



Supporting Information to Australia Post's
Notification of Domestic Reserved Letter Service
Price Changes

April 2010

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1. Background

In July 2009, Australia Post lodged a draft notification (Attachment 3) with the Australian Competition and Consumer Commission (ACCC) proposing price changes to Australia Post's domestic reserved letter service (eg Ordinary and PreSort Letters up to, and including, 250 grams) effective January 2010.

On 20 August 2009, the ACCC released an Issues Paper inviting interested parties to comment on the draft notification by 18 September 2009.

On 8 December 2009, the ACCC released a View (ACCC View). The ACCC View objected to Australia Post's proposal to increase prices within its domestic reserved letter service.

The ACCC stated in their View¹, 'The key issue overshadowing Australia Post's 2009 draft price notification is the significant fall in Australia Post's reserved letter volumes between the 2007-08 and 2008-09 financial years, and Australia Post's expectation of declining letter volumes into the future.'

In objecting to the proposed price changes, the ACCC's primary concern was that Australia Post did not adequately demonstrate that it had fully exhausted cost-based responses to its expectation of declining letter volumes and that before any further notification, '...it is of primary importance for Australia Post to address the relationship between its forecast costs and volumes.'²

The ACCC adopts a cost based approach in its assessment of price notifications. The appropriateness of the proposed prices is considered by assessing the extent to which the prices are forecast to recover the efficient costs of providing a notified service (ie the domestic reserved letter service).

To assess the extent to which the proposed prices reflect an efficient cost base and provide a reasonable return on capital requires reliable and transparent (able to be independently verified) demand and cost forecasts. Throughout the ACCC's View, the ACCC identified a number of deficiencies with Australia Post's demand and cost forecasts, most of which arose due to a lack of transparency and verifiable data.

Australia Post acknowledges the ACCC's concern regarding its inability to 'test' Australia Post's demand and cost forecasts, but notes the ACCC's primary concern that 'Even if the ACCC did have reliable demand forecasts, the ACCC would still have serious concerns about the efficiency of Australia Post's cost base.'³

Since the release of the ACCC View, Australia Post has; continued to work on cost reduction, worked closely with the ACCC to understand its concerns; and has commissioned a number of external subject matter experts to address the ACCC's concerns prior to lodging this notification.

¹ ACCC View, December 2009, page 1

² ACCC View, December 2009, page 166

³ ACCC View, December 2009, page 166

2. Introduction

The purpose of this document is to address the concerns expressed in the ACCC View and discussed further in meetings between the ACCC and Australia Post by providing new and detailed information regarding Australia Post's response to volume decline through the pursuit of efficiency and productivity opportunities which lead to a materially different financial forecast out to 2011/12. Contributing to this new financial forecast is the fact that:

- domestic reserved letter volumes – originally forecast to decline by 2.3% in 2009/10; are now forecast to decline by 5.8% in 2009/10 with revised average forecast decline of 4.3% per annum out to 2011/12;
- cost response to decline in volumes – domestic reserved letter costs originally forecast to increase by 2.8% per annum; are now forecast to decrease by 0.05% per annum over the period of the notification; and
- in light of the above, the price changes identified within Australia Post's draft notification, as possibly being required in 2011/12 may no longer be required and as such this notification is for a single set of price changes and the financial projections make no assumptions about any further increases.

The new information provided by Australia Post includes updated financial information. The financial data in the draft notification of July 2009 (draft notification) was based on financial information predominantly from the 2008/09 March Review. Whereas, within this document, unless noted otherwise; data for 2008/09 is based on Final Results for 2008/09 (as a basis for planning); data for 2009/10 is based on a revised estimate from the 2009/10 December Review forecast; and data for 2010/11 and 2011/12 is based on revised latest forecasts for those years. For ease of reading, the updated information is referred to as a latest forecast and that used in the draft notification is referenced as from the draft notification.

This notification, seeking a single price increase, is put forward as a stand alone submission to be considered on its merits. However, Australia Post recognises that providing the domestic reserved letter service in a future dominated by declining letter volumes, growing numbers of delivery points and likely increases in input costs will present long term challenges to the sustainability of the letter service.

Australia Post will develop a plan to address these sustainability issues. The plan will take account of a range of aspects relating to cost, volume, service and price.

3. Pricing proposal

This section:

- *summarises the proposed 28 June 2010 price changes;*
- *notes the prices are the same as those proposed in the draft notification; and*
- *notes that the notification is supported by financial data for the period 2009/10 to 2011/12.*

This notification proposes price changes to Australia Post's domestic reserved letter service effective 28 June 2010. The prices proposed in this notification are the same as those proposed by Australia Post in the draft notification to take effect in January 2010.

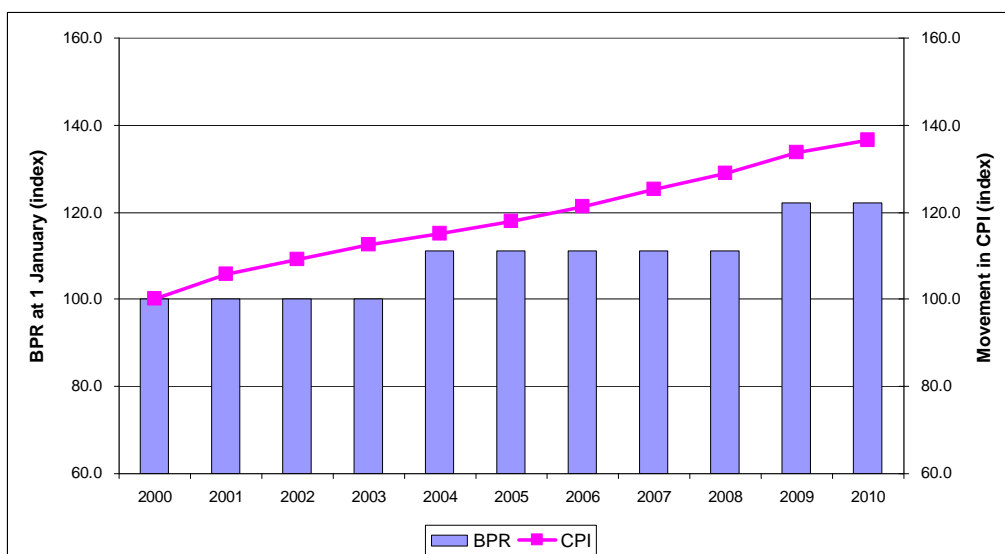
The same environmental pressures noted in the draft notification (eg not wanting to exacerbate volume decline through higher increases and proposing pricing consistent with the Letter Pricing Principles) apply, and as such Australia Post is not seeking to recover the revenues foregone by a later than planned for implementation date.

The proposed prices are supported by financial modelling over a three year period – 2009/10 to 2011/12. This modelling includes information on the revenues and costs of those non-reserved services that share the same costs as reserved services over this period.

Whereas the three year modelling in the draft notification identified that further price changes might be necessary in 2011/12, the revised financial information supporting this notification shows an improved financial position and indicates that further price changes may not be required. The improved position is a direct result of Australia Post's more aggressive response to volume decline.

The proposed prices represent the third increase to the Basic Postage Rate (BPR), and only the second general increase to PreSort prices, since 1992. As shown in Graph 1, since January 2000 the increase in the BPR is well below that of CPI.

Graph 1 – Comparison of CPI and change in BPR, from January 2000 to January 2010



The full detail of the proposed changes, with a comparison to current prices, is provided at Schedule 1 of Attachment 1, with the major elements as follows:

- increase of 5 cents to the BPR (to 60 cents);
- increase to other Ordinary Letter prices (eg large, seasonal greeting) to maintain relativity to the BPR; and
- increase to PreSort Letter prices of an average of 2.8 cents (GST Exclusive):
 - o Small PreSort an average increase of 2.6 cents (GST Exclusive); and
 - o Large PreSort an average increase of 5.0 cents (GST Exclusive).

The proposed prices have been modelled in an environment where:

- delivery points continue to increase by around 2% (200,000) per annum;
- there is reduced potential for significant productivity improvements;
- letter volumes are forecast to decline by an average of 4.3% per annum over the period of the notification; and
- Australia Post is required to fund its CSOs and meet its regulated performance standards.⁴ Performance against the regulated performance standards for 2008/09 is shown at Appendix 1.

⁴ Regulations made under section 28C of the APC Act detail the prescribed performance standards that Australia Post is required to meet.

4. Letter volumes

This section provides detail on:

- *revised domestic letter volume forecasts which replace the volume forecasts shown in the draft notification;*
- *an enhanced forecasting methodology – baseline forecasts derived from an econometric model then augmented by management opinion and market intelligence;*
- *the development of a dynamic econometric model;*
- *the impact of price elasticity estimates on forecast demand; and*
- *how management and market insight augments the econometric model.*

Australia Post acknowledges the comments made in the ACCC View regarding Australia Post's letter volume forecasts, in particular the need for Australia Post to adopt a more robust and transparent forecasting approach that can be independently verified, and one that allows sensitivity analysis to be undertaken around key economic assumptions.

This section details the activities undertaken by Australia Post to enhance its letter volume forecasting model (demand model) to address these concerns. Fundamental to this exercise, a number of dynamic econometric models have been developed to generate baseline forecasts which may then be augmented by management and market insight.

In comparing the letter volume forecasts in this notification to those included in the draft notification it is important to note that the volume forecasts that were included in the draft notification were developed earlier in the 2009 year. At that time the impact of the Global Financial Crisis (GFC) on letter volumes was in its infancy. Indeed the short term effects were relatively unclear and future trends remained uncertain. Statistically, a number of questions were raised:

- did the GFC represent a structural break in the letter volume data?
- if so, was that structural break transitory or permanent? and
- did the crisis act as a catalyst for accelerated movements towards substitutive technologies and increased consolidation and rationalisation practices as customers began to alter their behavioural patterns in an exceedingly tougher economic environment?

It is important to note that, prior to the impact of the GFC, Australia had not experienced an economic slowdown of the same magnitude within the observation period (1995 to 2009). Therefore there are no comparable experiences in recent times that can be drawn upon for insight into how letter volumes may respond during and / or after an economic slowdown.

Australia Post's 2009/10 December Review forecast, suggests that the GFC not only shifted letter volumes downwards (an observable structural break) but also may have altered the nature of prior associations (changed the slope coefficient). For example, in the draft notification, letter volumes were forecast to decline by 2.3% in 2009/10, however, actual results for the first six months of 2009/10 show that letter volumes declined by 6.9% resulting in a revised full year forecast of a decline of 5.8%.

As a result of the revised 2009/10 letter volumes and the suggestion that the GFC was more than a structural break, the letter volume forecasts in this notification assume an average volume decline of 4.3% per annum for the three years to 2011/12.

4.1. Forecasting method, considerations and assumptions

The letter volume forecasts within this notification reflect an enhanced methodology which Australia Post has adopted to address the concerns noted by the ACCC in its View of 2009.

Australia Post contends that the enhanced methodology now adopted is consistent with the observations made by Frontier Economics and the ACCC, using what can be broadly described as a two part process:

- development of several dynamic econometric models to provide baseline volume forecasts; and
- augmentation of these baseline forecasts to incorporate management opinion and further market intelligence.

