AUSTRALIA POST
DRAFT NOTIFICATION
AUGUST 2022

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
EMRP	Equity Market Risk Premium
EPM	Enterprise Profit Model
FTE	Full Time Equivalent
GBE	Government Business Enterprise
GFC	Global Financial Crisis
GST	Goods and Services Tax
LPO	Licensed Post Office
MIWG	Mail Industry Working Group
OECD	Organisation for Economic Co-operation and Development
PTRM	Post Tax Revenue Model
RoLS	Reform our Letter Service
TFP	Total Factor Productivity
TRR	Temporary Regulatory Relief
VBI	Vested Benefit Index
VECM	Vector Error Correction Model
WACC	Weighted Average Cost of Capital
WPI	Wage Price Index

1. Executive summary

This draft notification proposes price increases to Australia Post's reserved ordinary letter service, including a 10c increase to the basic postage rate (**BPR**), from $1.10 to $1.20, effective January 2023.

The proposed increases would be the first change to reserved ordinary letter service prices since January 2020. Since then:

- The number of new delivery addresses has increased by around 400,000 (January 2020 to June 2022).
- The annual volume of domestic addressed letters Australia Post delivers has declined by around 280 million (FY20 – FY22).
- Australia Post has, over the pandemic period, faced significant operational challenges and additional costs.

As part of the proposed January 2023 price increases, Australia Post will maintain the 2014 rate of

- Concession stamps ($3 for a booklet of five) and
- Seasonal greeting stamps (65 cents for a small letter).

Operating in an environment impacted by COVID-19 has been particularly challenging in our operational areas, however, we have continued to pursue and achieve productivity benefits through a range of network programs and continue to plan for ongoing productivity benefits which include, from 2022/23, continuing to optimise the volume of parcels streamed to our postal delivery officers for delivery.

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 draft 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 draft notification reflect a sustained pursuit of efficiency and productivity opportunities while managing the impacts of COVID-19;
- 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 draft notification is supported by information on Australia Post's letter volumes, revenues, and costs, and modelled over the 2021/22 to 2023/24 period.

Forecast data is based off March Quarter Forecast (2021/22) data as this is the most current data available when the forecasts were prepared.

The key pricing assumption to support the financial modelling contained in, and supporting this draft notification, is those prices proposed to be effective January 2023. Those proposed prices include the notifiable and other domestic letter prices.

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 2023/24 Australia Post's:

- Reserved ordinary letter service is forecast to under recover by $138m; and
- Domestic letter service is forecast to under recover by $813m.

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 draft 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 draft 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 with the article bearing a 'Postage Paid' postmark.

Ordinary letters include reserved (up to 250 grams) and non-reserved letters (over 250 grams and up to 500 grams).

[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'.

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 2023

The prices proposed in this draft notification ensure the ordinary letter service remains accessible to, and affordable by, all Australians.

While the scope of this draft notification is proposed changes to Australia Post's reserved ordinary letter service, there will also be price changes to other domestic letter products from January 2023. These price changes are included in the financial modelling.

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	$1.10	$1.20	9.1%
Ordinary large letter			
Up to 125g	$2.20	$2.40	9.1%
Over 125g up to 250g	$3.30	$3.60	9.1%

In setting the proposed prices, Australia Post applies pricing principles[3] and letter prices have been set to ensure a sustainable letter service. As shown in Table 33, the proposed prices (effective January 2023) do not exceed the efficient cost (including a reasonable rate of return) of providing the service.

3.2. Impact of the proposed prices

As part of the overall January 2023 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).
- The seasonal greeting card rate, available November and December, will also continue to be offered at the 2014 rate (65 cents for a small letter).

As the average consumer sends around 15[4] letters per year, for consumers that are either not eligible for, or have not taken up the concession stamp offer, the impact of the price increase, will be between $0.00 and $1.50 per year depending on the proportion of letters that are sent that are seasonal greeting cards.

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

[4] KPMG Community Sentiment Research, July 2022

There will be no impact, within this average, for eligible consumers who have taken up the concession stamp offer.

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.

At $1.20, the BPR continues to see Australian domestic letter prices remain one of the most affordable in the world as shown at Chart 1 which compares the change in stamp prices (postage rate including GST) to the change in the Consumer Price Index[5] (**CPI**) since 1975[6] and the change in the Wage Price Index[7] (**WPI**) since 1997.[8]

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.

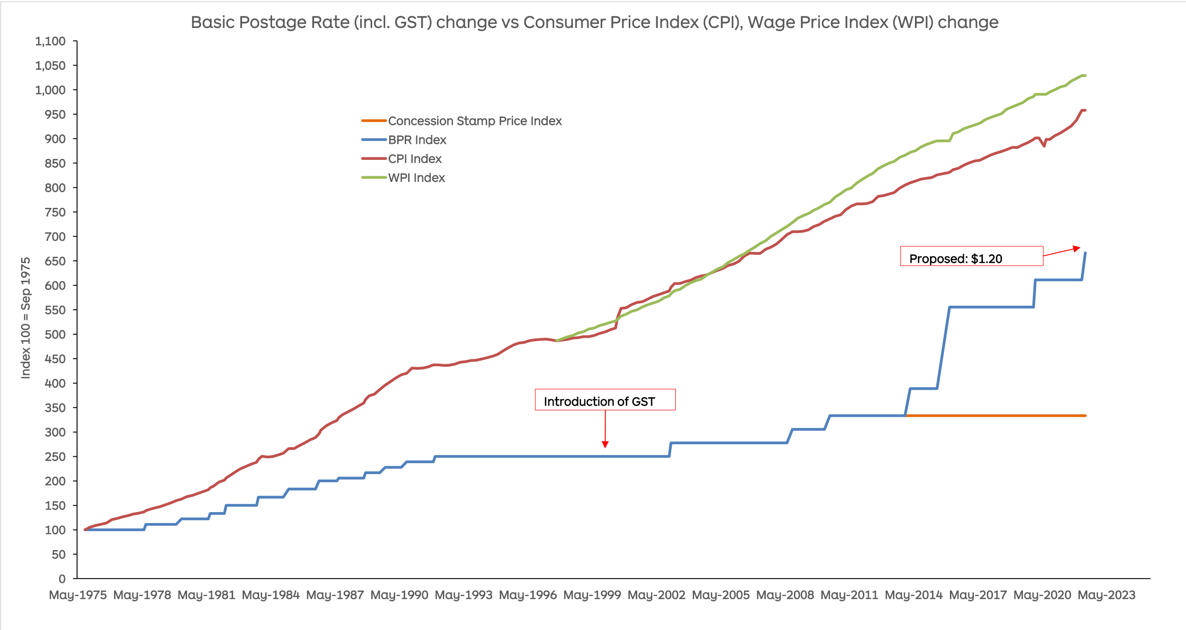
[5] Consumer Price Index; All groups; Quarterly; Publication Date: March 2022; Australian Bureau of Statistics / Reserve Bank of Australia; ABS Cat No. 6401.0.

[6] 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

[7] Wage Price Index; Quarterly, Total hourly rates of pay excluding bonuses, All Australia, Private and Public, All industries; Publication Date: March 2022; Australian Bureau of Statistics; ABS Cat No. 6345.0.

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

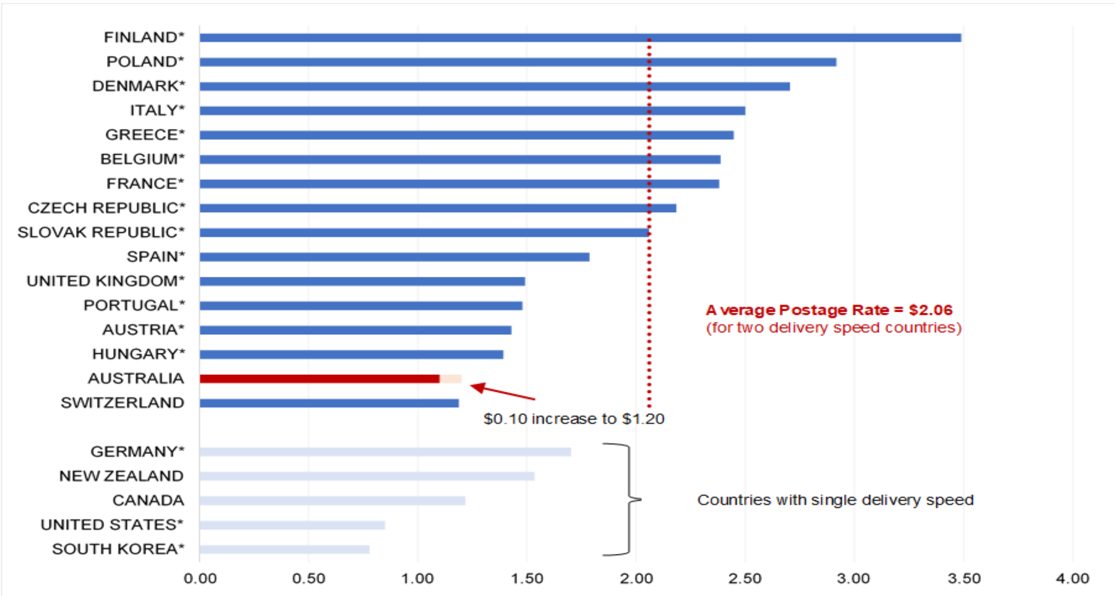
Chart 1 – Affordability of the BPR



3.5. BPR comparison to other OECD countries

As shown in Chart 2, when compared to other OECD countries, at $1.20, Australia's BPR is the second lowest where choice of delivery speed for letters is offered and fourth lowest overall.

Chart 2 – Domestic postage rates, Regular[9]



*countries where basic postage rate is tax exempt

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[9] Purchasing Power Parity (PPP) of basic letter price in A$ - source OECD and Australia Post, prices in other countries as at 7 June 2022.

4. Consumer insight

In May 2022, Australia Post engaged KPMG to undertake independent research to understand community sentiment with regards to letter services and assess reaction to a potential 10 cent stamp price increase.

To do this, a comprehensive 15-minute online survey was designed, covering behaviours, awareness and attitudes towards Australia Post and a potential stamp price increase.

The sample was designed to be a nationally representative sample of the views of the Australian community. A robust sample of n=2,078 consumers was collected (sample structure is aligned to 2016 Census data), with an additional sample of business owners, to achieve n=246 businesses.

The research fieldwork was conducted from 8 – 23 June 2022.

4.1. Reaction to a potential stamp price increase

Two thirds of the community surveyed (67%) indicate they expect the price of a domestic stamp for standard letters or cards to increase in the next 12 months. This was significantly higher amongst older Australians (55+), those who buy stamps and send letters, as well as those who are aware of the current domestic stamp price for standard letters or cards.

Of those who did not think the stamp price would increase; a quarter (26%) believe the price will stay the same or decrease, this tended to be younger age groups, and those unaware of the current stamp price.

When provided with context for the domestic stamp price increase, 56% of consumers were supportive and 26% of consumers were neutral to a 10-cent increase.

The results suggest the majority of the community (82% support/neutral) are unlikely to oppose a 10c stamp price increase under current circumstances.

4.2. Reasons for support versus opposition

Satisfaction with the size of the increase, and an understanding of current economic factors are the main reasons for support.

Amongst both businesses and consumers, those who support the increase are satisfied with the size of the 10-cent increase, and both groups recognise the current inflationary environment businesses are operating in. Reasons for opposition to the increase amongst those who oppose are that stamps are already expensive, and that the cost of living is already too high.

5. Letter volumes including econometric forecasting

In this section:

- The approach to volume forecasting – Baseline projections for each of the key letter segments are derived via an econometric model which are then finalised by overlaying insights based upon emerging trends, known future events and further market intelligence.
- Continuing pressure – Letter volume erosion continues primarily driven by intensifying e-substitutive pressures.
- The COVID-19 impact – Initiatives designed to limit the spread of COVID-19 had an adverse impact on letter volumes ranging from short to long-term effects depending upon the mail segment.
- Price elasticity – Inelastic price elasticities for each letter service highlights the limited impact price changes have on demand and support the assertion that migration to digital is primarily driving all communication activities.

5.1. Overview

The number of addressed letters sent in Australia has fallen by 65% since 2007/08 at an accelerating rate, as highlighted in Table 2. This substantial volume erosion is explained primarily by the proliferation and penetration of electronic alternatives to the physical mail item. Rapid technological progress combined with behavioural changes in the way Australians communicate has accelerated these e-substitution pressures.

Table 2 – Australia Post's letter volume fluctuations – AAGR[10] (%)

	2006/07 to 2010/11	2011/12 to 2015/16	2016/17 to 2020/21
Other small	(5.2)	(10.0)	(12.5)
PreSort small	(0.4)	(4.3)	(9.8)
Other large	(5.8)	(9.7)	(12.2)
PreSort large	(5.0)	(12.7)	(12.3)
Print Post	(3.0)	(5.2)	(13.4)
Total letters	**(2.9)**	**(6.9)**	**(10.9)**

Throughout this period, other factors such as movements in the price of a letter, delivery service performance, delivery point expansion were also important, albeit less statistically potent, economic explainers of volume fluctuations.

The global financial crisis (**GFC**) of 2007/08 was a catalyst for significant change in the mailing habits of Australia Post's key customers. During the GFC driven economic downturn, there was a greater propensity amongst the major mailers to engage in cost containment strategies because they could not realise their profit aspirations through sales. Key customers were therefore more likely to pursue digital alternatives in communication and this accelerated domestic letter volume erosion following the GFC.

[10] The average annual growth rate (AAGR) measures the numerical average % increase. This is a linear construction that assumes no compounding.

More recently, in March 2020, COVID-19 also impacted Australia Post's letters business, pushing volumes below the expected baseline. As with the events of 2007/08, there was a contraction in the level of economic activity reducing the number of transactions within the economy and leading to a fall in transactional mail.

The novel nature of the pandemic resulted in an impact on letter volumes beyond those associated with a conventional economic downturn, such as had occurred under the GFC. Imposing restrictions on social mobility, aimed at limiting the spread of COVID-19, altered the behaviours and lifestyle patterns of Australians. Consequentially, as retail trade stagnated, the lockdowns and closures to non-essential retail resulted in dramatic declines in letter volumes linked to discretionary spending, especially Print Post and the Promo Post sub-segment of PreSort small letter volumes.

