail billed output is formed by aggregating 15 separate mail articles components using their revenue shares. Non–mail billed output is formed by aggregating 5 separate components using their revenue shares. Delivery points are included as the best available proxy measure for the network size Australia Post is required to maintain and service. The three functional outputs are aggregated into a total output measure using output cost shares derived from estimating an econometric cost function. The total input measure is formed from four components: labour, mail contractors, capital and other inputs.

Australia Post's functional TFP grew by an average 2.0 per cent per annum over the last 27 years. Average annual TFP growth in the 17 years to 2008 was somewhat higher at 2.8 per cent. Average annual TFP growth reduced to a still quite strong 1.5 per cent for the period 2008 to 2013 as flat to slightly negative output growth was more than offset by reductions in input use. For the period from 2013 to 2018 average annual TFP growth turned to –0.3 per cent as continued input reduction could not offset the larger fall in functional output in that period. However, in the most recent four years period, 2015 to 2018, average annual TFP growth returned to a quite healthy 0.9 per cent as reductions in input use again exceeded the larger falls in functional output as recent reform efforts took effect.

At the reserved service level, we include two functional outputs: reserved service mail billed output and delivery points. Reserved service mail billed output is formed by aggregating 5 separate mail articles components using their revenue shares. Delivery points are again included as the best available proxy for the network Australia Post is required to maintain and service.

Figure 4 – Australia Post's reserved service functional output and input quantity indexes and TFP index, 1997–2018



In Figure 4 we plot the two reserved service functional outputs, total output, total input and TFP. Reserved mail output increased from 1997 to 2002 but then flattened out through to 2009 before falling sharply after that. Delivery points, on the other hand, increased steadily over the whole period, moderating the reduction in total functional output after 2013. Total input use has trended down markedly since 2000.

Reserved service functional TFP grew at a very strong average annual rate of 2.9 per cent over the 22 year period from 1997 to 2018. It grew at an exceptionally high average annual rate of 4.0 per cent between 1997 and 2003 as output grew strongly at the same time input use decreased. As output average annual growth declined after 2003 and the level of functional output started to fall after 2009, TFP average growth has slowed somewhat but still remained quite high due to the large reduction in input use. Average annual TFP change was 2.7 per cent for the period 2003 to 2013 and 2.1 per cent for the period after 2013. In this latter period average annual functional output change of –1.2 per cent was considerably more than offset by average annual input change of –3.3 per cent.

The reserved services functional TFP index has outperformed the ABS market sector productivity index which only had an average annual growth rate of 0.5 per cent for this period. Given that Australia Post's reserved services mail output has fallen substantially since 2008, being able to outperform the productivity performance of the economy as a whole has been an impressive achievement.

8.2. Productivity initiatives

There are a range of local and national initiatives and programs that support Australia Post's cost containment and productivity targets for the network.

They cover a spectrum from:

- process efficiencies pursued on a localised basis throughout the network to achieve budget and plan targets; to
- national programs to re-engineer core network processes to extract cost and where possible, build flexibility.

Productivity initiatives aimed at cost containment need to be viewed in a strategic context. While the aim is to drive and effectively manage costs, this must be done without failing to meet or compromising the delivery service standards, which Australia Post is required to meet and senders and receivers have come to expect.

Larger or national initiatives invariably have cross functional impacts and these are assessed against a strategic view of future network requirements and a 'whole of network' operation.

Australia Post operates an organisation-wide business efficiency program (the Enterprise Efficiency Program (**EEP**)) focused on increasing the efficiency of the cost base through cost containment and cost out initiatives. EEP is governed by an Australia Post Executive Team (the Efficiency Steering Committee) who set targets and assign accountability of outcomes.

The 2018/19 Corporate Plan details business efficiency benefits of $200m per annum from EEP initiatives which include those pursued as part of the One Network strategy and program of work.

EEP initiatives are tracked at the business unit level, reported through to the central finance team each month and presented formally each quarter at the Efficiency Steering Committee.

The annual efficiency benefit by business unit (as per the 2018/19 Corporate Plan) is at Table 24.

Table 24 – Enterprise Efficiency Program

Corporate Plan Enterprise Efficiency Program	**2018/19 $m**	**2019/20 $m**	**2020/21 $m**	**2021/22 $m**
Targets allocated to areas				
Customer access network	✂	✂	✂	✂
Operations Network	✂	✂	✂	✂
Support Functions	✂	✂	✂	✂
Efficiency Opportunities (to be identified)	✂	✂	✂	✂
Total Efficiency Benefit	**200**	**200**	**200**	**200**

8.3. Letters network efficiencies – from RoLS to One Network

Australia Post has a long history of pursuing network efficiencies. In recent years, the focus has shifted from finding scale benefits enabled by increasing letter volumes, to unlocking cost savings in response to declining letter volumes.

The RoLS Program was developed in 2014 with the key objective of establishing a sustainable operating model in the letters business in the face of the accelerating decline in volumes, and was implemented in the four years that followed. While the program was underway, the organisation started to look ahead to the next phase beyond RoLS and it became evident that Australia Post's best opportunity to finding further network efficiencies would be to pursue a much deeper integration of the letters and parcels networks. This led to the development of the One Network program in 2017, and the remainder of the RoLS program was folded into this new efficiency program.

In August 2015, Australia Post submitted a draft notification proposing changes to the Ordinary Letter Service. Information in that draft notification was based on Australia Post's 2014/15 – 2017/18 Corporate Plan.

At that time (and prior to any formal endorsement) product changes were targeted for July 2015, with all elements of the Program forecast to be executed by 2017/18 and provide a cumulative benefit of $262m.

In October 2015, to ensure the ACCC had the most relevant information to use as the basis of its assessment, a Supplementary Information document was provided to the ACCC in support of Australia Post's proposed product and price changes.

That document, based on Australia Post's 2015/16 – 2018/19 Corporate Plan, assumed product changes in January 2016 providing an increased benefit of $323.8m from the RoLS Program by 2018/19. The information in that document supported Australia Post's notification of November 2015.

This higher (than original forecast) benefit by 2018/19 is largely driven from changes to the original delivery strategy (as part of the RoLS Program), product mix and the increased streaming of parcels and packets to postal delivery officers; one of the initiatives that is furthered within the One Network program of work.

Table 25 compares the savings from the RoLS Program that Australia Post included in its notification of November 2015 with the actual (up until 2017/18) and forecast (2018/19) combined benefit from RoLS and the extension of initiatives from the One Network program of work.

