

BETWEEN CANADIAN BUSINESSES > < AND THEIR CUSTOMERS

BETWEEN SUSTAINABLE SERVICE > < AND FISCAL RESPONSIBILITY

MAKING THE CONNECTION

BETWEEN DIGITAL COMMUNICATIONS > < AND PHYSICAL MAIL

BETWEEN TODAY'S ACTIONS > < AND TOMORROW'S SUCCESS

BETWEEN OUR EMPLOYEES > < AND ALL CANADIANS

## Making the Connection

A CARE PACKAGE CONNECTS A CANADIAN SOLDIER IN AFGHANISTAN WITH HIS FAMILY BACK HOME. A FLYER CONNECTS A YOUNG ENTREPRENEUR WITH NEW CUSTOMERS. THE SIMPLE ACT OF RECEIVING AND PAYING BILLS LEADS TO MILLIONS OF CONNECTIONS EACH DAY.

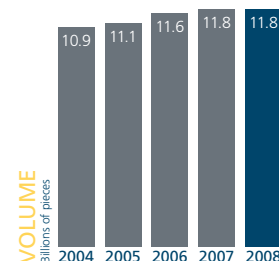
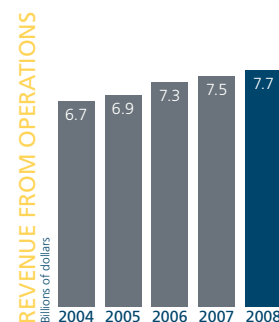
EVERY PIECE OF MAIL THAT CANADA POST DELIVERS MAKES A CONNECTION.

WE ENABLE BUSINESSES TO STAY CONNECTED WITH THEIR CUSTOMERS. WE ARE A VITAL PART OF THE CANADIAN ECONOMY, ONE THAT CONNECTS MILLIONS OF CANADIANS WITH EACH OTHER AND THE WORLD.

WE ARE MAKING ANOTHER POWERFUL CONNECTION: BETWEEN WHAT OUR CUSTOMERS NEED TODAY AND THE INVESTMENT WE MUST MAKE TO ENSURE THE SUSTAINABLE, MODERN POST THEY WILL NEED TOMORROW.

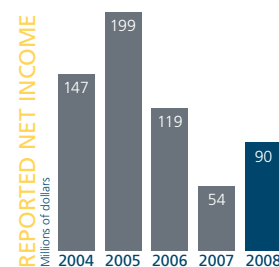
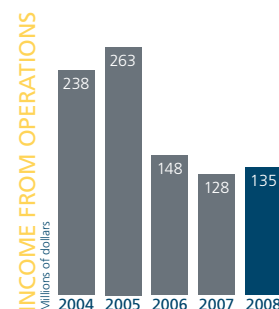
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## Financial and Operating Highlights – The Canada Post Group

| ANNUAL REPORT<br>(in millions of dollars) |  | 2008    | 2007    | % CHANGE |
|---|--|---------|---------|----------|
| <b>Operations</b>                         |  |         |         |          |
| Revenue from operations                   | As reported  | \$7,729 | \$7,474 | 3.0%     |
| Income from operations                    | Revenue from operations – cost of operations         | 135     | 128     | 5.6%     |
| Operating profit margin (%)               | Income from operations ÷ revenue from operations     | 1.8%    | 1.7%    | –        |
| Productivity (%)                          | Cost of operations as a % of revenue from operations | 98.2%   | 98.3%   | –        |
| Income before income taxes                | As reported  | 161     | 160     | 1.0%     |
| Net income                                | As reported  | 90      | 54      | 66.1%    |
| Return on equity (%)                      | Net income ÷ average equity                          | 6.1%    | 3.8%    | –        |
| Dividend paid                             |  | 22      | 47      | (54.1)%  |
| Dividend payout ratio (%)                 | Dividend paid as a % of prior year's net income      | 40%     | 40%     | –        |
| Cash from operations                      | As reported  | 597     | 344     | 73.6%    |
| Capital expenditures                      | As reported  | 391     | 331     | 18.1%    |
| <b>Financial Position</b>                 |  |         |         |          |
| Cash                                      |  | 605     | 386     | 56.9%    |
| Total assets                              |  | 5,591   | 5,167   | 8.2%     |
| Equity of Canada                          |  | 1,507   | 1,439   | 4.8%     |



The Canada Post Group processed 11.8 billion pieces during the 12-month period. Consolidated revenue from operations reached \$7.7 billion and consolidated net income totalled \$90 million.

## President's Message

AS THE ONLY COMPANY THAT TOUCHES EVERY CANADIAN, WE PLAY A VITAL ROLE IN THE ECONOMY. WE MUST MAINTAIN OUR FOCUS ON HELPING OUR CUSTOMERS CONNECT TO THEIR CUSTOMERS IN GOOD TIMES – AND IN BAD.

I am very pleased to report that Canada Post remained profitable in 2008 despite the difficult economic conditions that surfaced last fall. Like many other companies, Canada Post was affected by rising costs and decreasing volumes. The consolidated net income for The Canada Post Group was \$90 million, a slim margin on the \$7.7 billion of revenue earned.

Results were driven by a decline in transaction mail volume of 2% in 2008. While we are proud to deliver to every home every day, this drives high fixed costs, making us vulnerable to any volume decline. We cannot simply reduce our service when faced with reduced volumes.

To achieve these earnings, our people had to implement stringent cost-containment measures. In our core Canada Post segment, these steps reduced planned expenditures by \$150 million. This was on top of already budgeted costs savings of \$100 million, of which we achieved \$90 million in actual savings. Without this, the Canada Post segment would have suffered an operating loss of well over \$150 million in 2008. These results demonstrate the commitment of our people in what were clearly difficult circumstances.

In light of these and other challenges, in April 2008, the Government called the first independent review of our business in a decade. Our submission made a number of recommendations about key changes to our financial framework. These changes would enable us to continue to make the investments necessary to ensure Canada Post will always deliver the service Canadians expect and remain viable for years to come. I welcome

the opportunity in 2009 for an open exchange about the panel's recommendations and what is necessary to help our great company move forward successfully.

Like other large employers, one of the challenges we face relates to our Pension Plan. The Canada Post Pension Plan remains fully funded on a going-concern basis. That said, the economic downturn has had a negative impact on the Plan's position. Moreover, solvency deficit rules have created uncertainty regarding future cash flows for operations. The combination of economic conditions and solvency-funding rules may require additional contributions as early as 2010. That is above and beyond the regular \$270-million annual contributions.

Even as we manage all of these challenges, we know they also drive an urgent need for the modernization of our operations. We must continue to invest in our people and infrastructure, and we are ready with a detailed plan to do just that.

In 2008, we started implementing this plan to bring our vast network up to modern standards. We have made great progress. We are on schedule to open our first new mail processing facility in 20 years in Winnipeg by mid-2010, which will include new, faster, ergonomic processing equipment and will introduce a modern model for more efficient delivery.

This modernization is critical for our ability to continue to meet our service obligations. Contingencies in place are inefficient and costly. Existing, old equipment poses a health and safety hazard for our employees. Modern



### **PRIORITY:** KEEPING THE NATION'S MAIL SECURE

Canada Post understands the importance of keeping billions of items of mail safe. We are doing everything within our power to keep the mail secure in the face of new types of crime, including identity theft.



### **PRIORITY:** IMPROVING OUR SAFETY

While we did not reach our targets for reducing accidents in 2008, we are taking a proactive approach to identify and control workplace hazards. The results from 35 formal health and safety audits will help us continue to raise safety awareness and focus on high-risk activities.



“We must continue to invest in our people and infrastructure, and we are ready with a detailed plan to do just that.”



plants, equipment and technology will not only help us address these issues, but provide capabilities to enhance our service and remain relevant to Canadians in the future.

Given the uncertain economy, and until we can gain greater certainty regarding our financial framework going forward, phase one of our plan, estimated at \$750 million, addresses only our most critical needs. We will adjust our spending according to our financial situation.

In 2008, we also made more progress building a workplace that is respectful and safe. Our independent employee survey again showed cross-the-board improvements; we have seen an eight-percentage-point jump in our Employee Engagement Index in two years. We are also very proud to be named a Top 100 employer by Mediacorp for the third year in a row. Work will continue to connect our people's daily efforts with corporate priorities and success.

We know that the health and safety of our people is a key part of engagement. Regrettably, we did not meet our target to reduce our high number of accidents in spite of our extensive efforts during 2008. Going forward, we will continue to raise safety awareness and focus on safety training and leadership, which, along with our focus on environmental sustainability, is a key component of our overall strategies to improve corporate social responsibility at Canada Post.

While many charitable organizations are being squeezed, in just six months, the newly created arm's-length Canada Post Foundation for Mental Health surpassed its

fundraising goal of \$1 million. Our people's generosity and enthusiasm made this campaign an incredible success. The Foundation will begin distributing funds in 2009 to raise awareness, and to support patients and families dealing with mental illness.

The past year was difficult but with great achievements. I would like to acknowledge the tremendous efforts of my colleagues on our executive team and Canada Post employees, and all our partners for this year's results. I would also like to thank all of our loyal customers for their continued support.

This year will continue to be demanding. Like other companies, based on the current outlook, we are expecting continued volume decline. To counter this, we are seeking to aggressively cut planned costs in the Canada Post segment by another \$250 million.

Looking forward, we understand our challenges and what we must do to overcome them. Even as we work to establish a new financial framework, we will continue to focus on our business priorities. We are confident that we will be able to maintain our role in connecting Canadians in the future.

Moya Greene  
President and Chief Executive Officer

#### **PRIORITY:** BUILDING THE SUSTAINABLE POST

To remain relevant in the future, we must remain focused on several areas. First, in the short term, cost containment will continue to be a key priority for the company to counter anticipated decline in revenue. To be sustainable, however, we will continue to work with our Shareholder to seek needed changes to our financial framework, including how we can best manage and fund our Pension Plan. Even as we carefully manage our spending, however, we must maintain our investment in modernization to ensure that we are able to continue to provide service to Canadians.

# About Us

FOR 158 YEARS, CANADA POST HAS BEEN A PILLAR OF THE CANADIAN ECONOMY, CONNECTING CANADIANS, THEIR COMMUNITIES AND THEIR BUSINESSES. AS A FINANCIALLY SELF-SUSTAINING CROWN CORPORATION, CANADA POST CONTINUES TO PLAY THIS ESSENTIAL ROLE.

To compete more effectively, we operate as The Canada Post Group, a group of related businesses – with 72,000 employees – held by Canada Post Corporation, to deliver a full range of delivery, logistics and fulfillment services to customers. The Corporation’s holdings include subsidiaries Purolator Courier Ltd., SCI Group Inc. and Innovapost Inc. In this report, “Canada Post” or “Canada Post segment” refers to the core service of Canada Post, excluding other interests. The Canada Post segment represents approximately 80% of the Corporation’s consolidated revenue.

The Canada Post Group spends more than \$2.8 billion annually on goods and services, thereby supporting an additional 30,000 jobs.\*

Canada Post has the sole and exclusive privilege of collecting, transmitting and delivering letters up to 500 grams within Canada. More than half of the Group’s revenues are derived from business that operates in fully competitive markets, including Canada Post’s Parcels line of business and Purolator. Every business day, the Canada Post segment processes some 45 million pieces of mail to nearly 15 million residential and business addresses; this delivery network expands by approximately 200,000 addresses every year. There are more than 23,000 delivery routes in Canada. With more than 6,600 post offices, Canada Post has the largest retail network in Canada.

Canada Post and its people strongly believe in community involvement. In 2008, we raised more than \$1 million for mental health, our cause of choice. The company

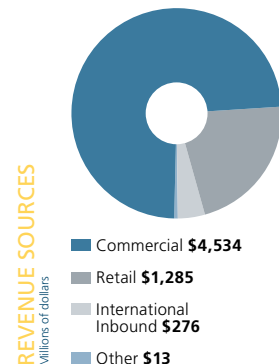
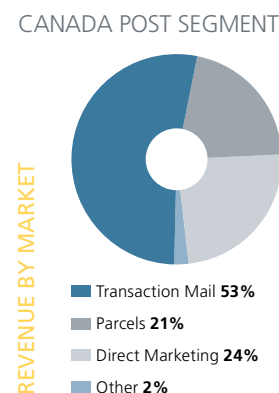
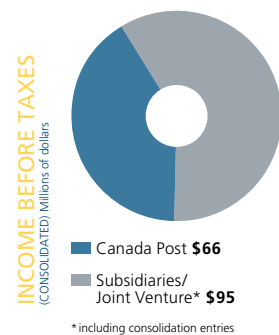
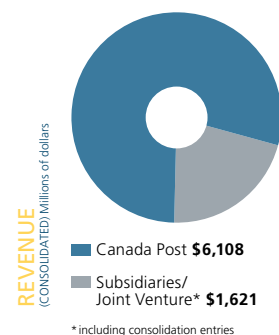
also supports literacy, the Canada Post Freestyle Team and the United Way. We are an official supplier for the Vancouver 2010 Olympic Winter Games. Each year, a team of employee volunteers helps Santa answer more than one million letters in 26 languages, a feat that has earned Canada Post a spot in The Guinness World Records.

As one of the largest and farthest reaching organizations in Canada, Canada Post is making a serious commitment to its corporate social responsibility (CSR). In 2008, we issued our first CSR Report.

Around the world, postal service is part of a shrinking sector. Most postal administrations are experiencing decreasing mail volumes, increasing points of call and demands from customers for more sophisticated services. Canada Post is no exception.

Canada Post’s competitors range from niche players to large multinationals. Unlike its competitors, Canada Post has a mandated universal service obligation to deliver mail to every address in Canada, five days a week. Since 2000, Canada Post has also been restricted by a price-cap formula that holds rate increases on the basic letter rate to two-thirds the rate of inflation.

As our customers’ needs evolve, Canada Post is changing too. The company is embarking on a substantial Postal Transformation plan, developing a modern, effective and efficient delivery model and renewing plants and equipment, so we can continue to offer real value to our customers, support safety and productivity and become more environmentally friendly.



\*Conference Board of Canada study, 2007

## CANADA POST AT A GLANCE

# 6,618

POST OFFICES ACROSS CANADA

# 96%

### ON-TIME DELIVERY PERFORMANCE

As measured by IBM, a representative sample of fabricated short/long and oversized Lettermail test pieces is weighted according to origin-destination mail volumes.