Australia Post's ability to fulfil its service obligation was also impacted throughout the pandemic. There were increasing obstacles to Australia Post in servicing it's delivery network as postal employees became increasingly restricted due to density requirements, lockdowns, and quarantining requirements. As a result, Australia Post was granted temporary regulatory relief (**TRR**) in the form of extended timeframes for intrastate delivery. Additionally, the Priority letter service was suspended, and an alternative priority service was introduced for some letter products albeit with a longer delivery window.

While these transient initiatives facilitated Australia Post's capacity to remain operationally viable, they came at the cost of providing a slower service.

The combined socio-economic impacts of COVID-19 therefore contributed to an increasingly pronounced total letter volume decline of -12.3% and -11.4% in 2019/20 and 2020/21 respectively. This represented a significant deterioration in domestic addressed letter volume[11] erosion from the 2018/19 decline of -7.6%.

Despite the recent issues confronting Australia Post's capacity to deliver letters throughout the pandemic, the technological progress that facilitates e-substitution has continued to advance at unprecedented levels.

Between 2014/15 and 2020/21 the number of wholesale NBN Services in operation throughout Australia increased by 1,578%. This created a high-speed network, unlocking real time video communications for the large proportion of the Australian workers who transitioned into work-from-home arrangements during the pandemic. Software applications such as Microsoft Teams facilitated video meetings, allowing participants to share files and documentation in real time, further limiting the need for the transmission of paper-based communications that were historically in the domain of the letter.

These developments occurred against a backdrop of ongoing growth in mobile phones with subscriptions for mobile phones growing strongly at an average annual rate of 5.4% since 2000/01. With this growth, advances in device and app related technologies ensured the smartphone became the preferred medium for Australians to communicate, access and share digital content. As these waves of e-substitution continue to multiply further letter volume erosion must be expected.

Despite diminishing demand, the letter remains an effective mode of communication for business and consumers, providing a reliable, trusted yet secure channel for information dissemination across the nation. To ensure the ongoing sustainability of the letters service at Australia Post a balance of rate rises coupled with the deployment of initiatives economising on cost efficiencies is therefore required.

[11] Excluding volumes from large member associations.

The following sections commence with an explanation about how the econometrics are deployed within the forecasting process, highlighting methodological changes from previous approaches. This leads into a quantitative estimation of the pandemic's impact upon letter volumes. Australia Post's econometric baseline letter volumes are then projected to 2023/24 under the assumption of the proposed rate rises. This is followed by an outline of the statistically significant demand drivers across each of Australia Post's key letter volume categories - Ordinary / Other, PreSort and Print Post. The final section quantifies the underlying price elasticities and discusses the evolution of these price sensitivities since the introduction of COVID-19 into Australia.

5.2. Approach to letter volume modelling and projections

Australia Post's econometric models, price elasticities and baseline projections are developed by Diversified Specifics Pty Ltd (an external consultancy engaged by Australia Post for independent analysis).[12] Methodologically, the approach to modelling/projecting letter volumes is consistent with all Australia Post's price notifications since 2010 and with the generally accepted principles of econometrics.[13] That is, the econometric models estimated by Diversified Specifics are premised upon Australia Post's revenue-based volumes and several statistically significant letter volume drivers. As different types of mail are driven by differing sets of demand factors, Australia Post's total domestic letter volumes are delineated and modelled separately according to each of the five key product segments:

- Other/Ordinary small
- PreSort small
- Other/Ordinary large
- PreSort large
- Print Post

The techniques that underpin the development of each letter volume model are premised upon best practice econometric methods in line with internationally accepted approaches to generating letter volume projections. Forecasts and extrapolations of the drivers are imposed upon the models to construct five letter volume baseline projections.[14]

As there are no guarantees past associations will be exactly replicated into the future, the projections generated by Diversified Specifics require an overlay of off model market and industry-based intelligence on emerging trends and/or future events that the econometric process does not completely recognize.

[12] The findings of this section are largely based upon the Diversified Specifics report: 'Australia Post Domestic Letter Volume Demand 2022 Update'. The reader is advised to consult the source documentation for greater detail where required. As the report constitutes an update, previous reports in the series provide an expanded discussion on the evolution of the econometric approach. See Paterson et al (2012) and Diversified Specifics (2013, 2019).

[13] For more insight into these principles see Martin VL, Hurn S. & Harris D 2013, '*Econometric Modelling with Time Series: Specification, Estimation and Testing',* Themes in Modern Econometrics, Cambridge University Press, New York.

[14] The projections provided in this section assume the prices proposed by Australia Post.

When contrasted to the 2019 price notification, the econometric models/processes have altered due to two main reasons. Firstly, the onset of the COVID-19 impacted letter volumes both directly, via changes in market demand, and indirectly through the TRR initiatives afforded to Australia Post during the initial phases of the pandemic. Secondly, Diversified Specifics has incorporated adjustments to its econometric approach taking into consideration recommendations from the previous ACCC price notification decision document.[15] These changes include:

- Utilising twin e-substitution indices designed to recognise differences in the evolution and penetration of the technological change that has eroded Australia Post's letter volumes. Each index utilises only data pertaining to Australia and is constructed via principal component statistical techniques.[16] This allows for the incorporation of a range of technology-related variables that individually explain some element of letter volume decline including:
    - Expansions in mobile phone, broadband, wireless and high speed NBN technologies that favour online transaction resolution, digital advertising and social media information dissemination; and
    - Replacements of traditional modes of bill payments, such as cheques, with direct debit facilities.
- Deploying a structured approach to variable selection that is consistent throughout the estimation of each segmented domestic letter volume model. This approach consists of three parts:
    - Economic theory - the compilation of variables must initially conform with conventional associations bound by the principles of economics and logical linkages governing how a potential driver relates to segmented letter volume movements. For example, all price elasticities should be inversely related to demand, and all income effects must be positive.
    - Historical precedence – each of the models builds upon Diversified Specifics segmented letter volume models that have evolved over a twenty-five-year period. Although slight variations take place at each iteration, for consistency the core framework depicting accelerated e-substitution and price effects remains constant. The process also must be agile enough to acknowledge shocks to the Australian economy and to each letter segment that tend to alter the volume outcomes. The socio-economic impact of COVID-19 is an example of a recent effect that is now included into the revised set of models under this current iteration.
    - Statistical test criteria – the class of models estimated by Diversified Specifics satisfy several important econometric validations including tests for cointegration. Establishing cointegration amongst the initial variables rules out a potential misspecification of the long run component of the model. Diversified Specifics then systematically test a range of potential variables for individual statistical significance to enhance the base models and capture any further variation in letter volumes.

[15] The Australian Consumer & Competition Commission (2019), '*ACCC view on Australia Post's draft price notification*', November, pp. 15 & 16.

[16] Principal component analysis involves reducing several interrelated variables into a single dimension yet retaining the underlying variation.

- The price of alternative technologies in Australia is utilised to assess the cross-price impacts on letter volume demand. On this occasion a basket of prices governing a range of services within the telecommunications industry was utilised to proxy these cross-price effects. This addition resulted in expanding the set of letter volume drivers within the Ordinary/Other small and PreSort large models.
- Adopting a structured approach to structural break testing throughout the modelling process.

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

As with previous price notifications, the emergence of e-substitution occurs in waves of multiple technologies/platforms, each at varying stages of development and penetration. As a result of this unpredictability, outputs from the econometric process must be considered baseline projections only. They necessarily require an overlay of recent market and institutional intelligence to ensure the final forecasts possess optimal currency. For example, although Federal elections are established as statistically significant events throughout the PreSort small letter testing process, this variable is not explicitly embedded within the econometric models due to the potential distortions this would result in attempting to predict the timings of future election dates. Therefore, Diversified Specifics baseline model projections are adjusted by Australia Post's addition of pertinent market intelligence to account for 'off- model' impacts. This implies precise volumes from significant mailings such as the 2022 Federal election and the most recent census are overlaid on the econometric projections.

This approach is consistent with that adopted by Australia Post in prior notifications and noted by the ACCC as being '… broadly consistent with recent trends in letter volumes.'[17]

To summarise, overlays of additional intelligence onto the baseline combined with a continual process of driver refinements ensure the final letter volume forecasts possess optimum currency and remain in line with principals of best practice.

5.3. Estimating the impact of COVID-19 on letter volumes

The COVID-19 socio-economic impacts are incorporated in the econometric modelling framework to address the additional demand effects associated with the pandemic. This is achieved via a series of time specific dichotomous variables on each of the product segment models to assess how letter volumes diverted from the expected trends. Following March 2020, policy initiatives were implemented within Australia designed to limit the spread of the pandemic and assist those members of society dealing with socio-economic COVID-19 related consequences. These initiatives included closures to non-essential retail, lockdowns, quarantining and informing Australians about available vaccination programs.

The presence of COVID-19 also resulted in significant changes to the specification of Australia Post's letter service as offered to its customers. That is, TRR led to mostly longer delivery windows for Australia Post's letter service. Altering these key letter product attributes, particularly in a short period of time may impact customer demand for letter services. Crucially, each letter segment was impacted in a different manner, and this is reflected in how the pandemic is treated within the various segmented econometric models.

[17] The Australian Consumer & Competition Commission (2014), 'Australia Post price notification for its 'ordinary' letter service ACCC Decision', February, p. 26

The clear implication from the trends and statistical analysis is that the pandemic was a significant demand driver of letter volumes over the first two years of onset into Australia. The econometric models permit the impact of the pandemic to be quantified by creating a counterfactual case where the COVID-19 impact is set equal to zero. Table 3 highlights the estimated additional volume impacts caused by pandemic-related changes, as distinct from the effects emanating from other drivers such as e-substitution, price, etc from January 2020 to December 2021.

Table 3 – Estimated impact of COVID-19 on Australian domestic letters

Segment	Total volume impact (m)	Volume impact as % of the total (%)
Ordinary / Other small	(57)	(6.5)
PreSort small	(131)	(6.7)
Ordinary / Other large	(6)	(4.8)
PreSort large	(7)	(8.8)
Print Post	(38)	(20.4)
Total letters	(239)	(7.5)

The key implication of Table 3 is from the start of 2020 to the end of 2021 (two full years) total letter volumes declined by an additional 7.5% (or 3.7%p.a) because of pandemic related effects. There is a risk the impact of the pandemic on letter volumes at Australia Post may continue over the coming years as businesses continue to migrate more communications to digital alternatives at an accelerated rate when contrasted to the hypothetical case of a world without COVID-19.

5.4. Letter volume baseline projections

Future baseline letter volume fluctuations are projected via Diversified Specifics' econometric models both with and without the proposed price increases applied.[18] The difference between the projections across the two scenarios are not qualitatively large. This implies e-substitution, rather than any changes in letter price, is likely to drive most of the anticipated volume erosion. Given all key letter price elasticities are inelastic this suggests a migration towards digital communications will be the dominant letter volume driver in future years.

As highlighted in Table 4, the volume forecasts in this draft notification assume an average annual letter volume decline of 9.3% per annum out to 2023/24. Delineating this decline by segment emphasises significant volume erosion is expected to occur across all key letter segments, Table 5.

Table 4 – Total domestic addressed letter volume – Econometric baseline

	Estimate[19]	Forecast	Forecast	AAGR
	2021/22	2022/23	2023/24	
Volume (m)	1,492	1,353	1,227	
Change (%)		(9.3)	(9.3)	(9.3)

[18] The projections provided in this section are generated by incorporating the prices proposed by Australia Post.

[19] The '2021/22 Final' volume is based upon nine months of actual values and 3 months of projected values as derived by the econometric models. This also applies to the '2021/22 Final' volumes of Table 5

Table 5 – Total domestic addressed letter volume by key segment – Econometric baseline

	2021/22 Estimate	2022/23 Forecast	2023/24 Forecast	AAGR
Ordinary / Other small				
Volume (m)	382	344	307	
Change (%)		(10.1)	(10.8)	(10.5)
PreSort small				
Volume (m)	917	840	763	
Change (%)		(8.4)	(9.2)	(8.8)
Ordinary / Other large				
Volume (m)	59	52	48	
Change (%)		(10.7)	(8.2)	(9.5)
PreSort large				
Volume (m)	45	39	35	
Change (%)		(13.8)	(8.9)	(11.3)
Print Post[20]				
Volume (m)	89	79	75	
Change (%)		(11.6)	(5.2)	(8.4)

Despite significant letter volume erosion, Australia Post's nationwide delivery network continues to grow. This is illustrated in Table 6 which suggests a 31.3% projected decline in domestic addressed letter volume between 2019/20 and 2023/24 accompanied by an anticipated 5.9% expansion in delivery points over that same period.

Table 6 – Addressed letter volume per delivery point

	Final	Final	Forecast	Forecast	Forecast	Percentage Change 2019/20 to 2023/24
	2019/20	2020/21	2021/22	2022/23	2023/24	
Delivery Points (m)[21]	12.3	12.4	12.7	12.9	13.0	5.9%
Letter volume (m)	1,787	1,582	1,492	1,353	1,227	(31.3) %

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 volumes well below the threshold required to access the PreSort letter service.

[20] Excluding volumes from large member associations.

[21] Diversified Specifics forecasts are based upon a linear trend extrapolation of 1972/73 to 2020/21 actual Australia Post delivery point data.

As a result, these segments have traditionally been more susceptible to substitutive pressures over a longer period in line with individuals and SME’s tendency to embrace digital solutions in their communication activities.

5.6. 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.

For the past two decades, significant e-substitution of this type of mail has occurred to reflect individuals and SME’s willingness to accept an online relationship with their biller on the payments side of a transaction. This has manifested in the traditional mode of bill payments by letter, cheque volumes, declining by an annual average rate of 13.3% since 2000/01, and by 17.6% since 2016/17. Additionally, direct debit payments within Australia have expanded by 196% since 2002/03 reflecting an acceleration in non-letter-based alternatives to account settlement.