Table 25 – RoLS and One Network

	2014/15	2015/16	2016/17	2017/18	2018/19
	$m	$m	$m	$m	$m
2015 Notification	27.2	83.3	158.2	319.0	323.8
Actual to 2017/18 and Forecast	27.2	92.2	165.6	293.4	336.7

8.4. Processing

8.4.1. Maximise the volume of letters processed during the day

Objective: Take advantage of the extended processing windows within our major letter processing facilities (through using day time processing) to increase the volume of sequenced small letters and round sorted large letters at mail centres. Introduce a round sort process in mail centres to reduce the time required at the delivery centre to prepare letters for delivery.

Status = complete 2017/18

8.4.2. Increase the level of automation

Objective: Rollout new mail processing equipment to deliver letter processing benefits and reduce manual work by increasing the level of automation at major mail centres.

There are two types of mail processing equipment being introduced:

- 12 Culler, facer, canceller and preparation machines (for small letters); and
- 6 Flat Sorting Machines (for large letters).

These machines replaced more than 60 mail processing machines across the network.

Targets

- Both types of machines to be rolled out progressively from April 2016, with all machines operational by January 2018.
- Once implemented, increasing the level of automation (with the use of a longer processing window) will be responsible for ✂ of the cost benefit by 2017/18 by reducing manual work effort and machine maintenance costs.

Status = on track

Implementation began February 2016 with the final machine implemented in September 2017.

8.5. National Delivery Efficiencies

8.5.1. Implement Delivery Efficiencies via a National Delivery Model (NDM)

Objective: Increase productivity of delivery resources by optimising the volumes carried per delivery resource compared to no operating changes.

The program allows a significant improvement in delivery labour efficiency. To succeed it requires:

- Over 80% of addressed letter volume to be sent to the Regular delivery timetable.
- Implementation of automation to significantly reduce the level of manual work in delivery centres.
- Volume forecasts (including mix) in line with 2014/15 to 2017/18 Corporate Plan.

Status = evolvement of strategy to One Network. As at June 2018, $✂of delivery related benefits have been achieved.

8.6. Facility Optimisation

Objective: To migrate work and maintain efficient operations resulting in a reduction of the number of delivery centres and mail centres for letters servicing:

Status = forecast financial benefit achieved.

- Benefit of $✂at June 2018 from North Queensland mail operations optimisation and delivery centre consolidation. Also includes $✂of benefit from property divestment.

The One Network program of work will continue to pursue opportunities to optimise the use of our facilities.

8.7. Streaming

A key focus of One Network is maximising the volume of items that are carried per postie. As such, Australia Post will continue to pursue the increased streaming strategy to deliver greater and sustainable efficiencies across our delivery function. Streaming has several benefits including providing

- redeployment opportunities as resources will be required to support the parcel volume growth,
- postal delivery officers with more sustainable jobs which in turn retains expertise and provides a more stable operation, and
- a more efficient cost for the delivery of inbound international Letter Post (up to 2kg) items and therefore assists Australia Post in achieving a more sustainable outcome in the fulfilment of this obligation.

As at June 2018 parcel streaming coupled with growth in overall parcel volume resulted in a cumulative uplift of ✂ in the volume of parcels delivered by postal delivery officers compared to the projected reform baseline. This has both improved Australia Post's productivity and resulted in greater proportion of the cost of the postal delivery network being allocated across to parcel products.

By June 2018, we have achieved $✂ cost savings via the strategy of increasing the volume of small parcels delivered by postal delivery officers, and thus enhancing the volume of items carried by and productivity of postal delivery officers.

By June 2019 the forecast benefit will increase to $✂. Efficiencies from Streaming will continue to be pursued as part of the broader One Network program.

8.8. One Network

The key objective of the RoLS Program was to implement the changes required to reduce Australia Post's network costs while providing all customers with a choice of delivery speed and maintaining service levels in an environment of structural letter volume decline.

Successful execution of the RoLS Program relied on managing and coordinating interrelated projects over a number of years.

As shown in Table 24, by 2015/16 benefits from the RoLS Program were ahead of forecast. While this was also the case for 2016/17 it was during this financial year that Australia Post trialled operational changes to integrate the delivery capability for letters and parcels to maximize the volume of small packets and parcels carried and delivered by postal delivery officers to provide a more viable longer term delivery capability even at very low letter volumes.

In an environment of planning for parcel growth and managing a decline in letter volumes, in late 2017, Australia Post broadened its efficiency agenda to extract costs through all operational and support areas of the business and presented the Ultimate Customer Network strategy to the Australia Post Board.

That strategy (later rebranded as One Network) was approved by the Board as the strategy to pursue and achieve the delivery benefits from the RoLS Program.

8.9. Achieving operational excellence

The One Network Strategy drives the prioritisation of investments and process improvements under a three-year plan and is focussed on delivering operational excellence for our customers and crafting our pathway to growth while at all times ensuring the safety of our people.

Pursuit of the One Network strategy delivers enterprise wide efficiency savings as it:

- optimises parcel deliveries across the existing first and last mile fleet;
- provides an integrated last mile of delivery and infrastructure e.g. offset letter delivery costs by increasing the volume of activities performed by postal delivery officers; and
- integrates use of mail processing and delivery facilities to support growing parcel and declining letters service requirements e.g. installation of a satchel sorter at the Sydney West Letters Facility to better utilise the facility.

In February 2018, One Network extended the trial of increased streaming of small packets to postal delivery officers) and by the end of 2017/18 generated $✂ in savings.

At the same time, as part of One Networks' objective to optimise the network a number of trials were implemented:

- introduction of a number eDVs (electronic delivery vehicles) as a direct replacement to the use of motorcycle;
- establishment of new vehicle outstations to reduce ride time to and from the first and last delivery point; and

- clearance of selected residential street posting boxes by the postal delivery officer.

As noted earlier pursuit of operational efficiency must be done without compromising the safety of our people. As such, in addition to introducing eDVs which enable the postal delivery office to carry more items (compared to the current motorcycle fleet), we have an overall motorcycle reduction strategy to reduce reliance on motorcycles and reduce exposure.

As shown in the following diagrams, our One Network Program continues to build on the 2017 Ultimate Customer Network Strategy.