# 14.7 million

### ADDRESSES SERVED IN CANADA

|                |               |   |
|----------------|---------------|---|
| AUSTRALIA      | \$0.45        | Canadian \$ equivalent<br>(as of Feb. 2009) |
| UNITED STATES  | \$0.45        |   |
| <b>CANADA</b>  | <b>\$0.54</b> |   |
| UNITED KINGDOM | \$0.71        |   |
| SWEDEN         | \$0.78        |   |
| JAPAN          | \$0.79        |   |
| FRANCE         | \$0.86        |   |
| GERMANY        | \$0.86        |   |
| ITALY          | \$0.94        |   |

CANADA HAS ONE OF THE LOWEST BASIC LETTER RATES IN THE WORLD

# Key Performance Indicators

## FINANCIAL PERFORMANCE – THE CANADA POST GROUP



The Canada Post Group remained profitable in 2008, despite lower-than-plan revenues for the Canada Post segment. Consolidated income before income taxes amounted to \$161 million, exceeding plan by \$34 million, thanks to a strong financial performance by our Purolator Courier Ltd. and SCI Group Inc. subsidiaries.

Aggressive cost controls were key to achieving a narrow operating margin of 1.8%. Management must remain vigilant in 2009 to contain costs.

At \$22 million, the dividend that Canada Post paid to its Shareholder, the Government of Canada, was 54% lower than the dividend paid the previous year. Since 2005, Canada Post has been

unable to meet the financial objectives set out in the Multi-Year Policy Framework established in 1998, falling well below targets of \$175 million in earnings before interest and taxes, and an 11% return on equity.

Canada Post is relying on sound management controls, relevant products and services, and business improvements from much-needed investment in the Modern Post to ensure its sustainability for the future.

## DELIVERY SERVICE – CANADA POST SEGMENT



Our goal is to deliver on time, every time. To support this, we set corporate targets and measure performance for key services in each of our lines of business: Transaction Mail, Parcels and Direct Marketing.

Lettermail™ remains among the most reliable services in Canada. Our delivery standards require that we deliver Lettermail consistently within two business days within the same metropolitan area or community, within three business days within the same province, and within four business days between provinces.

In 2008, we met our corporate target of 96% on-time performance.

We did not meet our targets for Expedited Parcel, Xpresspost™ and Priority™ Next A.M. To address this, we are improving process capabilities and strengthening transportation links, building on the flexibility gained with our new domestic air partnership with our subsidiary, Purolator.

Concerted efforts to improve the delivery of Direct Marketing products were successful – we achieved our target for Addressed Admail™ and came close for Unaddressed Admail™.

Continuing on-time delivery is crucial to Canada Post's long-term success. We will continue to look for ways to further improve the quality of our delivery, and earn our customers' loyalty and their business.



## CUSTOMER VALUE INDEX – CANADA POST SEGMENT



Our Customer Value Management program identifies the drivers of customer value and loyalty through relationship surveys and transactional questionnaires. The relationship surveys explore our customers' mailing habits and practices, assess their loyalty to Canada Post, and capture feedback on our products and services, delivery, price, reputation and image as well as service culture. The transactional questionnaires ask customers about their recent experience with Canada Post, including our sales and customer service representatives, post offices, delivery personnel and our website. These techniques offer insight into the quality of our service, our

competitive advantage and areas needing improvement.

In 2008, our Direct Marketing line of business surpassed its target by three percentage points. Parcels also achieved its 2008 CVI target. Transaction Mail did not meet its target; however, its improvement objectives in product offering, product delivery, price competitiveness, reputation and image as well as service culture were achieved.

## EMPLOYEE ENGAGEMENT – CANADA POST SEGMENT



Employee engagement remains a top priority for Canada Post. Our goal is to be the best place to work in Canada, with every employee contributing to and sharing in our success. Increasing the engagement level of employees will improve the customer experience and provide a strong foundation for achieving our business results.

Our focus is on a workplace marked by respect and fairness, attentive to employee health and safety, and with employees who feel connected to our business. Our efforts appear to be having a positive effect. The participation rate in the 2008 annual employee survey increased by 33% over 2007. We improved or maintained our survey scores in the vast

majority of the categories and achieved our target of raising the Engagement Index to 56.

We also achieved our goal of reducing to 5% the rate of errors that occur in processing the pay of our employees.

Accident frequency remains an area of concern. The 7% reduction target was not achieved. We will be intensifying our efforts to improve safety both on and off our premises. Our President will be chairing a new Health and Safety Task Force to drive a higher degree of attention on accident reduction at Canada Post.

We remain committed to building a modern workplace characterized by high levels of employee engagement.

## Postal Transformation

CANADA POST MUST INVEST IN OUR INFRASTRUCTURE TO ENSURE THAT CANADIANS CAN CONTINUE CONNECTING TO EACH OTHER.

Over the past two years, we have established and embarked on a Postal Transformation plan. This national infrastructure-renewal program includes significant investment in our equipment, technology and processes as well as extensive new skills training for our employees.

There is a critical and pressing need to invest now as our aging infrastructure is holding us back. Many of our plants are approaching 40 years of service and can no longer support a modern operation. Much of our mail processing equipment is almost 20 years old and has reached the end of its life cycle. While we make every effort to maintain the machines in safe working order, the existing equipment has reached its technological and physical limits. The addition of new functionality is not possible.

If we do not invest now, meeting service standards will be more challenging, and we won't be able to address our unacceptably high rate of injuries and modified duties.

### Replacing obsolete equipment

Canada Post relies heavily on automated mail sorting equipment to deliver affordable and quality service. The replacement cycle for this equipment is very long and very complex. Given the age of this equipment, we must start now to ensure that we are able to continue to offer the level of service Canadians need and expect, without incurring huge costs

required to maintain outdated technology and processes.

Our plan is to first replace the aging machines in our sorting plants with new state-of-the-art ergonomic mail processing equipment, capable of automating Lettermail to a much finer degree. This is a major step towards becoming a Modern Post, as the new machines will also enable us to enhance health and safety in our workplace, defend our core business by improving efficiency and productivity, and build a foundation for new and improved service offerings.

There is also a major opportunity to improve the health and safety of our employees by redesigning and introducing new modular containers used in our plants and depots. The new, smaller ergonomic containers have sturdy handles for ease of lifting and carrying, and are completely recyclable. These improvements, plus a unique sliding feature, will reduce the high incidence of common injuries from manual mail handling.

### A new way of delivering

The current delivery model has not changed in more than a century, so starting in Winnipeg, we will be introducing new ways of delivering mail.

More letter carriers will be "motorized," using lower-emission, more fuel-efficient vehicles. By equipping carriers with vehicles, they will be able to deliver all products in their delivery area, including parcels, and collect on route. This will



We must invest now to ensure we are able to continue to offer the service Canadians need and expect.



With a focus on our employees' health, new containers will have a more ergonomic design.

allow Canada Post to effectively respond to changes in market demand. This delivery approach is already being used in Europe and in the U.S.

#### **It all starts in Winnipeg**

A location was chosen for the new Winnipeg plant in 2008, and ground was broken by September. The plant, considered the flagship for Postal Transformation, is slated for completion by mid-2010. It will be located on a 27-acre property near the airport, allowing mail to be processed closer to this vital transportation link, rather than trucking it downtown, where the plant is currently situated.

Designed with health and safety in mind, this facility will be equipped with new ergonomically sound equipment, operate in an environmentally sensitive manner, and provide employees with a brighter and safer work environment. The building will have LEED™ (Leadership in Energy and Environmental Design) certification. This new plant will incorporate new, modern processes and feature new containers and carts that address safety and ergonomic issues for our employees.

#### **Working with our customers**

While change is often necessary, it is not always easy. As our Postal Transformation unfolds, Canada Post will ensure that our modernization efforts cause as little inconvenience to our customers as possible. We will also keep our customers informed at all times. With that in mind,

Canada Post held many customer consultations in 2008 to discuss Postal Transformation. These sessions help us better understand how changes could affect our customers, so we can plan to make any transitions as smooth as possible. In addition, this invaluable feedback has influenced our design decisions.

#### **Investing today for service tomorrow**

Designing, purchasing and installing new equipment, introducing new processes and technology, and training our people all take time and effort. However, there is a critical need to invest now in order to avoid equipment failure and the associated service and cost implications.

Moreover, we have an opportunity to make these changes and realize productivity gains without negatively affecting our employees, as we expect nearly 32,000 retirements and other departures from Canada Post over the next decade. Processes will be modified and streamlined to enable us to avoid replacing many of these departing employees.

Decades of postal technology cannot be changed overnight, but by recognizing the need and planning ahead, we will continue to meet our customer needs well into the future.



The new Winnipeg plant will be a flagship for our Postal Transformation, featuring modernized, more productive equipment, ergonomically designed workspaces and processes, and LEED certification.

## Making the Connection Transaction Mail

FROM THAT LETTER OF ACCEPTANCE BY YOUR CHILD'S SCHOOL TO THE MONTHLY UTILITIES BILL, MAIL IS AN ESSENTIAL PART OF EVERY CANADIAN'S LIFE. BUT THE ECONOMIC DOWNTURN ADDED TO CHALLENGES FACED BY OUR TRANSACTION MAIL BUSINESS IN 2008.

Transaction mail includes bills, statements, invoices, payments and other letters, and comprises three distinctive types of delivery services: domestic Lettermail™, international Letter-post and epost™, Canada Post's online bill presentment service. Canada Post has the sole and exclusive privilege of collecting, transmitting and delivering letters up to 500 grams within Canada. Transaction Mail accounted for \$3.2 billion, or 53% of revenue for the Canada Post segment (or approximately 42% of The Canada Post Group revenue) in 2008. Revenue was relatively flat compared to 2007.

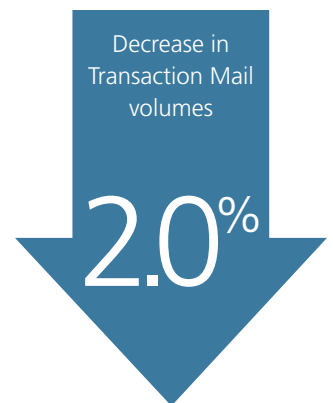
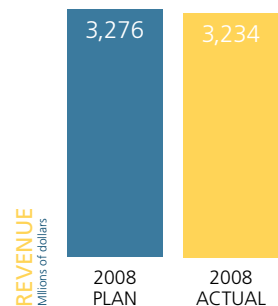
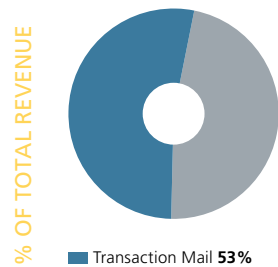
As Canadians have continued to shift to email, instant messaging and other means of electronic communication, and businesses have consolidated mailings and encouraged their customers to go online, the Canada Post segment has faced increasing pressures on the largest and most profitable part of its business. Total volume declined for the second straight year, to 5.32 billion Lettermail pieces in 2008, and has been relatively flat for several years. As the total number of delivery addresses continues to increase by approximately 200,000 per year, the amount of Lettermail pieces per household is declining, reaching 355 pieces in 2008, down more than 6% since 2004.

To address the marketplace's changing requirements and to provide customers with multi-channel, end-to-end solutions, Canada Post has developed several new services over the years that complement our traditional services. They include epost and our SmartFlow™ Document Management Services, which help businesses communicate seamlessly and easily with each other through the channel of their choice – physical mail, epost, email and fax. In 2008, the SmartFlow Recover/Respond services experienced triple-digit growth for the second year in a row. To help promote epost, Canada Post ran an extensive campaign in Southern Ontario to raise awareness of the environmental friendliness of this service.

While we have captured some of our customers' shift online, the market remains fiercely competitive. The economic downturn that started in 2008 has put tremendous pressure on many customers to cut costs where they can. We expect that this situation will continue through 2009 as businesses continue their cost-reduction efforts, reducing their mailings and offering further bill consolidation, for example.

In spite of these difficulties, Canada Post remains committed to making sure the country communicates efficiently, securely and on time. In 2008, we delivered Lettermail within our service standards 96% of the time, a result that ensures mail continues to be one of the most reliable services in Canada.

### CANADA POST SEGMENT



## MOVING BUSINESS FORWARD WITH SMARTFLOW

Every organization's critical business processes stream through it as documents: invisibly, continually and, ideally, flawlessly. When these documents – orders, invoices, payments, customer response forms, and so many other records – do not move fluidly, business slows down. At the same time, business customers are demanding more choice in the form that these documents take, digital or paper, which adds new complexities to the process. Frustrating and costly errors and delays can result.

Canada Post's SmartFlow Document Management Services improve various parts of this critical document workflow. SmartFlow marries up with our customers' existing processes and software, and changes what is often seen as an unfortunate obligation – “the paperwork” – into an opportunity to enhance an operation's effectiveness. SmartFlow can also raise delivery accuracy, speed customer response and reduce overall cycle time for the complete back-and-forth of business communications.

## Making the Connection Parcels\*

ACROSS THE COUNTRY OR AROUND THE WORLD, CANADA POST HAS THE SHIPPING SOLUTIONS THAT MEET OUR CUSTOMERS' NEEDS. THE OPPORTUNITY FOR LONG-TERM GROWTH IS PROMISING – BUT A WORSENING GLOBAL ECONOMY HIT HARD IN 2008.

Customers have several options when they entrust Canada Post with their parcels, ranging from *Priority™* Next A.M., which provides overnight delivery by noon within Canada, and *Xpresspost™*, a “deferred delivery” service providing next-day service regionally and two-day service nationally, to ground parcel delivery services and a full suite of international delivery services. The Parcels line of business also offers several other services, including *Borderfree™*, which allows Canadian consumers who purchase goods online from selected U.S. retailers to obtain landed cost pricing (in Canadian dollars).

Revenue from the Parcels line of business amounted to \$1.3 billion in 2008, or 21% of the Canada Post segment. Volumes fell 8.3% from 2007, to 159 million pieces shipped. This reduction was driven primarily by a change in mix in the international inbound business which saw a steep 26.7% decline in volume as the global economy worsened. However, the decline was more than offset by an increase in revenue per piece for international inbound. Overall, revenue increased 5.4% over 2007, driven by several factors, including rate action and strong growth in the Expedited Parcel line. A strong Canadian dollar in the first half of the year also mitigated the decline in inbound business from the United States.