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.

5.6.1. Ordinary / Other small letter volume drivers

Using a vector error correction modelling (VECM) framework the statistically significant volume drivers over the January 2011 to December 2021 timeframe are:

- E-substitution – Other small letter volume e-substitution pertains to bill payments and bill presentments therefore several variables are utilised in the construction of the principal component index designed to capture these tendencies. Bill payments type substitution are proxied by Australian cheque volume declines and the growth in direct debit payment options. These variables are combined with the need to quantify SME and owner operator bill presentments which necessitates the inclusion of Australian mobile phone subscriptions and a range of Australian internet connection variables including broadband, wireless and NBN service provision.
- Real own price – This variable reflects a combination of inflationary real price declines and nominal price increases. CPI projections for average changes in consumer prices were given by the Australian Bureau of Statistics whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.
- Real cross price – The price of a representative range of telecommunications services, as determined by the Australian Bureau of Statistics is utilised to assess cross price effects. As this is a nominal variable the Australian Bureau of Statistics CPI variable is used to account for inflationary pressures.

Two dichotomous variables are contained within the error correction component of the VECM. The first captures the impact of the atypical increase in the basic postage rate occurring in the March quarter of 2016 whilst the second isolates the additional effect on Other small letter volumes arising out of the COVID-19 related policies that altered the socio-economic landscape within Australia.

The *adjusted* r^2 for this model is 0.9933 suggesting the equation explains 99.33% of total variation in Other small letter volumes between January 2011 and December 2021.

5.6.2. 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.

Other large letter content skews towards ad-hoc non-standard size documents, including legal contracts and reports as sent by individuals and commercial entities. Given the advances in technology much of this correspondence now takes place in digital form. Initially electronic file transmission was limited to email attachments however households and businesses in Australia have become increasingly connected online. This has resulted in an ability to transmit substantial amounts of information in electronic form, such as pdf, document and picture files via email.

More recently, the popularity of flash drive usage, cloud storage facilities and file sharing services such as Microsoft Teams, Dropbox, iCloud and OneDrive facilitate instantaneous and cost-effective alternatives to larger document transmission. Additionally, detailed contracts and insurance policies now can be completed via online platforms provided by websites and apps which greatly reduces the need for large documents to be sent through Australia Post's delivery network.

5.6.3. Ordinary / Other large letter volume drivers

Using a VECM framework the statistically significant volume drivers over the October 2011 to December 2021 timeframe are:

- E-substitution – A digital migration away from the Other large letter item is captured by a principal component index that combines Australian mobile phone subscriptions and a range of Australian internet connection variables including broadband, wireless and NBN service provision. This variable is intended as a broad proxy of technological change and penetration that enables EDI technology, the transmission of larger documents via email and other cloud-based platforms in addition to online form facilities.
- Real price – This variable reflects a combination of inflationary real price declines and nominal price increases. CPI projections for average changes in consumer prices were given by the Australian Bureau of Statistics whilst the proposed nominal price increases were supplied to Diversified Specifics by Australia Post.

Within the error correction component of the VECM are several variables impacting Other large letters in the short run. These include:

- An allowance for the idiosyncratic demand impacts of the January 2016 atypical nominal increase in the Other large letter postage rate;
- A recognition of the volume stimulus of an additional 2.2 million Other large letter items in September 2021 associated with the Australian census; and
- The COVID-19 related impact on volume.

The *adjusted* r^2 for this model is 0.9941 suggesting the equation explains 99.41% of total variation in Other large letter volumes between October 2011 and December 2021.

5.7. PreSort

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

- Commercial transactional letter volume commonly generated by medium to large scale organisations as well as government enterprises who service substantial customer bases. These organisations use mail as an outcome of their processes to service their customers and constituents.

Therefore, this type of transactional mail, which are primarily bills, statements and public notices, tend to be distributed according to regular, structured cycles and reoccurring events; and

- Promotional or trans-promotional material such as brochures, catalogues or other addressed material that satisfies the relevant letter category, conditions, size and weight requirements.

5.7.1. PreSort small letter volume

This segment consists of the following items that satisfy the relevant, bulk lodged, 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.
- Public sector notifications and correspondence related to welfare, elections, etc.
- Promotional mail including direct mail, brochures and other addressed advertising material.
- Charity mail aimed at fundraising and increasing awareness of charitable institutions/causes.

Commercial transactional letters represent the dominant product category within this segment. Prior to the GFC of 2007/08, PreSort small letter volume fluctuations were positively associated with measures of Australian economic activity, such as real GDP.

The GFC driven economic downturn represented a turning point for PreSort small letter volumes as retail sales growth stagnated and firms focus shifted towards cost containment initiatives in their efforts to maintain profit margins. As part of that shift there was an increasing tendency for firms to explore how they might reduce their cost of communications, including economising expenditures on mail. In this environment, bill presentment-type mail was increasingly prone to the forces of:

- Rationalisation, which involves reducing the frequency that invoices and statements are provided to the recipient. For example, moving to a quarterly rather than monthly billing cycle;
- Consolidation, including the integrating of multiple messages, commonly transactional and promotional, within a single letter item; and
- *E-substitution,* via an expansion in the proliferation and penetration of digital channels.

Post-GFC annual PreSort small letter volume erosion continued at an average of -6.3% across the 2008/09 to 2018/19 period. In 2020 and 2021, the volume declines were exacerbated by the socio-economic impact of COVID-19. As a result, annual PreSort small letter volume declines in 2019/20 and 2020/21 deteriorated to -11.0% and -10.1% respectively.

In the short run, when the pandemic hit, the transactional component of PreSort small letter volumes was more resilient than the promotional component, Promo Post. As highlighted in Table 7, Promo Post volumes were 58% lower in the June quarter of 2020 compared to the 2019 equivalent. This dramatic volume decline was primarily due to the COVID-19 led reduction in discretionary expenditure as the closure of non-essential retail and lockdowns diminished the need for catalogues and in-store promotions.

Transactional letter volumes were not immediately impacted by the pandemic to the same degree as promotional mail. This is explained by the large component of PreSort small letter volumes that are generated either through:

- Fixed contractual arrangements with customers such as utility, phone and internet billing; or
- Reoccurring mailing cycles that include statements for bank accounts and credit cards.

However, as emphasised earlier, the 2007/08 GFC assisted in understanding why transactional volume erosion during the pandemic might lag any immediate impact. Economic shocks result in a greater propensity for firms to focus on cost containment objectives. This results in an increased tendency to deploy push and pull strategies aimed at migrating communications towards a digital alternative, reducing transactional letter volumes.[22] However, such initiatives take time to effect demand patterns because engendering a behavioural response from the recipient often requires provision of revised service terms and an acceptance of incentive schemes to assist in the migration. For these reasons the impact of the pandemic on PreSort small letter volumes at Australia Post is expected to continue as businesses transfer increasing numbers of communication items to digital alternatives.

Table 7 – PreSort small letter volumes - Transactional vs Promotional

Quarterly percentage changes in volume contrasted to the same quarter in the previous year

	Pre Covid-19 Period					Covid-19 Period						
	2019				2020				2021			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
PreSort small transactional[23]	-7	-4	-4	-10	-6	-14	-15	-5	-10	-7	4	-9
Promo Post	-1	22	-7	-10	-20	**-58**	-23	-22	-24	20	-8	-13

5.7.2. PreSort small letter volume drivers

Using a dynamic ordinary least squares (DOLS) framework the statistically significant PreSort small letter volume driver over the timeframe of December 2007 to June 2018 is e-substitution.[24] Principal component techniques are deployed to capture the evolution of core digital alternatives to the PreSort small letter item, encompassing transactional presentment and promotional activities.

This index-based measure combines Australian mobile phone subscriptions with various Australian internet connection variables such as broadband, wireless and NBN service provision. The omnipresent nature of smartphones, augmented by tablet and PC usage, has led to a behavioral adjustment in how Australians accept information from their billers, financial institutions and public agencies. This has led to an increased propensity to substitute away from the PreSort small letter item, in line with technological advances.

As with the PreSort small letter volume models estimated in previous research conducted by Diversified Specifics, abnormal movements in the level of economic activity also represents a statistically significant demand consideration. The updated PreSort small letter model incorporates these impacts via a number of dichotomous variables that capture the effects of COVID-19 in a similar manner to how the impacts of the GFC were embedded within the modelling in 2015 and 2019.

[22] Examples of these push and pull tactics can involve 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.

[23] PreSort small transactional segment excludes mail related to Promo Post and Charity mail.

[24] The PreSort small letter volume model is developed using a dynamic ordinary least squares technique consistent with previous submissions in 2015 and 2019.

Despite the January 2016 atypical increase in the PreSort small letter prices there is no statistical evidence that rate rises contribute to long run volume erosion within this segment. Although real price impacts are statistically insignificant, the price elasticity is estimated within the model construct due to its economic significance. This provides consistency across all models estimated as part of the entire research task and conforms with the requirements in satisfying the tests on cointegration.

An important consideration for modelling PreSort small letter volumes is correspondence relating to the 2022 Federal election are not included in the underlying data series. Therefore, it is recommended any forecasts incorporate a baseline overlay of the additional election related items lodged during April and May of 2022.[25]

The *adjusted* r^2 for this model is 0.9746 suggesting the equation explains 97.46% of total variation in PreSort small letter volumes between July 2016 and December 2021.

5.7.3. 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.

Prior to 2006/07 PreSort large letter volumes were positively associated with the level of Australian economic activity. However, in 2007 legislative changes facilitated a migration of annual reports towards digital platforms. In doing so this reduced PreSort large letter service usage in the correspondence to stakeholders in Australian public listed companies.[26] This coincided with the GFC where Australian firms were generally reducing bulk distributions of large publications to accrue potential cost savings amidst the economic downturn. Most of this e-substitution tended to be irreversible and therefore PreSort large letter volumes have continued to erode at an accelerated rate.

In more recent times, this erosion has intensified due to this increasing penetration of digital communications, at a declining relative price to mail. From March 2020 additional contractionary forces arose when attempts to limit the spread of COVID-19 caused further declines in bulk promotional activities as non-essential retail closed. Combined, these effects led to an annual average PreSort large letter volume decline of -8.8% between 2016/17 and 2020/21.

5.7.4. PreSort large letter volume drivers

Using a VECM framework the PreSort large letter volume drivers over the timeframe of January 2003 to December 2021 are[27]:

- E-substitution – PreSort large letter migration to digital is captured by a principal component index underlined by the increasing number of Australian mobile phone subscriptions and internet connections across the broadband, wireless and NBN services. This index proxies the technological advances and penetration rates that have enabled large corporations to disseminate information digitally, *en masse* in a comprehensive, immediate and relatively costless manner.

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[25] As the 2022 baseline projections reported in Section 5.5 are comprised of nine months of actuals combined with 3 months of projections, only the April and May PreSort small letter Federal election volumes should constitute the overlays.

[26] Parliament of Australia (2007), '*Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*', Department of Parliamentary Services No. 174–176, 2006–07, ISSN 1328-8091, see www.legislation.gov.au

[27] Own price effects represent a statistically insignificant volume driver however, are included within the long run component of the PreSort large letter econometric model to reflect the economic importance of the variable.

- Real cross price – The price of a representative bundle of telecommunications services acts as a quantifiable measure of alternative technologies to the PreSort large letter item. Australian CPI transforms this variable to account for inflationary pressures.

Within the error correction component of the VECM several dichotomous variables are included to capture the effects of:

- The additional 2.6 million PreSort large letter volumes related to the 2021 census.
- The atypical increase in the PreSort large letter rate occurring in the March quarter of 2016.
- The general demand impact of the initiatives aimed at limiting the spread of the COVID-19 pandemic.

5.8. 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 increasing amount of information digested, largely for free, by Australians in digital forms through social media and digital publications, Print Post volumes have declined at an average annual rate of 6.8% since 2010/11 and by 10.6% since 2016/17. Firms producing magazines are also less incentivised on the supply side due to declines in print-based advertising revenue that has been cannibalised by online mediums. These reflect general magazine and publication industry trends where subscription (and circulation) rates have deteriorated worldwide.

5.8.1. Print Post volume drivers

Using a DOLS framework the dominant Print Post volume driver over the timeframe of January 2015 to December 2021 is e-substitution.[28] Principal component techniques are used to trace the proliferation in mobile phone subscriptions and broadband, wireless and NBN internet connections across Australia. This index proxies the increased penetration of technologies that have enabled the quantity of users engaging with social media platforms, websites and digital magazines to grow at unprecedented rates. As Australians divert their behaviours towards online mediums, a greater proportion of promotional spend is also redirected away from printed catalogues that once utilised Australia Post's Print Post service.

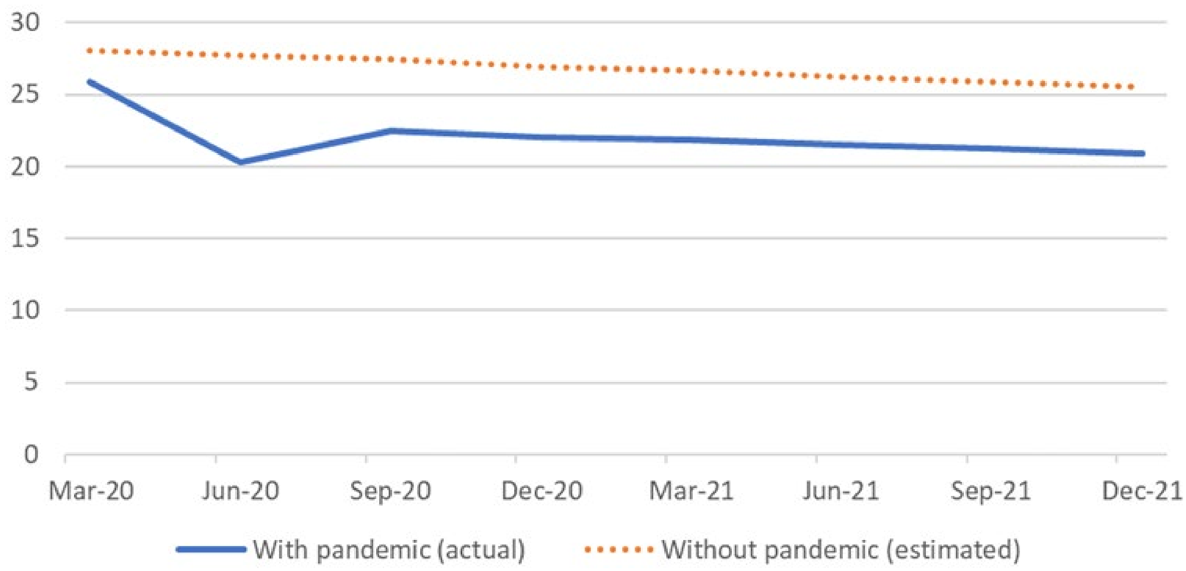
During the pandemic, Print Post volumes deteriorated significantly because of the link to discretionary expenditure and the closures to non-essential retail that diminished the importance of promotional activities, such as catalogues.