Diagram 1 – 2017 Ultimate Customer Network

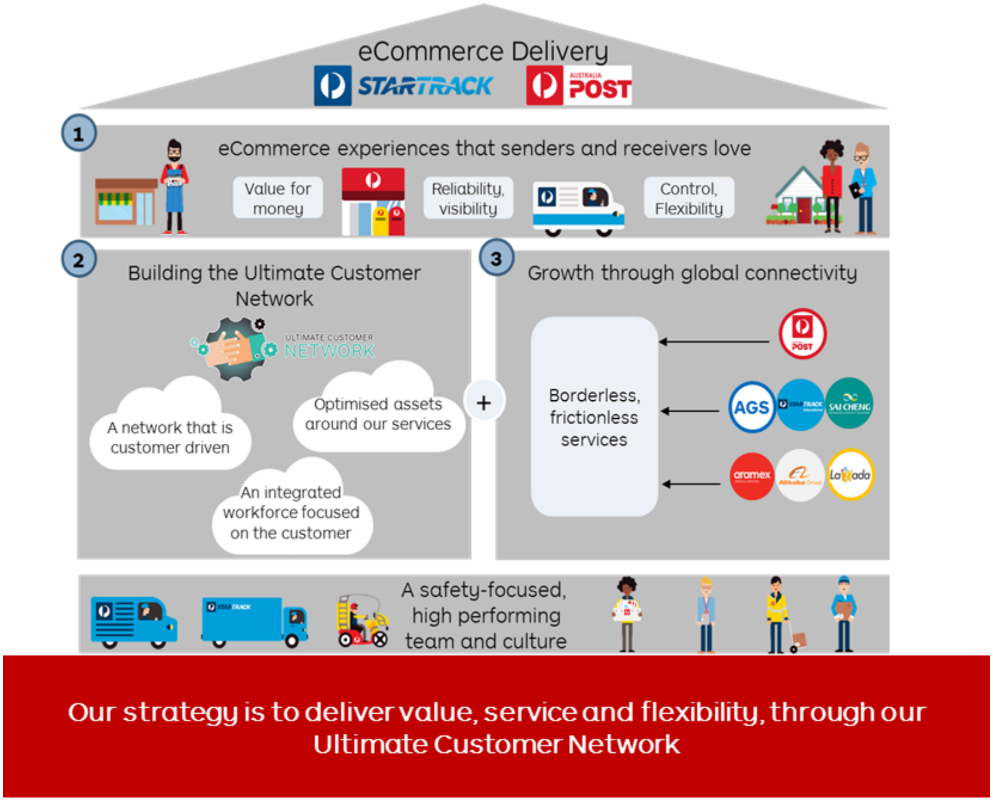
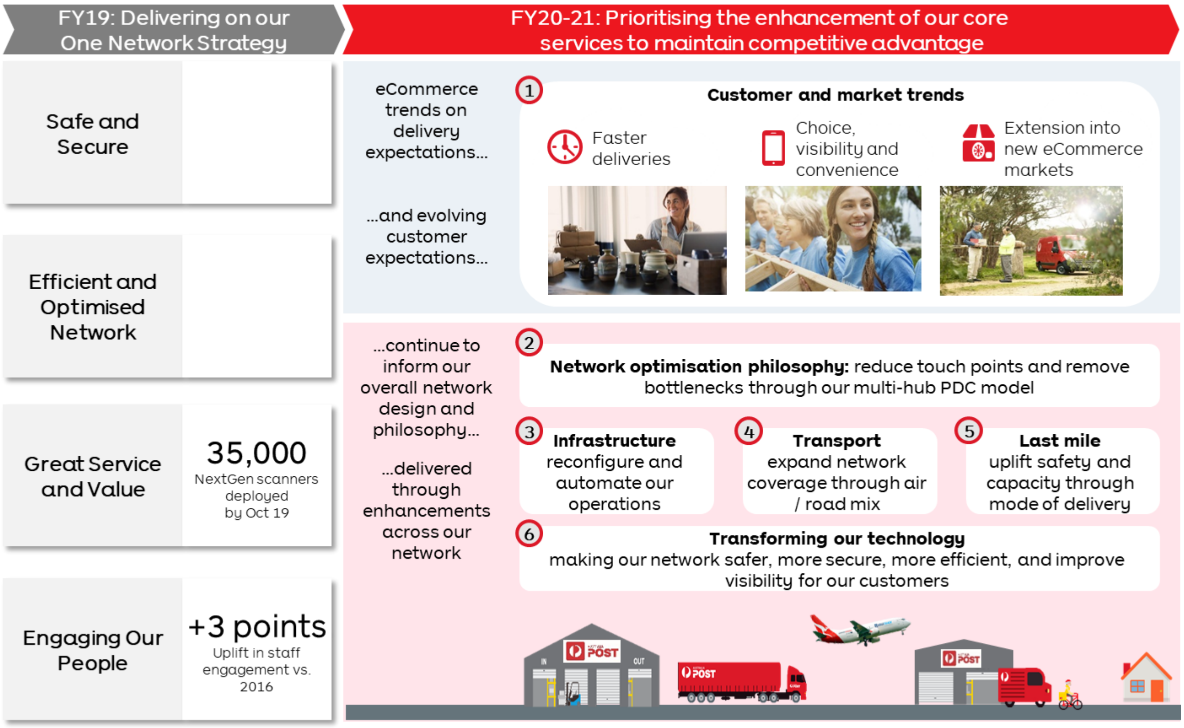


Diagram 2 – One Network Program



9. Asset base

In this section:

- Australia Post's balance sheet as at 30 June 2018;
- Australia Post's capital expenditure plan to 2021/22; and
- Australia Post's forecast asset base to 2021/22.

This section focuses on Australia Post's fixed asset base and includes both the inherited fixed asset base and the incremental changes to it arising from the Australia Post's capital investment plans out to 2021/22.

9.1. Australia Post's balance sheet

As at 30 June 2018[26] Australia Post's balance sheet comprised $5,592m in total assets, $3,224m in liabilities, and $2,368m in equity, or net assets. Table 26 shows the current and non-current (fixed) assets as per the balance sheet (Appendix 6).

Table 26 – Australia Post total assets

Assets	**$m**
Current Assets	
Cash and cash equivalents	592
Trade and other receivables	749
Prepayments	120
Inventories	51
Other current assets	211
Assets held for sale	16
Total current assets	**1,739**
Non-Current Assets	
Finance lease receivable	-
Net Superannuation asset	919
Land & Buildings	867
Plant and Equipment	733
Intangible assets	742
Investment property	169
Deferred tax assets	387
Equity accounted investees	11
Other non-current assets	25
Total non-current assets	**3,853**
Total Assets	**5,592**

[26] Australia Post Annual Report 2017/18, Financial and Statutory Reports, page 98.

9.2. Asset accounting policies and practices

As shown in Table 26, at 30 June 2018 Australia Post had $3,853m of non-current assets recognised in the balance sheet.

Fixed assets are grouped into approximately 500 asset classes. Depreciation rates are set asset by asset within each asset class level, and are reviewed annually. Asset stocktakes are also conducted annually where assets and their location are confirmed, transferred to a new work centre, or removed from the asset register if they cannot be located or are no longer used. These practices support the annual report preparation process to ensure that asset balances are not being reported above their appropriate values.

Appendix 7 provides further detail on Australia Post's fixed assets.

9.3. Capital investment plan

Australia Post prepares a capital investment plan each year as part of the annual planning process. Table 27 details forecast capital investment out to 2021/22 and is consistent with the 2018/19 to 2021/22 Corporate Plan.