The dynamic econometric models that provide the baseline forecasts have been developed by Diversified Specifics. Australia Post previously commissioned Diversified Specifics to provide econometric analysis on historical relationships between letter volume growth and a number of independent variables (eg GDP, credit card growth, etc). Consistent with the previous work undertaken on developing explanatory models, separate forecasting models have been developed for the four letter categories:

- Small Letter PreSort;
- Large Letter PreSort;
- Small Letter Other/Ordinary; and
- Large Letter Other/Ordinary.

In developing these models a comprehensive set of potential drivers were examined and the long run static associations modelled. The variables tested were identified largely through the knowledge gained from previous studies undertaken on explanatory associations. This provided a basis for the development of a system of letter segment specific co-integrating equations capturing the short run dynamics within a Vector Error Correction Model framework. A series of further tests then determined the appropriate lag structure and ex-post forecasting robustness of the models prior to the development of ex-ante forecasts under a variety of scenarios on the exogenous drivers.

Detailed information on the development of these models has been provided to the ACCC, along with a report that provides an overview of the development of the models.

Australia Post recognises that the models are dynamic and, as such, will require ongoing review to validate existing associations and test for emerging ones. This is particularly important at the moment given the impact that the GFC has had upon letter volumes, with further monitoring and analysis required to understand the extent to which current relationships have altered.

Final forecasts are derived by augmenting the baseline forecasts (from the econometric models) with management opinion and market intelligence. This augmentation reflects the impact of factors that are not incorporated within the econometric model (eg where an independent variable or tractable data can not be established), but which through management opinion and market intelligence are known to be having an impact upon letter volume growth.

As the augmentation reflects the market environment and customer behaviour, the impact of the factors is detailed by the letter segments (ie Transactional, Promotional and Social) and from there into the four letter categories.

Table 1 and Table 2 provide an overview of the two major letter segments, Transactional and Promotional (which account for over 95% of all letter volume), and key factors that are impacting volume growth for these segments.

Table 1 – Transactional letter segment

Type	Driver	Observation / Comment
Underlying transaction growth	Economic	Factors such as GDP which are incorporated in the econometric model that stimulate overall activity.
	Prepaid / prearranged (ie direct debit)	Incorporating the negative impact of increased uptake of prepaid products and opt in to pre-arranged payment arrangements (in lieu of account based transactional activity). Mainly visible in telcos (post paid mobiles).
	Statement cycles	Incorporating the generally negative impact of change in statement frequency. Most visible in banks, but may follow in telcos and utilities.
	Account consolidation	Incorporating the negative impact of bundling of multiple services under a single account. Most visible in telcos, utilities and investments.
Communication Mode / Type	Online presentment (by the biller)	Incorporating the negative impact of a switch to email or online channels (both sent by the biller or via a third party).
	Online servicing	Incorporating the negative impact of the move from business and governments to encourage customers to adopt an online service model (ie entering information, submitting claims etc).
	Online payments	Incorporating the negative impact of the move of consumers (private and business) to use online payment methods (in lieu of cheques). This is partly recognised in the econometric model for Ordinary / Other Small Letters.
	Mobile	Incorporating the relatively new trend of transactions undertaken using mobile devices. Expected to grow as functionality, handset base and speed of mobile devices increase

Table 2 – Promotional letter segment

Type	Driver	Observation / Comment
Underlying advertising growth	Economic	Factors such as GDP which are incorporated in the econometric model that stimulate overall activity.
	Improved targeting	Enhanced Customer Relationship Management practices and marketing strategies to improve return on investment from campaigns.
	Specific events	Incorporating impact from specific events (eg elections).
Communication Mode / Type	Movement to online	Incorporating the negative impact of expectations that 'traditional' marketing budgets (eg direct mail) will continue to be put under pressure from online offerings.
	Declining power of mass media	Incorporating a positive impact of the general trend to consider use of direct media (including direct mail) – in lieu of current spend on mainstream mass media (TV, press, etc.).

4.2. Price impact and elasticity

The volume forecasts provided in the draft notification did not explicitly reflect the impact of any price elasticity. This reflected a generally conservative approach (in regard to the PTRM modelling) where past analysis had identified that letters were inelastic to price – although the econometric modelling had identified real price as being statistically significant, but inelastic, for Other Small Letters.

In developing econometric models to produce a baseline forecast, real price was tested as an explanatory variable within each of the econometric models. In this research undertaking, real price was found to be statistically significant for one letter category – Other Small Letters. Consequently the change in real price has been incorporated into the econometric model used to generate baseline forecasts for Other Small Letters.

4.3. Forecast letter volumes

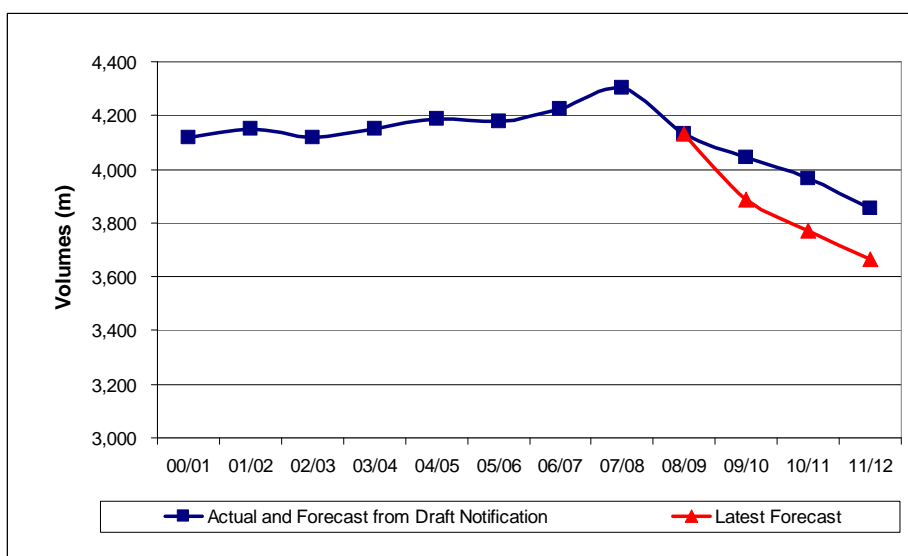
The volume forecasts in this notification assume an average annual volume decline of 4.3% per annum over three years to 2011/12. Table 3 provides a high level comparison of the forecast change in volume between this notification and forecasts in the draft notification. Letter volume forecasts for the four letter categories are shown at Appendix 2.

Table 3 – Domestic reserved letters 2008/09 to 2011/12

	2008/09 Full Year	2009/10 DEC YTD	2009/10 Full Year	2010/11 Full Year	2011/12 Full Year
Current - actual/forecast (%)	(3.9%)	(6.9%)	(5.8%)	(3.5%)	(3.5%)
draft notification (%)	(3.9%)	(4.3%)	(2.3%)	(2.0%)	(2.7%)

Graph 2 compares recent letter volume growth with the forecasts in this notification and those in the draft notification.

Graph 2 – Comparison of letter volume forecasts



A breakdown of volume forecasts by the three letter segments is shown in Table 4 along with the last full year results for 2008/09.

Table 4 – Domestic letters volumes by segment 2008/09 to 2011/12⁵

	2008/09	2009/10	2010/11	2011/12	Av growth rate %
Transactional	3,165	2,959	2,800	2,693	-5.2
Promotional	777	748	779	761	-0.7
Social	188	180	173	166	-4.1
Total	4,130	3,888	3,752	3,620	-4.3

Appendix 3 shows an overview of letter volume demand by letter category and Appendix 4 provides a detailed explanation of volume forecasts, illustrating the augmentation of the econometric baseline estimates.

⁵ Includes Addressed Small and Large letters up to 500g

5. Australia Post's costs

This section:

- *contains updated cost forecasts for the three year period (2009/10 to 2011/12) which replaces the cost forecasts in the draft notification;*
- *compares 2008/09 forecasts in the draft notification to final 2008/09 results;*
- *compares 2009/10 forecasts in the draft notification to the latest 2009/10 forecast;*
 - o *detailing how Australia Post has limited cost growth to just 0.7% in 2009/10; and*
 - o *showing FTEs in 2009/10 down 765 on 2008/09.*
- *provides revised forecasts for the 2009/10 to 2011/12 period for domestic reserved letter service, showing how Australia Post has managed to reduce costs by 0.05% per annum over the three years to 2011/12.*

The ACCC in its View considered that Australia Post's draft notification did not demonstrate that Australia Post had fully exhausted cost-based responses to its expectation of declining letter volumes.

The ACCC View also noted a number of deficiencies with Australia Post's demand and cost forecasts, most of which had arisen due to a lack of transparency either through a lack of supporting information or confidentiality concerns meaning that the data or information provided by Australia Post in support of its draft notification could not be subjected to review by third parties or lead to fully informed decision making.

While a lack of reliable and independently verifiable forecasts for the demand of Australia Post's domestic reserved letter services made it difficult for the ACCC to form a view on the extent to which the proposed prices reflected an efficient cost base and a reasonable return on capital, the ACCC went on to say that 'Even if the ACCC did have reliable demand forecasts, the ACCC would still have serious concerns about the efficiency of Australia Post's cost base.'⁶

Noting this, while this section addresses the ACCC's concern regarding the provision of transparent and testable forecast data, the primary focus is on demonstrating the efficiency of Australia Post's cost base. This is achieved by analysing Australia Post's revenue and cost since the draft notification and as reflected in the new information provided (ie an improved financial position).

5.1. Financial budget and forecast process

Planning for Australia Post's Corporate Plan (which includes financial forecasts for a three year period) commences around February / March each year with budget submissions (from business units / divisions) projected off the most recent forecast for that year.

The budgeting process for Australia Post is:

- framed by the top down expectations of the Australia Post Board for corporate profitability growth;
- developed within a structured framework based on the external drivers and internal management levers governing cost and revenue growth;
- based on strong management accountabilities; and
- iterative in terms of 'top down / bottom up' process to finalise and then track the corporate budget position.

As part of the annual budgeting and forecasting process, Australia Post updates its forecasts during the year at the end of each quarter (September, December and March). Appendix 5 provides a chronological overview of the budgeting process.

⁶ ACC View, December 2009, page 166

Prior to preparing a budget submission, business units / divisions will consider a number of factors, including those related to volume variability (further information is provided later in this section) which are used to validate the volume related cost movements, separate to the other cost drivers and the savings targets.

As part of the overall budget process, the budget base and financial forecasts are adjusted for work years identified as savings in the approved business cases which relate to the relevant years. The budget process provides a structured and transparent approach to cost management based on clear accountabilities for targeted savings across the management hierarchy, and direct traceability for the fundamental cost drivers in the budget base.

At a macro level, future year costs rely on a number of planning assumptions. These are at three broad levels; those that are economy wide assumptions; those that are relevant only to Australia Post, but that apply across all of the business; and those at a particular product level.

At this point, Australia Post has an agreement with relevant staff associations to provide wage increases up until December 2010. Beyond this point Australia Post has assumed that the outcome of future wage negotiations will trend in a similar way to changes in the ABS labour data. The expected drivers of cost over the three years of this notification (2009/10 to 2011/12) are shown in the following two Tables:

Table 5 – External assumptions

	2009/10	2010/11	2011/12
GDP growth (%)	1 ½	3	3 ½
CPI increase (%)	1 ¾	2 ¼	2 ½
Bond rates	Unchanged	Unchanged	Unchanged
A\$ / SDR⁷	\$1.77	\$1.74	\$1.74

All economic forecasts are sourced / determined by Australia Post. Major sources of external advice used to produce internal economic planning assumptions are The Reserve Bank of Australia, Access Economics, and (for the first year only) the Commonwealth Treasury. Additional data reviewed are from The International Monetary Fund, OECD, National Australia Bank and The Economist.