Accelerated annual Print Post volume erosion, from -9.1% (in 2018/19) to -21.3% (in 2019/20), was symptomatic of the pandemic-driven effects on Australian consumer discretionary expenditure. These results illustrate the importance of the June quarter of 2020 where a one-off decline in Print Post volumes, in the early stages of the pandemic, created a gap between actual and expected volumes.

[28] Own price effects represent a statistically insignificant volume driver however, are included within the Print Post DOLS econometric model to reflect the economic importance of the variable.

This gap has persisted through to December 2021 emphasising the irreversible nature of the transition from print to digital that accelerated because of the pandemic. A graphical summary of actual Print Post volumes against the counterfactual estimate, without the presence of the pandemic, is provided in Chart 3. The modelling accounts for these immediate and sustained COVID-19 related effects via a combination of statistically significant dichotomous variables.[29]

Chart 3 - The estimated impact of COVID-19 on Print Post volumes (quarterly, millions)



5.9. Estimating a reliable set of price elasticities

In the absence of changes to its service obligations and when responding to the substantial rates of volume erosion that has occurred this century, Australia Post has two options to ensure the sustainability of its letters business. The first involves a restructuring of the delivery timetable to economise on the costs associated with servicing a large and expanding point of call network. Initiatives such as the introduction of the '*Priority*' service and a widening of the delivery window for some letter segments are examples of how Australia Post have attempted to reconfigure its cost base in processing and delivery to ensure sustainability. Given the comprehensive nature of volume erosion combined with the speed of demand deterioration, the second lever available to Australia Post to ensure the letters business remains commercially viable is via the imposition of rate rises. As such, each of Australia Post's letter volume segments has been characterised by an increasing number of price changes this century in response to the impact of e-substitution.

Diversified Specifics estimate a series of price elasticities by letter segment to evaluate how recent pricing strategies have impacted volume demand, relative to the dominant forces of letter consolidation, rationalisation and e-substitution. For each letter volume segment, the econometric modelling process estimates a price elasticity that is relevant to the prevailing postal landscape. This also provides a guide as to how volumes might respond to any future changes in postage prices.

[29] Complicating the quantification of volume erosion attributed to the pandemic, in recent years some key Print Post customers have altered the way they engage with this service as the number and importance of digital alternatives has proliferated. For example, dwindling readership numbers for some publications have led to modifications in frequency of distribution, moving from quarterly to annual/bi-annual, whist others now produce scaled down printed publications intended to augment, and drive traffic towards, online counterparts.

As with previous letter volume demand studies conducted by Diversified Specifics, all price elasticities of demand are inelastic. When contrasted to the previous 2019 update, price for several letter segments registers as a statistically insignificant driver of demand. This is an unsurprising result given recent years have witnessed significant letter volume erosion due to accelerating pandemic induced e-substitution pressures whilst the price of a letter item remains largely stable.

Table 8 highlights how the estimated price elasticities have altered between the current updates as contrasted to that of 2019.

Table 8 – Price elasticities of demand (Diversified Specifics models)

	2019	2022
Small letter volumes		
Ordinary / Other	(0.42)	(0.15)
PreSort	(0.24)	(0.55)*
Large letter volumes		
Ordinary / Other	(0.60)	(0.18)
PreSort	(0.40)*	(0.47)*
Print Post volumes	(0.34)	(0.06)*

** denotes statistically insignificant*

The findings of Diversified Specific series of recent reports from 2013 to 2022 provide powerful empirical evidence that price changes do not explain the vast majority of long run volume erosion. Indeed, a review of Australian letter volume fluctuations before, during and after the January 2016 atypical price changes provides compelling evidence to suggest letter volume declines eventually return to their long-run trend, dominated by the forces of e-substitution.

Table 9 illustrates how the short run additional declines in letter volume demand due to the January 2016 rate rises, dissipate in the longer run. By 2018/19 the annual volume declines had returned to approximate pre-price rise levels for all key segments. This supports the assertion that aggressive e-substitution pressures cause the behavioral change that drives long term letter volume erosion, rather than price effects.

Table 9 – Limited long run impact of the January 2016 price increases on letter volumes

Percentage change in the volumes of Australia Post's key letter segments				
	2015/16	2016/17	2017/18	2018/19
Small letter volumes				
Ordinary / Other	(14.5)	(18.8)	(10.2)	(8.5)
PreSort	(6.1)	(7.5)	(10.3)	(7.7)
Large letter volumes				
Ordinary / Other	(11.9)	(13.8)	(15.2)	(10.6)
PreSort	(22.8)	(25.3)	(25.1)	16.6
Print Post volumes	(10.2)	(10.6)	(9.9)	(9.1)

Diversified Specifics project declining letter volumes every year to 2023/24 across all letter segments irrespective of any rate increases. The key finding is that e-substitution remains, and is expected to remain, the leading statistical and economic driver of letter volumes over the foreseeable future. Moreover, the substitutive pressures have only intensified because of the socio-economic and behavioural changes that occurred since the onset of the COVID-19 pandemic.

Diversified Specifics research also emphasises how under rapid technological change, projections generated from econometric models that are premised upon historical associations can quickly become obsolete. Therefore, ongoing research is essential to ensure letter volume projections are augmented with appropriate institutional, industry and market-based intelligence to ensure all models and projections retain optimal levels of accurate and robustness.

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

5.10. Promoting and sustaining mail

Formed in March 2016, the Mail Industry Working Group (**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 provide a forum for consultation and idea sharing in an open and transparent way, on areas of mutual interest across the mailing industry including industry promotion and innovation, mail product developments and changes and supply chain efficiencies.

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:

- Fundraising Institute of Australia.
- The Real Media Collective (**TRMC**).
- Envelope suppliers.
- Postage meter suppliers.
- Mailhouses.

5.10.1. Industry campaigns

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

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.

TRMC was formed in 2018 under a merger from the Australasian Catalogue Association, Australasian Paper Industry Association and Two Sides Australia Limited. TRMC has 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
- Love Paper – advocates and provides research, data, and case studies on the value of paper and paper-based communication.

Australia Post also supports industry award events such as TRMC Real Media Awards to ensure catalogues and mail remain part of the multi-channel marketing conversation.

5.10.2. Australia Post promotions

In addition to working with industry partners, Australia Post continues to undertake activities to promote mail including:

- The Effectiveness of Mail Campaign which was a broad campaign underpinned by extensive research highlighting the communication attributes of mail; and
- Sector specific promotions:
- Fundraising and charities: since 2020, have offered to fundraisers who use Charity Mail a seasonal incentive which provides a rebate for increasing usage
- Publishing sector: during Covid, introduced a temporary relaxation of Print Post usage conditions to encourage publishers to develop new publications for their existing subscriber base
- Marketers: in April 2022 launched a first time user incentive to encourage marketers who had not previously, to use mail for their marketing or promotional activity.

5.10.3. Australia Post Product Developments, Enhancements and Tools

- Campaign Targeter – developed and launched in October 2017, Campaign Targeter is a free online tool to help customers 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 11,000 users have registered, enabling them to better target either unaddressed or addressed mail campaigns.
- Print Post personalisation – introduced in January 2017 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, 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 2021/22 financial year represented 12.8% of total PreSort volume and 9.6% of total PreSort revenue.

5.10.4. 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 engagement – a regular engagement 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 including management of major mailings.

6. Costs

In this section:

- An overview of Australia Post's costs by major category. Detail on how these costs change by price, volume or other impacts.
- Detail on the superannuation arrangements available to employees of Australia Post.

Table 10 – Financial overview

	Actual	**Forecast**	**Forecast**	**Forecast**
$million	**2020/21**	**2021/22**	**2022/23**	**2023/24**
Trading Revenue				
Letters[30]	1,794	1,769	1,624	1,532
Non-Letters	6,469	7,073	7,249	7,697
Total Trading Revenue	**8,264**	**8,842**	**8,873**	**9,229**
Trading Expenses (Cost)				
Labour and Oncosts	3,778	3,967	4,056	4,081
Goods / Services for Sale	219	205	215	218
Accommodation	240	284	268	286
Depreciation	517	530	592	680
Other Non-Labour	3,368	3,856	3,859	3,979
Total trading expenses	**8,121**	**8,843**	**8,990**	**9,244**
Trading profit	**142**	**(1)**	**(117)**	**(15)**

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

6.1. 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.

A review of the LPO payment scheme commenced in February 2018 and concluded in February 2019 with the revised LPO Payment Scheme effective from 1 July 2019 and the benefits of the new payment rates applied retrospectively to licensees from 1 January 2019.

At that time, the LPO payment scheme provided an increase in payment to LPOs of circa $34m. The payment to LPOs is included in the financial data supporting this draft notification.

6.2. Full Time Equivalent usage

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

Table 11 – Australia Post total FTEs by function

Activity / Area	Actual	Forecast	Forecast	Forecast
	2020/21	**2021/22**	**2022/23**	**2023/24**
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**38,394**	**39,169**	**38,888**	**38,227**

A breakdown of Table 11 by type is shown at Table 12.

Table 12 – Australia Post total FTEs by type

Activity / Area	Actual	Forecast	Forecast	Forecast
	2020/21	**2021/22**	**2022/23**	**2023/24**
Full time	28,371	28,679	28,418	27,943
Overtime	2,923	3,093	3,158	3,167
Part time/ casual	6,047	5,865	5,688	5,551
External labour	1,106	1,442	1,624	1,566
Total	**38,394**	**39,169**	**38,888**	**38,227**

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

Table 13 – Domestic letter service FTEs by function

Activity / Area	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**11,912**	**12,488**	**12,094**	**11,522**

Table 14 – Reserved letter service FTEs by function

Activity / Area	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other areas	✂	✂	✂	✂
Total	**10,506**	**10,771**	**10,515**	**10,051**

6.3. Domestic letter service

This section details domestic, reserved and reserved ordinary / other letter forecast data to 2023/24.

Table 15 – Domestic letter service

	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Volume (m)	2,082	2,107	1,821	1,628
Revenue ($m)	1,661	1,657	1,515	1,425
Cost ($m)	✂	✂	✂	✂
Profit ($m)	✂	✂	✂	✂

Table 16 – Reserved letter service

	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Volume (m)	1,569	1,501	1,336	1,211
Revenue ($m)	1,506	1,486	1,358	1,278
Cost ($m)	1,570	1,595	1,628	1,597
Profit ($m)	**(64)**	**(109)**	**(269)**	**(320)**

Table 17 – Reserved letter service costs by function

$m	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other	✂	✂	✂	✂
Total Costs	**1,570**	**1,595**	**1,628**	**1,597**

Table 18 – Reserved Ordinary / Other letter service

	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Volume (m)	483	441	393	352
Revenue ($m)	532	508	466	436
Cost ($m)	606	595	608	590
Profit ($m)	**(74)**	**(88)**	**(142)**	**(154)**

Table 19 – Reserved Ordinary / Other letter service costs by function

$m	Actual	Forecast	Forecast	Forecast
	2020/21	2021/22	2022/23	2023/24
Sales & Acceptance	✂	✂	✂	✂
Processing	✂	✂	✂	✂
Transport	✂	✂	✂	✂
Delivery	✂	✂	✂	✂
Other	✂	✂	✂	✂
Total Costs	**606**	**595**	**608**	**590**

6.4. Superannuation

There are two types of superannuation arrangements available to employees of Australia Post:

- A defined benefit plan – formerly operated as the Australia Post Superannuation Scheme (**APSS**) but now managed as a sub-plan of Australian Retirement Trust following a successor fund transfer on 30 April 2022. The APSS was closed to new employees in 2012. At 31 March 2022, 17,185 or 46% of Australia Post employees, were members of the APSS.
- Accumulation fund – principally AustralianSuper Select and, for StarTrack Award employees, TWU Super. Australia Post and StarTrack Award level accumulation members receive employer superannuation contributions of 12%. Contract-level employees in accumulation funds receive the Superannuation Guarantee Rate, currently 10.5% of ordinary time earnings but legislated to incrementally increase to 12% from 1 July 2025. At 30 June 2022, there were 12,368 active employees who are members of AustralianSuper and 1,991 StarTrack Award employees in TWUSuper. A smaller number of StarTrack employees are in the MLC Superannuation Fund.

A proportion of employees have exercised their choice to contribute to other complying superannuation funds as well as self-managed super funds (SMSFs).

6.4.1. APSS (defined benefit) plan

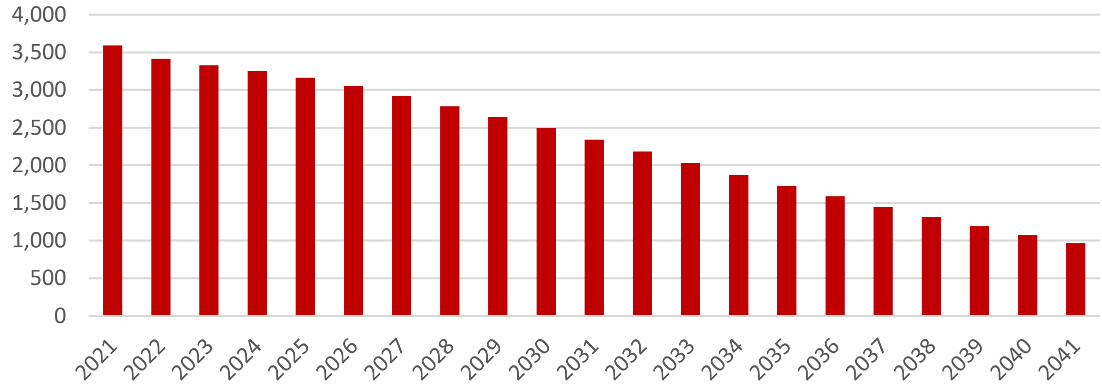
The defined benefit in the APSS plan for permanent employees is 14.3% of their final average salary for each year of service. For fixed-term and casual employees, the accrual rate is the Superannuation Guarantee Rate.