Table 27 – Capital investment outlays by category

$m	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Strategic initiatives				
Strategic programs	✂	✂	✂	✂
Tactical projects and reserve	✂	✂	✂	✂
Total strategic initiatives	**253**	**200**	**200**	**200**
Non-discretionary	172	150	150	150
Total	**425**	**350**	**350**	**350**

9.4. Forecast asset base

Table 28 details Australia Post's total fixed assets out to 2021/22. Asset values are allocated to products according to procedures specified in the Regulatory Accounts Procedures Manual (**RAPM**). The RAPM records the procedures to be followed within Australia Post in preparing the Regulatory Accounts.

Australia Post maintains the RAPM as per its obligations under section 22 of the Record Keeping Rules (July 2016). A copy of the RAPM can be provided to the ACCC upon request.

Investment Property and Land and Buildings are measured at Fair Value, whereas Plant and Equipment and Intangible Assets are measured at cost, net of any accumulated depreciation/amortisation and/or impairment losses. Fixed asset opening and closing balances include assets under construction and agree to the Record Keeping Rules schedules.

Table 28 – Australia Post total fixed assets and intangibles

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	3,455	3,398	3,532	3,609	3,670
Net additions	247	421	350	350	350
Depreciation & amortisation	(304)	(287)	(273)	(288)	(324)
Closing balance	**3,398**	**3,532**	**3,609**	**3,670**	**3,696**

Table 29 details the reserved letter service total fixed assets, consistent with Record Keeping Rules practice and excludes assets under construction until the assets are in service and transferred out. Appendix 8 provides a breakdown of Table 29 by each letter category.

Table 29 – Reserved letter service fixed assets

$m	Final	Forecast	Forecast	Forecast	Forecast
	2017/18	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Opening balance	732	718	694	661	624
Net additions	85	62	49	48	47
Depreciation & amortisation	(99)	(86)	(82)	(85)	(86)
Closing balance	**718**	**694**	**661**	**624**	**586**

10. Rate of return

Australia Post engaged Value Adviser Associates (**VAA**) to provide an independent assessment of the weighted average cost of capital (**WACC**) for the Australia Post Reserved Letters Business.

The WACC parameters have been assessed on a forward-looking basis.

Table 30 details the parameters with further detail at Appendix 9.

Table 30 – Australia Post WACC

WACC Parameter	Based on latest advice
rf nominal risk-free rate-of-return	1.34%
rm-rf market risk premium	7.00%
Tc corporate tax rate	30.00%
γ imputation factor	0.00
βa asset beta	0.70
βd debt beta	n/a
βe equity beta	0.90
D/V Australia Post's gearing ratio	22.9%
Cost of equity	7.6%
Cost of Debt	4.6%
Nominal post tax vanilla WACC	6.9%

11. Post Tax Revenue Model Summary

Australia Post is proposing that the price changes take effect from January 2020. A comparison of the proposed and allowable revenues over the 2019/20 to 2020/21 financial years is below.

Table 31 – Post Tax Revenue Model summary

Summary of PTRM outputs		2018/19 $m	2019/20 $m	2020/21 $m
Nominal Vanilla WACC	**6.93%**			
A: Ordinary reserved letters				
Required Revenue		$ 204	$ 188	$ 176
Present Value of Required Revenue		$ 199	$ 180	$ 165
Sum of PV over 2 years (2019/20 - 2020/21)				$ 345
Letters Revenue at proposed prices		$ 137	$ 125	$ 114
Present Value of Proposed Letters Revenue		$ 134	$ 120	$ 107
Sum of PV over 2 years (2019/20 - 2020/21)				$ 227
Deficiency of Letters Revenue to Required Revenue		$ 65	$ 60	$ 58
Sum of PV over 2 years (2019/20 - 2020/21)				$ 118
B: Domestic reserved letters				
Required Revenue		$ 1,865	$ 1,760	$ 1,707
Present Value of Required Revenue		$ 1,825	$ 1,685	$ 1,599
Sum of PV over 2 years (2019/20 - 2020/21)				$ 3,285
Letters Revenue at proposed prices		$ 1,835	$ 1,690	$ 1,599
Present Value of Proposed Letters Revenue		$ 1,795	$ 1,618	$ 1,498
Sum of PV over 2 years (2019/20 - 2020/21)				$ 3,116
Deficiency of Letters Revenue to Required Revenue		$ 29	$ 68	$ 101
Sum of PV over 2 years (2019/20 - 2020/21)				$ 169
C: Domestic letters				
Required Revenue		$ 2,147	$ 2,038	$ 1,985
Present Value of Required Revenue		$ 2,101	$ 1,951	$ 1,859
Sum of PV over 2 years (2019/20 - 2020/21)				$ 3,810
Letters Revenue at proposed prices		$ 2,027	$ 1,873	$ 1,776
Present Value of Proposed Letters Revenue		$ 1,983	$ 1,793	$ 1,664
Sum of PV over 2 years (2019/20 - 2020/21)				$ 3,456
Deficiency of Letters Revenue to Required Revenue		$ 118	$ 158	$ 196
Sum of PV over 2 years (2019/20 - 2020/21)				$ 354

Appendix 1 – Price changes

While only reserved ordinary letter services are notified services, Australia Post is providing, for information only, detail on other addressed domestic letter service price changes. All prices are proposed to take effect in January 2020.

Table 32 – Proposed Ordinary / Other prices

Stamped #

Size / Weight	Regular		
	Current	Proposed	Increase
Small			
Stamped	$1.00	$1.10	10.0%
Seasonal Greeting *	$0.65	$0.65	0%
Concession ^	1 stamp	1 stamp	0%
Large			
Stamped			
Up to 125g	$2.00	$2.20	10.0%
Over 125 up to 250g	$3.00	$3.30	10.0%
Over 250 up to 500g	$5.00	$5.50	10.0%
Seasonal Greeting *			
Up to 125g	$1.30	$1.30	0%
Concession stamp ^			
Up to 125g	2 stamps	2 stamps	0%
Over 125 up to 250g	3 stamps	3 stamps	0%
Over 250 up to 500g	5 stamps	5 stamps	0%

To send by Priority, purchase a Priority label 50c and place to the left of the stamp(s).

Notes:
* Seasonal Greeting card price available during November and December
^ Concession stamps available in packs of five for $3.00. For small letters use one stamp, for large use number stated.

Prepaid Envelopes / Postcards #

Size / Weight	Regular		
	Per item	Pack of 10	
		Single	5+ packs
Envelope			
DL Plain	$1.35	$13.15	$12.15
C5	$2.80	$27.30	$25.20
C4	$4.80	$46.80	$43.20
B4	$5.80	$56.50	$52.20
	Per item	Pack of 50	Box of 500
Window face			
DL		$65.75	$607.50
Postcard	$2.40		

To send by Priority, purchase a Priority label 50c and place to the left of the postage paid mark.