Table 6 – General business assumptions

	2009/10	2010/11	2011/12
Wage growth (%)	4	∞	∞
Delivery Points	Continued growth of 2% (200,000) per annum		
Portfolio growth (revenue)			
– Letters & Associated Services (%)	(3.5)	3.1	(1.2)
– Parcels & Logistics (%)	0.8	6.2	7.9
– Agency Services & Retail Merchandise (%)	(2.1)	4.0	3.8

⁷ Special Drawing Right (SDR) is the monetary unit of the reserve assets of the International Monetary Fund. SDRs are the basis for the international fees of the Universal Postal Union – Assumption is included for completeness only and not relevant to the domestic reserved letter service

5.2. 2008/09 final results, with comparison to the draft notification

The overall outcome for 2008/09 was stronger than forecast in the draft notification. Final outcomes for 2008/09 are shown in Table 7.

Table 7 – 2008/09 results – Australian Postal Corporation^{8,9}

	draft notification	2008/09 Actual	Variance
Trading revenue (\$m)	4,912	4,907	(5)
Trading expenses (\$m)	4,577	4,550	27
Trading profit (\$m)	336	357	21
Non-trading profit (\$m)	5	24	19
Profit before tax (\$m)	341	381	40

In the trading expenses category, non-labour expense items were relatively close to the forecast levels. However, labour expense items were \$42m below forecast; \$35m of that fall was due to favourable impacts of bond rate changes on employee related liabilities and expenses, while the remaining \$7m represented a reduction in underlying labour expenses.

Labour is the cost area with the greatest potential for reduction when letter volumes decline. Australia Post actively manages its cost base in line with business activity and had already begun to respond to the change in volumes by the time the draft notification was lodged. Activities initiated after the budget processes for Australia Post's Corporate Plan was prepared, were not reflected in the 2009 Corporate Plan forecasts.

In terms of labour usage, full-time equivalents (FTEs) reduced to 32,765 (37 FTEs below that shown for 2008/09 in the draft notification), driven through a reduction in overtime FTEs – which was more than 4% below that estimated for 2008/09 in the draft notification for overtime.

5.2.1. 2008/09 final results – domestic reserved letter service

Volume and revenue results for the domestic reserved letter service were very close to the forecasts provided to the ACCC as part of the draft notification and actual costs were below forecast. Final results for the domestic reserved letter service with a comparison to the data provided in the draft notification are shown in Table 8.

Table 8 – 2008/09 results – domestic reserved letter service¹⁰

	draft notification	2008/09 Actual	Variance
Volume (m)	4,113	4,104	(9)
Revenue (\$m)	1,874	1,867	(7)
Expenses (\$m)	1,962	1,934	28
Product profit (\$m)	(88)	(67)	21

5.3. 2009/10 December Review forecast, with comparison to draft notification

The 2009/10 December Review incorporates six months of actual results with re-forecasts for the remainder of the financial year.

⁸ 2008/09 Actual = 2008/09 Final for Planning result

⁹ A negative (positive) figure in the Variance column is a negative (positive) contribution to profit

¹⁰ A negative (positive) figure in the Variance column is a negative (positive) contribution to profit

At the time that the 2009/10 December Review was established the timing of any domestic reserved letter service price increases was unknown. Therefore, a decision was taken to not include any domestic reserved letter service price increases in the 2009/10 December Review forecasts.

A key feature of the 2009/10 December Review is that domestic reserved letter volumes have declined by more than the forecast declines (2.3%) in the draft notification. Full-year volumes (incorporating a 6.9% decline for the first half year) are now expected to decline by 5.8% driven by an accelerated decline in Small Ordinary Letter volumes (down 6.7%) and Small PreSort Letter volumes (down 4.8%) on last year.

The accelerated decline, together with the removal of the letter price rises (originally budgeted to take effect from 25 January 2010), has resulted in a revenue forecast for the domestic reserved letter service that is \$87m below that of 2008/09. Australia Post corporation summary results for 2009/10 are as shown in Table 9.

Table 9 – 2009/10 forecasts – summary details

\$million	2008/09	2009/10		
		Draft notification	December Review forecast	Variance
Revenue				
- Letters & Associated Services	2,555	2,820	2,659	(161)
- Parcels & Logistics	1,345	1,421	1,355	(66)
- Agency Services & Retail products	736	731	721	(10)
Other trading revenue	72	73	80	7
Total trading revenue	4,907	5,044	4,814	(230)
Expenses				
- Labour, contract labour and delivery	2,639	2,746	2,629	107
- Superannuation	47	110	129	(19)
- Other contract services	720	779	706	73
- Non-labour	1,144	1,156	1,117	39
Total trading expenses	4,550	4,791	4,581	210
Trading Profit	357	253	233	(20)
Profit before tax	381	290	290	0

A number of aspects of the 2009/10 December Review should be highlighted. These are:

- despite a variation in trading revenue (against that shown in the draft notification) of \$230m, Australia Post has been able to achieve and / or target cost savings to almost neutralise the 2009/10 trading revenue decline. The 2009/10 December Review cost forecast is \$210m (4.4%) below that shown in the draft notification;
- despite wages inflation of around 4% and CPI inflation approaching 2%, Australia Post's expense total for 2009/10 is now planned to be only \$30m higher than the \$4,550 achieved in 2008/09, ie growth of less than 0.7%;
- savings have been achieved in the three major expense categories, ie labour, contractors of all types, and non-labour;
- the labour savings include a non- controllable gain of \$16m in bond rate impacts and an offsetting non-controllable loss of an extra \$19m of superannuation expense;
- all areas involving discretionary spending have contributed to the savings result achieved; and

- cost savings planned for the second half (\$97m) of 2009/10 are broadly equivalent to those achieved in the first half (\$113m).

Australia Post asserts that the savings already achieved (\$113m) and those planned for the second half (\$97m) demonstrate an appropriate cost management focus in an environment of volume decline.

5.3.1. Labour usage in 2009/10

Labour usage across all areas of Australia Post is forecast to reduce in 2009/10 to 31,525 FTEs, a reduction of 765 on 2008/09. Contributing to this result is a reduction of FTEs in each of the four network functions – Sales & Acceptance, Processing, Transport and Delivery.

To put this into a longer-term perspective, this single year reduction is larger than the total (419 FTEs) achieved in the four years to 2008/09. All three types of FTE – full-time, part-time and overtime – are affected, with higher-cost overtime reduced the most.

5.3.2. Domestic reserved letter service, 2009/10 forecast, with comparison to draft notification

The financial data for the domestic reserved letter service used in the draft notification were the same as those included in Australia Post’s Corporate Plan. Table 10 shows the variance between the draft notification and the 2009/10 December Review.

Table 10 – 2009/10 forecasts – domestic reserved letter service

	draft notification ¹¹	December Review forecast	Variance
Volumes (m)	4,019	3,865	(154)
Revenue (\$m)	1,907	1,780	(127)
Expenses (\$m)	2,055	1,940	115
Product Profit (\$m)	(148)	(160)	(12)

In relation to the above results:

- domestic reserved letter service volumes are not only well below the forecast level for 2009/10 in the draft notification, but have declined to near a level that Australia Post did not forecast until 2011/12; and
- consistent with the overall corporate setting, Australia Post has taken a high level of cost out of the domestic reserved letter service.

5.4. Revised forecasts for the three years to 2011/12

As is evident in the December Review forecast for 2009/10, the three year forecasts provided in the draft notification no longer apply. While Australia Post will not formally revise the 2010/11 and 2011/12 forecasts until May / June this year, to meet the ACCC requirements of providing three year forecasts, the forecasts have been updated and reflect the most recent information available.

At a corporate level, while Australia Post will continue to promote the core business and identify growth opportunities within it, the managing director and the executive team are committed to creating a sustainable cost base for Australia Post.

¹¹ Updated to reflect the cost allocation changes incorporated in the 2008/09 Final result and used in the 2009/10 December Review forecast

5.4.1. Three year financial outlook to 2011/12

In preparing a three year financial outlook for the purpose of this notification, Australia Post has prepared latest estimates for each of the three years. This includes updating the 2009/10 December Review to include:

- \$32m impairment provision (which will not affect domestic reserved letters); and
- \$16m reduction in in-year labour costs against the December Review, which forms the basis for the forecast in 2010/11 and 2011/12.

It is unlikely that the impairment provision will be brought to account until the end-year closing of the accounts, when the amount required is more certain and when it has been reviewed by the external auditors. The impairment is not related to the domestic reserved letter service. The associated impairment expenses will be allocated directly to the areas concerned, and will not affect the domestic reserved letter service. They are included in Table 11 only for completeness.

Impairment is covered by accounting standard AASB 136. It is designed to ensure that assets are not carried at amounts that exceed their recoverable amounts, ie the amounts that can be recovered through use and / or sale of the asset. If the carrying value exceeds the recoverable amount, then the asset is to be regarded as impaired, and AASB 136 requires recognition of an impairment loss to write the asset down to its recoverable amount.

The latest forecasts for all three years (2009/10 to 2011/12) are set out in Table 11.

Table 11 – Latest financial forecasts

\$million	2009/10 Dec Rev Fcast	2009/10 Latest Fcast ¹²	2010/11	2011/12
Trading revenue	4,814	4,814	5,008	5,172
Expenses				
- Labour, contract labour and delivery	2,629	2,618	2,684	2,739
- Superannuation	129	129	154	162
- Other contract services	706	705	741	752
- Non-labour	1,117	1,115	1,171	1,229
Total trading expenses	4,581	4,567	4,750	4,882
Trading profit	233	247	257	291

This materially different cost outlook for the 2009/10 to 2011/12 forecasts (to that provided previously to the ACCC) reflects the substantial progress reducing costs during 2009/10 as part of Australia Post's response to volume decline.

To give an alternative view on how the various cost segments are now planned to behave, the three-year average growth ie 2008/09 to 2011/12:

- in Labour costs (including contract and delivery labour but excluding superannuation) is just 1.6% per annum;
- for other contractor services is just 1.4% per annum; and
- for non-labour is 3.4% per annum (mainly reflecting higher depreciation and accommodation expenses).

¹² In preparing latest forecast for this notification, an update to the 2009/10 December Review has been made and is the base for the latest forecast in 2010/11 and 2011/12

5.4.2. Labour usage outlook to 2011/12

In the three years to 2011/12 Australia Post plans to reduce labour usage in the traditional areas of the business (eg those areas associated with the domestic reserved letters service). While the reductions are a result of the response to the volume decline, over the same period Australia Post will seek to pursue growth opportunities in other parts of the business, such as parcels and warehousing & logistics as well as identifying and pursuing new business opportunities. Therefore, while FTEs will reduce in some areas, FTEs may increase in other areas to meet those opportunities.

These reductions, which include the savings from programs such as Future Delivery Design, will be achieved through a combination of natural attrition, redeployment and redundancy.