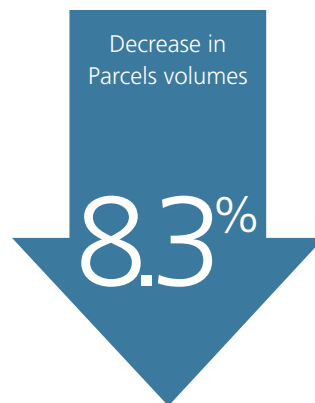
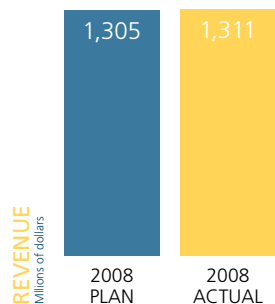
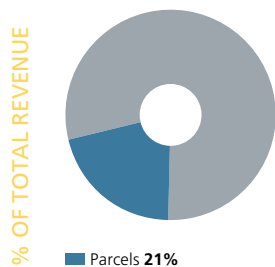
The Parcels line of business operates in a highly competitive, low-margin, unprotected market. Canada Post leads in the home delivery segment, which benefits from the growth of e-commerce retailing.

During 2008, Canada Post forged a partnership with Purologor for air transport. This agreement gives us greater flexibility and control over our flights, helping to meet shifting service demands more effectively while ending our reliance on commercial passenger airlines. Canada Post and FedEx™ also combined forces to launch a new international service called *Priority™* Worldwide, giving Canadian consumers a premium service offering to more than 220 countries and territories. Canada Post introduced other new products to meet specific customer needs. To strengthen its offering to the online community, Canada Post created a new product called eBay™ Flat Rate Box. And when financial institutions needed assistance to comply with new anti-money laundering legislation, they turned to Canada Post to co-develop an in-person identity authentication service.

To help customers track their parcels, we expanded our parcel scanning capability in 2008. We completed network-wide coverage for our motorized delivery personnel and added capabilities to support near real-time data transmission. We are also working to improve our service performance by strengthening process capabilities and transportation links.

In light of economic conditions, expectations for growth in 2009 are low. Meanwhile, global competitors are quickly adopting new technologies, accelerating the need for Canada Post to continue to make the necessary investments to remain relevant, deliver better service, and maintain profitable growth.

### CANADA POST SEGMENT



\*Canada Post segment only. Does not include Purologor Courier.

## PROOF OF IDENTITY HELPS BUSINESSES SAVE COSTS ON NEW LEGAL REQUIREMENTS

With fraud and identity theft on the rise, FINTRAC\* now requires banks and some other organizations to provide in-person identity checks to ensure confidential or high-value items, such as credit cards, get into the right hands. As a company that already conducts more than 19 million ID verifications annually, Canada Post is in a prime position to help.

By signing up for Canada Post's new Proof of Identity with Data Transfer, available for Xpresspost or *Priority Next A.M.* shipments, organizations can eliminate the hassle and expense of implementing and operating their own identity authentication system. Items are sent right to a post office, where the trained clerk verifies ID, then uses a secure digital channel to send the data, including signature, to a secure site for the bank or other institution to audit.

With close to 3,000 post offices now offering this service, Canadians will also never have to travel too far to pick up confidential items or credit cards.

\* Financial Transactions and Reports Analysis Centre of Canada

## Making the Connection Direct Marketing

AS A MAJOR PLAYER IN THE \$24-BILLION CANADIAN ADVERTISING BUSINESS, CANADA POST DIRECT MARKETING OFFERS ONE OF THE MOST EFFECTIVE WAYS TO CONNECT ADVERTISERS WITH CUSTOMERS. BUT AS GOES THE ECONOMY, SO DOES OUR BUSINESS.

Canada Post is one of the largest players in the Canadian direct marketing business, delivering Addressed Admail™ and Unaddressed Admail™ across the country. Offerings, such as AdCard™, GeoPost™ Plus and Business Reply Mail™, are complementary services that help customers to better plan their mailings by narrowing down their targeted audiences, and improve their response mechanisms. As well, through Canada Post's website, customers can manage their own direct mail campaigns directly. Publications Mail™ – the distribution of magazines, newspapers and newsletters – is also part of Canada Post's Direct Marketing line of business.

The advertising industry has borne the full brunt of the economic downturn, with a greater number of competitors chasing fewer ad dollars, as companies seek to reduce their costs. As a result, Direct Marketing delivered lower-than-expected growth in 2008. Revenue increased by \$40 million, or 2.5%, over 2007 levels to \$1.4 billion. Volumes increased slightly, by 0.9%. Amid economic weakness, the financial services, retail and manufacturing sectors significantly reduced the level of direct marketing spending, resulting in the weakest revenue and volume gains in the business in years.

Last year saw several successful initiatives that helped to better meet the needs of our customers. We introduced new products and services, including an Oversize Unaddressed Admail product and Scented AdCard, and simplified our processes to make it easier for customers to do business with us. As well,

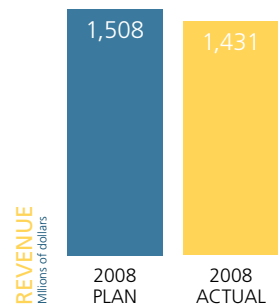
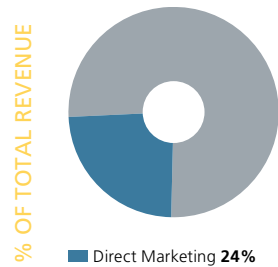
we improved our online delivery route maps for clients who want to target customers by specific letter carrier routes, making them easier to use. Through the "go green" section of our website, we helped raise the awareness of marketers, mail service providers and agencies on mail's impact on the environment, providing tips and solutions to help reduce waste in the mail stream. In Publications Mail, the creation of an electronic return service for undeliverable items allows senders to revise their mailing lists faster, reducing their waste and costs while improving their service to customers.

Keeping the industry informed about Canada Post's direct mail best practices is an ongoing endeavour. In 2008 alone, Direct Marketing's advisory team provided counsel to more than 100 audiences.

The global downturn is affecting all marketing media. While direct marketing has been the fastest growing segment of advertising, traditional media investments have been redirected to building cost-effective online solutions. Meanwhile, customers have responded to the weaker economy by shifting to lower-priced Unaddressed Admail at the expense of premium Addressed Admail. In addition, Canada Post continues to face intense competition from domestic firms.

Canada Post is ensuring it remains a viable option to marketers by continuing to improve delivery performance of its Admail products to make the delivery more predictable, building on operational improvements introduced in 2008.

### CANADA POST SEGMENT







## TAKING INNOVATION ABOVE AND BEYOND DELIVERY

In today's market, organizations must ensure that every communications dollar they spend is accountable to their bottom line – and direct mail is one of the few advertising media that can be measured with precision. In 2008, Canada Post continued to create innovative direct marketing services that go beyond simply delivering the mail, and help our customers achieve their business goals.

### **Scented AdCard brings the sweet smell of success**

From fresh earth to bubble gum scents, new Scented AdCard allows customers to add an attention-getting twist to their Admail.

### **Big improvements with Unaddressed Admail Oversize**

Size stands out with an Unaddressed Admail Oversize category that delivers Admail up to 12" x 9" in urban markets.

### **In the right place with Undeliverable Publications Mail**

An automated process now lets customers know weekly when publications are undeliverable, allowing them to update their mailing list faster and reduce waste.

## Subsidiaries

ESTABLISHING CONNECTIONS AND OFFERING GLOBAL SOLUTIONS ARE ESSENTIAL TO THE GROWTH OF ANY SUCCESSFUL BUSINESS. CANADA POST'S SUBSIDIARIES SUPPORT THE GROUP IN THIS ENDEAVOUR.

### **Purolator Courier Ltd.**

Purolator Courier is Canada's leading overnight courier company. Purolator's focus is the business-to-business market while Canada Post concentrates on the business-to-consumer market.

The Mississauga-based company, which accounted for 19% of The Canada Post Group's revenue, or \$1.6 billion, in 2008, employs 11,500 people and processes more than 5.5 million items each week. It has more than 4,000 vehicles and Canada's largest dedicated air express fleet. Purolator's network consists of more than 140 operations locations, 140 shipping centres, 550 authorized shipping agents and 350 drop boxes. Purolator serves more than 215 countries worldwide.

Canada Post owns a 90.96% share of Purolator, the Group's most profitable subsidiary. Over the past five years, Purolator has increasingly contributed to the profitability of The Canada Post Group.

In 2008, the Purolator segment contributed \$91 million to consolidated income before income taxes, an increase of \$7 million over the previous year. Revenue also grew by 7.4%, due primarily to increases in revenue per shipment. In spite of the current global economy, 2008 was a good year for Purolator. Its annual volumes grew marginally.

Nevertheless, Purolator experienced a sharp volume decline in the last few months of 2008, a situation that is expected to continue well into 2009. Faced with this new reality, Purolator intends to be even more aggressive in reducing costs and easing the impact of the market's declining revenue.

### **SCI Group Inc.**

SCI Group Inc. (formerly SCI Logistics Inc.) supports the logistics requirements of its customers as well as those of Purolator and Canada Post. Owned at 98.75% by Canada Post, SCI is one of the largest Canadian-owned logistics companies and is the parent organization of Progistix-Solutions Inc., Assured Logistics Inc., AMG Logistics Inc. and First Team Transport Inc. SCI's financial performance improved significantly in 2008, with income before income taxes of \$14 million, up from \$8 million in 2007. Revenue increased by 6.4%, to \$156 million.

### **Innovapost Inc.**

Innovapost Inc., a joint venture between Canada Post (51%) and CGI Information Systems and Management Consultants Inc. (49%), is responsible for the development, maintenance and operation of The Canada Post Group's computing and information systems. In 2008, Innovapost continued to assist its clients in converting savings in technology operating costs to investment in new technology. Innovapost revenues are heavily dependent upon the level of information technology activity undertaken by The Canada Post Group. In 2009, revenue is expected to decline, as Canada Post and Purolator reduce the pace of technology investment while continuing to require savings in their base operating costs. Total revenue for Innovapost, along with Canada Post International Limited, a former subsidiary of the Group that was dissolved in 2008, was \$176 million for 2008.



2940



## Connecting With Our People

IT IS A PROVEN CONNECTION: WHEN SKILLED PEOPLE ARE HAPPY, HEALTHY AND ENGAGED IN THEIR WORK, THEY PERFORM BETTER, AND ENABLE A COMPANY TO BUILD STRONG RELATIONSHIPS WITH CUSTOMERS AND OTHER STAKEHOLDERS.

Our goal is to become the best place to work in Canada, with every employee contributing to and sharing in our success. That is why Canada Post has made cultural change and employee engagement a top priority.

There are many exciting and unique advantages to working at Canada Post. As one of the largest companies in Canada, with 72,000 employees, The Canada Post Group touches virtually every community. Its size and scope mean talented employees have opportunities for advancement, and employees may be able to change jobs or locations throughout their career – all without leaving the company. Canada Post employees support their local communities in many ways, as well as supporting such causes as the Canada Post Foundation for Mental Health and the United Way, and helping to answer more than one million letters to Santa each year.

The Canada Post segment offers an enviable total compensation package that includes competitive salaries, benefits, pension plans, and generous vacation and leave. A Work Options program offers opportunities for employees to take extended leave, giving them the freedom to pursue personal development opportunities.

We are pleased with our employee initiatives to date. However, we recognize that much needs to be done if we are to become the best place to work in Canada. We have one of the highest employee accident rates in Canada, and a high rate of absenteeism. Relations between unions and management have improved since the 1990s, though an “us-versus-them” attitude still lingers for some.

To track our progress, employees of the Canada Post segment tell us each year what they think about their jobs, their working environment and leadership through a confidential survey. The results help to set objectives and identify areas for improvement.

The 2008 survey results show improvement in most categories and we achieved our target for our Engagement Index. Our success was also validated by other organizations: Canada Post was named a Top 100 employer for the third year in a row by Mediacorp.

In 2008, our strategy supported respect and fairness in the workplace, strong dedication to health and safety, and a concerted effort to encourage more two-way communications.

Carrying out the strategy involved extensive face-to-face communication with front-line team leaders and employees. In 2008, the President and senior executives held 15 Regional Forums with 2,500 front-line team leaders across the country. For the first time, more than 500 employees represented by the Canadian Union of Postal Workers attended the Forums. Executives also held more than 600 meetings with small groups of employees to discuss business results and corporate goals. There was extensive communication with team leaders and employees to ensure that health and safety remains a top priority.

Excellent leadership was another key focus. We provided leadership training for our front-line team leaders, as they play a critical role in engaging their employees and achieving our business results.



\* Percentage points

### OUR VALUES

We work to earn our customers' business.

We succeed by working together.

We take responsibility for our actions.

We treat each other with fairness and respect.

We strive to continuously improve.

We act with integrity in all that we do.



## REFLECTING CANADA'S RICH DIVERSITY

Canada Post has a long tradition of supporting cultural diversity both in its workforce and in its workplace. In 2009, the company received the Gold Hallmark for Progressive Aboriginal Relations from the Canadian Council for Aboriginal Business (CCAB) and was also recognized as one of Canada's Best Diversity Employers by Mediacorp.

One way Canada Post delivers on diversity is through its alignment with World Skills, a community-based non-profit organization established by Local Agencies Serving Immigrants (LASI), a coalition of immigrant service agencies in Ottawa that helps new Canadians find meaningful employment. As the result of a joint recruitment initiative with World Skills, the Canada Post segment interviewed numerous candidates, resulting in 36 job offers.

Among our new hires through the program was Ephriam Francisco, pictured above, who moved to Canada from the Philippines and joined the company in June 2008 as a Rural and Suburban Mail Carrier.



Randy Saunders, Stephanie Simpson, Kevin Burttt

## WORKING TOGETHER WORKS: EMPLOYEE ENGAGEMENT

The Thornhill Delivery Centre, north of Toronto, is a large, two-shift station with more than 150 employees serving almost 57,000 addresses. Admail volumes are among the highest in the country. Despite this workload, Thornhill is known for its engaged employees. In 2008, Thornhill earned a Canada Post Best of Operations Award. The station's positive, can-do attitude is supported by the leadership of zone manager Kevin Burttt, director of the Central Greater Toronto Area Stephanie Simpson, and Thornhill superintendent Randy Saunders. While these three credit the employees' own work ethic and dedication for the station's success, they also try to foster open communication, collaboration, and a sense of fun and camaraderie. Burttt says, "Supervisors have begun really listening to employees and their ideas, and are earning their respect."

## Corporate Social Responsibility

SOCIAL RESPONSIBILITY HAS ALWAYS BEEN IMPORTANT AT CANADA POST. WE CONTINUE TO BE DEDICATED TO BEHAVING ETHICALLY, GIVING BACK TO CANADIANS, AND MAKING A DIFFERENCE IN COMMUNITIES FROM COAST TO COAST.

Being in virtually every community across our country is a unique privilege – and responsibility – for our company. In 2008, we continued to work for the benefit of Canadian communities and contribute to their quality of life. We recognize that strong thriving communities benefit all Canadians and Canadian companies – including Canada Post.