Metered / Imprint

Size / Weight	Regular	Priority
Small		
Up to 250g	$1.055	$1.555
Large		
Up to 250g	$2.110	$2.610
Over 125 up to 250g	$3.165	$3.665
Over 250 up to 500g	$5.275	$5.775

Local Country and Clean Mail

Size / Weight	Regular	Priority
Local (Country)		
Small	$1.020	$1.050
Large		
Up to 125g	$1.800	$2.100
Over 125 up to 250g	$2.400	$2.700
Over 250 up to 500g	$2.700	$3.150
Clean Mail		
Small	$1.050	$1.340
Small Plus up to 125g	$1.650	$2.020

Reply Paid

Size / Weight	Regular	Priority
Small		
Barcoded	$0.730	$0.950
Unbarcoded	$1.400	
Large - Barcoded		
Up to 125g	$2.200	$2.500
Over 125 up to 250g	$3.300	$3.600
Over 250 up to 500g	$5.500	$5.800
Large - Unbarcoded		
Up to 125g	$2.500	
Over 125 up to 250g	$3.600	
Over 250 up to 500g	$5.800	
Annual Fee	$115.00	

Table 33 – Proposed Business Letter prices

PreSort

Size / Weight	Regular				Priority			
	Barcode Direct Tray		Barcode	U/Bcode	Barcode Direct Tray		Barcode	U/Bcode
	Same State	Other State	Residue	Residue	Same State	Other State	Residue	Residue
Small Letters								
Up to 125g	$0.960	$0.995	$1.040	$1.050	$1.160	$1.205	$1.295	$1.340
Charity Mail	$0.550	$0.570	$0.600	$1.050	$0.675	$0.710	$0.775	$1.340
PromoPost	$0.685	$0.705	$0.735	$1.050				
Small Plus								
Up to 125g	$1.200	$1.250	$1.530	$1.650	$1.540	$1.600	$1.750	$2.020
Large								
Up to 125g	$1.675	$1.765	$2.025	$2.060	$2.100	$2.210	$2.500	$2.560
Up to 125g - Charity Mail	$1.160	$1.220	$1.425	$2.060				
Over 125 up to 250g	$2.230	$2.410	$2.710	$2.870	$2.730	$2.910	$3.200	$3.360
Over 125 up to 250g - Charity Mail	$1.515	$1.615	$1.870	$2.870				
Over 250 up to 500g	$2.870	$3.050	$3.420	$3.720	$3.370	$3.550	$3.910	$4.220

Acquisition Mail

Size / Weight	Regular			
	Barcode Direct Tray		Barcode	U/Bcode
	Same State	Other State	Residue	Residue
Small - up to 125g	$0.635	$0.660	$0.735	$1.050
Small Plus - up to 125g	$0.885	$0.925	$1.170	$1.650

Impact Mail

Size / Weight	Regular		
	Postcode Direct Tray	Area Tray	Residue
Small - up to 125g			
Same State	$1.125	$1.190	$1.265
Other State	$1.155	$1.215	$1.300
Small Plus - up to 125g			
Same State	$1.665	$1.750	$1.840
Other State	$1.710	$1.800	$1.890

Registered Post

Size / Weight	Per envelope	Pack of 10	
		Single	5+ packs
Prepaid envelopes			
DL	$5.40	$52.65	$48.60
B4	$7.20	$70.20	$64.80
	Per item	Per box of 50	
Labels			
Label on lodgement	$4.30		
Prepaid label	$4.30	$180.00	
Delivery Confirmation	$2.95 *		
Person-to-person	$6.30 *		

* no change

Registered Post Imprint

Size / Weight	Regular Timetable		Priority Timetable	
	Barcoded Residue	Unbarcoded Residue	Barcoded Residue	Unbarcoded Residue
Small Letters				
Up to 125g	$4.590	$4.650	$4.825	$4.940
Small Plus				
Up to 125g	$4.920	$5.250	$5.205	$5.620
Large				
Up to 125g	$5.625	$5.660	$6.100	$6.160
Over 125 up to 250g	$6.045	$6.470	$6.545	$6.960
Over 250 up to 500g	$6.620	$7.320	$7.120	$7.820

Notes:
All prices are GST Inclusive, except for External Territories where they are as stated but GST free.

Table 34 – Proposed Print Post Letter prices

Size / Weight	Regular				
	Same State			Other State	
	Postcode Direct	Area Direct	Residue	Area Direct	Residue
Small					
0 - 125g	-	-	0.880	-	$0.910
Large					
0 - 125g	$0.905	$0.955	$1.230	$1.375	$1.460
126g - 175g	$1.030	$1.225	$1.485	$1.780	$1.935
176g - 250g	$1.140	$1.375	$1.640	$1.970	$2.115
251g - 300g	$1.225	$1.555	$1.760	$2.145	$2.290
301g - 350g	$1.320	$1.670	$1.895	$2.305	$2.470
351g - 400g	$1.400	$1.780	$2.035	$2.465	$2.645
401g - 450g	$1.490	$1.930	$2.175	$2.675	$2.865
451g - 500g	$1.625	$2.085	$2.370	$2.805	$2.990
501g - 600g	$2.425	$2.895	$3.235	$3.675	$4.240
601g - 700g	$2.905	$3.405	$3.775	$4.250	$4.870
701g - 800g	$3.240	$3.920	$4.170	$4.780	$5.300
801g - 900g	$3.530	$4.220	$4.480	$5.085	$5.645
901g - 1000g	$3.780	$4.505	$4.800	$5.385	$5.965

Size / Weight	Priority				
	Same State			Other State	
	Postcode Direct	Area Direct	Residue	Area Direct	Residue
Small					
0 - 125g	-	-	0.970	-	$1.000
Large					
0 - 125g	$1.040	$1.150	$1.440	$1.540	$1.610
126g - 175g	$1.180	$1.440	$1.700	$1.990	$2.110
176g - 250g	$1.300	$1.560	$1.840	$2.120	$2.320
251g - 300g	$1.420	$1.740	$2.020	$2.310	$2.510
301g - 350g	$1.550	$1.910	$2.190	$2.520	$2.740
351g - 400g	$1.650	$2.100	$2.330	$2.730	$2.910
401g - 450g	$1.750	$2.250	$2.480	$2.880	$3.140
451g - 500g	$1.860	$2.410	$2.670	$3.040	$3.320
501g - 600g	$2.820	$3.390	$3.640	$4.120	$4.670
601g - 700g	$3.280	$3.890	$4.190	$4.740	$5.290
701g - 800g	$3.630	$4.300	$4.650	$5.210	$5.760
801g - 900g	$3.950	$4.650	$4.980	$5.570	$6.140
901g - 1000g	$4.250	$4.960	$5.300	$5.880	$6.450

Notes:
All prices are GST Inclusive, except for External Territories where they are as stated but GST free.