The planned reductions are lower in the Sales & Acceptance function and the Transport function. Impacting FTE reductions in these functions are:

- retail outlets; staff levels reflect the need to maintain the appropriate capability for all activities undertaken at retail outlets; there are also requirements to maintain a presence (total number and location); and meet daily peak customer demands regardless of mail volume variances (eg lower volumes may mean smaller lodgements as opposed to fewer lodgements);
- the transport network is largely invariant to mail volume changes in terms of the volume changes assumed in this application. Transport demands are set by the distance and frequency of the mail runs that are required to meet delivery standards incorporated into product design. The exception will be contract transport where changes are based on weight carried.

As an example of the first point, Sales & Acceptance FTEs are expected to be broadly consistent over the three years due to a planned introduction of new agency services, however, the share for the domestic reserved letter service will fall.

5.4.3. 2009/10 to 2011/12 latest forecast for domestic reserved letter service

The financial data for the domestic reserved letter service in this notification are forecasts based on the revised estimates to the 2009/10 December Review and revised data for the 2010/11 and 2011/12 years. This reflects the most recent assumptions Australia Post has at the time of writing this notification.

The domestic reserved letter service outlook for the three years to 2011/12 is set out below and includes a latest estimate for 2009/10. As noted earlier this notification is seeking a single set of price changes and the financial projections make no assumptions about any further increases.

Table 12 – Latest forecast for domestic reserved letters 2009/10 to 2011/12¹³

	2009/10	2010/11	2011/12
Volume (m)	3,865	3,730	3,599
Revenue (\$m)	1,780	1,840	1,772
Expenses (\$m)	1,983	1,961	1,932
Profit (\$m)	(204)	(121)	(159)

5.4.4. Labour usage to 2011/12 – domestic reserved letter service

In the three years to 2011/12 there will also be reductions in the allocation of labour to the domestic reserved letter service. The reductions are largely a result of the response to the volume decline.

¹³ Aligns to the latest forecasts shown in Table 11.

5.5. Relationship between costs and volumes

Australia Post notes the ACCC comments on cost / volume relationship and the views cited by Frontier Economics¹⁴ that Australia Post:

- makes no distinction between short run and long run cost elasticities and that low cost volume elasticities are more difficult to justify in the medium to longer term; and
- has effectively assumed a cost volume elasticity of 0, whilst international studies on mail delivery functions conclude that whilst the cost volume elasticity is likely to be less than 1, it is significantly different to 0.

This section provides an overview of short run cost / volume parameters, with further detail for the Processing function and the Delivery function in Appendix 6. These parameters were used in updating the cost forecasts contained in this notification.

In the long term, cost volume elasticities can be expected to increase as a wider range of operational responses and initiatives come into play. However, in current network circumstances where the volume declines have been greater for the products with higher proportions of variable processing costs (Small Ordinary letters versus Small PreSort letters) there is a challenge to sustain the current rates of cost variability as volumes decline.

As regards external cost elasticity estimates quoted by Frontier Economics, Australia Post notes that such estimates are specific to the data coverage for the functions, facilities, products and processes involved. Moreover, such studies have generally been estimated over periods of rising rather than declining letter volumes. Therefore, while they offer insights, they cannot be used uncritically to substitute for the internal operational analyses of process variability.

Australia Post has commissioned Economic Insights Pty Ltd to undertake an econometric assessment of Australia Post's potential for cost / volume elasticity. This will provide Australia Post with econometric data that can be used to:

- identify or track variability in cost from changes in volume over time; and
- provide enhanced information on these changes to estimate future costs.

This work will focus initially on the Processing function and then the Delivery function. To overcome the current limitation in data available (insufficient observations), the feasibility of panel data is being considered.

Based on the current environment, an overview of cost variability from volume change within each of the four network functions is now evidenced.

5.5.1. Sales & Acceptance

Sales & Acceptance includes the provision of retail outlets and the acceptance and lodgement of letters at those outlets or at any lodgement point, including street posting boxes. The major cost component is the operation of the retail outlets; which are provided through a combination of corporate (owned / operated by Australia Post) and 'other' (ie operated by a licensee, franchisee or community postal agent) outlets. A key requirement is the need to maintain a number of retail outlets (in total and in rural and remote locations).

At corporate outlets, variability of costs in line with volume changes is relatively low. As Sales & Acceptance of letters is very rarely based on a single item, lower volumes generally mean smaller lodgements as opposed to fewer lodgements. Where volume can be a factor is in the streaming process (mail related 'back office' activity), however, that is a small proportion of the Sales & Acceptance function cost (\$21m in 2009/10 at corporate outlets). Another factor that impacts short term variability is that staff numbers per outlet are relatively small (5 – 7 FTEs) so moderate changes in volume have a minimum impact.

¹⁴ ACCC View, December 2009, page 78

5.5.2. Processing

The main cost drivers of variability in the Processing function are:

- letter attributes (volume in total and from changes in product mix; which can impact readability and machinability etc);
- equipment performance (throughput rates, reading technology, etc); and
- the processing window required to meet delivery standards.

The cost base incorporates an assessed 25% average variability in processing labour to volume change in the metropolitan mail centres. Detail on cost volume parameters within the Processing function is at Appendix 6.

The Processing result is an average across letter types, as not all letters undergo the same processes in a mail centre. For example, Small Ordinary letters have higher potential resource variability than Small PreSort letters as Small PreSort letters generally only pass through the Barcode Sorters (BCS) and not through the more cost-variable processes such as Culler Facer Cancellor (CFC), Multi line optical character reader (MLOCR), Optical Character Recognition (OCR), video coding and manual sorting. Differences such as these are not as pronounced in the Delivery function.

Increased variability in the long term is dependent upon more fundamental change to existing constraints, including service commitments, labour arrangements and network structure.

The elements impacting variability in the long term include:

- commitments made within labour agreements and awards. Australia Post cannot legally and unilaterally reduce individuals' working hours and associated salary levels to match letter volume losses:
 - o overtime has already been reduced towards minimum viable levels.
- size and scope of reductions will change with changes in product mix – as the volume of letters that has a greater dependency on manual handling decreases the overall ratio for reductions decreases:
 - o volume variability within mail centres depends on the type of letter whose volumes are changing. There is a higher degree of potential variability with Ordinary / Other letters (in particular Small Ordinary) than for PreSort letters. This is because Ordinary letters pass through equipment that is generic and which can be partly shut down (eg the CFC and the MLOCR).

5.5.3. Transport

Australia Post uses a combination of 'own' and contract transport. The 'own' transport network is largely invariant to the level of volume declines forecast in this notification. Transport demands are set by the distance and frequency required to meet delivery standards incorporated into the product offer (including the delivery standards required under the prescribed performance standards). For contract transport there is potential cost variability where the contracts have weight factors; this is an automatic variability that does not require Australia Post management to intervene to realise savings.

5.5.4. Delivery

The Delivery function includes both an 'indoor' component (eg round sorting and sequencing) and an 'outdoor' component (eg delivery to street addresses). The variability of costs to changes in letter volume will vary within each component. Indoor work is generally more variable with letter volume, whereas outdoor work is impacted more by the need to deliver to a certain number of points – which are increasing by around 2% per annum.

An assessed average labour variability of 30% to variations in letter volume is applied for the Delivery function. Detail on cost volume parameters within the Delivery function is at Appendix 6.

Elements impacting the variability of labour with respect to volume are similar to the Processing function in terms of existing labour agreements, but also include the work unit / facility size. In small delivery facilities (where one FTE represents a higher proportion of total FTEs pool, reductions become harder). Australia Post will address this through long term planning of the delivery centre network.

5.6. Cost allocation

The ACCC, in its Decision of July 2008, considered that a review of Australia Post's approach to allocating costs between reserved and non-reserved services, before the ACCC received a further price notification from Australia Post, '... would provide the ACCC additional comfort on apportionment of costs between reserved and non-reserved services, and also on the costs of categories of reserved mail services.'¹⁵

The ACCC completed a review of Australia Post's cost allocation methodology (CAM) in June 2009.¹⁶ As a result of the review the ACCC raised a number of issues with Australia Post which were satisfactorily addressed and as a result of the review and its outcomes, the ACCC was satisfied with Australia Post's CAM and considered it appropriate for the purposes of its assessment of Australia Post's current draft notification. Notwithstanding this positive outcome, Australia Post is committed to working with the ACCC to address any issues it may have in the future.

5.7. Superannuation

The ACCC View expresses a concern that a major driver of cost increases over the period of the price notification is the forecast increases in superannuation expense and that Australia Post, by offering a defined benefit scheme, faces a higher financial risk than if it provided superannuation benefits through an accumulation scheme, because costs under a defined benefit scheme are influenced by a number of factors including fluctuations in global financial markets. Noting this, the ACCC is concerned about the longer term implications of Australia Post continuing with a defined benefits scheme.

As referenced in the ACCC View, Australia Post provided advice to the ACCC stating that Australia Post, at present, would incur a higher annual cost if it provided superannuation benefits solely under an accumulation scheme as opposed to a defined benefits scheme. In fact, as a straight forward comparison between the two types of scheme (where the minimum payment is 9%) Australia Post would incur, in 2009/10, an annual superannuation cost of around \$165m which is more than the \$129m, \$154m and \$162m forecast annual superannuation expenses shown in Table 13 for financial years 2009/10, 2010/11 and 2011/12 respectively.

Table 13 – Superannuation expense¹⁷

Financial year	Superannuation expense
Actual expense	
2004/05	\$130m
2005/06	\$101m
2006/07	\$74m
2007/08	\$36m
2008/09	\$48m
Forecast expense	
2009/10	\$129m
2010/11	\$154m
2011/12	\$162m

¹⁵ ACCC Decision, July 2008, page 68

¹⁶ ACCC View, December 2009, page 58

¹⁷ Data are shown for only for 2004/05 onwards, as the current relevant parts of AASB 119 only became operational on and from that year.

5.8. Depreciation

Depreciation expense within the notification is unchanged from the draft notification. The depreciation allocations are updated after a revised capital plan is approved. The current capital plan was approved in June 2009 and will not be updated until June 2010.

The depreciation expense is forecast to rise from \$187m in 2007/08 to \$207 m in 2008/09, \$209 m in 2009/10, \$234 m in 2010/11, and \$263 m in 2011/12 (numbers shown to the nearest \$m) – higher than previous years reflecting an increased investment in the network and technology to support the business.

Note 1(s) of the 'Notes to and forming part of the financial report' of the Australia Post Annual Report details the depreciation rates applying to items in each class of depreciable asset.

6. Future Delivery Design

This section provides:

- *an update on the progress and outlook for Future Delivery Design (FDD) benefits aligned to those elements set down at Appendix 17 of Australia Post's draft notification; and*
- *the detail of the benefits of FDD out to 2013/14.*

Australia Post notes the comments in the ACCC View on the status of automated small letter sequencing:

- Australia Post appears to be slow in deploying automated sequencing; and
- had Australia Post invested in additional sequencing machines it would now be benefiting from long term reductions in its operational expenses.

Australia Post has previously outlined its approach to automated sequencing, highlighting:

- the distinctive role that the early introduction of manual Vsort frames in delivery centres (DCs) had in extracting cost saving benefits relative to overseas operators using automated sequencing;
- the gains that could be realised from maximising the utilisation of existing machine sequencing capacity prior to major capital expenditure on new capacity; and
- the need for careful assessment on a case by case basis of the incremental savings from any investment in new capacity given declining letter volumes.