From support for the Canada Post Foundation for Mental Health, the Canadian Freestyle Ski Association and United Way to reducing greenhouse gas emissions, registering new buildings for Leadership in Energy and Environmental Design (LEED) certification and improving the health and safety of employees, we are proud to contribute to Canadians, Canadian society and the environment.

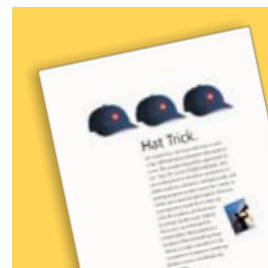
We remain committed to dedicating 1% of the pre-tax profits of The Canada Post Group to non-profit and registered charitable organizations across the country.

In 2008, the company devoted more than \$2.7 million to sponsorships, and donated \$400,000 to 241 different registered charities and not-for-profit organizations. Canada Post employees also volunteered their time to a further 160 organizations. We maintain openness and accountability in all of our charitable efforts. All submissions for donations or sponsorships must meet strict eligibility criteria.

### Mental illness awareness

We made significant strides toward raising awareness of the scope, scale and severity of the effects of mental illness – our cause of choice – on Canada and Canadians in 2008. In the spring, our Board of Directors approved the formation of the Canada Post Foundation for Mental Health. Canada Post donated \$150,000 as start-up funds. Guided by an independent board of trustees, the Foundation had a target of raising \$1 million by the end of the year. The Foundation not only surpassed this goal, but also connected employees at all levels and across all functions, as individuals and teams embraced our cause of choice.

From October 1 to November 17, 2008, staff in some 3,000 post offices asked customers if they wanted to donate one dollar to the Foundation. The response was overwhelmingly positive, as customers donated a total of \$522,000. On October 6, 2008, Canada Post issued a stamp to raise awareness of, and funds for, mental health. The cost of a booklet of 10 stamps included a surcharge of \$1, with all proceeds going to the Foundation. Demand for the stamp has been strong, and sales raised \$250,000 in 2008. Employees organized events that ranged from lunch-hour head shaving and pizza lunches to ice cream socials. In 2009, with ongoing support from employees, businesses and the public, the Foundation will continue to raise money and awareness, and begin to distribute funds to those in need.



### A TOP-100 EMPLOYER HAT TRICK

For the third year in a row, Canada Post was recognized as one of Canada's Top 100 Employers by Mediacorp, as announced in Maclean's magazine. The annual survey recognizes Canada's best places to work.



### GOLD HALLMARK FOR ABORIGINAL RELATIONS

Canada Post received the Gold Award for Excellence in Progressive Aboriginal Relations from the Canadian Council of Aboriginal Business. The award recognizes our leadership and sustainability in progressive Aboriginal relations.

## IN 2008, WE PUBLISHED OUR FIRST CORPORATE SOCIAL RESPONSIBILITY REPORT. THE REPORT PRESENTED A CLEAR PICTURE OF CANADA POST'S CSR PROGRAMS, INITIATIVES, TARGETS AND RESULTS IN A NUMBER OF AREAS. WE ALSO SET BASELINES TO MEASURE FUTURE PROGRESS.

Literacy has long been an area of importance and involvement for us. In 2008, for the second year in a row, we were the presenting sponsor of the CanWest Canspell National Spelling Bee. This partnership is one example of how we strive to celebrate excellence in academic achievement and encourage positive study habits. Additionally, the Canada Post Literacy Awards recognize the accomplishments of adults who have learned to read and write, and the individuals and organizations that helped them succeed. In 2008, we made awards to 16 individuals.

We are also committed to helping young people continue their education. The Canada Post Aboriginal Education Incentive Award (AEIA) celebrates Aboriginal people who have overcome personal, economic or social adversity in their pursuit of learning. Sixteen recipients were awarded a cash prize of \$1,000 in 2008. We also provide direct educational support to the children of full- and part-time employees through our Scholarship Program.

### Environmental sustainability

Given our national presence, we are especially committed to managing our environmental footprint. We are dedicated to implementing energy-conservation strategies and recycling programs, and encouraging the purchase and use of supplies that are recycled, recyclable, reusable, renewable or otherwise environmentally sustainable.

Our commitment to register all major new buildings for Leadership in Energy and Environmental Design (LEED) certification is consistent with our efforts to conserve

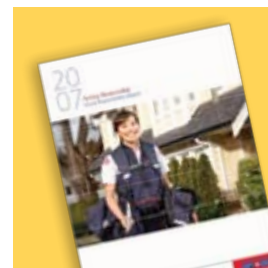
resources, protect the environment and reduce our greenhouse gas emissions. In 2008, we registered eight buildings for LEED certification.

### Green products

We introduced our first carbon-neutral product in 2008: new prepaid shipping envelopes for Xpresspost and *Priority Next A.M.*. These envelopes are 100-per-cent recyclable and include carbon-neutral packaging, which means that the carbon emissions associated with the life cycle of the envelopes is offset by carbon credits purchased through Zerofootprint. To select the "greenest" envelopes possible, we rated the environmental friendliness of manufacturers' envelopes against more than 60 criteria, including the extent to which materials used to create the envelope came from renewable resources and the characteristics of inks and adhesives.

### Corporate social responsibility (CSR)

In 2008, we launched a formal corporate social responsibility framework and strategy, and appointed a Senior Vice-President of CSR. Along with our CSR Steering Committee, the Senior Vice-President is responsible for planning, executing and reporting on our CSR activities. Additionally, the Board of Directors' Environmental and Occupational Health and Safety Committee was renamed the Corporate Social Responsibility, Environment and Occupational Health and Safety Committee, and its terms of reference were modified to include corporate social responsibility and compliance.



### AWARD-WINNING CORPORATE SOCIAL RESPONSIBILITY

In December 2008, Canada Post won the Algonquin College and Ottawa Community Loan Fund's inaugural Corporate Social Responsibility (CSR) Award.



### ONE OF CANADA'S BEST DIVERSITY EMPLOYERS FOR 2009

Canada Post was proud to be selected as one of Canada's Best Diversity Employers for 2009 by Mediacorp, as announced in Maclean's magazine. This annual survey recognizes employers across Canada that have developed exemplary diversity initiatives in five employee groups.

## Chairman's Message

THE ENVIRONMENT IN WHICH WE OPERATE CHANGED DRAMATICALLY IN 2008. LATE IN THE YEAR, WE SAW A PRECIPITOUS FALL IN REVENUE AS THE EFFECTS OF THE FINANCIAL CRISIS BEGAN TO BE FELT AROUND THE WORLD. AS A RESULT, WE FACE MANY CHALLENGES IN 2009.

On behalf of the Board and our Shareholder, I am pleased to present The Canada Post Group's financial results for the 12-month fiscal period ending December 31, 2008.

Despite the fact that 2008 was a challenging year at Canada Post, the Group ended the period with net income of \$90 million. Income before taxes was \$161 million against a plan of \$127 million. Although this extends the Group's record of profitability to 14 consecutive years, our profit is very slim and is becoming increasingly difficult to achieve. In 2008, Canada Post paid a dividend of \$22 million to its Shareholder, the Government of Canada. Our return on equity reached only 6.1 per cent, reflecting the challenging market conditions in 2008.

The Canada Post Group's profitability in 2008 was largely due to some very aggressive cost-cutting measures that were put in place in March of last year by the Canada Post segment, well before the recession started. If it had not been for this timely and proactive effort, the Group would have lost money for the first time in 14 years.

To remain successful and profitable, the Board recognizes that Canada Post must continue to transform, improve delivery services across all media, and deliver real value to all its customers – businesses and consumers alike.

To meet customer needs in these challenging times and remain profitable, the Board and management agree that significant investments must continue to be made in renewing our network and equipment, and upgrading our infrastructure. We must also invest in our people. Management and the

Board will continue to work closely together to ensure that these important investments are made prudently and that the ensuing benefits to employees, customers and all Canadians are realized.

In 2008, we started work on a new state-of-the-art, environmentally friendly mail processing plant in Winnipeg. The plant, which is expected to be up and running in 2010, will be equipped with new technology and ergonomically sound, next-generation mail processing equipment. A model for the Modern Post and other facilities across the country, the plant will give Canada Post's customers the service they need to compete in the marketplace, and its employees a new and efficient working environment with more safety features.

In October 2007, after much study and review, the Board approved a five-year plan to renew the aging infrastructure of Canada Post. This decision was taken in order that we may be able to continue to serve Canadians in the manner they deserve. At the time of this approval, it was anticipated that Canada Post would be able to finance its requirements mostly from internal sources. Unfortunately, with the severe economic downturn in 2008, and the impact this is having on both our revenues and pension funding requirements, Canada Post no longer has the internal resources to fully fund the renewal of its infrastructure. In its submission to the Canada Post Strategic Review, Canada Post recommended a number of changes to our existing financial framework, including greater flexibility for the company to price its products





and timely access to capital markets, in order to protect service and allow for Postal Transformation. These changes are now more important than ever. We look forward to working with our Shareholder over the coming months to see these recommendations through.

With some 72,000 employees, The Canada Post Group has a presence in every community across the country. As a result, our operations can have far-reaching effects on Canadians from coast to coast as well as on the environment and our economy. The Board recognizes that Canada Post must take a serious approach to its corporate social responsibility and is pleased to play a key oversight role in these crucial activities.

It is clear that 2009 will be even more challenging than 2008 and that we will face tremendous uncertainty in many key areas. In January 2009, our Shareholder, the Government of Canada, tabled a Budget that forecasts a steep deficit for the first time in more than a decade. The government also made clear that it does not expect the recession to end in the near future. For Canada Post, there is another very specific problem; even before the financial crisis, the postal sector was in decline around the world. The declining Lettermail volumes we experienced in 2007 continued into 2008. The current recession and financial uncertainty is causing businesses to curb spending. Any reduced spending will put pressure on Canada Post's revenues in 2009, especially in direct mail. We must further reduce our cost base if we are to weather the continuing revenue declines caused by this recession. We must also continue

our evolution into a dynamic, forward-thinking organization if we are to prevail over the new and ongoing challenges that 2009 will bring.

On behalf of the Board of Directors, I would like to say that I am convinced that we have the committed management team and dedicated employees we need to continue to operate successfully and profitably even during this economic downturn. These people did a great job in 2008 and will do so again in 2009. Eventually the economy will improve and, as the only company that touches every Canadian and every community daily, we can help that recovery by focusing on our customers and being sensitive to the hardships that many Canadians will endure. The Board is committed to continue to work with management and employees to transform Canada Post into a Modern Post that is prepared and able to meet the needs of Canada and all Canadians – today and tomorrow.

Marc A. Courtois  
Chairman of the Board of Directors

# Corporate Governance

## Role and composition of the Board

The role of the Board is explicitly supported by the statutory framework within which Canada Post operates (the *Canada Post Corporation Act* and the *Financial Administration Act*), the Corporation's bylaws, and its Statement of Board Values and Board Charter. The Board is responsible for overall guidance on the strategy, business plans and related affairs of Canada Post. It is responsible for overseeing Canada Post on behalf of the Shareholder. In carrying out its oversight role, it is the Board that holds management accountable for business performance and achievement of Canada Post's other objectives. To fulfill these responsibilities, the Board is called upon to exercise judgment in the following general areas:

- the strategic direction and Corporate Plans of Canada Post;
- major contracts;
- safeguarding the resources of Canada Post;
- establishing and implementing processes for senior officer and Board member recruitment;
- monitoring corporate performance; and
- providing timely reports to the Shareholder.

The Board of Directors of Canada Post is comprised of 11 members, including Canada Post's President and Chief Executive Officer. Two directorships were vacant during part of 2008. However, in May and July, the vacancies were filled to constitute a full Board. All members of the Board and the President and Chief Executive Officer are Governor-in-Council appointees. As overseer of a \$7.7-billion commercial and self-sufficient enterprise (on a consolidated basis), the Board must bring strong business judgment and valuable experience and insight in other fields to the stewardship of Canada Post. The Board meets on both pre-arranged meeting dates and at such other times as deemed necessary by the Chairman. In order to provide strong oversight for such a large, complex and

important company, the Board must devote approximately 35 days a year to its deliberations. In 2008, the Board met 11 times. In addition, individual committees of the Board met a combined 24 times.

## Independence of the Board

The position of the Chairman and that of the President and Chief Executive Officer are separate. In addition, the Board normally holds its meetings with the President and Chief Executive Officer as a member and the Chief Operating Officer as an invitee. Otherwise, the Board meets without the presence of management unless its presence is required for presentations or reports and, at each meeting, the Board holds an in camera session. The Audit Committee regularly meets in camera individually with Canada Post's external and internal auditors. Furthermore, the Board, its committees and individual directors may engage independent counsel and advisors upon request and at the discretion of the Board.

## Committees of the Board

The Board has formed the following committees to assist it in fulfilling its oversight responsibilities:

- The Audit Committee reviews financial information, which will be provided to Parliament and other stakeholders, the systems of corporate controls, which management and the Board have established, the audit process and the risk management framework. It also assesses Canada Post's financial performance against its Corporate Plan.
- The Corporate Governance and Nominating Committee provides a focus on corporate governance, assesses corporate values and the elements that facilitate Board effectiveness, such as Board self-assessment, Committee structure and Terms of Reference, assists the Board in determining the

composition and structure of the Board and recommends candidates for Board membership, Chairman, and President and Chief Executive Officer.

- The Human Resources and Compensation Committee reviews human resources and compensation matters, including the compensation of the President and Chief Executive Officer and other Corporate Officers, recruitment, compensation and development, retention, significant human resource policies, and labour relations issues.
- The Pension Committee oversees the \$12-billion Canada Post Pension Plan, Pension Plan matters and policies, including Pension Plan liabilities, Pension Plan strategies, Canada Post's responsibilities as Pension Plan sponsor, and Canada Post's fiduciary responsibilities as Pension Plan administrator.
- The Corporate Social Responsibility (CSR), Environment, Health and Safety Committee oversees Canada Post's policies, programs, practices, procedures and performance with respect to CSR, including the environment and occupational health and safety.

### **Board effectiveness**

The Board regularly assesses its effectiveness and functioning through a self-assessment survey. The Board has created membership criteria that set out the skills and personal qualities expected of its members for the use of the Government in appointing Board members. The compensation of the Board complies with the Remuneration Guidelines for Part-time Governor in Council Appointees in Crown Corporations issued by the Privy Council Office, and an orientation process is established for new directors. As well, a process is in place to assess the ongoing development requirements of directors, and training opportunities are provided to continue to enhance the effectiveness of existing directors.