The defined benefit liability is funded by assets built up by contributions made by Australia Post based on actuarial advice. The funding position, or assets as a percentage of liabilities, has varied significantly over time, largely due to asset price cycles. The funding position is most commonly measured as the percentage of the assets relative to the vested benefits, known as the Vested Benefits Index (VBI). A VBI of 100% indicates that benefit obligations are fully funded.

At 31 March 2022, the APSS held $4,283.5m in assets, representing a $735.1m surplus over the $3,548.4m of vested benefits (120.7% VBI as at 31 March 2022). This position has been affected by more recent market volatility.

With APSS closed to new employees since 2012, the vested benefit liability has begun to decline but is projected to be a significant financial obligation for many years to come as shown in Chart 4.

Chart 4 – Projected Defined Benefit Liability[31]

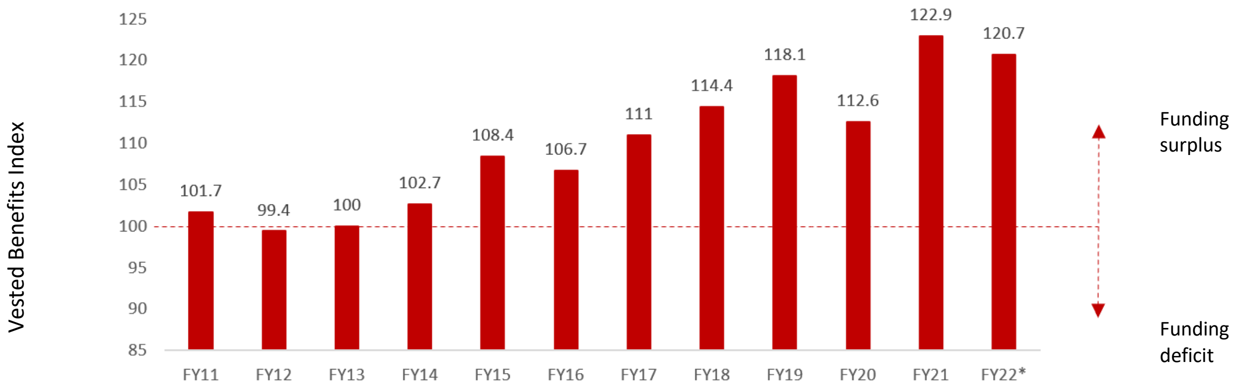


6.4.2. APSS Funding Risk

The APSS is subject to an independent actuarial review every three years, required under the Trust Deed and APRA Superannuation Prudential Standards. The last review was performed in December 2021 with an effective date of 30 June 2021. The key outcome from these triennial reviews is the level of cash contributions by Australia Post required to fund the defined benefit liability, expressed as a percentage of salaries. The 2021 review resulted in a reduction in the contribution rate from 7.5% to 5.0%, effective from 1 July 2021.

Among certain other factors, the contribution rate till the next actuarial review will depend on the level of the funding surplus (or deficit). Australia Post will undertake a further review of its contribution rate if the VBI were to reduce below 110% or rise above 130%. The recent history of the VBI is shown in Chart 5.

Chart 5 – Vested Benefit Index



*To March 2022

The Trustee would, in addition, be required to formulate a three-year VBI top-up funding plan if the VBI falls below the regulated Shortfall Limit, which is set at 98%.

[31] Source APSS Actuary, Willis Towers Watson 2021

To limit the risk of market volatility to the funding position and Australia Post's contribution requirements, the former trustee of the APSS substantially reduced the asset allocation to equity markets in stages from 2018 to 2021, while seeking to achieve a sufficient return on investments to fund the benefit liability, in conjunction with Australia Post's contributions. Management of the assets transferred to the trustee of Australian Retirement Trust in April 2022, with broadly the same mandate to balance the achievement of an adequate return with opportunities to de-risk the assets.

The transfer of the APSS to Australian Retirement Trust also secured net operational cost savings of approximately $5m per annum, which are embedded in the Enterprise budget plans.

6.4.3. Superannuation Expense

Australia Post's annual superannuation expense is the sum of its employer contributions to accumulation funds and, for employees in the APSS plan, a defined benefit superannuation expense, which is calculated according to a formula prescribed under accounting standard AASB119. The calculation uses the G100 corporate bond rate at 30 June each year as the prescribed discount factor. The discount rate, which is subject to bond market price movements, has a significant impact on the superannuation expense from year to year, in addition to changes in the APSS membership profile itself.

Table 20 shows the defined benefit expense and accumulation fund contribution expense met by Australia Post.

Table 20 – Enterprise Superannuation Expense

$m	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Defined Benefit Expense	197	163	143	156	158	147
Accumulation Contributions	79	92	107	122	133	155*
Total Superannuation Expense	**276**	**255**	**250**	**278**	**291**	**302***

*Budgeted

6.5. Depreciation

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

Table 21 – Depreciation expense, domestic letter service

$m	Actual	Forecast	Forecast	Forecast
	2020/21	**2021/22**	**2022/23**	**2023/24**
Buildings & Fitout	56	51	52	55
Plant & equipment	27	25	25	27
Computer software	18	15	14	20
Motor vehicles	12	12	15	16
Total	**112**	**103**	**106**	**118**

Table 22 – Depreciation expense, reserved letter service

$m	Actual	Forecast	Forecast	Forecast
	2020/21	**2021/22**	**2022/23**	**2023/24**
Buildings & Fitout	50	45	46	48
Plant & equipment	24	22	22	24
Computer software	16	13	12	17
Motor vehicles	10	10	12	13
Other Depreciation	0	0	0	0
Total	**99**	**90**	**92**	**102**

Table 23 – Depreciation expense, reserved ordinary / other letter service

$m	Actual	Forecast	Forecast	Forecast
	2020/21	**2021/22**	**2022/23**	**2023/24**
Buildings & Fitout	24	21	22	23
Plant & equipment	10	9	9	10
Computer software	6	5	5	7
Motor vehicles	3	3	4	4
Total	**43**	**38**	**40**	**44**

7. Cost allocation

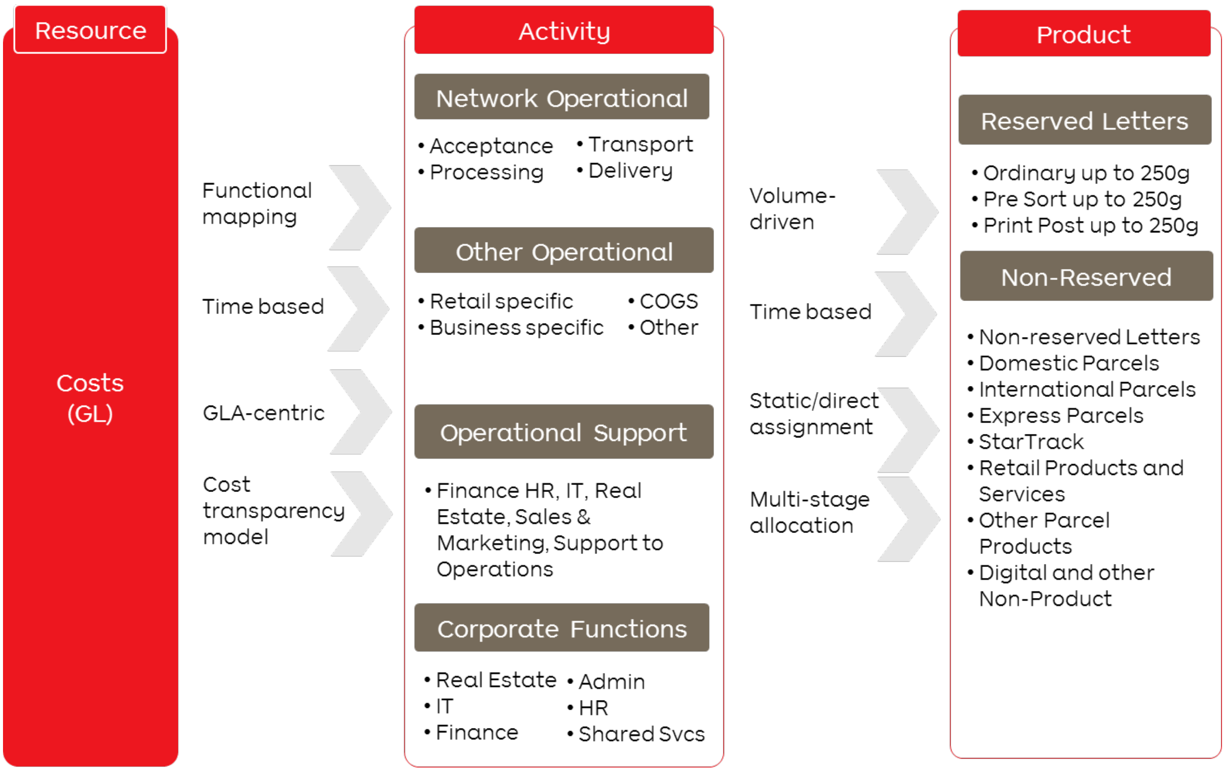
- An overview of Australia Post's cost allocation model and methodology.
- Detail regarding updates to Australia Post's cost allocation model to ensure the model responds to, and is aligned with, operational structures and practices and is transparent in its cost allocation methodology

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 1 – 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 is also a key input into the Pricing models used throughout the enterprise and assist in developing individual customer pricing and profitability.

EPM also supports external reporting requirements including:

- Maintenance of the Regulatory Accounting Procedure Manual (RAPM).
- Production of the Record Keeping Rules (RKR) Schedules.
- Quarterly shareholder reports.
- Letters / Non-Letters services (Annual Report.)
- Key input into the CSO Model to calculate the CSO cost estimate.
- 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 that are not serviced by an activity, receive none of that activity's cost.

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 change within the network (mail or non-mail).

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. Transport Review

In line with the EPM Roadmap shared with the ACCC in 2019, Australia Post's most recent review was the detailed review of its Transport function.

The review involved no field work and was essentially a desktop review, using video conferencing technology, Excel and emails.

Given the COVID-19 restrictions imposed on Australia over the last two years, the review was fit for purpose and timely. The review covered:

- Van Operations
- Interstate Linehaul
- Interstate Air Transport

The Van Operations survey was a detailed review that involved the individual surveying of each van operations site throughout Australia. Surveys were completed within the context of representing a typical week for a facility in terms of the activities they undertook and how much time was spent on each.

The surveys achieved a 100% completion rate, and the results identified a shift away from the amount of time van operations spent on street posting box (**SPB**) clearances, and an increase in the amount of time spent on customer pick-ups and retail outlet drop offs and pick-ups. The survey also identified new activities consistently performed across the sites; Express Post recovery deliveries and parcel locker deliveries

The impacts of the Van Operations update, and the other Transport (interstate linehaul and interstate air transport) resulted in a shift in costs away from reserved letters.

Table 24 – Van Operations 2020/21

2020/21 cost ($m) Actual	**Change**
Ordinary Stamped	✂
PreSort	✂
Print Post	✂
Ordinary Other	✂
Total Reserved Letters	**(17)**
Non-reserved Letters	✂
Total Domestic Letters	**(17)**

Table 25 – Other Transport 2020/21

2020/21 cost ($m) Actual	Change
Ordinary Stamped	✂
PreSort	✂
Print Post	✂
Ordinary Other	✂
Total Reserved Letters	**(3)**
Non-reserved Letters	✂
Total Domestic Letters	**(5)**

7.5.2. Delivery Cost Review

Prior to the Transport review, Australia Post undertook a field-based review of the time standards associated with the Indoor and Outdoor activities performed by postal delivery officers.

This update was reflected in EPM in 2019/20. Table 26 shows the impact on a 2018/19 basis.

Table 26 – Delivery Time Standard Update

2018/19 cost ($m) Actual	Change
Ordinary Stamped	✂
PreSort	✂
Print Post	✂
Ordinary Other	✂
Total Reserved Letters	22
Non-reserved Letters	✂
Total Domestic Letters	**22**

7.6. Cost elasticity (delivery centres)

In support of this draft notification, Australia Post has requested Quantonomics produce updated estimates of cost elasticities for delivery centres.

Cost elasticities measure the percentage change in costs in response to a one per cent change in output. They provide information on the likely effects of declining mail volumes and declining mail density on Australia Post's future costs.

Cost elasticities are estimated by the econometric analysis of costs. The methodology used in this report is consistent with that used in the last study of Australia Post's cost elasticities, by Economic Insights (2018). The present study is based on a considerable amount of additional data, which is combined with the data used by Economic Insights in the previous study.

Economic Insights (2018) notes that delivery accounts for around 62 per cent of Australia Post's reserved service costs, so the likely effects of output trends on delivery centre costs have a substantial bearing on Australia Post's overall reserved services costs.

Delivery centres are taken to have three key outputs:

- the number of articles delivered.
- the number of delivery points serviced.
- the distance travelled on delivery rounds.

The elasticity of *total* delivery centre cost with respect to a proportionate increase in all three outputs is 0.67.

The elasticity of *variable* delivery centre cost with respect to a proportionate increase in all three outputs is 0.50.

Despite the data sample used in this study being almost twice the size of that used in the 2018 study, these estimates for the elasticities of total cost and variable cost with respect to total output are very close to the estimates obtained in the previous study.