Australia Post's draft notification highlighted the challenge to contain the growth in delivery costs in the face of declining letter volumes, ongoing growth in delivery points and network geography, and rising workforce ageing and OH&S risks arising from a current high dependence on motorcycles for outdoor street delivery.

FDD was activated to respond to this challenge and to set the future direction for delivery operations. The intent was to implement a range of changes to improve processes, systems and work practices – to realise substantial efficiency improvements over a 5-7 year period and to create greater flexibility in letter delivery operations.

Notwithstanding this, in responding to the ACCC's concerns, as detailed in this section, Australia Post has accelerated the pace and scope of change, including the speed in which automated small letter sequencing is being deployed.

6.1. Key elements within FDD

There are three key elements within FDD:

- **Enhanced OCR address recognition** software on MLOCR equipment to increase the volume of letters (by a minimum 10% in the business case) sorted to the highest delivery point identifier level, reduce missorts, and develop system architecture to reduce the cost of future recognition software improvements;
- **Automated small letter sequencing** that makes maximum use of existing barcode sorter (BCS) equipment capacity and enables a more efficient processing and delivery process to be rolled out across target DCs and rounds, to extract savings from reducing manual mail preparation in DCs from 2008:
 - o **Additional sequencing equipment and associated network process change**, to extend the rollout of machine sequenced rounds (targeted from 2011) and realise further savings; and
 - o **Separate bundle delivery (SBD)**, as an alternative to the merging process (for machine sequenced and manual sequenced mail) deployed initially to rounds already converted to machine sequencing.
- **Reconfiguring indoor and outdoor delivery operations** to realise the gains from automation:
 - o **Delivery round optimisation (DRO)** process and software tool to recast delivery rounds and realign the outdoor delivery tasks to the work required; and

- **Other FDD elements**, including alternative delivery modes to reduce dependence on motorcycle delivery and extension of remote delivery rounds that commence and / or cease away from the DC.

6.2. 2009 draft notification

At the time the draft notification was developed (ie before July 2009), the first component of the Enhanced OCR address recognition project was being implemented and around 400 rounds were being machine-sequenced using existing BCSs, with a further 680 rounds in progress to bring the total machine-sequenced rounds in 2009 to 1,080.

A wider range of studies and pilots were in progress associated with the next stages of OCR address recognition enhancements, the rollout of machine sequenced rounds in 2010 and beyond, and the assessment of new equipment to expand automated sequencing capacity. Other studies were in progress on alternatives to the manual merging process in DCs (SBD), alternative delivery modes and a DRO capability.

Many of these assessments were pre business case and the savings and expenditure profile for FDD was based on high level estimates, with net savings in 2009/10 and 2010/11 heavily influenced by project and implementation team costs.

6.3. 2010 notification

There has been major progress towards implementation of core elements of FDD, as well as significant developments in identifying additional savings opportunities from process innovation. In addition, noting the ACCC's concerns, program priorities and governance have been reviewed to bring forward and accelerate, as far as practicable, those elements where current assessments suggest the largest savings contributions can be made.

As shown in Table 14, the current estimated savings out to 2013/14 are now \$69.8m, significantly above the \$29.2m advised during the draft notification assessment process. A more detailed comparison is provided in Table 16 and Table 17.

Table 14 – Comparison of FDD Savings

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Totals
2009 Draft notification (\$m)	(0.4)	4.4	4.0	5.8	6.0	9.4	29.2
2010 Notification (\$m)	(2.9)	10.1	2.6	24.1	19.2	16.6	69.8
Savings change (\$m)	(2.5)	5.7	(1.4)	18.3	13.2	7.2	40.6

Essential points of difference between then and now are: an acceleration of the rollout of machine-sequenced letters using both existing and proposed new sorting equipment, the use of SBD during the outdoor delivery process and a greater level of savings anticipated from rollout of a DRO process and software tool.

The anticipated increase in savings in this update is dependent in part on high level estimates until the detailed state implementation planning is completed. Net savings in 2010/11 are negatively affected by implementation and planning expenses associated with the accelerated machine sequencing rollout and project costs related to other initiatives described below.

6.4. Enhanced OCR address recognition

The draft notification noted that Stage 1a of the Recognition Improvement project would be rolled out in the final quarter of 2009 and the anticipated productivity benefits were incorporated in 2009/10 financial projections.

Additional benefits from an address learning capability and other address recognition enhancements were noted also, but these components were not separately listed in the briefings provided to ACCC staff on FDD (August 2009) – showing net savings totalling some \$7.5m by 2010/11.

As indicated during the draft notification assessment process, the Recognition Improvement project is both a generator of cost savings in its own right and an important enabler of other FDD projects – most importantly automated small letter sequencing.

Appendix 7, Table 22 provides further details of the components of the enhanced recognition improvement project and compares status to the draft notification. Table 22 also summarises the rollout achieved and planned, highlighting changes since the draft notification and briefings to ACCC staff.

6.5. Automated small letter sequencing

The draft notification outlined a plan to achieve automated small letter sequencing of 3,480 delivery rounds nationally by 2012 (around 63% of metropolitan delivery rounds at the time). The plan also foreshadowed further rollout in later years to achieve a total of 5,100 machine sequenced rounds (over 90% of total metropolitan delivery rounds). The plan involved two key stages of rollout:

1. Rollout using existing equipment capacity from 2008 to 2010 to a total of 1,880 rounds; and
2. Rollout after new sequence sorting capacity was created to 800 rounds per year commencing in 2011.

6.5.1. Sequencing rollout using existing BCS machines (2008 to 2010)

By the end of 2009, a total of 1,150 rounds (around 20% of total metropolitan delivery rounds nationally) were machine sequenced using a manual merging process at delivery facilities to combine machine sequenced and manual sequenced mail for each round, prior to delivery.

Some 500 rounds have been confirmed for machine sequencing to continue the rollout to June 2010, which would take the total number to 1,650 rounds (30% of metropolitan rounds). Up to a further 500 rounds are targeted for machine sequencing on existing equipment for the remainder of 2010, but the evaluation of final numbers and locations is still being finalised and Table 17 is based on a total of 800 rounds added in 2010.

Table 23 (at Appendix 7) provides a summary of the rollout plan using existing BCS machines, highlighting changes since the draft notification.

6.5.2. Sequencing rollout based on expanded sorting capacity (2011 to 2014)

The draft notification foreshadowed our intent to roll out machine sequenced rounds at a rate of around 800 per year, based on extended sorting capacity, to reach a total of 4,280 by 2013 and some 5,100 by 2014.

Current estimates target an accelerated rollout of machine sequenced rounds based on the creation of additional sorting capacity. This challenging target will be created through a combination of:

- further extending the sequencing window – the time available on existing BCS machines to sort sequenced mail;
- new methods of processing small letters and equipment enhancements to increase the effective BCS sorting throughput, including sequenced mail; and
- purchase of new equipment – dedicated sequence sort machines (SSMs) – to expand sorting capacity in key processing nodes across the network.

This revised plan would see a total of 4,000 rounds sequenced by the end of 2011; then 5,000 by end of 2012, 6,150 by end of 2013 and ultimately up to 6,500 by June 2014 – potentially some 85% of the total number of delivery rounds.

A summary of the rollout plan based on new network capacity, highlighting changes since the draft notification, is shown at Appendix 7, Table 24.

The accelerated rollout achieves a sequenced to total rounds ratio of around 65% two years earlier than anticipated in the draft notification. The revised plan also achieves a greater penetration of sequencing by 2014 – a total of 6,500 machine-sequenced rounds compared with some 5,100¹⁸ anticipated earlier – and involves significant additional savings as well through the new element described below.

The accelerated roll out of automated small letter sequencing involves the end to end process from mail preparation and lodgement through to final delivery.

Table 15 – Sequencing rollout – comparison against draft notification

Rounds sequenced	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Aggregate
Draft notification	740	740	800	800	800	800	4,680
Current notification	774	876	1,325	1,525	1,075	925	6,500
Cumulative increase	34	170	695	1,420	1,695	1,820	1,820

6.5.3. Separate bundle delivery

In the draft notification, the assumption made was that the rollout of automated small letter sequencing – using both existing and new sorting machines – would be based on a manual merge of machine sequenced and manual sequenced mail at delivery facilities prior to final delivery.

At the time, an alternative concept was being evaluated in association with trials of alternative modes of delivery. Through these trials, Australia Post has identified and proven additional savings opportunities. Current plans now involve converting existing machine sequenced rounds to SBD and applying this concept to all future machine sequenced delivery rounds as they are rolled out.

SBD will be applied first to rounds not involving motorcycle delivery, but the savings estimates assume that its application to all machine sequenced rounds will be confirmed by the motorcycle trials that are still to be completed.

Significant industrial issues associated with the changed delivery process, particularly motorcycles, could delay the broader implementation of SBD, placing at risk the timing of anticipated savings.

6.6. Reconfiguring indoor and outdoor delivery operations

The rollout of small letter automated sequencing requires significant delivery round recasting to enable the optimal use of outdoor delivery resources.

6.6.1. Delivery round optimisation

DRO uses information related to the outdoor delivery activities and proprietary Geographical Information Systems software to calculate optimum delivery rounds and labour resource requirements that can be displayed geographically.

A consistent and reproducible DRO process is vital to maximise benefits from FDD by ensuring outdoor delivery resources can be better aligned with the round types, delivery modes, changed letter volumes, and the labour mix.

At the time of the draft notification, the DRO process was still undergoing a feasibility study. Preliminary estimates of savings out to 2013/14 – totalling \$5.3m – were provided to the ACCC in relation to the draft notification.

¹⁸ 5,100 was by the end of calendar year 2014. At the end of 2013/14 this was estimated at 4,680

The DRO Stage 1 business case has now been finalised. Stage 1 involves implementation at DCs with over 20 delivery rounds using manual interfaces with other delivery systems. Stage 2, which will be subject to a separate business case, involves automated interfaces and would facilitate further DRO efforts after 2013/14.

There is a significant upfront investment for DRO – mainly to establish competencies to operate the process – but net savings are expected from 2011/12 onwards and are expected to total \$15.8m by 2013/14. Trials from the feasibility study have informed these estimates and they are based on an average 4% reduction in delivery labour costs at the DCs targeted for DRO.

A summary of the revised position included in the Stage 1 business case, highlighting changes since the draft notification and related briefings, is shown at Appendix 7,

Table 25.

6.6.2. Other FDD elements

The draft notification referred to several other elements of FDD, chiefly:

- the extension of remote commencement and / or cessation of delivery rounds; and
- the introduction of alternative delivery mode technologies.

Remote commencement and / or cessation provides DC managers with greater flexibility to realise productivity savings in local delivery networks from the other FDD elements outlined above, through savings in accommodation and managerial costs and a reduction in dead running time (ie the time spent travelling to and from the DC to the start and finish of the delivery round). This alternative network design will enable further DC centralisation notwithstanding ongoing growth in delivery points.

Alternative delivery mode technologies also enable reduced reliance on motorcycle delivery to address recruitment and safety issues and are a proven method of delivery that can accommodate SBD.