Appendix 2 – Financial Overview

Table 35 shows the revenue impact of the January 2020 price changes.

Table 35 – Domestic letter service

	Reserved				
	Ordinary /Other	**Other Bulk**	**Total**	**Total Non-Reserved**	**Grand Total Domestic Mail**
2018/19					
Volume	653	1,379	2,032	646	2,678
Revenue ($m)	671	1,164	1,835	192	2,027
Total costs ($m)	738	1,076	1,814	✂	✂
Contribution ($m)	(67)	88	21	✂	✂
ROR %	(10)	8	1	✂	✂
2019/20					
Volume	590	1,238	1,828	579	2,407
Revenue ($m)	623	1,067	1,690	183	1,873
Total costs ($m)	701	1,006	1,708	✂	✂
Contribution ($m)	(79)	61	(18)	✂	✂
ROR %	(13)	6	(1)	✂	✂
2020/21					
Volume	533	1,124	1,657	542	2,199
Revenue ($m)	585	1,014	1,599	176	1,776
Total costs ($m)	680	973	1,653	✂	✂
Contribution ($m)	(95)	41	(53)	✂	✂
ROR %	(16)	4	(3)	✂	✂
2021/22					
Volume	485	1,026	1,511	508	2,018
Revenue ($m)	547	952	1,499	170	1,669
Total costs ($m)	656	932	1,588	✂	✂
Contribution ($m)	(109)	19	(90)	✂	✂
ROR %	(20)	2	(6)	✂	✂

Appendix 3 – Australia Post's Letter Pricing Principles

- The letters pricing structure will be as simple as possible;
- The letters pricing structure will reflect Australia Post's commercial, social and governmental obligations;
- The primary social obligation is to supply a letter service that is accessible, available equitably and meets community needs;
- Letter prices will be set to enable Australia Post to meet its statutory requirement to provide an adequate commercial return and to fund its CSO;
- The Regular letter service is a 'safety net' service priced to recover the efficient cost of providing the service;
- The Priority service is a commercial product but is priced to incentivise migration to the Regular service;
- The BPR – the rate for the ordinary small letter – is the keystone of the letter pricing structure;
- Carriage of the Ordinary Small Letter at a uniform rate is central to the CSO. Pricing of the BPR reflects the need to maintain an affordable rate. Consequently, the BPR may not always fully recover the costs of providing these services and as such, prices for other domestic reserved letter services may contain a cross subsidy to the BPR;
- Subject to this need to cross subsidise letter products, letter prices have been set to achieve an appropriate aggregate rate of return for the letters business as a whole;
- Price changes will wherever possible be implemented on a regular basis with adequate notice and after appropriate consultation with stakeholders and customers;
- Subject to meeting minimum agreed quantities and conditions, bulk interconnection prices will be applied uniformly regardless of volume;
- Bulk interconnection prices will, in addition to, the requirements of section 32A(2) (c) of the APC Act, broadly reflect the level of work saved by Australia Post through work carried out by customers; and
- Bulk interconnection prices will be applied uniformly for carriage within Australia subject to the point of lodgement (same/other state prices apply).

Appendix 4 – Detail on Finalisation of Letter Volume Forecasts

As noted in Section 5, the econometric forecasts represent a baseline upon which further intelligence may be overlaid to counter a lack of tractable empirical data on emerging threats to letter volumes.

As such, to derive the final volume forecasts, Australia Post augments the baseline forecasts with management and market insight. Management and market insights are derived from:

- Input from the salesforce, account managers regarding customer behaviour;
- Market intelligence from participants in the mail value chain;
- Information in the public domain; and
- Interpretation of qualitative and quantitative reports commissioned by Australia Post and external sources.

The following pages show the augmentation from baseline forecast to final volume forecast for 2018/19 to 2021/22.

Table 36 – 2018/19 volume forecast

	2017/18 Volumes (m)	Baseline Volume Est (from Eco Model)		Transactional		Promotional		Total Market Adjust (m)	2018/19 Volume Forecast (m)
		Raw Growth	Raw Volume	Market Changes	Changes in use of Comm	Market Changes	Changes in use of Comm		
Ordinary / Other									
Small	651	-8.2%	598	(13)	3	0	0	(10)	587
Large	86	-10.1%	77	(4)	(1)	0	0	(5)	72
Total Ordinary / Other	736	-8.4%	674	(16)	2	0	0	(15)	660
PreSort									
Small	1,302	-10.0%	1,172	15	4	14	(2)	31	1,203
Large	51	-7.0%	47	(1)	(1)	0	(0)	(2)	46
Total PreSort	1,353	-9.9%	1,219	14	3	14	(2)	29	1,249
Print Post	150	-7.1%	139	(5)	(6)	0	0	(11)	129
Large Member Associations *	35		35	(1)	0	0	0	(1)	34
Total Print Post	185		174	(5)	(6)	0	0	(11)	162
Total PreSort / Print Post	1,538	-9.4%	1,393	9	(3)	14	(2)	18	1,411
Total Addressed Mail	**2,274**	**-9.1%**	**2,068**	**(8)**	**(1)**	**14**	**(2)**	**3**	**2,071**

* Econometric Model growth / decline excludes large (volume) member association magazines in generating its Baseline

Table 37 – 2019/20 volume forecast

	2018/19 Volume Forecast (m)	Baseline Volume Est (from Eco Model)		Transactional		Promotional		Total Market Adjust (m)	2019/20 Volume Forecast (m)
		Raw Growth	Raw Volume	Market Changes	Changes in use of Comm	Market Changes	Changes in use of Comm		
Ordinary / Other									
Small	587	-10.1%	528	5	(3)	0	0	2	530
Large	72	-7.6%	67	(1)	0	0	0	(1)	66
Total Ordinary / Other	660	-9.8%	595	4	(3)	0	0	2	596
PreSort									
Small	1,203	-8.5%	1,101	(8)	(6)	(10)	(2)	(26)	1,075
Large	46	-10.5%	41	0	0	0	0	1	41
Total PreSort	1,249	-8.6%	1,142	(8)	(6)	(10)	(2)	(26)	1,116
Print Post	129	-8.7%	117	(1)	0	0	0	(1)	117
Large Member Associations *	34		34	0	0	0	0	0	34
Total Print Post	162		151	(1)	0	0	0	(1)	150
Total PreSort / Print Post	1,411	-8.4%	1,293	(9)	(6)	(10)	(2)	(26)	1,267
Total Addressed Mail	**2,071**	**-8.8%**	**1,888**	**(5)**	**(9)**	**(10)**	**(2)**	**(25)**	**1,863**