When the three outputs move in different directions, which has been the case for more than a decade, we need to look at the output elasticities individually. The total cost elasticity for articles delivered is estimated to be 0.10, for points served is 0.24 and for distance travelled on rounds is 0.33. The elasticity of variable cost with respect to articles delivered is estimated to be 0.08, for points served is 0.05 and for distance travelled on rounds is 0.36.

Over the last decade, the number of articles delivered has fallen rapidly, whereas the number of points and the aggregate distance travelled in delivering articles, have both increased steadily. Since the elasticities of total cost with respect to points served and distance travelled are larger than the cost elasticity of articles, the combination of these trends means that cost increases remain likely even with a decline in the number of articles delivered.

The same point applies to variable costs. The elasticity estimates suggest that, for both variable cost and total cost functions, the effect on cost of decreases in the quantity of articles delivered is likely to be offset, or more than offset, by the effects of increases in delivery points and delivery distances (depending on the rates of decline and increase respectively).

8. Productivity

In this section:

- Detail on the total factor productivity (**TFP**) results for Australia Post at the enterprise and reserved service levels; and
- Detail on Australia Post's cost containment and efficiency initiatives.

8.1. Total factor productivity

TFP is a measure of the overall productivity of a business—the amount of production of all of its outputs in proportion to the amount of inputs it uses to produce those outputs.

Productivity indexes are formed by aggregating individual output quantities into a measure of total output quantity and aggregating individual input quantities into a measure of total input quantity.

TFP growth is defined as the proportional change in total output divided by the proportional change in total inputs used between two periods.

8.1.1. Measuring Australia Post's total factor productivity

There has been a relatively long history of measuring Australia Post's TFP growth commencing with Swan Consultants (Canberra) (1992). In 2002 the Australian Competition and Consumer Commission (ACCC) commissioned a report quantifying Australia Post's aggregate TFP performance over the preceding five years and the following five-year regulatory period (Lawrence 2002). This report was input to the ACCC's review of Australia Post's draft notification of proposed increases in the price of a range of reserved postal services.

Australia Post later commissioned the Lawrence (2007) report which included Australia Post's actual aggregate and reserved service productivity performance up to 2007. Improvements to Australia Post's information systems over the intervening period meant that it was then possible to include considerably more detail on the outputs provided by Australia Post and to better allocate inputs between reserved and non–reserved services. This work was further updated and refined in Economic Insights (2009) and Economic Insights (2019).

Some of the main findings from the previous studies of Australia Post's productivity trends were:

- The 2002 study found that Australia Post's TFP grew by an average 3 per cent per annum over the period from 1976 to 2002.
- The 2007 study estimated the average growth of Australia Post's TFP from 1990 to 2007 was 2.4 per cent per annum. Within this period TFP growth was strongest in the first 12 years, and slightly slower in the last five years (ie, 2002 to 2007), averaging 1.7 per cent per annum. Reserved services TFP growth from 2002 to 2007 was slower than corporate-wide TFP growth, averaging 0.7 per cent per annum.
- The 2009 study estimated that reserved service TFP grew at an average annual rate of 1.7 per cent over the 13-year period from 1997 to 2009.
- The 2019 study found Australia Post's corporate TFP grew by an average 1.7 per cent per annum over the 28-year period from 1992 to 2019. Average annual TFP growth in the 16 years to 2008 was estimated to be somewhat higher at 2.7 per cent. This is broadly consistent with the earlier studies. The growth rate of TFP subsequently slowed. Over the last four years of the sample period (ie, 2015 to 2019), average annual TFP growth was estimated to be 0.9 per cent.

- The 2019 study also found that reserved service TFP grew at average annual rate of 2.5 per cent over the 23-year period from 1997 to 2019. Over the four years from 2015 to 2019, reserved services average TFP growth was estimated to be 2.5 per cent per annum.

The 2019 study is the latest of a series of productivity studies of Australia Post carried out by Dr Denis Lawrence, previously Director of Economic Insights and an Associate of Quantonomics at the time of the report.

In support of this draft price notification, Australia Post has commissioned Quantonomics to produce updated estimates of its TFP trends at the enterprise and reserved service levels. The approach taken adopts the same methodology as Economic Insights (2019) *Australia Post's Corporate and Reserved Service Total Factor Productivity*.

8.1.2. Australia Post's corporate and reserved services TFP - 2022

Since around 2009, the throughput volumes of postal services have started to decline due to technological change and other factors. From 2015 to 2022 the fall in postal volumes has accelerated with the number of reserved service postal articles falling by more than 10 per cent annually (from 2015 to 2022). At the same time, Australia Post has been required to make its network available to an ever-increasing number of geographically dispersed customers which has increased broadly in line with population growth.

Productivity growth based is calculated at the corporate level for 1992 to 2022 and at the reserved services level for 1997 to 2022.

At the corporate level, we include three outputs: mail billed output, non-mail billed output and the number of delivery points. Mail billed output is formed by aggregating 15 separate mail articles components using a Fisher Ideal quantity index. Non-mail billed output is formed by aggregating five separate components using a Fisher Ideal quantity index.

Delivery points are included as the best available proxy measure for the network size Australia Post is required to maintain. The three functional outputs are aggregated into a total output measure using output cost shares derived from estimated econometric cost function from Economic Insights (2019). The total input measure is formed from four components: labour, mail contractors, capital and other inputs.

Australia Post's long-term Corporate TFP growth rate of 1.5 per cent per year exceeds the average rate of productivity growth for the market sector. Over the period from 2015 to 2021, the ABS market sector productivity index averaged an annual growth rate of 0.4 per cent. Australia Posts' Corporate TFP growth rate of 0.7 per cent has continued to exceed, and the Reserved Services TFP growth rate of 3.5 per cent has been well above, the average TFP growth rate for the market sector as a whole over the most recent period since 2015.

At the Reserved Services level, we include two functional outputs: reserved service mail billed output and delivery points. Reserved service mail billed output is formed by aggregating five separate mail article components using a Fisher Ideal quantity index. Delivery points are again included as the best available proxy for the network Australia Post is required to maintain.

Australia Post's Reserved Services TFP growth of 2.8 per cent, on average from 1997 to 2022, has outperformed the ABS market sector productivity index which averaged an annual growth rate of 0.6 per cent for the period from 1997 to 2021.[32] 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 as well as ensuring the safety of our team members is not compromised.

Larger or national initiatives invariably have cross functional impacts. 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 annual efficiency benefit by business unit (as per the 2022/23 Corporate Plan) is at Table 27.

Table 27 – Enterprise Efficiency Program

Corporate Plan Enterprise Efficiency Program	**2022/23 $m**	**2023/24 $m**	**2024/25 $m**	**2025/26 $m**
Targets allocated to areas				
Retail	✂	✂	✂	✂
Network Operations	✂	✂	✂	✂
Customer Experience & Digital Technology Support	✂	✂	✂	✂
Support Functions	✂	✂	✂	✂
Total Efficiency Benefit	**216**	**253**	**189**	**160**

8.3. We remain committed to ongoing letter network efficiencies

Australia Post's price notification of 2019 provided detail on the One Network Program. At that time the forecast benefit from the Program was $336.7.m by FY19. Actual data for FY19 shows that a total benefit of $338m was realised.

Since then, Australia Post has continued to identify and pursue cost savings in response to declining letter volumes however, over the recent past this has been challenging driven by the impact of Covid-19.

[32] ABS 5260.0.55.002 'Estimates of Industry Multifactor Productivity, Australia', Table 2: Hours worked basis.

8.4. Temporary Regulatory Relief

On 21 April 2020, the Government announced temporary adjustments to Australia Post's Performance Standards to reflect the operating constraints and limitations that resulted from the COVID-19 crisis. The changes applied until 30 June 2021 and were subject to review.

Under the temporary changes, the priority letters service was suspended and for the regular service the delivery timeframe for intrastate letters was extended to five days after the day of posting.

In addition to this, delivery frequency in metropolitan areas was adjusted to every second business day but delivery into regional, rural and remote areas did not change. Each of these is discussed in turn.

8.4.1. Suspension of the priority letters service

Due to the significant impacts of Covid-19, the priority letter service was suspended from 1 June 2020 for all letter products. However, as some customers rely on the priority service for delivery of large volumes of mail, while the priority letter was suspended a temporary alternative priority timetable was introduced for some business letter services including PreSort and Print Post.

None of the business letter services that had the option of being sent to the alternative priority timetable could be lodged in an SPB.

The alternative priority timetable delivery timetable was the previous (suspended) priority delivery timetable plus one business day. However, due to restrictions on air transport, delays of up to an additional two business days were flagged on some delivery paths. Introduction of this timetable balanced our large volume business customers' needs for a faster delivery option and the operating constraints we faced.

At the expiration of the temporary regulatory relief i.e. 1 July 2021, the option of priority delivery was reinstated to all products that previously had the offer. However, as the impact of Covid-19 was still being managed (air restrictions, social distancing, staff absences etc), business delivery timetables were reviewed and updated on a monthly basis to identify and highlight paths that were likely to be delayed.

8.4.2. Delivery timeframe for intrastate regular letters

Under the temporary changes, the delivery timetable for intrastate letters was extended to five days after the day of posting.

This extension allowed Australia Post to maintain on-time letters delivery with a reduction in flight capacity and while practicing social distancing.

8.4.3. Delivery frequency in metropolitan areas

As Australians adapted to living under COVID-19 restrictions, Australia Post was managing significant operational challenges compounded by unprecedented parcel volumes.

Introducing a delivery model where letters in metropolitan areas were delivered to each address every second business day provided more parcel delivery capability and enabled Express Post articles, parcels and items addressed to a post office box to be delivered to each address every business day.

During the temporary relief, 131 metropolitan delivery facilities, representing around 6,600 delivery rounds operated under an alternative delivery model which was progressively rolled out between June and November 2020. Delivery rounds in regional, rural or remote areas were not affected.

At the expiration of the temporary regulatory relief, from July 2021 facilities and delivery rounds operating under the alternative delivery model were progressively rolled back to five day a week delivery.

8.4.4. Street posting box clearance times

Australia Post maintains a network of over 15,000 SPBs across Australia.

Over the last 20 years while letter volumes have declined, and delivery points have grown the volume of SPBs has remained relatively stable. In 2001/02 there were 15,689 SPBs and as at June 2021 there were 15,070 red SPBs

In 2018, Australia Post undertook a trial of earlier clearance time for selected SPBs. The trial focussed on SPBs in metropolitan areas in multiple states and excluded SPBs in high traffic areas.

The purpose of the trial was to trial the viability of postal delivery officers clearing those SPBs. The earlier clearance option would enable Australia Post an additional option when managing SPBs with low (and declining) levels of volume.

Although the trial was originally intended to conclude in March 2019, it was extended throughout 2019 to monitor the impact of customers lodging parcels via SPBs and we continued to trial different clearance times including 12pm.

The extended trial involved changing the clearance times on more than 3,800 SPBs; with almost 2,800 changed to a 12pm clearance. The customer impact of a 12pm v 2pm clearance was found to be minimal (no complaints received).

In 2021, an additional 2,000 (approx.) SPBs were changed to a 12pm advertised clearance time to increase the number of SPBs able to be cleared by postal delivery officers. This resulted in around 50% of SPBs nationally having an advertised 12pm clearance time and the other 50% generally later e.g. SPBs co-located with an AP facility would be 3pm if located with a licenced post office or 4pm if located with a corporate outlet. There are also around 100 SPBs (metro locations) with a 6pm advertised clearance time.

In addition to these changes, as part of the regulatory changes in response to Covid-19, the requirement to clear SPBs on a Sunday was removed permanently.

8.5. Supporting a sustainable delivery model

Australia's postal market is changing. As we emerge from an environment dominated by Covid-19 we are pursuing a sustainable delivery model that will meet the needs of Australians and is financially viable.

Domestic addressed letter volumes have declined at an annual rate of circa 11% between the period 2018 to 2021, with forecast domestic declines of 8.5% in FY22/23 23 (i.e. excluding Census and Federal Election addressed letter volume from FY22 Forecast)and 9.4% in FY23/24.

The decline in letters has been accompanied by a marked shift in the profile of parcels handled by the postal delivery officer network.

Since 2019, the volume of parcels from overseas, has declined by around ✂ which has significantly reduced the volume of small parcels suitable for delivery by motorcycle, pushbike and walker postal delivery officers.

By 2025, Australians could receive almost one parcel for every two letters, up from one per every five in 2019. Australia Post needs a customer-centric, scalable, and flexible operating model that provides a sustainable letter service that meets the needs of Australian consumers and business and is also flexible and adaptable as letter volumes decline and parcel volumes increase.

This means while our previous streaming strategy was to maximise the volume of items that are carried per postie, the product profile post Covid-19 has impacted the volume our posties can carry.

In addition to streaming, there are a range of strategies and initiatives that are being considered to support a sustainable delivery model. Any such proposals would need to be implemented in a way that engages our stakeholders and without compromising safety.

8.5.1. Parcel Streaming

Parcel streaming has several benefits including:

- Workforce flexibility – resources can be deployed to support parcel volume growth
- Workforce stability – postal delivery officers have 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.

In 2022/23, through parcel gauge changes and delivery facility compliance, the volume of parcels streamed to postal delivery officers will increase. The proportion of parcels delivered by postal delivery officer is expected to be circa ✂

8.5.2. Delivery round review

At the expiration of Temporary Regulatory Relief, the target was to reduce the number of corporate metropolitan postie rounds. By the end of 2021/22 the number of metropolitan delivery rounds decreased by ✂ with net savings of ✂

8.5.3. Delivery mode review

In addition to introducing eDVs which enable the postal delivery officer to safely carry more items (compared to the current motorcycle fleet), as part of our overall motorcycle reduction strategy to reduce reliance on motorcycles and reduce exposure we continue to seek out alternative mode of delivery.

As of May 2022, the Australia Post corporate network still utilises around 3500 motorcycles for daily delivery of letters, representing 40% of total corporate delivery rounds. Based on the understood capabilities of new three wheel bikes, the business forecasts the further replacement of approx. 1000 to 1500 motorcycles in the next two years.