### **Fraud and error**

Pursuant to recommendations issued by the Canadian Institute of Chartered Accountants, the Audit Committee fulfilled its responsibility to consider fraud and error in financial statements. Accordingly, the Audit Committee reports that it has reviewed and accepts the company's financial statements, the attached notes, the auditors' opinions and their assertions on independence.

### **Subsidiaries**

A Governance Model for Canada Post's subsidiaries ensures consistent governance practices where Canada Post holds a majority interest.

### **Governance in principle**

The Board and management of Canada Post hold the view that sound governance practices that are dynamic in nature are the bedrock of a quality organization that builds value and is dedicated to its employees and customers. Corporate governance is an essential component to the fulfillment of Canada Post's public-policy and commercial mandates, and will contribute to ensuring that all Canadians continue to receive a universal and affordable national postal service.

# Board of Directors



**Marc A. Courtois** ▲\*\*●★  
Westmount, Quebec  
Chairman of the Board  
Canada Post Corporation



**A. Michel Lavigne** ▲★  
F.C.A.  
Brossard, Quebec



**Robert Pletch** ▲\*  
Q.C.  
Regina, Saskatchewan



**Moya Greene**  
Ottawa, Ontario  
President and CEO  
Canada Post Corporation



**Daurene E. Lewis** ♦\*  
C.M.  
Bedford, Nova Scotia



**William H. Sheffield** ☆★  
Vancouver, British Columbia  
Corporate Director



**Denyse Chicoyne** ▶▲  
CFA, MBA  
Outremont, Quebec  
Corporate Director



**Siân M. Matthews** \*●  
Calgary, Alberta



**Donald Woodley** ♦●  
Mono, Ontario



**Thomas Cryer** ■★  
F.C.A.  
Etobicoke, Ontario



**Iris Petten** \*●  
Conception Bay South,  
Newfoundland and Labrador

- 
- Chairperson of the Audit Committee
  - ♦ Chairperson of the Corporate Governance and Nominating Committee
  - ❖ Chairperson of the Corporate Social Responsibility, Environment and Health and Safety Committee
  - ☆ Chairperson of the Human Resources and Compensation Committee
  - ▶ Chairperson of the Pension Committee

- 
- ▲ Member of the Audit Committee
  - ✱ Member of the Corporate Governance and Nominating Committee
  - ✱ Member of the Corporate Social Responsibility, Environment and Health and Safety Committee
  - Member of the Human Resources and Compensation Committee
  - ★ Member of the Pension Committee

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Annual Public Meeting:  
June 17, 2009  
Regina, Saskatchewan

# Officers of the Corporation



**Moya Greene**  
President and CEO



**Cheryl A. Persad**  
Senior Vice-President  
Transaction Mail



**Douglas Greaves**  
Vice-President  
Pension Fund and  
Chief Investment Officer



**Jacques Côté**  
Chief Operating Officer



**John Smith**  
Senior Vice-President and  
Chief Information Officer



**Kathy Haley**  
Vice-President  
Marketing



**Stewart Bacon**  
Senior Vice-President and  
Chief Sales and  
Marketing Officer



**Mary Traversy**  
Senior Vice-President  
Operations



**Douglas Jones**  
Vice-President  
Field Operations



**Wayne Cheeseman**  
Chief Financial Officer



**Phil Ventura**  
Senior Vice-President  
Strategy



**Susan Margles**  
Vice-President  
Government Relations and  
Policy Framework



**Laurene Cihosky**  
Senior Vice-President  
Direct Marketing, Advertising  
and Publishing Business



**Robert Waite**  
Senior Vice-President  
Corporate Social Responsibility



**Clary Ottman**  
Vice-President  
Finance and Comptroller



**Cal Hart**  
Senior Vice-President  
Postal Transformation



**Bonnie Boretzky**  
Vice-President,  
General Counsel, Corporate  
Secretary and Compliance



**Serge Pitre**  
Vice-President  
General Business Sales



**Peter Melanson**  
Senior Vice-President  
Enterprise Sales



**John Duncan**  
Vice-President  
Human Resources



**Gerard Power**  
Vice-President  
International



**Louis F. O'Brien**  
Senior Vice-President  
Parcels



**Stephen Edmondson**  
Vice-President  
Customer Service



**Anthony Wilson-Smith**  
Vice-President  
Communications

## Ombudsman's Message

WHEN I BEGAN MY TENURE AS CANADA POST'S THIRD OMBUDSMAN IN 2008, I QUICKLY RECOGNIZED THAT MY TEAM WAS DEDICATED TO SAFEGUARDING THE INTERESTS OF CUSTOMERS WITH THE UTMOST ATTENTION TO FAIRNESS AND INDEPENDENCE.

With three basic principles as our goalposts – standardization, consistency and simplification – we rallied around streamlining and improving many of our management processes and interfaces with the customer. As a first step, we redesigned the “look and feel” of our final reports to customers to bring more clarity to our findings and recommendations. In September, we introduced an online complaint process to increase customer accessibility to our office.

We experienced a 16 per cent increase year-over-year in the number of requests for assistance processed by the team. The introduction of the online complaint process, coupled with the PSAC labour disruption, which limited the general public's access to Customer Service in November and December, accounted for 10 per cent of this increase in the last quarter.

Forty-three per cent of these requests for assistance (3,494) resulted in full-fledged investigations, while 57 per cent (4,547) were satisfactorily closed at intake. The outcome of these investigations produced 2,163 recommendations to Canada Post. I would be remiss at this point not to thank Canada Post for its diligent and continued co-operation in our investigation process and in the timely implementation of these recommendations. Despite the significant increase in cases investigated in 2008, I am pleased to report that 87 per cent of case outcomes were communicated to the customer within 40 days, of which 61 per cent were closed within 20 days – a performance achievement comparable to 2007. A detailed

view of the outcomes of these investigations and their regional distribution is provided in our annual report, available at [www.ombudsman.postescanadapost.ca](http://www.ombudsman.postescanadapost.ca). With a shared goal of improving the customer's experience, our 2009 business plan focuses on three strategic objectives: enhancing our visibility within Canada Post front-line management; improving communications with customers; and promoting excellence in our case management processes. To bring the voice of the customer to the forefront of our plan, we designed a customer feedback program administered by an independent third party. The program was launched in January 2009, and I look forward to incorporating these results and insights on the customer's overall experience in next year's report.

As Canada Post strives to build the Modern Post, the Office of the Ombudsman is proud to contribute to the organization's customer-centric goals by independently reviewing customer concerns in a fair and unbiased manner, to help improve postal service for all Canadians.



Nicole Goodfellow



# Financial Performance

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) comments on the operations and financial condition of Canada Post Corporation (the "Corporation" or "Canada Post") for the year ended December 31, 2008. This discussion should be read together with the consolidated financial statements and accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles and are reported in Canadian dollars. The information in this MD&A is current to March 6, 2009, unless otherwise noted.

Management is responsible for the information presented in the Annual Report, including the MD&A. All references to "our" or "we" are references to management of Canada Post.

### Forward-looking statements

This Annual Report, including this MD&A, contains forward-looking statements that reflect management's expectations regarding the Corporation's objectives, plans, strategies, future growth, results of operations, performance, and business prospects and opportunities. Forward-looking statements are typically identified by words or phrases such as "plans," "anticipates," "expects," "believes," "estimates," "intends," and other similar expressions. These forward-looking statements are not facts, but only estimates regarding future results. These estimates are based on certain factors or assumptions regarding expected growth, results of operations, performance, business prospects and opportunities (collectively, the "Assumptions"). While we consider these Assumptions to be reasonable, based on information currently available to us, they may prove to be incorrect. These estimates of future results are subject to a number of risks, uncertainties and other factors that could cause actual results to differ materially from what the Corporation currently expects. These risks, uncertainties and other factors include, but are not limited to, those risks and uncertainties set forth in *Section 5 – Risk Management* on page 57 of this MD&A (collectively the "Risks").

To the extent the Corporation provides forward-looking information that is future-oriented financial information or financial outlooks, such as future growth and results of operations, the Corporation is providing this information for the purposes of describing its future expectations. Readers are, therefore, cautioned that this information may not be appropriate for any other purpose. Further, future-oriented financial information and financial outlooks, as with forward-looking information generally, are based on the Assumptions and subject to the Risks.

Readers are urged to consider these factors carefully when evaluating these forward-looking statements. In light of these Assumptions and Risks, the events predicted in these forward-looking statements may not occur. The Corporation cannot assure that projected results or events will be achieved. Accordingly, readers are cautioned not to place undue reliance on the forward-looking statements.

The forward-looking statements included in this Annual Report, including this MD&A, are made only as of the date of this Annual Report, and the Corporation does not undertake to publicly update these statements to reflect new information, future events or changes in circumstances or any other reason after this date.



## 1 Introduction and Financial Highlights

*An overview of The Canada Post Group and a summary of the 2008 financial results*

### 1.1 Materiality

In assessing what information is to be provided in the MD&A, management applies the materiality principle as guidance for disclosure. Management considers information material if, under current circumstances, it is considered probable that its omission or misstatement would influence or change the decisions of our Shareholder.

### 1.2 The Canada Post Group

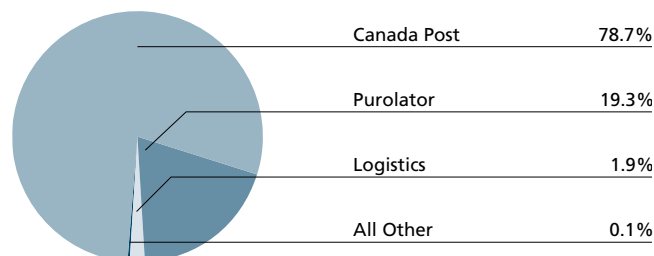
The consolidated financial statements of Canada Post include the accounts of the Corporation, our subsidiaries, including Purolator Courier Ltd. (Purolator) and SCI Group Inc. (SCI), and our interest in Innovapost Inc. (Innovapost), a joint venture. These companies are collectively referred to as "The Canada Post Group."

We periodically evaluate our corporate holdings to assess strategic fit and whether business objectives continue to be met. Changes over the last two years include:

- In January 2009, as part of its rebranding strategy, SCI changed the name of its parent company to SCI Group Inc. (formerly SCI Logistics Inc.). SCI Logistics Inc. was established in March 2007 as the parent organization of Progistix-Solutions Inc. and Assured Logistics Inc., and in March 2007 acquired AMG Logistics Inc., First Team Transport Inc. and Partnership Inc. to diversify its services and competencies.
- In April 2008, Canada Post International Limited (CPIL), a former subsidiary of the Corporation, transferred all of the shares of its subsidiary Nieuwe Post Nederlandse Antillen N.V. (NPNA) to the Government of the Netherlands Antilles, thereby causing an early termination of the concession agreement to provide postal and post-banking services in the Netherlands Antilles. Subsequently, in November 2008, the Corporation wound up and dissolved CPIL.

The chart below illustrates the distribution of revenue by segment, as a percentage of total revenue.

### Revenues by segment – 2008



| Revenues by segment | 2008  | 2007  | 2006  |
|---------------------|-------|-------|-------|
| Canada Post         | 78.7% | 79.4% | 80.0% |
| Purolator           | 19.3% | 18.6% | 18.0% |
| Logistics           | 1.9%  | 1.8%  | 1.7%  |
| All Other           | 0.1%  | 0.2%  | 0.3%  |

### 1.3 Financial highlights

#### 2008 results

Canada Post reported consolidated net income of \$90 million for the year ended December 31, 2008. This represents an increase of \$36 million, when compared with 2007. Income before income taxes of \$161 million remained at last year's level, which was \$34 million better than planned. Despite positive results, earnings remained low with an operating margin of only 1.8%.

The year has been a most challenging one for our company, our competitors and our customers. Economic conditions deteriorated globally and the downturn in the economy had a negative effect on our revenues, which increased 3.0% over 2007 levels due mainly to price, but fell short of plan by \$89 million.

We were impacted by rising fuel prices in the first half of the year and by a weakening of the Canadian dollar and the economy in the latter half. Transaction mail volumes declined while the number of new addresses in our delivery network increased. Lettermail volume declines lower the value of Canada Post's exclusive privilege while the cost of public-policy obligations continues to increase.

In an effort to protect earnings against these and other pressures, we undertook a significant cost-management program early in 2008, reducing planned expenditures for the Canada Post segment by \$150 million, over and above the \$90 million savings already incorporated in the plan.

## 2009 outlook

Looking forward to 2009 and beyond, the uncertainty created by financial market volatility has made it more difficult to predict future revenues, earnings and cash. The economic crisis is having a significant impact on Canada Post in three major areas: revenue and earnings, pension and employee future benefits, and Postal Transformation.

### *Revenue and earnings*

Our planned income before income taxes for 2009 is \$117 million. However, the deteriorating economic situation is expected to negatively impact Canada Post segment revenue by an estimated \$250 million. Given the volatility of the current environment, this estimate could change significantly as the year progresses.

With narrow margins, the Corporation needs to be very vigilant in controlling its discretionary costs and finding new operational efficiencies, if we are to reach our profitability target. We have developed and are implementing a program of cost reductions and reduced expenditures to counteract these revenue losses and protect our earnings.

### *Pension and employee future benefits*

Recent economic changes have also had a significant effect on the value of the Canada Post Pension Plan and its funding. Over the past year, declines in the stock market have reduced the value of the Pension Plan, leaving it in a solvency deficit position at the end of the year. The Corporation resumed making current service contributions to the Pension Plan in November 2008 and these contributions are expected to be \$271 million in 2009. In 2009 and beyond, the Corporation intends to reintroduce smoothing of assets for solvency purposes. The reintroduction of asset smoothing, which embeds a longer-term economic cycle in our funding calculation, should make solvency payments less volatile and more predictable in the future. We do not expect to have to make special payments to the Pension Plan until 2010.

Accounting for employee future benefits, of which pension is the largest component, is complex in any circumstance. It is even more difficult in 2009 due to an increase in the discount rate used to establish the pension and other benefits obligations, for accounting purposes. As a result, income before income taxes in 2009 is expected to be artificially inflated due to an unplanned net non-cash gain of more than \$270 million, largely relating to the change in discount rate from 5.9% to 7.5%. This situation could change again significantly in 2010. This adjustment is not an indicator of the earnings of Canada Post.

### *Postal Transformation*

Modernization of Canada Post's infrastructure is essential to meet our service commitment to Canadians, drive significant productivity improvement, and create financial sustainability and competitiveness now and in the future. Over the next five years, our Postal Transformation plan to modernize the processing, delivery and technology infrastructure would require investment of up to \$2.7 billion, including \$2.3 billion of capital expenditures.