* Econometric Model growth / decline excludes large (volume) member association magazines in generating its Baseline

Table 38 – 2020/21 volume forecast

	2019/20 Volume Forecast (m)	Baseline Volume Est (from Eco Model)		Transactional		Promotional		Total Market Adjust (m)	2020/21 Volume Forecast (m)
		Raw Growth	Raw Volume	Market Changes	Changes in use of Comm	Market Changes	Changes in use of Comm		
Ordinary / Other									
Small	530	-12.0%	467	12	2	0	0	14	481
Large	66	-7.3%	61	(2)	(1)	0	0	(3)	58
Total Ordinary / Other	596	-11.5%	528	10	1	0	0	11	539
PreSort									
Small	1,075	-8.7%	981	(3)	(4)	0	(0)	(7)	974
Large	41	-13.1%	36	1	1	0	0	1	37
Total PreSort	1,116	-8.9%	1,017	(3)	(3)	0	(0)	(6)	1,011
Print Post	117	-8.8%	106	(2)	0	0	0	(2)	104
Large Member Associations *	34		34	(1)	0	0	0	(1)	33
Total Print Post	150		140	(3)	0	0	0	(3)	138
Total PreSort / Print Post	1,267	-8.6%	1,157	(5)	(3)	0	(0)	(9)	1,149
Total Addressed Mail	**1,863**	**-9.5%**	**1,685**	**4**	**(2)**	**0**	**(0)**	**2**	**1,687**

* Econometric Model growth / decline excludes large (volume) member association magazines in generating its Baseline

Table 39 – 2021/22 volume forecast

	2020/21 Volume Forecast (m)	Baseline Volume Est (from Eco Model)		Transactional		Promotional		Total Market Adjust (m)	2021/22 Volume Forecast (m)
		Raw Growth	Raw Volume	Market Changes	Changes in use of Comm	Market Changes	Changes in use of Comm		
Ordinary / Other									
Small	481	-10.8%	429	7	1	0	0	8	437
Large	58	-6.2%	54	(1)	(1)	0	0	(2)	53
Total Ordinary / Other	539	-10.3%	483	6	0	0	0	7	490
PreSort									
Small	974	-7.4%	902	(2)	(10)	(2)	(1)	(14)	888
Large	37	-14.3%	32	1	1	0	0	2	34
Total PreSort	1,011	-7.7%	934	(1)	(9)	(2)	(0)	(12)	922
Print Post	104	-6.6%	97	(3)	(1)	0	0	(4)	94
Large Member Associations *	33		33	(1)	0	0	0	(1)	33
Total Print Post	138		131	(4)	(1)	0	0	(5)	126
Total PreSort / Print Post	1,149	-7.3%	1,065	(4)	(10)	(2)	(0)	(17)	1,048
Total Addressed Mail	**1,687**	**-8.3%**	**1,548**	**2**	**(10)**	**(2)**	**(0)**	**(10)**	**1,537**

* Econometric Model growth / decline excludes large (volume) member association magazines in generating its Baseline

Appendix 5 – Media Release

Media Release

15 February 2019

Australia Post reaches new agreement to protect the viability of our Community Licensed Post Office partners

Australia Post today announced it will invest an extra $34 million as part of a new agreement with Community Licensed Post Offices.

This investment will provide our LPO partners with upgraded technology, in addition to increased payments for supporting the growth in parcels and financial services.

The agreement also includes an increase to the safety-net minimum payment to protect our smallest and most vulnerable Community Post Offices in regional and rural Australia.

The new payments follow a thorough independent payment review and consultation with licensee representative associations to better reflect the changing nature of Australia Post business conducted in 2800+ Licensed Post Offices.

Australia Post Group Chief Executive Officer and Managing Director Christine Holgate said the new payment scheme is an important milestone in improving the way we pay our valued licensee partners.

"I believe Licensed Post Office partners play an essential role in protecting and building the prosperity of communities across Australia, particularly in regional and rural Australia. This critical investment also acknowledges the importance of these hardworking small business owners to the future of Australia Post," said Ms Holgate.

The benefits of the new payment rates will be applied retrospectively to licensees from 1 January 2019.

– Ends –

Appendix 6 – Australia Post Consolidated Group Balance Sheet at 30 June 2018

	2017	2018
ASSETS		
Current Assets		
Cash and cash equivalents	443	592
Trade and other receivables	722	749
Prepayments	117	120
Inventories	50	51
Assets held for sale	138	211
Other current assets	11	16
Total current assets	**1,482**	**1,739**
Non-Current Assets		
Finance lease receivable	97	-
Net superannuation Asset	700	919
Land & buildings	825	867
Plant and equipment	735	733
Intangible assets	859	742
Investment property	169	169
Deferred tax assets	400	387
Equity accounted investees	248	11
Other non-current assets	23	25
Total non-current assets	**4,056**	**3,853**
Total assets	**5,537**	**5,592**
LIABILITIES		
Current Liabilities		
Trade and other payables	1,100	958
Employee provisions	772	750
Interest-bearing liabilities	-	-
Other provisions	29	18
Income tax payable	85	36
Other current liabilities	12	14
Total current liabilities	**1,998**	**1,776**
Non-Current Liabilities		
Interest-bearing liabilities	703	703
Employee provisions	273	236
Other provisions	44	46
Deferred tax liabilities	356	393
Other non-current liabilities	45	70
Total non-current liabilities	**1,421**	**1,449**
Total liabilities	**3,419**	**3,224**
Net assets	**2,118**	**2,368**
EQUITY		
Contributed Equity	400	400
Reserves	5	21
Retained Profits	1,713	1,947
Parent interest	**2,118**	**2,368**
Total equity	**2,118**	**2,368**

Appendix 7 – Fixed assets

Asset Register structure – Australia Post's fixed assets are grouped into approximately 500 asset classes, each of which is broadly descriptive of the nature of the assets contained within that class rather than by each asset's accounting treatment. For example, the buildings asset class (asset class no. ZB00) comprises administrative buildings, post offices, depots, mail centres etc.

Assets within a class do not necessarily have the same accounting treatment. Within class ZB00, for example, there are three different service lives – 40 years, 50 years, and 70 years – depending on the type of building. Other asset classes similarly can have a range of service lives and/or residual values.

Land and Buildings – at 30 June 2018 asset values provided in this notification include land and building assets measured at fair value. The fair value of land and buildings at 30 June 2018 was $1,653m compared with a historical cost book value of $867m.