An ongoing program of work is in place to test and evaluate new vehicles for potential inclusion in Australia Post’s fleet mix e.g. electric motor bikes.

8.5.4. Unaddressed Mail capacity management

Objective – Implement enhancements to Australia Post’s Unaddressed Mail Booking system to manage capacity and support better allocation of resources.

Status – On track.

8.5.5. Indoor Planner

Objective – Implement the ‘Indoor Planner’ management and reporting system to enforce greater process discipline within delivery vs expected work rates during indoor sort and preparation activities.

Status – Fully implemented in 2019/2020 with savings of ✂realised over an 18-month period. System still being used in the daily management of >8000 postal delivery officers.

8.5.6. Automation

Objective – As small parcel sorting machines are deployed, review night sorting processing activities to reduce manual work effort in delivery by increased use of mail processing equipment implemented as part of the Reform our Letter Service (**RoLS**) Program (flat sorting machine – **FSM**)

Status – As at June 2022, five small parcel processing machines have been deployed with two more (WA and Vic) to be deployed in 2022 and 2023.

8.5.7. Operational Efficiencies within Letters Processing

Objective – drive a program of lean operational excellence and efficiency to reduce processing costs and release static floorspace for alternative uses.

Status – Cumulative benefit delivered across 2019/20 to Apr YTD 2021/22, arising from a variety of initiatives, including:

- Processing efficiency improvements to machine processing and mail movements within facilities.
- Consolidation of QLD metropolitan mail processing.
- Review and restructure of technician labour.
- Review and restructure of management and supervisory structures.
- Shift alignment changes.
- Mail centre processing footprint associated with Letters activities reduced by 25,000 sqm.

8.5.8. Regional Mail Centre Optimisation

Objective – Leverage latent letters processing capacity at the Sydney West Mail Centre to uplift the efficiency of processing letters originating from the Canberra, Wollongong and Hunter Mail Centres. This will be done by:

- Implementing own to own (O2O) letter processing across regional NSW.
- Processing non O2O letters upstream on RoLS implemented mail processing equipment, reducing manual sortation and improving efficiencies.
- Removing ageing sorting equipment from regional centres (MLOCR).

Status – Complete.

8.5.9. Deconsolidation of Heathwood Delivery Centre

Objective – Complete exit of mail delivery activities from Heathwood Delivery Centre, to enable the property to be either disposed of or reused for a different purpose. The exit was made possible after mail processing activities for Brisbane and South Queensland were consolidated from Heathwood into the Northgate Mail Centre.

Establish three fit-for-purpose delivery centres in close proximity to delivery areas, minimising non-productive stem travel.

Target

By the end of 2022/23, the exit of mail delivery activities from the Heathwood facility will release 14,700 sqm of prime Brisbane industrial real estate to be either sold of reused for other business needs.

Status – On track (commenced Q2 2021/22).

9. Asset base

In this section:

- Australia Post's balance sheet as at 30 June 2021.
- Australia Post's capital expenditure plan to 2023/24.
- Australia Post's forecast asset base to 2023/24.

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 2023/24.

9.1. Australia Post's balance sheet

As at 30 June 2021[33] Australia Post's balance sheet comprised $7,065m in total assets, $4,577m in liabilities, and $2,488m in equity, or net assets.

Table 28 shows the current and non-current (fixed) assets as per the balance sheet (Appendix 5) including Right of Use Assets following the adoption of the new Australian Accounting Standard; AASB 16 shown for the first time in the annual reporting period commencing 1 July 2019.[34]

AASB 16 Leases (AASB 16) has replaced AASB 117 Leases (AASB 117), Interpretation 4 Determining whether an Arrangement contains a Lease, Interpretation 115 Operating Leases – Incentives and Interpretation 127 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The Standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements.

The standard introduces a new lease accounting model for lessees that requires lessees to recognise all leases on balance sheet, except short-term leases and leases of low value assets. Under AASB 16, the present value of lease payments is shown as a liability on the balance sheet together with an asset representing the right-of-use. In addition, the previous operating lease expense recognised in profit or loss in the statement of comprehensive income has been replaced with depreciation and interest expense.

The approach to lessor accounting remains largely unchanged, although the classification of sub-leases as either operating or finance leases is required to be reassessed under the criteria of the new standard. AASB 16 also requires lessees and lessors to make more extensive disclosures than under AASB 117.

[33] Australia Post Annual Report 2020/21, Financial and Statutory Reports, page 103.

[34] Australia Post Annual Report 2019/20, Notes to the Financial Statements, page 136.

Table 28 – Australia Post total assets

Assets	$m
Current Assets	
Cash and cash equivalents	653
Trade and other receivables	771
Prepayments	122
Inventories	72
Other current assets	5
Total current assets	**1,623**
Non-Current Assets	
Net Superannuation asset	931
Property, Plant and Equipment	1,909
Intangible assets	715
Right-of-use assets	1,027
Investment property	158
Deferred tax assets	668
Equity accounted investees	9
Other non-current assets	24
Total non-current assets	**5,442**
Total Assets	**7,065**

9.2. Asset accounting policies and practices

As shown in Table 28, at 30 June 2021 Australia Post had $5,442m 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 6 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 29 details forecast capital investment out to 2023/24 as detailed in Australia Post's 2022/23 to 2025/26 Corporate Plan.

Table 29 – Capital investment outlays by category

$m	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Strategic initiatives			
Strategic programs	✂	✂	✂
Total strategic initiatives	✂	✂	✂
Non-discretionary	✂	✂	✂
Total	**432**	**454**	**450**

9.4. Forecast asset base

Table 30 details Australia Post's total fixed assets out to 2022. 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 30 – Australia Post total fixed assets and intangibles[35]

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	4,709	4,908	4,810	4,671
Net additions	715	432	454	450
Depreciation & amortisation	(517)	(530)	(592)	(680)
Closing balance	**4,908**	**4,810**	**4,671**	**4,441**

Table 31 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 7 provides a breakdown of Table 31 by each letter category.

Table 31 – Reserved letter service fixed assets

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	756	747	721	704
Net additions	90	64	75	65
Depreciation & amortisation	(99)	(90)	(92)	(102)
Closing balance	**747**	**721**	**704**	**667**

[35] Asset forecast data includes Right of Use Assets

10. Rate of return

Australia Post engaged Deloitte Financial Advisory Pty Ltd (**Deloitte**) 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 and Australia Post has adopted the mid point of the assessed range.

The nominal, vanilla WACC is the weighted average cost of capital using a pre-tax cost of debt and a post-tax cost of equity.

Table 32 details the parameters with further detail at Appendix 8.

Table 32 – Australia Post WACC

WACC Parameter	Based on latest advice
Risk-free rate[36]	3.73%
Equity market risk premium	5.75%
Beta (ungeared)	1.00
Beta (geared)	1.04
Calculated cost of equity capital	9.69%
Net debt / enterprise value	5.0%
Tax rate	30.00%
Cost of debt (pre-tax)	6.89%
Cost of debt (post-tax)	4.82%
Nominal post tax vanilla WACC	**9.55%**

[36] As at 30 June 2022

11. Post Tax Revenue Model Summary

Australia Post is proposing that the price changes take effect from 2 January 2023. A comparison of the proposed and allowable revenues over the 2022/23 to 2023/24 financial years is below.

Table 33 – Post Tax Revenue Model summary

Summary of PTRM outputs		**2021/22 $m**	**2022/23 $m**	**2023/24 $m**
Nominal Vanilla WACC	**9.55%**			
A: Ordinary reserved letters				
Required Revenue		$ 187	$ 195	$ 190
Present Value of Required Revenue		$ 176	$ 174	$ 159
Sum of PV over 2 years (2022/23 - 2023/24)				$ 333
Letters Revenue at proposed prices		$ 123	$ 116	$ 110
Present Value of Proposed Letters Revenue		$ 116	$ 103	$ 92
Sum of PV over 2 years (2022/23 - 2023/24)				$ 195
Deficiency of Letters Revenue to Required Revenue		$ 60	$ 70	$ 68
Sum of PV over 2 years (2022/23 - 2023/24)				$ 138
B: Domestic reserved letters				
Required Revenue		$ 1,628	$ 1,668	$ 1,641
Present Value of Required Revenue		$ 1,534	$ 1,481	$ 1,374
Sum of PV over 2 years (2022/23 - 2023/24)				$ 2,856
Letters Revenue at proposed prices		$ 1,486	$ 1,358	$ 1,278
Present Value of Proposed Letters Revenue		$ 1,401	$ 1,207	$ 1,070
Sum of PV over 2 years (2022/23 - 2023/24)				$ 2,276
Deficiency of Letters Revenue to Required Revenue		$ 134	$ 275	$ 305
Sum of PV over 2 years (2022/23 - 2023/24)				$ 579
C: Domestic letters				
Required Revenue		$ 1,927	$ 1,959	$ 1,926
Present Value of Required Revenue		$ 1,817	$ 1,740	$ 1,612
Sum of PV over 2 years (2022/23 - 2023/24)				$ 3,352
Letters Revenue at proposed prices		$ 1,657	$ 1,515	$ 1,425
Present Value of Proposed Letters Revenue		$ 1,562	$ 1,346	$ 1,193
Sum of PV over 2 years (2022/23 - 2023/24)				$ 2,539
Deficiency of Letters Revenue to Required Revenue		$ 255	$ 395	$ 419
Sum of PV over 2 years (2022/23 - 2023/24)				$ 813

Appendix 1 – Price changes

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 January 2023.

Table 34 – Proposed Ordinary / Other prices

Proposed Letter Prices - Ordinary / Other Letters **Jan-2023**

Stamped #

Size / Weight	Regular		
	Current	Proposed	Increase
Small			
Stamped	$1.10	$1.20	9.1%
Seasonal Greeting *	$0.65	$0.65	0.0%
Concession ^	1 stamp	1 stamp	0%
Large			
Stamped			
Up to 125g	$2.20	$2.40	9.1%
Over 125 up to 250g	$3.30	$3.60	9.1%
Over 250 up to 500g	$5.50	$6.00	9.1%
Seasonal Greeting *			
Up to 125g	$1.30	$1.30	0.0%
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%
Priority label	$0.50	$0.55	10.0%

To send by Priority, purchase a Priority label 55c 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.

Metered / Imprint

Size / Weight	Regular	Priority
Small		
Up to 250g	$1.140	$1.690
Large		
Up to 250g	$2.280	$2.830
Over 125 up to 250g	$3.420	$3.970
Over 250 up to 500g	$5.700	$6.250

Local Country and Clean Mail

Size / Weight	Regular	Priority
Local (Country)		
Small	$1.100	$1.130
Large		
Up to 125g	$1.950	$2.270
Over 125 up to 250g	$2.600	$2.920
Over 250 up to 500g	$2.900	$3.400
Clean Mail		
Small	$1.130	$1.445
Small Plus up to 125g	$1.785	$2.185

Prepaid Envelopes / Postcards #

Size / Weight	Regular		
	Per item	Pack of 10	
		Single	5+ packs
Envelope			
DL Plain	$1.45	$14.15	$13.80
C5	$3.05	$29.75	$28.95
C4	$5.20	$50.70	$49.40
B4	$6.30	$61.45	$59.85
	Per item	Pack of 50	Box of 500
Window face			
DL		$70.75	$690.00
Postcard	$2.55		

To send by Priority, purchase a Priority label 55c and place to the left of the postage paid mark.

Reply Paid

Size / Weight	Regular	Priority
Small		
Barcoded	$0.780	$1.020
Unbarcoded	$1.500	
Large - Barcoded		
Up to 125g	$2.400	$2.700
Over 125 up to 250g	$3.600	$3.900
Over 250 up to 500g	$6.000	$6.300
Large - Unbarcoded		
Up to 125g	$2.700	
Over 125 up to 250g	$3.900	
Over 250 up to 500g	$6.300	
Annual Fee	$122.00	

Table 35 – 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	$1.040	$1.070	$1.115	$1.130	$1.255	$1.300	$1.400	$1.445
Charity Mail	$0.580	$0.605	$0.640	$1.130	$0.720	$0.755	$0.830	$1.445
PromoPost	$0.725	$0.750	$0.785	$1.130				
Small Plus								
Up to 125g	$1.295	$1.350	$1.655	$1.785	$1.665	$1.725	$1.895	$2.185
PromoPost	$0.970	$1.025	$1.240	$1.785				
Large								
Up to 125g	$1.810	$1.910	$2.190	$2.230	$2.275	$2.390	$2.690	$2.725
Up to 125g - Charity Mail	$1.235	$1.295	$1.510	$2.230				
Up to 125g - PromoPost	$1.365	$1.435	$1.785	$2.230				
Over 125 up to 250g	$2.415	$2.605	$2.930	$3.110	$2.930	$3.105	$3.430	$3.605
Over 125 up to 250g - Charity Mail	$1.610	$1.720	$1.985	$3.110				
Over 125 up to 250g - PromoPost	$1.815	$1.960	$2.345	$3.110				
Over 250 up to 500g	$3.110	$3.300	$3.700	$4.030	$3.620	$3.815	$4.215	$4.540

Acquisition Mail

Size / Weight	Regular			
	Barcode Direct Tray		Barcode	U/Bcode
	Same State	Other State	Residue	Residue
1 – 299				
Small - up to 125g				$1.140
Small Plus - up to 125g				$2.280
300 - 3999				
Small - up to 125g	$0.990	$1.025	$1.102	$1.130
Small Plus - up to 125g	$1.235	$1.290	$1.635	$1.785
4000+				
Small - up to 125g	$0.675	$0.700	$0.785	$1.130
Small Plus - up to 125g	$0.935	$0.985	$1.240	$1.785

Dometic letter with tracking

Size / Weight	Per envelope	Pack of 10	
		Single	5+ packs
Prepaid envelopes			
Small	$3.15	$31.00	$30.40
Medium	$5.30	$51.70	$50.35
Large	$6.40	$62.40	$60.80
Extra Cover	$2.50		