However, payments to fund our Pension Plan are limiting the Corporation's ability to make the needed infrastructure improvements. We are monitoring our financial position closely and intend to adjust spending, as required. Current commitments over the plan period will be limited to the most critical infrastructure, with investments not to exceed an estimated \$750 million until we can ensure adequate financing.

Any inability to fully implement Postal Transformation could have a materially negative impact on the financial sustainability of Canada Post in the long term.

### *Strategic Review*

In our submission to the Strategic Review panel, we proposed a new financial framework, which includes the need for pricing flexibility, payment for our public-policy obligations, dividend relief, pension relief and access to capital markets. This framework would enable the Corporation to continue to fulfill its dual mandate of providing a postal service to Canadians on a financially self-sustaining basis.

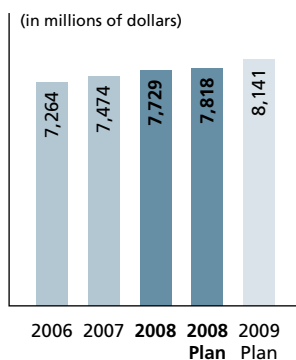
## 1.4 Consolidated performance to prior year

(in millions of dollars)

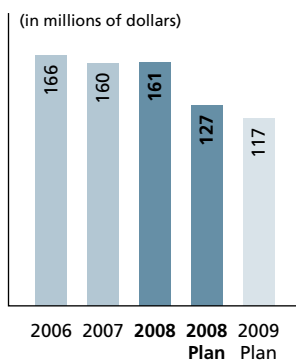
| Year ended December 31                | 2008  | 2007  | Change  | Explanation of change  |
|---------------------------------------|-------|-------|---------|--|
| Consolidated income statement         |       |       |         | <i>Highlights, as discussed in Section 8 – Results from Operations on page 71</i>  |
| Revenue from operations               | 7,729 | 7,474 | 3.0%*   | Primarily price increases  |
| Cost of operations                    | 7,594 | 7,346 | 3.4%    | Primarily contractual wage increases and inflation; cost growth was contained due to a program to reduce planned expenditures by approximately \$240 million, including discretionary investment, advertising, travel and a reduction of some two million hours worked in our processing and delivery operations |
| Income before income taxes            | 161   | 160   | 1.0%    | Reflects aggressive cost control measures implemented in 2008  |
| Net income                            | 90    | 54    | 66.1%   | Income tax expense decreased by \$35 million as statutory tax rates stabilized in 2008. Income tax expense in 2007 was high due to the reduction of the long-term statutory income tax rate  |
| Return on equity                      | 6.1%  | 3.8%  | 2.3%    | Higher net income in 2008  |
| Dividends paid                        | 22    | 47    | (54.1)% | Based on 40% of previous year's net income   |
| Consolidated cash flow statement      |       |       |         | <i>Highlights, as discussed in Section 6 – Liquidity and Capital Resources on page 62</i>  |
| Cash and cash equivalents             | 605   | 386   | 56.9%   | Maturing investments were reinvested for shorter terms to minimize risk created by financial market volatility   |
| Cash provided by operating activities | 597   | 344   | 73.6%   | Primarily changes in working capital, particularly salaries and benefits payable, and accounts payable and accrued liabilities   |
| Cash used in investing activities     | 434   | 513   | (15.2)% | Primarily a significant decrease in the change of net position in short-term investments from normal cash management transactions, partially offset by increased capital investment and reduced proceeds from the sale of capital assets   |
| Capital expenditures                  | 391   | 331   | 18.1%   | Primarily Canada Post and Purolator multi-year modernization initiatives   |
| Cash provided by financing activities | 56    | 56    | 1.2%    | Primarily lower dividends paid, offset by a decline in transitional funding from the Government of Canada related to pension contributions   |

\* Adjusted for trading days

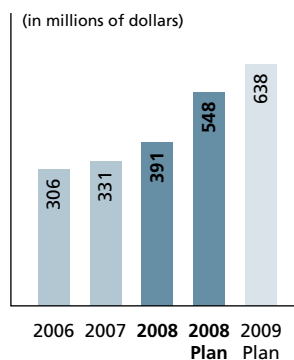
### Revenue



### Income before income taxes



### Capital expenditures



## 1.5 Consolidated performance to plan

The Canada Post Group exceeded its earnings plan by \$34 million, earning income before income taxes of \$161 million. This better-than-plan performance is mainly due to the Corporation's tactical cost reductions implemented to offset the negative pressure on revenue growth caused by the economic slowdown.

The following table presents the Corporation's consolidated performance for the 2008 fiscal year compared to the 2008 Corporate Plan.

(in millions of dollars)

| Year ended December 31     | 2008 results | 2008 plan |      | Explanation  | 2009 plan |
|----------------------------|--------------|-----------|------|--|-----------|
| Consolidated               |              |           |      | <i>For further information, see Section 2 – Our Business, Vision and Strategy on page 35 and Section 8 – Results from Operations on page 71</i>  |           |
| Revenue from operations    | 7,729        | 7,818     | (89) | Fell short of expectations by \$89 million, primarily due to: <ul style="list-style-type: none"> <li>• Impact of economic slowdown on Admail</li> <li>• Continued Lettermail erosion</li> <li>• Decrease in outbound volumes in the Canada Post segment</li> </ul> This was partially offset by: <ul style="list-style-type: none"> <li>• Higher fuel surcharge revenue for parcel delivery</li> </ul>   | 8,141     |
| Cost of operations         | 7,594        | 7,714     | 120  | Exceeded expectations by \$120 million, primarily due to: <ul style="list-style-type: none"> <li>• Tactical cost controls over labour, advertising, administration and project spending</li> <li>• Indirect labour savings in operations</li> <li>• Lower amortization</li> </ul> This was partially offset by: <ul style="list-style-type: none"> <li>• Higher transportation and fuel costs</li> <li>• Absenteeism</li> <li>• Restructuring charges</li> </ul> | 8,032     |
| Non-operating income       | 26           | 23        | 3    | Exceeded expectations by \$3 million, due to: <ul style="list-style-type: none"> <li>• Purolator foreign exchange gain and lower-than-planned interest expense, offset by lower interest income in the Canada Post segment</li> </ul>  | 8         |
| Income before income taxes | 161          | 127       | 34   | Exceeded expectations by \$34 million  | 117       |

Each year, we review our priorities, assumptions and expectations, and submit a five-year Corporate Plan to our Shareholder. At the date of this report, our Shareholder had not approved the 2009 – 2013 Corporate Plan.

In light of the current economic situation, we estimate that 2009 revenue could be significantly lower than planned. In response to this risk, we continue to monitor our costs diligently and to implement effective cost-savings and cost-containment measures to reduce the impact of lower levels of revenue.

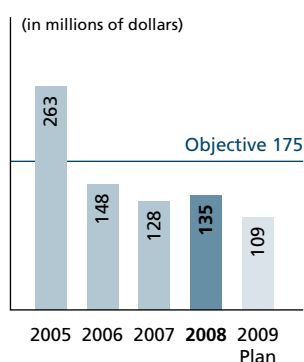
## 1.6 Consolidated performance to Policy Framework objectives

The Multi-Year Policy Framework for Canada Post, established in 1998, sets out financial and service objectives as well as a price-cap formula for the basic letter rate. Key financial objectives, which are calculated on a consolidated basis, include:

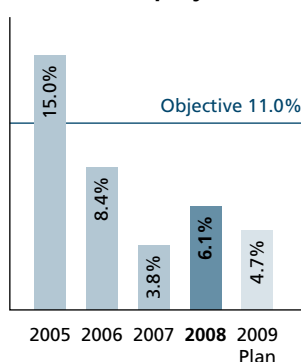
- Earnings before interest and taxes (EBIT<sup>1</sup>) of \$175 million;
- Return on equity<sup>2</sup> of 11%; and
- Productivity ratio<sup>3</sup> of 97%.

The charts below set out the Policy Framework financial objectives and our progress in achieving them.

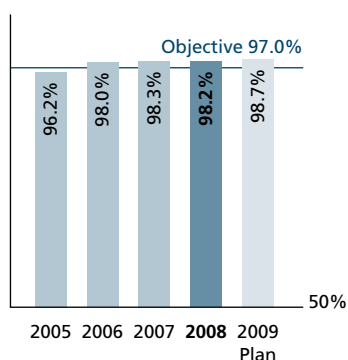
### EBIT



### Return on equity



### Productivity



The Corporation has not met these financial objectives since 2005. In April 2008, the Government of Canada announced a Strategic Review of Canada Post to examine the Corporation's public-policy objectives, our ability to remain financially self-sustaining, and the continued relevance of the Policy Framework. *The Strategic Review is discussed further in Section 2.2 on page 36.*

<sup>1</sup> EBIT equates with income from operations as reported in the consolidated financial statements

<sup>2</sup> Return on equity = net income ÷ average equity

<sup>3</sup> Productivity ratio = cost of operations ÷ revenue from operations

## 2 Our Business, Vision and Strategy

*A discussion of the business, vision and strategy of our core businesses*

The Canada Post Group exists to serve Canadians. "From anywhere... to anyone™," our 72,000 employees deliver more than 11 billion pieces of mail, parcels and messages each year to some 15 million addresses in urban, rural and remote locations across Canada. Our objective is to provide Canadians with world-class postal service while remaining financially self-sustaining. Fulfilling this objective requires an efficient and financially viable Canada Post.

Our vision for Canada Post is to remain a service provider that Canadians value, an employer of choice, a socially responsible company, and an organization that can continue to reinvest in the services we provide because of our financial success. Just as we have evolved to better meet Canadians' needs over the past 27 years since we became a Crown corporation, we are committed to transforming Canada Post for the future for the same reason.

The environment in which we operate has changed, and we face many challenges. In response, we have undertaken a program of investment and innovation in our services, our infrastructure and our culture.

### 2.1 Trends, opportunities and threats

#### Global trends

Canada Post's commitment to modernization is not occurring in isolation. Numerous Posts, including Austria, Germany, Australia and France, have undertaken and continue to carry out substantial modernization initiatives. By transforming operations, postal administrations are improving their work environment while responding to evolving customer and market needs and defending their business against competitors. Further, transformation has generally taken place under updated postal regulatory frameworks, with governments giving their Posts more commercial freedom and, increasingly, opening postal markets to competition in a bid to spur innovation and customer choice.

Modernization has been driven by the increasing challenge of providing universal postal service while remaining financially viable in a more competitive marketplace. All postal operators in the developed world retain responsibility for some level of public service, referred to as a universal service obligation or USO. Traditionally, the USO has been financed through a legislated "exclusive privilege," where a portion of the postal market is reserved for the Post. Declining lettermail volumes, due mainly to electronic substitution and increased competition, has eroded the value of the exclusive privilege in these reserved markets.

Many Posts have recently reported stagnant or declining mail volumes. In addition to a 2% decline in Canada Post's transaction mail volumes in 2008, New Zealand Post reported a decline in traditional mail volumes of 1.5% (2008); Posten (Norway) a 3.3% decline in letter volumes (2008); and Swiss Post a 0.7% decline in addressed letters (2007). More ominously, the United States Postal Service (USPS) reported total mail volumes down 4.5% (2008).

Although the current economic downturn is undoubtedly having an impact on mail volumes, it is doubtful if an economic recovery will fully recoup the losses. Further, unlike their private sector competitors, postal services' requirement to provide universal service limits their ability to rationalize their operations in response to reductions in mail volumes or to economic downturns.

The more successful Posts have taken advantage of modernized regulatory frameworks as well as increasingly liberalized postal markets. They have transformed their operations and expanded their product and service portfolios as well as their geographic reach, often through acquisitions. Deutsche Post (Germany), Austrian Post and Nordic Posts, such as Sweden and Finland, are examples of operators that have become leaders at home while expanding their footprint outside their domestic markets. They have improved productivity and efficiencies and generated new sources of revenue, in many cases with vertical integration in communications and courier operations.

However, the challenge of balancing financial performance with the costs of providing universal postal service remains. No government has removed or substantially diminished its Post's USO. Recent reports on the postal sector in the United States, the United Kingdom and France all supported the continuation of universal service while acknowledging the varying financial difficulties faced by their Posts.

The European Union (EU) will continue to lead the evolution of postal markets. The majority of its members are scheduled to have fully liberalized domestic postal markets in 2011, although this is two years later than originally scheduled and follows much heated debate. The EU experience highlights the difficulty of determining the appropriate balance of regulation, governance and competition necessary to provide adequate customer choice, quality of service and innovation. At the same time, governments and regulators must ensure that customers, particularly consumers, receive some guaranteed level of basic service from a financially viable national postal operator. The importance of these issues was highlighted in the recent study, *Modernize or decline: Policies to maintain the universal postal service in the United Kingdom*. The report noted that sustaining universal service in the U.K. is contingent upon modernizing the Royal Mail. It recommended, among other things, that the Post seek a strategic partner to assist in its transformation.

## Canada

Under the *Canada Post Corporation Act*, Canada Post has a dual mandate to "establish and operate a postal service" and "conduct its operations on a financially self-sustaining basis." Canada Post continues to be a marginally profitable company and it faces many challenges. The results of competitive pressures across the business, the severe downturn in the economy, and the cost of public-policy obligations put our continued financial sustainability at risk.

Our business, including our reserved market, is under pressure on many fronts. Customers have electronic substitutes for lettermail, which is our most profitable line of business. Internationally, low-cost re-mailers offer outbound mail services without the requirement of public-policy obligations that we must provide. A variety of alternative media, from traditional to digital, can substitute for direct mail. The domestic parcel market, increasingly a technologically driven business, is highly competitive because of the presence of all the major global players – UPS, FedEx and DHL. Under the current economic climate, our customers are aggressively looking for ways to cut their costs.

We face cost pressures that our competitors do not, and these pressures are particularly difficult given the current economic climate. Canada Post is expected to provide five-day-a-week mail delivery to all Canadians and to meet specific service standards at a reasonable cost. While our delivery network grew by more than 200,000 points of delivery in 2008, our lettermail volumes declined. Our ability to replace this revenue is limited by price regulation on products in our reserved market, and by vigorous competition in the parcels and direct marketing parts of our business. Our fixed costs remain high, particularly labour and network costs resulting from the USO and collective agreements. Moreover, our profitability is limited further by the financial pressures of Shareholder directives and public-policy commitments.

As a result of these challenges and in consideration of our need to remain financially self-sufficient, we continue to explore with our Shareholder, the Government of Canada, various alternatives to fund our increasing universal-service and public-policy obligations.