Alternative delivery modes involve the use of E Bicycles, E Tricycles, All Terrain Buggies and a new design of Walk Buggy – all fitted out for SBD. SBD will also be rolled out on rounds using non powered bicycles. Current progress with alternative delivery modes is summarised at Appendix 7, Table 26.

Remote commencement and / or cessation of delivery rounds, facilitates wider part time recruitment opportunities for outdoor delivery and provides options for greater operational flexibility and DC consolidation. To date over 900 rounds involve either remote commencement and / or remote cessation; with 323 involving both.

6.7. Detailed comparison of savings

At the August 2009 FDD briefings to the ACCC, a table was presented covering the period to 2013/14 and the key elements of FDD driving labour savings. Table 16 reproduces those net savings numbers, altered to show the incremental savings and the aggregate of these - \$29.2m.

Table 16 – FDD net savings provided during draft notification assessment process

Net savings \$m	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Aggregate
Components							
Enhanced OCR address recognition	-	4.7	2.8	-	-	-	7.5
Sequencing 2008 – 2010 (1,880)	(0.4)	0.8	5.1	1.8	-	-	7.3
Sequencing 2011 – 2013 (2,400)	-	-	(1.2)	1.8	3.4	5.1	9.1
Delivery round optimisation	-	(1.1)	(2.8)	2.3	2.6	4.3	5.3
Totals	(0.4)	4.4	4.0	5.8	6.0	9.4	29.2

Table 17 provides an update of Table 16, based on current rounds converted to machine sequencing of small letters and plans for rollouts to the end of June 2014, with SBD rolled in. Table 17 also incorporates updates on Enhanced OCR address recognition and Stage 1 DRO.

Table 17 – FDD net savings to 2013/14 (basis for notification)

Net savings \$m	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Aggregate
Components							
Enhanced OCR address recognition	✂	✂	✂	✂	✂	✂	✂
Sequencing 2008 – 2010 (1,950)	✂	✂	✂	✂	✂	✂	✂
SBD on 1,950 rounds	✂	✂	✂	✂	✂	✂	✂
Sequencing 2011 – 2014 (4,550)	✂	✂	✂	✂	✂	✂	✂
SBD on 4,550 rounds	✂	✂	✂	✂	✂	✂	✂
Delivery round optimisation	✂	✂	✂	✂	✂	✂	✂
Totals	(2.9)	10.1	2.6	24.1	19.2	16.6	69.8

Assumes all machine sequenced rounds converted to or introduced with SBD, including retained motorcycle rounds.

DRO savings are independent of, and additional to, savings accrued through process changes – enhanced address recognition, machine sequencing and SBD. Alternative delivery modes and remote commencement and cessation are used to enable identified savings to be achieved at planned levels.

The revised outlook for FDD contains a challenging but achievable savings target but is not without risk. In summary, the revised outlook compared to that in Table 16 highlights that;

- for the 6 years 2008/09 to 2013/14, some \$69.8m net savings are being targeted compared with \$29.2m in the draft notification when a number of feasibility studies were in early development;
- for the 3 years 2009/10 to 2011/12, net FDD savings of \$36.8m are being targeted compared with \$14.2m in the draft notification; and
- current outlook net savings of \$2.6m in 2010/11 incorporates \$5.7m in implementation team costs from accelerating the sequencing rollout in that year and from preparatory work on DRO, where savings build significantly from 2011/12 onwards.

7. Asset base

Australia Post prepares a capital investment plan each year as part of the annual planning process. The current capital investment plan was approved in June 2009 (it was used in the draft notification) and remains current until the next capital investment plan is approved in June 2010.

7.1. 2009 Capital investment plan

The main capital expenditure items (by category) included in the current three-year capital investment plan are detailed in Table 18.

Table 18 – Capital investment outlays by category (\$m)

	2008/09	2009/10	2010/11	2011/12
Australia Post Network				
- Sales & Acceptance	36	24	33	31
- Processing	31	20	22	49
- Delivery	25	19	30	45
Information technology	120	176	162	118
Motor vehicles	41	28	46	49
Other capital investment	79	50	16	14
Total capital investment	332	316	308	307

Capital expenditure for 2009/10 is now forecast to be \$282m, compared with the budget forecast of \$316m used for the 2009 draft notification. The current-year shortfall is largely a matter of timing (there has been no change to the projects contained within the 2009 Capital Plan), and is expected to be substantially made up in 2010/11. Consequently there is no material change to the asset forecasts contained in section 10.9 of the draft notification.

8. Rate of return

This section details that Australia Post:

- for this notification, accepts the WACC input parameters detailed in the ACCC View; and
- will look at a specific WACC for domestic reserved letter service in future notifications.

Australia Post notes that the ACCC View adopted Weighted Average Cost of Capital (WACC) parameters that differed from those proposed by Australia Post.

While Australia Post has reservations about some of the ACCC's WACC choices, for the purpose of this notification, Australia Post is not challenging these parameters other than to update the period selected to set the bond rate; for which Australia Post nominates the month of January 2010. As the PTRM modelling in section 9 demonstrates, the WACC parameters do not make any practical difference given that the revenue from the proposed prices is well below that calculated by the PTRM as the maximum allowable.

8.1. WACC for Australia Post

Proposed key Capital Asset Pricing Model and WACC parameters are set out in Table 19.

Table 19 – Domestic reserved letter service WACC – input and output values

WACC Parameter	Value
r_f nominal risk-free rate-of-return	5.60%
$rm-r_f$ market risk premium	6.50%
T_c corporate tax rate	30.0%
γ imputation factor	0.65
Cost of debt	8.31%
D/V Australia Post's gearing ratio	0.3
β_a asset beta	0.355
β_d debt beta	0.10
β_e equity beta	0.463
WACC Result	
Nominal vanilla WACC	8.52%
Pre-tax nominal WACC	9.2%

In terms of the pre-tax nominal WACC formulation in section 18(3) of the RKR, Australia Post's pre-tax nominal WACC, including the domestic reserved letter service, is 9.2%.

8.2. WACC for domestic reserved letter service

The ACCC in its View notes '...some of the WACC parameters Australia Post has provided are for Australia Post's whole business, rather than its reserved services.'¹⁹ Australia Post notes the ACCC's View and will work with an Independent consultant to investigate the feasibility of a domestic reserved letter service WACC for future price notifications.

¹⁹ ACCC View, December 2009, page 158

9. Post Tax Revenue Model

As the 2009/10 data reflects the 2009/10 December Review forecast any impact from a change in the domestic reserved letter service prices is not included in the 2009/10 revenue.

As the impact of the proposed prices equates to around \$3m per week, the inclusion of revenue from the proposed prices in the last three days of 2009/10 would not materially change the result.

A comparison of the proposed and allowable revenues over the 2009/10 – 2011/12 financial years is as follows:

Table 20 – Post Tax Revenue Model summary 2009/10 – 2011/12

		2009/10 \$m	2010/11 \$m	2011/12 \$m
Nominal Vanilla WACC	8.5%			
Required Revenue		\$ 2,046	\$ 2,030	\$ 2,010
Present Value of Required Revenue		\$ 2,046	\$ 1,871	\$ 1,706
Sum of PV over 3 years		\$ 5,623		
Letters Revenue at proposed prices		\$ 1,780	\$ 1,840	\$ 1,772
Present Value of Proposed Letters Revenue		\$ 1,780	\$ 1,696	\$ 1,505
Sum of PV over 3 years		\$ 4,980		
Deficiency of Letters Revenue to Required Revenue		\$ 266	\$ 175	\$ 202
Sum of PV over 3 years		\$ 642		

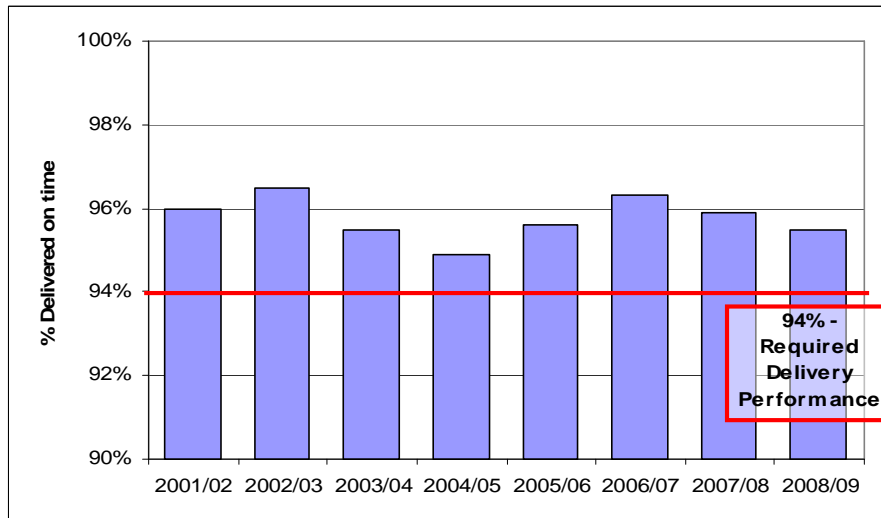
Appendix 1 – Performance standards

As detailed in Table 21, Australia Post continued to meet its regulated performance standards in 2008/09. Furthermore, as indicated in Graph 3, for the last eight years, Australia Post's delivery performance standard has continued to exceed the minimum required.

Table 21 – Performance standards 2008/09²⁰

Standard	Required Performance	Actual Performance
Number of street posting boxes	10,000	16,055
Delivery timetables	Maintained	Maintained
On time delivery of non bulk letters	94%	95.5%
Points to receive deliveries five days per week	98%	98.8%
Points to receive deliveries no less than twice a week	99.7%	99.9%
Retail outlets	4,000 (2,500 in rural and remote areas)	4,433 (2,541 in rural and remote areas)

Graph 3 – Delivery performance over time – non bulk letters 2000/01 – 2008/09



²⁰ Australia Post Annual Report 2008-09, Financial and Statutory Reports, page 110

Appendix 2 – Volume, revenue and costs by product category

Details of volume, revenue and cost by product category for the 2008/09 to 2011/12 financial years are as follows:

	PreSort Letters			Other (inc Ordinary) Letters			Total Letters	
	Small	Large	Subtotal	Small	Large	Subtotal		
2008/09								
Volume	m	2,112.5	153.5	2,266.0	1,640.1	198.4	1,838.5	4,104.5
Revenue	\$m	\$ 777.2	\$ 99.6	\$ 876.9	\$ 780.7	\$ 209.5	\$ 990.2	\$ 1,867.1
Total Cost	\$m	∞	∞	\$ 888.4	∞	∞	\$ 1,045.9	\$ 1,934.3
Contribution	\$m	∞	∞	(\$ 11.5)	∞	∞	(\$ 55.7)	(\$ 67.2)
ROR	%	∞	∞	(1.3%)	∞	∞	(5.6%)	(3.6%)
2009/10								
Volume	m	2,011.0	140.2	2,151.2	1,529.5	184.0	1,713.5	3,864.7
Revenue	\$m	\$ 750.0	\$ 92.2	\$ 842.1	\$ 739.9	\$ 197.7	\$ 937.5	\$ 1,779.7
Total Cost	\$m	∞	∞	\$ 917.9	∞	∞	\$ 1,065.3	\$ 1,983.3
Contribution	\$m	∞	∞	(\$ 75.8)	∞	∞	(\$ 127.8)	(\$ 203.6)
ROR	%	∞	∞	(9.0%)	∞	∞	(13.6%)	(11.4%)
2010/11								
Volume	m	1,998.1	136.1	2,134.2	1,420.6	174.9	1,595.5	3,729.7
Revenue	\$m	\$ 796.3	\$ 96.1	\$ 892.4	\$ 743.7	\$ 204.2	\$ 947.9	\$ 1,840.4
Total Cost	\$m	∞	∞	\$ 937.5	∞	∞	\$ 1,023.7	\$ 1,961.2
Contribution	\$m	∞	∞	(\$ 45.0)	∞	∞	(\$ 75.8)	(\$ 120.8)
ROR	%	∞	∞	(5.0%)	∞	∞	(8.0%)	(6.6%)
2011/12								
Volume	m	1,947.9	133.6	2,081.5	1,351.0	166.7	1,517.7	3,599.2
Revenue	\$m	\$ 776.1	\$ 94.2	\$ 870.3	\$ 707.2	\$ 194.6	\$ 901.8	\$ 1,772.1
Total Cost	\$m	∞	∞	\$ 934.2	∞	∞	\$ 997.4	\$ 1,931.6
Contribution	\$m	∞	∞	(\$ 63.9)	∞	∞	(\$ 95.6)	(\$ 159.5)
ROR	%	∞	∞	(7.3%)	∞	∞	(10.6%)	(9.0%)

Note: 2008/09 data is Actual, 2009/10 to 2011/12 are latest forecasts.