Registered Post Imprints

Size / Weight	Regular Timetable		Priority Timetable	
	Barcoded Residue	Unbarcoded Residue	Barcoded Residue	Unbarcoded Residue
Small Letters				
Up to 125g	$4.935	$4.995	$5.190	$5.310
Small Plus				
Up to 125g	$5.290	$5.650	$5.600	$6.050
Large				
Up to 125g	$6.055	$6.090	$6.555	$6.590
Over 125 up to 250g	$6.505	$6.970	$7.005	$7.470
Over 250 up to 500g	$7.130	$7.715	$7.630	$8.215

Registered Post

Size / Weight	Per envelope	Pack of 10	
		Single	5+ packs
Prepaid envelopes			
DL	$5.90	$57.55	$56.05
B4	$7.70	$75.10	$73.15
	Per item	Per box of 50	
Labels			
Label on lodgement	$4.60		
Prepaid label	$4.60	$193.50	
Extra Cover	$2.50		
Delivery Confirmation	$3.05		
Person-to-person	$6.50		

Notes:

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

Table 36 – Proposed Print Post Letter prices

Print Post

Size / Weight	Regular				
	Same State			Other State	
	Postcode Direct	Area Direct	Residue	Area Direct	Residue
Small					
0 - 125g	-	-	0.930	-	0.960
Large					
0 - 125g	$0.985	$1.035	$1.335	$1.430	$1.515
126g - 175g	$1.120	$1.315	$1.615	$1.845	$2.000
176g - 250g	$1.240	$1.475	$1.780	$2.040	$2.185
251g - 300g	$1.335	$1.665	$1.910	$2.225	$2.370
301g - 350g	$1.440	$1.790	$2.060	$2.390	$2.555
351g - 400g	$1.525	$1.905	$2.210	$2.555	$2.735
401g - 450g	$1.625	$2.065	$2.360	$2.775	$2.965
451g - 500g	$1.775	$2.235	$2.575	$2.910	$3.095
501g - 600g	$2.655	$3.125	$3.515	$3.835	$4.400
601g - 700g	$3.175	$3.675	$4.100	$4.435	$5.055
701g - 800g	$3.540	$4.220	$4.530	$4.985	$5.505
801g - 900g	$3.860	$4.550	$4.870	$5.305	$5.865
901g - 1000g	$4.135	$4.860	$5.215	$5.620	$6.200

Size / Weight	Priority				
	Same State			Other State	
	Postcode Direct	Area Direct	Residue	Area Direct	Residue
Small					
0 - 125g	-	-	1.015	-	$1.060
Large					
0 - 125g	$1.135	$1.250	$1.565	$1.605	$1.670
126g - 175g	$1.290	$1.555	$1.850	$2.070	$2.185
176g - 250g	$1.420	$1.685	$2.000	$2.205	$2.400
251g - 300g	$1.555	$1.880	$2.195	$2.405	$2.600
301g - 350g	$1.695	$2.060	$2.380	$2.620	$2.835
351g - 400g	$1.805	$2.260	$2.535	$2.840	$3.015
401g - 450g	$1.915	$2.420	$2.695	$2.995	$3.250
451g - 500g	$2.035	$2.590	$2.900	$3.165	$3.440
501g - 600g	$3.085	$3.650	$3.955	$4.295	$4.840
601g - 700g	$3.595	$4.205	$4.555	$4.950	$5.495
701g - 800g	$3.975	$4.650	$5.050	$5.445	$5.990
801g - 900g	$4.330	$5.035	$5.390	$5.820	$6.385
901g - 1000g	$4.660	$5.375	$5.735	$6.150	$6.715

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

Appendix 2 – Financial Overview

Table 37 shows the revenue impact of the January 2023 price changes.

Table 37 – Domestic letter service

	Reserved				
	Ordinary /Other	**Other Bulk**	**Total**	**Total Non-Reserved**	**Grand Total Domestic Mail**
2020/21 Actual					
Volume	483	1,086	1,569	512	2,082
Revenue ($m)	532	974	1,506	155	1,661
Total costs ($m)	606	964	1,570	✂	✂
Contribution ($m)	(74)	10	(64)	✂	✂
ROR %	(14)	1	(4)	✂	✂
2021/22					
Volume	441	1,060	1,501	606	2,107
Revenue ($m)	508	979	1,486	171	1,657
Total costs ($m)	595	1,000	1,595	✂	✂
Contribution ($m)	(88)	(21)	(109)	✂	✂
ROR %	(17)	(2)	(7)	✂	✂
2022/23					
Volume	393	943	1,336	485	1,821
Revenue ($m)	466	892	1,358	156	1,515
Total costs ($m)	608	1,020	1,628	✂	✂
Contribution ($m)	(142)	(127)	(269)	✂	✂
ROR %	(30)	(14)	(20)	✂	✂
2023/24					
Volume	352	859	1,211	418	1,628
Revenue ($m)	436	841	1,278	148	1,425
Total costs ($m)	590	1,007	1,597	✂	✂
Contribution ($m)	(154)	(166)	(320)	✂	✂
ROR %	(35)	(20)	(25)	✂	✂

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 cognisant of the requirement for Australia Post to meet its statutory requirement to provide an adequate commercial return and to fund its CSO.
- 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.
- The BPR – the rate for the ordinary small letter – is the keystone of the letter pricing structure.
- 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.
- 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.
- 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 2022/23 to 2023/24.

Table 38 – 2022/23 volume forecast

	2021/22	Baseline Volume Est (from Eco Model)		Transactional		Promotional			2022/23
	Volume (m)	Raw Growth	Raw Volume	Underlying Market Changes	Changes in use of Comm Medium	Underlying Market Changes	Changes in use of Comm Medium	Total Market Adjust (m)	Volume Forecast (m)
Ordinary / Other									
Small	386	-10.1%	347	(2)	0	0	0	(2)	345
Large	59	-10.7%	53	(1)	(0)	0	0	(1)	52
Total Ordinary / Other	445	-10.2%	399	(3)	(0)	0	0	(3)	396
PreSort									
Small	933	-8.4%	855	(6)	(4)	(13)	0	(22)	833
Large	47	-13.8%	40	(1)	(1)	1	0	(0)	40
Total PreSort	980	-8.7%	895	(7)	(4)	(12)	0	(23)	872
Print Post	90	-11.6%	80	1	0	0	0	1	80
Large Member Associations *	19		17	0	0	0	0	0	17
Total Print Post	109		97	1	0	0	0	1	97
Total PreSort / Print Post	1,089	-8.9%	992	(6)	(4)	(12)	0	(22)	970
Total Addressed Mail	**1,533**	**-9.3%**	**1,391**	**(9)**	**(5)**	**(12)**	**0**	**(25)**	**1,366**

* Econometric Model growth / decline excludes volumes from large member associations in generating its Baseline.

Table 39 – 2023/24 volume forecast

	2022/23	Baseline Volume Est (from Eco Model)		Transactional		Promotional			2023/24
	Volume Forecast (m)	Raw Growth	Raw Volume	Underlying Market Changes	Changes in use of Comm Medium	Underlying Market Changes	Changes in use of Comm Medium	Total Market Adjust (m)	Volume Forecast (m)
Ordinary / Other									
Small	345	-10.8%	307	2	0	0	0	2	309
Large	52	-8.2%	47	0	(1)	0	0	(1)	46
Total Ordinary / Other	396	-10.5%	355	2	(1)	0	0	1	356
PreSort									
Small	833	-9.2%	756	4	(2)	(0)	0	2	758
Large	40	-8.9%	36	(0)	0	0	0	(0)	36
Total PreSort	872	-9.2%	792	4	(2)	(0)	0	1	794
Print Post	80	-5.2%	76	(4)	(1)	0	0	(4)	72
Large Member Associations *	17		17	0	0	0	0	0	17
Total Print Post	97		93	(4)	(1)	0	0	(4)	89
Total PreSort / Print Post	970	-8.7%	885	0	(3)	(0)	0	(3)	882
Total Addressed Mail	**1,366**	**-9.2%**	**1,240**	**2**	**(4)**	**(0)**	**0**	**(2)**	**1,238**

* Econometric Model growth / decline excludes volumes from large member associations in generating its Baseline.

Appendix 5 – Australia Post Consolidated Group Balance Sheet at 30 June 2021

	2020	2021
ASSETS		
Current Assets		
Cash and cash equivalents	775	653
Trade and other receivables	787	771
Prepayments	153	122
Inventories	63	72
Other current assets	6	5
Total current assets	**1,784**	**1,623**
Non-Current Assets		
Net superannuation Asset	627	931
Property, Plant and equipment	1,784	1,909
Intangible assets	709	715
Right-of-use-assets	1,032	1,027
Investment property	162	158
Deferred tax assets	653	668
Equity accounted investees	8	9
Other non-current assets	27	24
Total non-current assets	**5,001**	**5,442**
Total assets	**6,785**	**7,065**
LIABILITIES		
Current Liabilities		
Current Lease Liabilities	184	214
Trade and other payables	1,055	1,153
Employee provisions	769	792
Interest-bearing liabilities	250	100
Other provisions	19	21
Income tax payable		30
Total current liabilities	**2,277**	**2,309**
Non-Current Liabilities		
Interest-bearing liabilities	467	363
Employee provisions	264	276
Other provisions	48	48
Non-Current Lease Liabilities	947	920
Deferred tax liabilities	579	660
Other non-current liabilities	1	
Total non-current liabilities	**2,306**	**2,268**
Total liabilities	**4,582**	**4,577**
Net assets	**2,203**	**2,488**
EQUITY		
Contributed Equity	400	400
Reserves	19	19
Retained Profits	1,784	2,069
Parent interest	**2,203**	**2,488**
Total equity	**2,203**	**2,488**

Appendix 6 – 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 2021 asset values provided in this draft notification include land and building assets measured at fair value. The fair value of land and buildings at 30 June 2021 was $1,850m compared with a historical cost book value of $751m.

Fair value has been determined through valuations performed by CBRE Group Inc. with each property valued once over a four-year period, on a rolling basis unless a valuation is required sooner. 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 2021 the value of this asset class was $158m. Investment property is not allocated to products and services and is not part of the asset base on which this draft notification is based.

This assessment was conducted by CBRE Group Inc. (CBRE), an accredited, external and independent valuer. CBRE is an industry specialist in valuing these types of investment properties in accordance with Australian Valuation Standards. The fair value for 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, its location and the economic environment as at the reporting date.

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 2021 Annual Report (page 117).

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 7 – Reserved letter service fixed assets

The following Tables provide a breakdown of the reserved letter service fixed assets (shown at Table 31) by product category. Asset data is based on 2020/21 final.

Table 40 – Ordinary letters

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	90	105	94	82
Net additions	27	0	0	0
Depreciation	(13)	(11)	(12)	(13)
Closing balance	**105**	**94**	**82**	**69**

Table 41 – Other letters

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	237	228	226	228
Net additions	22	26	30	26
Depreciation	(31)	(28)	(28)	(31)
Closing balance	**228**	**226**	**228**	**223**

Table 42 – Small PreSort letters

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	333	315	304	298
Net additions	26	29	34	29
Depreciation	(44)	(40)	(41)	(46)
Closing balance	**315**	**304**	**298**	**281**

Table 43 – Large PreSort letters

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	27	29	28	27
Net additions	5	3	3	3
Depreciation	(3)	(4)	(4)	(4)
Closing balance	**29**	**28**	**27**	**26**

Table 44 – Print Post letters

$m	Final 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Opening balance	68	69	68	69
Net additions	10	7	8	7
Depreciation	(8)	(8)	(8)	(9)
Closing balance	**69**	**68**	**69**	**67**

Appendix 8 – Weighted Average Cost of Capital

Australia Post has adopted the midpoint of the estimated WACC parameters as per the Deloitte '*Assessment of WACC for Australia Post's Reserved Letters Business',* June 2022 report. A copy of that report has been made available to the ACCC.

Table 45 – WACC parameter values

WACC parameter	Value (based on latest advice)
Risk free rate	3.73%
Equity market risk premium	5.75%
Beta (ungeared)	1.00
Beta (geared)	1.04
Calculated cost of equity capital	9.69%
Net debt / enterprise value (gearing)	5.00%
Tax rate	30.00%
Cost of debt (pre-tax)	6.89%
Cost of debt (post-tax)	4.82%

Risk Free Rate

The risk-free rate compensates the investor for the time value of money and the expected inflation rate over the investment period. The frequently adopted proxy for the risk-free rate is the long-term Government bond rate.

In determining the risk-free rate, we have calculated the five-day average zero coupon yield on the Australian Government Bond, being 3.73% as at 30 June 2022. This rate represents a nominal rate and therefore includes inflation.

Equity Market Risk Premium (EMRP)

In evaluating the EMRP, Deloitte considered both the historically observed and prospective estimates of EMRP.

Beta ungeared and geared

In estimating an appropriate beta for the Letters Business, Deloitte considered the betas of listed comparable companies operating in the postal and logistics industries. These betas have been calculated based on weekly and monthly returns, over a two- and four-year period, compared to the relevant domestic index and were then 'Blume adjusted' as per the adjustment formula detailed in the Report.

Net debt / enterprise value (gearing)

In selecting an appropriate level of gearing for the Letters business to determine net debt / enterprise value, Deloitte considered the gearing of companies comparable to the Letters business, gearing of companies comparable to the broader Australia Post group, the level of operating leverage of the comparable companies, the current capital structure of the Australia Post group and the content in a 2017 report from the Auditor General[37] outlining that it seems unlikely that the Letters business would be able to sustain any debt in its capital structure, absent of government subsidies.

Tax Rate

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

Cost of Debt (pre and post tax)

In selecting a cost of debt for the Letters Business, Deloitte considered the borrowing capacity of the business on a standalone basis.

To reflect the borrowing margin of businesses of similar size and operations, the yield on 10 year non-financial BBB-rated corporate bonds as at 30 June 2022 was considered.

The 10 year maturity of the observed corporate bonds is appropriate as a commercial enterprise would not seek to refinance its entire debt portfolio every two years, rather would rationally seek to refinance a portion of its debt every year.

[37] G. Hehir, “Australia Post’s Efficiency in Delivering Reserved Letters Services”, ANAO report No. 11, September 2017