## 2.2 Strategic Review of Canada Post

In April 2008, the Government announced a Strategic Review of Canada Post to examine the Corporation's public-policy objectives, our ability to remain financially self-sustaining, and the continued relevance of the Multi-Year Policy Framework set in 1998. The terms of reference for the Strategic Review identified four main areas of focus: market and competition; public-policy objectives and responsibilities; commercial activities; and financial and performance targets.

An independent Advisory Panel, appointed to undertake the Review, met with many stakeholders, including Canada Post's senior management and Board of Directors, various customers, mailer associations, suppliers, unions, competitors and government officials. The panel also sought input from all Canadians through written submissions.

In September 2008, we submitted our vision and recommendations to the Strategic Review concerning the company's future ability to provide service to Canadians on a financially self-sustaining basis. In summary, Canada Post highlighted the need for reform through these key proposals:

- A measured and controlled approach to any changes to Canada Post's exclusive privilege for letters to ensure alignment between the scope and funding of the universal service obligation, and to allow the company to adjust to a liberalized market
- Compensation at market levels and on commercial terms for any public-policy services that we provide on behalf of Government, so that the costs of such services are not borne by postal users through higher rates
- Adoption of a proximity-based standard for retail postal services and establishment of a clear definition of rural and urban communities, to update the conditions around the current moratorium on the closure of rural post offices
- Greater regulatory pricing flexibility
- Regulatory flexibility for Canada Post's Pension Plan solvency obligations
- Access to increased levels of borrowing commensurate with the size and scale of the company's business and capital needs
- An independent third-party review of the overall competitiveness of the collective agreement with the Canadian Union of Postal Workers, our largest union, and its alignment with Canada Post's service and financial sustainability
- Implementation of an employee share ownership plan
- Clarification and strengthening of the role of Canada Post's Board of Directors

The Advisory Panel submitted its report and recommendations to the Minister in December 2008. We anticipate that the Government's consideration of the Panel's report and its subsequent response and direction will be forthcoming in 2009.

### 2.3 Strategic vision – Building the Modern Post

Our vision is for Canada Post to be a service provider of choice, an employer of choice and a socially responsible company. Achieving this vision involves continuous transformation and change in a rapidly evolving postal market where consumers and businesses have more choices than ever and where global integrators, some owned by foreign Posts, pose stiff competition.

In 2008, we embarked on a massive transformation program to invest in updating our outdated physical and technological infrastructure. Indeed, remaining financially sustainable and relevant hinges on our ability to embrace market changes and to see our Postal Transformation plan through.

Although the current serious economic downturn threatens to reduce our revenues and mail volumes, we must stay the course. A sound modernization plan, linking our physical network to a relevant electronic network, is critical to respond to Canadians' current and future needs. We must make our operations more efficient, safer for our employees, more environmentally friendly, and better able to respond to changes in volume and customer demand if we are to achieve our vision.

#### Laying the foundation

Canada Post has operated a national network for many years. To deliver to some 15 million addresses every day and meet service commitments to customers, all elements of the network must work in harmony.

A number of strategic initiatives designed to build the Modern Post are now underway, as outlined below.

#### Engage our Employees

Ensure our people understand what they can do every day to be successful

- Communicate directly with employees
- Instill a passion for health and safety

#### Invest in our Infrastructure

Build the most efficient and productive Post

- Invest in plants, equipment and technology
- Use investment to defend current business and secure our future

#### Grow our Business

Diversify into new, profitable revenue streams

- Use the new platform to deliver additional near-core products and services
- Seek opportunities to grow revenue in new areas

We have made strong progress in our journey and laid the foundation for the transformation of our company. In the past two years, we have increasingly shifted our mindset toward our customers, continuously improved our employees' level of engagement, commitment and job satisfaction, and improved productivity. In 2007, we intensified our efforts to engage our employees and improve health and safety. We further clarified our long-term strategies and roadmap for building the Modern Post. This foundation better positions us to make necessary investments to revitalize our core infrastructure, allowing us to become more competitive, flexible and able to deliver a new value proposition to our customers and our customers' customers.

### Postal Transformation

In 2008, we set the groundwork for our Postal Transformation plans, including approval to proceed with our infrastructure modernization. Inadequate investment in our core infrastructure has left our network in great need of renewal. Our aging infrastructure stands in the way of our priorities for modern, efficient operations. New infrastructure will provide capabilities to enhance our product and service offerings so we can defend and grow our core businesses.

Over the next five years, investment of up to \$2.7 billion, including \$2.3 billion of capital expenditures, would be needed to support Postal Transformation. This amount is in addition to almost \$1 billion of capital investment needed to support ongoing operations. Given the current economic climate, we intend to monitor our financial position closely and adjust spending as needed. Current commitments over the five-year plan period have been limited to the most critical investments, which are expected to total \$750 million until we can ensure adequate financing. See *Section 6.6 – Liquidity and capital resources on page 64*.

However, the critical operating components must be modernized, as much of our existing equipment has reached its technological limits and needs to be replaced or updated. Every day, we are at risk of not being able to meet our service commitments due to breakdowns of this antiquated equipment. Contingencies are in place, but these are not effective solutions over the long term. Modernization will also address the health and safety hazards posed by our aging infrastructure to provide better tools and safer working conditions for our employees. Much of our current operating infrastructure was acquired in the 1970s and 1980s and limits operating flexibility, reliability and maintainability. Extensive and costly workarounds are required to address new service offerings or to deal with mechanical and software breakdowns.

The transformation aims to enable annual cost savings made possible through increased automation and productivity improvement. Anticipated benefits will be achieved through leveraging the coming wave of attrition, as close to one-third of our employees become eligible for retirement within ten years.

Postal Transformation intends not only to enable important efficiencies throughout our physical and electronic network by reducing labour-intensive work, but also provide the platform to develop and deliver enhanced features and innovative services to customers.

Canada Post's plans for Postal Transformation are to invest in equipment modernization and new technology that is intended to:

- Modernize operational processes for better and more reliable service;
- Enhance letter automation equipment for standardized, high performing operations and maintenance;
- Automate manual sequencing to facilitate Canada Post's ability to respond to attrition requirements and changes in market mix as well as improve productivity and efficiency of operations;
- Create a motorized delivery force;
- Replace and/or improve current plants; and
- E-enable the physical network to meet new customer expectations and generate alternate revenue streams to reduce our financial reliance on declining lettermail volumes

Investments in modernization and obsolescence replacement are expected to produce modest cost savings in 2011, which will increase yearly as investment progresses, and to generate permanent cost reduction of more than \$300 million annually upon full program implementation and stabilization in 2016. The majority of anticipated savings will be derived from synchronizing upcoming accelerated attrition with machine sequencing of the mail to each point of call thus minimizing reliance on manual work. Additional savings will result from increased productivity of new equipment and processing efficiencies through the implementation of new technology and world-class ergonomic material handling methods and processes.

A significant milestone in our plan is the Winnipeg City Transformation. In 2010, a new mail processing plant – the first in Canada in 20 years – is scheduled to open in Winnipeg after more than a year of planning and 18 months of construction. Sustainable development principles will be incorporated into existing sites and green design principles will be incorporated within our new buildings. We intend to focus on reducing operating costs in existing facilities through energy-saving initiatives, maintenance costs and increasing standardization in our new building designs. The introduction of new ergonomically sound mail processing equipment aims to reduce the amount of time employees spend manually handling and sorting mail, and reduce the physical risks associated with the repetitive nature of the manual sortation. More automation is expected to make possible total coverage of our network with fewer letter carriers than we require today, allowing us to take advantage of a window of natural attrition while



respecting all provisions in our collective agreements, including commitments relating to job and income security. Postal Transformation also plans to bring increased motorization, with more letter carriers using fuel-efficient, low-emission vehicles for delivery.

Without investment in transformation, we risk significant declines in core operational performance and quality as well as further declines in productivity and competitiveness. With our existing equipment and technology, getting the mail into the hands of our delivery force, with reliability and high quality, gets harder every day. Ultimately, the need for contingency plans and workarounds has made our operations more expensive and our ability to introduce needed change more complex and costly.

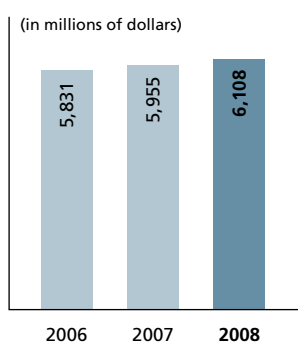
We face increasing risk of equipment, technology and service failures due to our aging infrastructure. Poor service performance and an inability to meet competitive service offerings will increasingly leave us as the supplier of last resort. Customers are already seeking better, predictable service from competitors. If we do not invest now, we anticipate that our ability to maintain or grow revenues will be negatively affected, as our competitors will continue to take our business if we are unable to offer similar basic features. The transformation is also essential to make our workplace safer, and to help us address high rates of injury and absences due to injury.

Despite the challenges posed by the economic downturn, Postal Transformation will first address critical infrastructure requirements needed to ensure essential business continuity. As part of our dedication to corporate social responsibility and employee engagement, we intend to make sure our investments and strategies meet sustainable environmental criteria as well as protect our employees' health and safety.

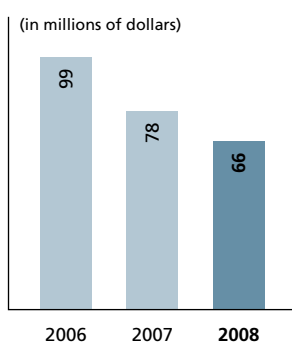
## 2.4 Canada Post segment

The Canada Post segment generated revenue of \$6.1 billion, which is approximately 79% of consolidated revenue from operations.

### Revenue

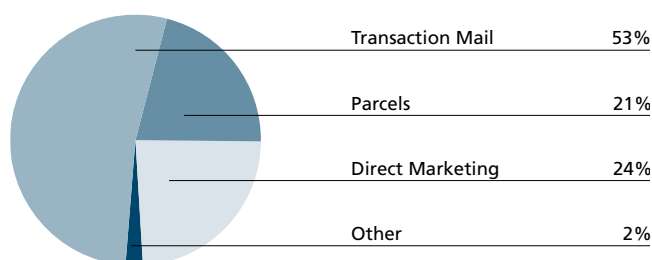


### EBT



The following chart illustrates the distribution of Canada Post revenue by line of business, as percentages of the segment's total.

### Operating revenues by market – 2008



| Operating revenues by market | 2008 | 2007 | 2006 |
|------------------------------|------|------|------|
| Transaction Mail             | 53%  | 54%  | 55%  |
| Parcels                      | 21%  | 21%  | 20%  |
| Direct Marketing             | 24%  | 24%  | 23%  |
| Other                        | 2%   | 1%   | 2%   |

## 2.5 Canada Post – Transaction Mail

### Our business

Transaction Mail, including bills, statements, invoices, payments and other letters in either paper or electronic form, is Canada Post's most profitable line of business. It accounts for \$3.2 billion or 53% of the Canada Post segment revenue of \$6.1 billion. Transaction Mail comprises three distinct delivery services: domestic Lettermail™, international Letter-post and epost™, our online bill-presentment service.

Transaction Mail also serves institutional customers' communication needs before and after delivery. Our SmartFlow™ Document Management Services allow businesses and governments to simplify and streamline the production and management of their communications. This suite of services includes various aspects of document creation, management, storage and retrieval. By handling data conversion and monitoring, we have given customers a more certain, valuable and flexible means to communicate with their own customers as they choose. We also ensure the information is integrated into our customers' Customer Relationship Management or Enterprise Resource Planning systems.

### Vision

*Our vision is to be recognized as a unique provider of multi-channel services that combine the physical mail stream and electronic channels with security and certainty, increasing communication value for our customers and their customers.*

## Business environment

Transaction Mail competes in the larger Canadian communications market that includes email, instant messaging, telephones and other means of communication. With our entry into document processing, Canada Post also has a presence in the outsourced data conversion market.

Lettermail volumes, under threat from the economic downturn, the Internet and email substitutes, continue to decline. In 2008, this decline was especially evident with the loss of consumer and small business stamp sales at retail postal outlets.

Canadians are shifting increasingly to email as a primary means of communication. More consumers are using electronic bill-presentment services and paying their bills online. Large mailers are consolidating the bills they send to their customers. The use of electronic filing services for transactions, such as income taxes, is growing.

For Canada Post, like other businesses, the rapidly changing economy presents one of our largest challenges. The economic crisis has put increased pressure on businesses and consumers to review their costs and look for more economical or valuable ways to serve their communication needs.

In 2008, Transaction Mail volumes decreased. At the same time as volumes are declining, the Canadian postal network is increasing each year, thereby increasing our delivery costs. These trends have resulted in less revenue per address to offset rising network costs.

| Transaction Mail                              | 2008   | 2007   | 2006   | 2005   | 2004   |
|---|--------|--------|--------|--------|--------|
| Total volumes<br>(in billions of pieces)      | 5.32   | 5.40   | 5.47   | 5.45   | 5.41   |
| Less outbound mail<br>(in billions of pieces) | (0.11) | (0.13) | (0.15) | (0.15) | (0.17) |
| Delivered volumes<br>(in billions of pieces)  | 5.21   | 5.27   | 5.32   | 5.30   | 5.24   |
| Delivery addresses<br>(in millions)           | 14.70  | 14.49  | 14.29  | 14.05  | 13.81  |
| Pieces of lettermail<br>per household         | 355    | 364    | 372    | 377    | 379    |

## Strategy

Our experience in 2007 and 2008 reflects our vulnerability to reductions and shifts in physical mail volumes. We are pursuing a mix of strategies to mitigate the impact of these trends. In 2009, we plan to focus on four strategic priorities.

After progress with our SmartFlow services in 2008, we plan to focus resources on its rapid growth in 2009. We are pursuing broader opportunities for document processing created by the initial SmartFlow Recover, Respond and Send services.

We intend to strengthen our current Transaction Mail services by adding value that will increase the effectiveness of our customers' key communications. Particularly in these difficult economic times, Canadians value and demand services with the strong historic trust of Canada Post's brand. By emphasizing this trust, we can add to our value and further distinguish our services. We intend to continue to add or enhance possible value-added features, such as communication activity data analytics, for all delivery services, including Lettermail.

We will strive to expand our business with small to medium-sized commercial customers. We must increase our connection with all Canadians to remain relevant to Canadian businesses. We plan to enhance and update electronic services so Canadians can more effectively choose in what form they receive their mail. In particular, we made good progress with epost in 2008, and plan to continue its evolution and integration with other secure electronic services during 2009.

We also remain focused on improving productivity to reduce costs. Continued investment in Postal Transformation would allow us to continue to improve our services, including increasing visibility of the mail and greater mechanization of mail processing.