Appendix 3 – Overview of letter volume demand by letter category

	Actual 07/08 Volume (m)	Actual 08/09 Volume (m)	Last Est 09/10 (f) Volume (m)	Year 2 10/11 (f) Volume (m)	Year 3 11/12 (f) Volume (m)
PreSort Letters					
Small					
Econometric base line				2,003	2,015
Adjustment - Mgmt & Mkt Intel				- 5	- 67
Total Small PreSort	2,135	2,113	2,011	1,998	1,948
Change on Prior Year		- 23 -1.1%	- 102 -4.8%	- 13 -0.6%	- 50 -2.5%
Large					
Econometric base line				140	139
Adjustment - Mgmt & Mkt Intel				- 4	- 5
Total Large PreSort	170	153	140	136	134
Change on Prior Year		- 16 -9.6%	- 13 -8.6%	- 4 -2.9%	- 3 -1.8%
Total PreSort Letters					
Econometric base line				2,143	2,153
Adjustment - Mgmt & Mkt Intel				- 9	- 72
Total PreSort Letters	2,305	2,266	2,151	2,134	2,082
Change on Prior Year		- 39 -1.7%	- 115 -5.1%	- 17 -0.8%	- 53 -2.5%
Ordinary / Other Letters					
Small					
Econometric base line				1,460	1,403
Adjustment - Mgmt & Mkt Intel				- 39	- 52
Total Small Ordinary	1,753	1,640	1,529	1,421	1,351
Change on Prior Year		- 113 -6.4%	- 111 -6.7%	- 109 -7.1%	- 70 -4.9%
Large					
Econometric base line				184	177
Adjustment - Mgmt & Mkt Intel				- 9	- 10
Total Large Ordinary	215	198	184	175	167
Change on Prior Year		- 17 -7.8%	- 14 -7.3%	- 9 -5.0%	- 8 -4.7%
Total Ordinary / Other Letters					
Econometric base line				1,644	1,580
Adjustment - Mgmt & Mkt Intel				- 48	- 62
Total Ordinary / Other Letters	1,968	1,838	1,714	1,596	1,518
Change on Prior Year		- 130 -6.6%	- 125 -6.8%	- 118 -6.9%	- 78 -4.9%
Total Domestic Reserved Letters	4,273	4,104	3,865	3,730	3,599
Change on Prior Year		- 169 -3.9%	- 240 -5.8%	- 135 -3.5%	- 131 -3.5%

Note: Econometric base line is calculated from the prior year volume estimate.

Appendix 4 – Further detail on augmentation

	2009/10 Last Est Volumes (m)	Assumptions used in 2010/11 Forecasts						Total Market Adjust (m)	2010/11 Year 2 Volumes (m)
		Baseline Volume Est (from Eco Model) Raw Growth Raw Volume		Transactional		Promotional			
				Underlying Market Changes	Changes in use of Comm Medium	Underlying Market Changes	Changes in use of Comm Medium		
PreSort									
Small	2,011	-0.4%	2,003	(20)	(15)	30	(0)	(5)	1,998
Large	140	0.1%	140	(2)	(2)	0	(0)	(4)	136
Total PreSort	2,151	-0.4%	2,143	(22)	(17)	30	(0)	(9)	2,134
Ordinary									
Small	1,529	-4.6%	1,460	(8)	(31)			(39)	1,421
Large	184	0.1%	184	(2)	(7)			(9)	175
Total PreSort	1,714	-4.1%	1,644	(10)	(38)			(48)	1,596
Total Dom Reseved Letters	3,865	-2.0%	3,787	(32)	(55)	30	(0)	(57)	3,730
Assumptions used in 2011/12 Forecasts									
	2010/11 Year 2 Volumes (m)	Baseline Volume Est (from Eco Model) Raw Growth Raw Volume		Transactional		Promotional		Total Market Adjust (m)	2011/12 Year 3 Volumes (m)
				Underlying Market Changes	Changes in use of Comm Medium	Underlying Market Changes	Changes in use of Comm Medium		
		PreSort							
Small	1,998	0.8%	2,015	(17)	(15)	(33)	(2)	(67)	1,948
Large	136	2.0%	139	(2)	(3)	0	(0)	(5)	134
Total PreSort	2,134	0.9%	2,153	(19)	(18)	(33)	(2)	(72)	2,082
Ordinary									
Small	1,421	-1.2%	1,403	(10)	(42)			(52)	1,351
Large	175	0.9%	177	(3)	(7)			(10)	167
Total PreSort	1,596	-1.0%	1,580	(13)	(50)			(62)	1,518
Total Dom Reseved Letters	3,730	0.1%	3,733	(31)	(67)	(33)	(2)	(134)	3,599

Note: Social Mail (5%) of volumes is included in transactional

A summary of the changes in each of the years is described below.

PreSort Letters

Assumptions impacting Transactional Mail are summarised into two groups (underlying market changes – eg consolidation and rationalisation; and changes in communication medium – eg substitution):

Underlying market changes – incorporates impact of expected customer behaviour resulting from:

- prepaid / Direct Payment arrangements; most notable in the telecommunications industry where growth in mobile phones is typically in prepaid;
- rationalisation of statement cycles; behaviour most notable within the banking / finance industry with a trend for statements to be provided over less frequent periods (eg movement of monthly statements to quarterly); and
- mailing consolidations – trend across most industries (banking, telecommunications and utilities). Where customers are consolidating communications for the same customer / householder.

Changes in communication medium – incorporates impact of substitution to (generally) electronic or digital channels including:

- encouraging the receipt of electronic bills / statements. This is happening across most industries with notable examples including the banking/finance industry encouraging online banking customers to switch to electronic statements and telecommunications industry encouraging customers to switch to on-line bills;
- use of third party providers (eg BPay View) to receive bills digitally. Use across a variety of industries and often provided as an alternative (not instead of) to a digital communication from the business; and
- trend of businesses encouraging their customers to interact in an on-line environment. Occurring across different businesses and is often part of changes to the total service model provided (eg trend in business to offer 'online' only products).

Assumptions impacting promotional mail are summarised into two groups; underlying market changes specific to direct mail and changes in use of communication medium:

underlying market changes incorporates the impact of behaviour changes of businesses in planning marketing campaigns (includes better targeting, improved metrics around predictive response rates, etc.) and impact upon demand from particular events.

- the major impact from this factor is expected to the additional demand that is generated from the 2010 Federal election, which in its absence in 2011/12 will have a negative effect.

Change in communication medium covers the net impact of movements away from direct mail (typically to digital / online) and the movement into direct mail from more traditional advertising media.

Ordinary / Other Letters

Assumptions impacting the Transactional component of Ordinary / Other Letters are similar to PreSort Transactional – underlying market changes and changes in use of mode of communication.

Underlying market changes – incorporates impact of expected customer behaviour resulting from;

- use of prepaid or direct payment arrangements;
- rationalisation of mailing frequency; and
- consolidation of communications for the same person / address.

Changes in communication mode – incorporates impact of substitution to (generally) electronic or digital channels including:

- forwarding of bills / statements electronically, includes use of third party providers (eg BPay View);
- payment of bills / accounts (however received) electronically;
- trend for the distribution of general business correspondence (eg much of the B2B comms) via electronic or digital means; and
- trend of some business to move adhoc self service communications (which would be included in Ordinary / Other mailings) to a digital service / delivery model. This would include items such as downloading brochures, forms, conditions, price lists etc. as well as the completion and submission of some forms electronically (eg through use of new software applications widely available).

Market insights are derived from:

- input from the Account Manager regarding customer behaviour;
- market intelligence from other participants in the mail value chain;
- information in the general public arena – both in Australia and Overseas; and
- interpretation of qualitative and quantitative reports commissioned by Australia Post and external sources.

Appendix 5 – Budget process

Australia Post's approach to budgeting operates at two fundamental levels:

- A top down process:
 - o Initially establishes targets linked to corporate profitability expectations which are then distributed throughout the corporation for the development of 'bottom up' budgets: and
 - o On receipt of the 'bottom up' forecasts, budgets are disaggregated by state and by function and then analysed and contested according to the fundamental drivers of cost movement – eg input prices, volume change, new network or other capability requirements, infrastructure change and additional depreciation. This includes targeted cost savings, independent of the other drivers of cost movement; and
- A bottom up process:
 - o Involving budget development at a workcentre level using the general ledger hierarchy, where the budgeted costs are built up from resource requirements, labour and other charges, volume and activity levels, and savings opportunities – to provide a budgeted line item by general ledger account eg the estimated general ledger labour expenditure for a delivery centre; and
 - o Based on a top down review work units may be requested to make (downward) changes to their forecasts to align with overall corporate expectations.

Planning for Australia Post's Corporate Plan (which includes financial forecasts for a three year period) commences around February / March each year when Group Financial Control (GFC), issue guidelines for the completion of the financial operating plan (Year 1 of the Corporate Plan) and the following two years (Years 2 and 3 of the Corporate Plan).

The guidelines are prepared to provide 'top down' instructions to business units / divisions to outline key corporate expectations. They also include key points / requirements (based on an in depth analysis by GFC of the 'early estimate' data – point 1 in the timeline below) as well as assumptions that are to be factored into the forecasts.