Fair value has been determined through valuations performed by Savills Pty Ltd with each property valued once over a 3 year period, on a rolling basis. Savills is an industry specialist in valuing these types of properties in accordance with Australian Valuation Standards. The fair value of each property has been determined by reference to the highest and best use of the property taking into account the specific characteristics and location of the asset.

Investment Property – at 30 June 2018 the value of this asset class was $169m. Investment property is not allocated to products and services, and is not part of the asset base on which this notification is based.

Investment property is initially recorded at cost and subsequently re-measured to fair value on an annual basis with the valuations undertaken by Savills Pty Ltd using the methodology noted above.

Plant and Equipment & Other – are initially recorded at cost and subsequently measured at cost less accumulated depreciation and less any impairment losses. Information technology assets and motor vehicles are also stated at cost less accumulated depreciation.

Asset Lives – a high level summary of asset lives is shown below and is consistent with the summary provided in the notes to the financial statements contained in the 2018 Annual Report.

Asset Category	Useful Life Range
Buildings – general post offices	70 years
Buildings other facilities	40 – 50 years
Leasehold Improvements	Lower of lease term and 10 years
Motor Vehicles	3 – 10 years
Specialised plant / equipment	7 – 20 years
Other plant / equipment	3 – 10 years

Appendix 8 – Reserved letter service fixed assets

The following Tables provide a breakdown of the reserved letter service fixed assets (shown at Table 29) by product category. Asset data is based on 2017/18 final.

Table 40 – Ordinary letters

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	110	84	76	69	61
Net additions	(15)	0	0	0	0
Depreciation	(11)	(8)	(8)	(8)	(8)
Closing balance	**84**	**76**	**69**	**61**	**54**

Table 41 – Other letters

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	244	230	230	225	218
Net additions	18	28	22	21	21
Depreciation	(32)	(28)	(27)	(28)	(28)
Closing balance	**230**	**230**	**225**	**218**	**211**

Table 42 – Small PreSort letters

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	303	319	306	291	273
Net additions	60	27	21	20	20
Depreciation	(44)	(39)	(37)	(39)	(39)
Closing balance	**319**	**306**	**291**	**273**	**254**

Table 43 – Large PreSort letters

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	41	30	30	29	29
Net additions	(7)	3	2	2	2
Depreciation	(4)	(3)	(3)	(3)	(3)
Closing balance	**30**	**30**	**29**	**29**	**28**

Table 44 – Print Post letters

$m	Final 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22
Opening balance	35	56	52	48	43
Net additions	29	5	4	4	4
Depreciation	(8)	(8)	(8)	(9)	(9)
Closing balance	**56**	**52**	**48**	**43**	**38**

Appendix 9 – Weighted Average Cost of Capital

Australia Post has adopted the Value Adviser Associates (**VAA**) estimated WACC parameters per their *Reserved Letters Business WACC Assessment* report.

Table 45 – WACC parameter values

WACC parameter	Value (based on latest advice)
rf nominal risk-free rate-of-return	1.34%
rm-rf market risk premium	7.00%
βa asset beta	0.70
γ imputation factor	0.00
βe equity beta	0.90
Tc corporate tax rate	30.00%
βd debt beta	n/a
Cost of Debt	4.6%
D/V Australia Post's gearing ratio	22.9%

Risk Free Rate

The nominal risk-free rate used is the 10-year Commonwealth Government bond yield, a widely-used proxy for the risk-free rate of return on investment, and the rate conventionally used in the capital asset pricing model. To avoid the impact of daily volatility, Australia Post has used a 20 trading day average to 25 July 2019. We would note that when compared to the average rate over the last 10 years (around 3.5%) the current rate is well below recent historical levels.

Market Risk Premium (MRP)

Advice from VAA is that a market risk premium of 7.0% is appropriate at the current time. This MRP is at a level in line with a large body of evidence supporting an MRP estimate in the range of 7.0 – 7.1% under 'normal' capital market conditions.

Asset β

VAA has independently estimated Australia Post's asset beta with reference to betas for comparable listed companies. In estimating asset betas, VAA:

- Sourced equity betas from Bloomberg data using 60 monthly observations where available; and
- Estimated the market value gearing ratio for each company using the most recent annual historical data available.

VAA has recommended an asset beta of 0.70.

Equity β

Re-lever the Australia Post asset beta of 0.70 to derive the equity beta of 0.90.

Imputation Credits (gamma)

In assessing the appropriate imputation factor, VAA's view remains unchanged from previous WACC assessments. That is, the appropriate gamma value used to determine the tax component of the PTRM's cost build-up should be zero as:

- Australia Post does not distribute any franking tax credits; and
- Australia Post's shareholder, the Australian Government, does not claim franking tax credits.

Tax Rate

As previously accepted by the ACCC, the statutory corporate tax rate of 30% is used.

Debt β

VAA has attributed a debt beta value of zero in its WACC assessment. VAA has tested the sensitivity of the outcome with and without the use of debt beta and did not find material difference in the outcome.

Cost of Debt

In assessing Australia Post's cost of debt VAA has:

- Estimated Australia Post's cost of debt based on the traded corporate Bonds with similar credit rating to Australia Post's AA- credit rating. The Reserved Letter business does not have a separate credit rating. The longest maturing AA rated corporate bonds currently trading in the market has 7 years to maturity. To compensate for the term difference, VAA added a debt premium based on the yield spread between 7-year and 10-year Queensland Government Bonds to the 7-year AA rated Corporate Bond to estimate the yield of 10 Year AA rated Corporate Bond. This yielded a cost of debt of 3.59% and a debt risk premium over the risk free rate of 1.39%.
- Calculated Australia Post's actual pre-tax cost of debt for 2017/18 as 4.6%, based on Australia Post's 2017/18 interest payment of $32m over average debt balance of $703m for the year.

VAA applied the higher actual cost of debt of 4.6% in its WACC calculation.

Gearing

Australia Post's book gearing (D/D+E) at 30 June 2018 was 23% a level at which increases to 33% after minor adjustment of the balance sheet to account for the financial impact of the APSS which is not controlled by Australia Post.

VAA has applied the actual 2017/18 book gearing ratio in its WACC assessment, consistent with the use of Australia Post's actual 2017/18 cost of debt in the WACC calculation.

Table 46 – Debt, Equity and Gearing

$m	Debt	Equity	Adjusted Equity	Gearing (D/D+E)	Adjusted Gearing
June 2009	562	1845	1377	23%	29%
June 2010	559	1559	1387	26%	29%
June 2011	556	1804	1517	24%	27%
June 2012	618	1506	1740	29%	26%
June 2013	633	1682	1684	27%	27%
June 2014	714	1763	1715	29%	29%
June 2015	714	1914	1301	27%	35%
June 2016	709	1839	1435	28%	33%
June 2017	703	2118	1418	25%	33%
June 2018	703	2367	1448	23%	33%