Standard instructions include:

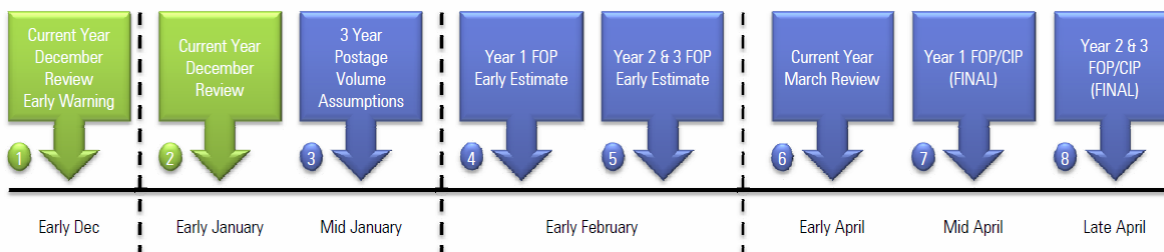
- volume and revenue growth (based on postage volume assumptions);
- broader economic outlook assumptions (relating to CPI, unemployment, GDP, household real consumption and salary inflation);
- SDR rate;
- calculation of depreciation;
- information required for key projects and initiatives;
- guidelines for subsidiary companies and joint venture / associated companies;
- number of trading / work days;
- employee entitlements (including recreation leave, long service leave, worker's compensation risk premium rates, payroll tax on superannuation and salaries); and
- technical directions on data returns to provide consistency of information and analysis.

These assumptions are tested and confirmed or updated throughout the year as part of the September, December and March Review.

Instructions particular to the submission of 2010 budgets included the following:

- a reconciliation is required between proposed redundancy payments, FTE and labour payment levels; and
- all risks to achieving the plan are to be highlighted within an agreed risk management framework and template as set out in the guidelines.

The timeline below details the key deliverables in the development of the three year forecast which informally begins with the December Review, (initially used as the planning base and from which 'early estimates' are obtained), and ends in May / June when the forecasts incorporated into the Corporate Plan are submitted to the Australia Post Board for approval.



Each of these key deliverables is discussed in turn:

1) December Review, Early Warning – areas complete an 'early warning' template detailing any revenue and expense related issues and their impact at a total movement level on a first half of the year, second half of the year and full year basis. Because of the timing of the early warning, December, which is incorporated into the first half of the year data, is an estimate rather than an actual figure.

2) December Review – areas are provided with an overview of how Australia Post is performing and how the year is expected to continue. Commentary is provided for specific areas of focus: eg the 2009/10 December Review continued to emphasise the need for significant cost reduction in light of the greater than forecast decline in letter volumes. As noted above, underpinning assumptions are tested and confirmed or updated.

3) 3 Year postage volume assumptions – the Commercial Division, in conjunction with each of the product groups is responsible for collating, analysing (which includes the impact on the Australia Post network) and reporting the postage volume assumptions which are incorporated into the following three year forecasts. Postage volume assumptions include Letters, Parcels, Express (letters and parcels) and International (letters and parcels). In practice, volume forecasts are discussed between HQ marketing groups and State sales forces to reach a balanced agreement; in the absence of agreement, the volume forecasts are resolved at the Commercial Division centre.

4 & 5) Early Estimates for Year 1 (the next full-year's Plan and year 1 of the Corporate Plan) and the following two year's forecasts (Years 2 and 3 of the Corporate Plan) – areas are required to provide detailed commentary relating to Year 1 that explains movement away from information provided as part of the December Review. While not prescriptive, the commentary must be sufficient enough to allow for meaningful explanations to be given to senior management regarding the assumptions incorporated within each area's estimate and outline any significant movements in planned FTE numbers.

For the Year 2 and 3 Early Estimates, similar commentary to Year 1 is to be provided by each of the areas outlining the key movements to estimates / assumptions incorporated in these years.

To enable accurate analysis of the forecast data by GFC, areas are required to provide revenue forecast data and cost of sales data at the individual General Ledger account level (split between corporate and non-corporate outlets).

7) March Review – in early April all area are required to repeat the same process as detailed for the December Review which is then used as the base for the future year forecast.

8) Year 1 – all areas are required to provide detailed commentary on key movements from the March Review including:

- Revenue (where applicable)– outlining volume growth, price growth, new revenue and any other relevant assumptions;
- Expenditure – year on year expenditure and labour growth, attrition rates, significant projects and expenses relating to voluntary retrenchment packages; and
- FTE analysis – movements across functional areas and savings from project / program initiatives.

Areas are also required to provide:

- depreciation calculations which are used to produce the Corporate Plan balance sheet;
- key risk matrix (detailing all related assumptions quantifying the potential impact); and
- for product groups, in depth analysis and commentary for key revenue movements.

9) Year 2 and Year 3 – all areas are required to provide sufficient detail and analysis on a number of data key deliverables for inclusion into the Corporate Plan. The same detailed commentary required for Year 1 is required for Year 2 and 3, however, commentary is based on key movements from the Year 1 data as opposed to the March Review.

Years 1, 2 and 3 forecasts are reviewed by GFC and where necessary business units will be advised of changes to achieve targets in line with corporate expectations and parameters.

Appendix 6 – Potential cost variability by function

The following parameters are used for budgetary purposes in determining cost / volume impacts and are based on assessments by senior operational management and operational and financial analysis.

	Potential variability	Share of facility staffing
Processing		
Cancellation	✂	✂
Small letter sorting	✂	✂
AEG	✂	✂
MLOCR	✂	✂
BCS	✂	✂
Manual / video coding	✂	✂
Large letter sorting	✂	✂
Mail handling	✂	✂
Non-processing	✂	✂
Manager / administration	✂	✂
Technicians	✂	✂
Leave	✂	✂
Total	25%	100%
Delivery		
Night shift		
Primary sort	✂	✂
Miscellaneous letters	✂	✂
Slotting	✂	✂
Day shift	✂	✂
V-sort	✂	✂
Miscellaneous	✂	✂
Travel	✂	✂
Outdoor delivery	✂	✂
Administration	✂	✂
Total	30%	100%

Appendix 7 – Future Delivery Design, supporting Tables

Table 22 – Enhanced OCR address recognition – comparison against draft notification

Components	Current Status	Changes since draft notification
Recognition Engine Improvements Stage 1a	Rollout completed in Sep 2009. So far, an address recognition improvement of an average 11.3% has been achieved against a target of 10% – taking the total DPID read rate ²¹ for small letters above 81%.	The overall net savings included in the briefing to ACCC staff in August 2009 were based on a 10.0% recognition improvement. The latest net savings estimate for this component is \$7.1m, part of a total Enhanced OCR recognition estimate of \$10.8m to 2013/14 compared with the earlier \$7.5m.
Address Learning System (ALS) Stage 1b	System install scheduled for April 2010.	Separate net savings by 2011/12 for ALS have been identified based on the scheduled install date and included in the overall estimate.
Recognition Engine Stage 2 – options currently being evaluated include a new MLOCR camera, hand address recognition engine and other technical improvements	Proof of concept in progress with business case scheduled for July 2010.	Indicative net savings, based on conservative scenarios, have been included in the total savings estimates associated with FDD – refer Table 17

Table 23 – Automated sequencing using existing BCS machines

Components	Current Status	Changes since draft notification
Rollout 2008 – targeted up to 400 rounds to test rollout strategy and confirm the level of savings that could be achieved.	398 rounds machine-sequenced in 34 DCs.	Post implementation review confirmed net saving of 30 minutes per round – saving of 45 minutes per round offset by net BCS processing cost (10 minutes) plus 5 minutes per round additional transport cost. Time to realise full benefits is around 5 months allowing for training, round reconfiguration and data cleansing.
Rollout 2009 – targeted 684 rounds; with manual merging in DCs.	A net 752 sequenced rounds added, taking the total number to 1,150 by October 2009.	National total machine-sequenced rounds 1,150 – compared with 1,080 anticipated in draft notification.
Rollout 2010 - 800 rounds as a planning baseline, with a stretch target up to 1000, using existing sorting equipment.	2010a – up to 500 rounds confirmed with state operational areas for implementation in first half 2010. 2010b - 300 additional machine-sequenced rounds by end 2010 under current financial assessment in Table 17.	Planning baseline would take the total number of machine-sequenced rounds by end 2010 to around 1,950 – 70 more than the 1,880 in draft notification and some 25% of total rounds.

²¹ As the Delivery Point Identifier (DPID) read rate increases, the number of small letters that can be machine-sequenced increases

Table 24 – Sequencing based on expanded sorting capacity (including SSMs)

Components	Current Status	Changes since draft notification
Rollout 2011– targets up to 2,050 additional rounds, with new sequence sort machines (SSMs) and associated process change.	SSM requirement dependent on extended processing windows and the movement in letter volumes – business case by July 2010.	Adds up to 2,050 machine-sequenced rounds versus 800 in draft notification. Achieves a total of 4,000 machine-sequenced rounds (over 50% of the total) – compared with 2,680 anticipated earlier.
Rollout 2012 – targets up to 1,000 additional rounds with new sequencing machines.	Any further SSM requirement dependent on extended processing windows and the movement in letter volumes.	Adds 1,000 sequenced rounds versus 800 quoted in the draft notification. Achieves a total of 5,000 machine-sequenced rounds (over 65% of total rounds) – compared with 3,480 anticipated earlier.
Rollout 2013 – targets up to 1,150 additional rounds with new sequencing machines.	Any further SSM requirement dependent on extended processing windows and the movement in letter volumes.	Adds 1,150 versus 800 projected in the draft notification total of around 5,100. Achieves a total of 6,150 machine-sequenced rounds (over 80% of the total) – compared with some 4,280 anticipated earlier.
Rollout 2014 – targets residual rounds justifying machine sequencing (around 350).	Given the volume trends, additional machines not likely to be required for proposed implementation of 350 additional machine-sequenced rounds by June 2014.	Adds some 350 machine-sequenced rounds to bring the total number to 6,500 by June 2014, up from the around 5,100 projected in the draft notification by the end of 2014.

Table 25 – Delivery round optimisation

Components	Current Status	Changes since the draft notification
Stage 1 Implement – targets 158 DCs involving a total of 6,358 delivery rounds (about three quarters of all existing delivery rounds)	Business Case completed and Stage 1 approval granted Feb 2010 with an implementation start of June 2010.	Has moved from feasibility study and assessment for business case development to approved business case for implementation of Stage 1. Estimated savings revised. Savings to 2013/14 total \$15.8m, compared with an early estimate of \$5.3m in the draft notification.
Stage 2 Interface – automated interface of DRO process with other Australia Post systems	Cost estimates provided in Stage 1 business case, but not included in scope of approved business case for Stage 1.	Separately identified component that will now be subject to separate business case approval.

Table 26 – Alternative delivery modes

Mode	Current Status	Changes since the draft notification
Non-powered Bicycle – Aussie Mail Bike (AMB).	Contract for supply of AMB frames for next three years to be confirmed.	Recommendation to continue with trialled e-bike solution based on kit conversion of existing AMB.
E-Bicycle – kit-converted AMB.	E-Bikes in operation – NSW – 25 March 2010 deployment – NSW – 36 WA – 9 SA – 10 Requirements over next 3 years subject to business cases.	Successful trial of e-bike solution based on conversion of current AMB (non-powered bicycle) including SBD assessment.
E-Tricycle – Industrial E-Trike.	E-trikes in operation – QLD – 6 March 2010 deployment – QLD – 10 April 2010 deployment – QLD – 39 Further deployment in progress	Successful trial of e-trike solution including SBD assessment.
All Terrain Buggy (ATB) including SBD carrier	Testing of prototype is scheduled for April / May 2010.	Development of a more robust ATB, including SBD carrier, has progressed to prototype stage.
Walk Buggy – PT200.	Final design, which includes an SBD frame and bag, sourced from Germany. Intent is to deploy some walk buggies in Q3 2010.	A specific solution has now been identified with links to the SBD initiative for machine-sequenced mail.