## 2008 objectives and achievements

The following outlines the progress made against the three-pronged plan set out for Transaction Mail in 2008. Above all, we continued to meet our Lettermail service performance target of 96% as measured by an independent firm, assuring that our Lettermail service remains among the most consistently reliable services in Canada.

### *Refine products and services to meet the evolving needs of customers*

In 2008, revenue for Transaction Mail was effectively flat compared with 2007. Volume declined 2.0% year over year. Several achievements partially addressed this ongoing erosion.

- In August 2008, we launched the first of several services to provide a local look and feel to mail sent by Canadian exporters to other countries such as, in this case, the United States.
- We created stamps in 3,000- and 5,000-unit machine-affixed coils to satisfy the need of many customers who appreciate the value a stamp brings to their mail but send high volumes and need a machine-placeable stamp.
- We expanded successful contracts for SmartFlow Recover services in 2007 into two complete Document Management Service contracts in 2008, giving market credence to our latest document service offering.
- We collaborated with several of Canada's largest mailers to integrate our mail receiving, planning and scheduling to improve entry of mail into the mail processing network.

### **Develop markets**

In 2008, we renewed our focus on expanding our markets, helping customers find increased benefits by working with us.

- Canada Post ran an extensive promotional campaign in Southern Ontario last summer to raise awareness of epost's environmental friendliness.
- Experts from Canada Post and other companies travelled across the country to show our customers the ease and value of meaningfully customizing transactional customer communications. This approach – known as Transpromo – is expanding rapidly.
- Albeit on a small base, SmartFlow Recover and Respond services experienced triple-digit growth for the second year in a row, demonstrating that it connected with customers.

### **Invest in capabilities to improve productivity**

Three initiatives started or completed the creation of new capabilities to better serve customers and increase our effectiveness.

- Transaction Mail sponsored the International Postal Corporation (IPC) certification of international exchange offices in Montréal, Toronto and Vancouver. This was completed in 2008. IPC certification provides assurance to our international partners that we are efficiently processing and delivering international incoming and outbound mail in keeping with the best global practices.
- Over the next few years, we plan to invest in new letter-sorting equipment and a new mail-processing plant to improve the speed and reliability of service and to reduce physical mail handling and processing time. The first year of this long-term strategic renewal has progressed very well.
- We made strong progress in rationalizing the interfaces and internal processes across our print and electronic production environments in 2008, including the integration of SmartFlow and epost mailer consoles. This has laid the groundwork for added customer-facing capabilities, planned for 2009.

### **Financial highlights**

Transaction Mail revenue remained relatively flat at \$3,234 million in 2008, when compared with 2007. This represents an overall increase of 0.2%. Letter-related revenue decreased by 0.8%. Although volumes declined by 2.0%, this was offset by an increase of 1.2% in the average revenue for each piece. Also affecting Transaction Mail revenue were increases from epost, custom solutions, and a change in accounting estimate relating to the revenue deferral for stamps. *For further discussion of year-over-year results, see Section 8.4 – Results from Operations – Canada Post segment on page 72.*

## **2.6 Canada Post – Parcels**

### **Our business**

The Parcels line of business, which provides a broad range of domestic and international delivery services, accounts for \$1.3 billion, or 21%, of Canada Post's revenue of \$6.1 billion.

Within Canada, *Priority*™ Next A.M. service provides fast overnight delivery by noon, while economically priced Regular Parcel provides a non-time-critical ground service. *Xpresspost*™ is between the two, as a “deferred delivery” service providing next-day service regionally and two-day service nationally. Expedited Parcel is a fast commercial ground delivery service for businesses.

For international and U.S. destinations, a similar broad range is offered, including our new *Priority*™ Worldwide service, and our *Xpresspost*-International, Expedited Parcel-USA, International Air Parcel, International Surface Parcel and Small Packet™ services.

### **Vision**

***Our vision is to use the competitive advantage of our national network to become the standard for efficient delivery of parcels, offering clear end-to-end tracking and delivery flexibility to our customers.***

### **Business environment**

The Canadian shipping and delivery market is part of the larger Canadian logistics and supply chain management market that is worth \$45 billion.

The shipping and logistics business is a physical manifestation of trade. It is directly linked to economic activity and serves as a leading indicator of economic performance. The international economic downturn that affected Canada in 2008 has had a dramatic effect on the shipping and delivery industry, and our business. Fortunately, Canada Post was able to weather the storm better than many competitors. This was particularly true in the first eight months of the year, which saw volume growth in the face of industry declines. Our strength in ground and deferred services allowed us to counter volume declines as shippers turned to these services to replace competitors' more costly alternatives. By the fourth quarter, however, our business was negatively impacted by the severity of the economic deterioration, and our annual volumes dropped below the previous year. Inbound parcel volumes from the U.S. declined dramatically, in tandem with the fall of the Canadian dollar.

With an estimated value of \$6.8 billion in 2007, the originating market in Canada has five major players: Purolator, FedEx, Canada Post Parcels, UPS and DHL.

DHL, owned by Deutsche Post, the German postal administration, retrenched from the U.S. market after suffering severe losses. Much of DHL's U.S. business was absorbed by UPS, which now delivers to U.S. and international destinations for Purolator, in place of DHL. In Canada, Canada Post and FedEx™ entered into an arrangement where Canada Post delivers for FedEx Ground to rural and remote destinations. In addition, we have combined forces with FedEx to launch *Priority Worldwide*. This service is sold in Canada through Canada Post's retail and commercial networks and delivered worldwide through the extensive FedEx international delivery network. Also, UPS and Purolator entered into a similar arrangement where Purolator delivers to regions, including Atlantic Canada and rural and remote destinations, on behalf of UPS.

As transportation is a significant cost component of the industry, costs are highly dependent on the price of fuel. As a result, the industry uses a fuel surcharge as a means to correlate prices with fuel costs. High fuel prices in 2008 led to historic highs in fuel surcharges, with some competitors' surcharges on air services reaching 34.5%. Canada Post followed industry convention by introducing differentiated fuel surcharges for air and ground services in August 2008. We continue to monitor the level of energy prices and regularly adjust the fuel surcharge relative to market prices.

### Strategy

The Parcels line of business operates in a low-margin, extremely competitive market. We require improvements in service, productivity and visibility (track and trace) to grow profitably, delivering primarily to consumers.

We lead in home delivery in Canada, which, driven by e-commerce, is the fastest-growing market segment in the parcel delivery industry. E-retailers increasingly recognize the critical importance of delivery as a component of their value chain and are demanding ever-increasing sophistication from their delivery suppliers. For us, this means that tracking visibility – through increasing the number of scans for each item and improving the timeliness of those scans – is a strategic priority. As part of this, we must also look for ways to integrate more easily with shippers to give them ready access to shipping services and shipment data such as through web service interfaces. Improved online interfaces for receivers would let us further enhance the home delivery experience through services such as delivery alerts, online payment, and delivery or return options.

First and foremost, we will strive to improve delivery execution and service performance at the same time as we work to improve efficiencies to reduce costs. Postal Transformation investment initiatives are intended to improve parcel processing and delivery costs by renewing infrastructure and delivery processes across the Corporation.

### 2008 objectives and achievements

Parcels surpassed its revenue objective and reached its targeted improvement in the Customer Value Index. We also improved efficiency in processing and delivery, driving significant gains in our margin. Visibility was greatly enhanced. On-time delivery performance was not improved, however, and as a result, service performance targets were not met.

Achieving a loyalty score of 26% in 2008, Parcels marked the third successive year of attaining its Customer Value Index objective. Customer satisfaction was supported by a variety of customer-facing initiatives.

As visibility is an immediate strategic priority, we implemented numerous initiatives to support and improve it:

- The implementation of scanners on the packet sortation line in our two largest facilities, Montréal and Toronto, provided a new in-process scan.
- We purchased 4,800 additional Personal Data Terminals (PDTs) to complete network-wide automated scanning capabilities for our motorized delivery staff.
- We supported near-real-time scan data transmission by enabling cell chips in our PDTs and installing Wi-Fi capabilities in our plants and depots.
- We delivered more customer-friendly communication by making several web and telephone messaging changes.
- We supported our international product by adding a despatch scan within our three international exchange offices.

With the dramatic rise of the Canadian dollar in 2007, international inbound parcel volumes, mainly from the U.S., increased in the first three quarters of 2008. In response to this increase, we expanded the Toronto Exchange Office to a secondary site to expedite the Canada Customs clearance process and alleviate bottlenecks.

Learning from the successful introduction of quality work methods in Toronto in 2007, we extended that methodology into the western provinces to improve efficiency in our parcel hubs in Vancouver, Calgary and Edmonton.

While we did not achieve our targets for improving service performance in 2008, the Parcels line of business has laid the foundation for a targeted action plan in 2009. This plan is supported by a new air transportation network established together with Purolator and successfully launched in September 2008. This move brought our air network in-house, ending our reliance on commercial passenger airlines. This is an important step, as commercial passenger airlines are suffering from reduced cargo capacity because they use smaller aircraft and allow less passenger carry-on baggage.

Last fall, Canada Post and FedEx™ combined forces to introduce a new international service called *Priority Worldwide*. This service provides Canadian consumers with premium U.S. and international delivery. To strengthen the online market, we created a new product called eBay™ Flat Rate Box, which was supported with our first viral promotion.

To satisfy financial institutions' requirements for authentication of delivery of their card services, Parcels established a robust proof-of-identification process undertaken at our retail postal counters. The proof-of-identity service, launched in July, has been very successful and has exceeded growth expectations.

Further improving the e-commerce shopping experience for Canadians, our Borderfree™ service, which enables cross-border e-commerce capabilities for U.S. retailers, saw growth in 2008.

### Financial highlights

In 2008, the Parcels line of business had revenues of \$1,311 million, an increase of \$72 million, or 5.4%, when compared with the previous year. The revenue increase was driven primarily by an increase of 14.6% in the average revenue per piece, which was partially offset by a volume decrease of 8.3%. *For further discussion of year-over-year results, see Section 8.4 – Results from Operations – Canada Post segment on page 72.*

## 2.7 Canada Post – Direct Marketing, Advertising and Publishing

### Our business

Direct Marketing, Advertising and Publishing (Direct Marketing) accounts for \$1.4 billion or 24% of the total Canada Post segment revenue of \$6.1 billion. Addressed Admail™ and Unaddressed Admail™ (collectively "Admail" or "Admail products") are the primary products of this line of business. The Addressed Admail product targets promotional messages to specific businesses or individuals (for example, credit card applications). The Unaddressed Admail product enables our customers to reach specific neighbourhoods or regions across Canada (for example, store flyers).

We also distribute periodicals, including newspapers, magazines and newsletters. *As discussed in note 21 to the consolidated financial statements on page 131, Canada Post has been supporting Canadian Heritage's Publication Assistance Program and will do so, as directed by the Government of Canada, until March 31, 2009.*

### Vision

***Our vision is to be recognized as a foremost driver of effective, results-proven direct marketing in Canada, helping companies grow their business while serving as an industry leader in consumer knowledge, consumer protection and privacy, and multi-channel direct marketing delivery.***

### Business environment

Our Admail products compete in the \$24-billion Canadian advertising industry with other advertising media that range from traditional television and newspaper channels to email and text messaging. Our direct-mail products participate within the Direct Marketing sector, a growing segment within the broader marketing and ad services industry. In 2007, the direct marketing segment was valued at \$7.7 billion on an annual basis with an estimated growth rate of 8.6%. Growth expectations, however, are primarily driven by the interactive or online marketing services, a smaller subset of direct marketing. The significant downturn in world and domestic markets in the latter part of 2008 is affecting growth rates of all marketing media.

The direct marketing market is being shaped by major trends and challenges that, in turn, are driving the need for change. As budget pressures continue to grow, marketers are increasingly looking to improve the return on their marketing investments via media accountability. They are looking to make both their online and offline communications more responsive while reducing overall communication costs. The proliferation of marketing channels has cluttered the marketing environment and is dulling consumer response. This, in turn, is driving the need for communications to be more targeted and relevant to the intended audiences. Consumers also are changing the media landscape as they become more empowered and increase their influence over their private space. As well, environmental pressures are driving more marketers and service providers to adopt "green" practices.

Canada Post remains one of the largest players in the Canadian direct marketing business. Direct mail permits our customers to deliver targeted messages and offerings to highly defined target groups, and continues to enjoy high consumer acceptance. As the market transforms and demands increased measurability and effective marketing returns, the need for a multi-channel offering with greater analytical capabilities and more personalization will emerge as an essential part of doing business. Combining a multi-channel offering with enhanced data analytics and direct mail is expected to provide better returns, attention to consumer preferences, and sophisticated assessments of direct marketing's contribution to customers' profits.

## Strategy

Our strategy continues to focus on growth by enabling the industry's customer-centric marketing initiatives. We intend to develop products and services, knowledge, and capabilities to help marketers deliver the right message and offer to the right customer through the right channel at the right time. We intend to fuel growth by concentrating on four key strategic goals:

### **Customer-driven growth**

- Grow our share of direct marketing expenditure by demonstrating the impact and effectiveness of direct mail through trial programs of existing products to our large enterprise and retail customers, and by providing ongoing education programs for the marketing community (through seminars, case studies and direct marketing best practices).
- Help enable the marketing community with improved direct marketing products and services.
- Acquire new customers by making direct marketing more accessible to small and medium-sized businesses.

### **Product-driven growth**

- Continue to develop new products and services that meet our customers' needs.
- Offer more options that improve the effectiveness and return on investment of direct marketing campaigns. Our initiatives will focus on improving response rates, cost-effectiveness and measurability of results.

### **Improving the customer experience**

- Improve the customer channel experience and usability. We intend to make improvements across the value chain to improve customers' overall experience and focus on ensuring that customers' issues are resolved immediately.
- Move Canada Post from being a commodity to becoming a trusted marketing and solutions partner. We plan to continue to review trends and engage with both consumers and customers to better understand future needs.

### **Building our future**

- Transform our products to meet the needs of the Modern Post, using these new capabilities to develop new product offerings.
- Continue to build a Direct Marketing Centre of Excellence and drive strategic thought leadership throughout the industry.

## 2008 objectives and achievements

### **Changed market perceptions by building strategic thought leadership**

- We are building our credibility as a strategic marketer within the industry and with our customers, with more than 100 speaking engagements in 2008 alone. Canada Post's Direct Marketing team members are becoming widely recognized as knowledgeable leaders in the industry and with other Posts, and are often sought after as speakers. Presentations, ranging from the "ROI of Green" to "Direct Marketing's Creative Flexibility," underscore the value and effectiveness of mail while ensuring its sustainability.
- Through webcasts, webinars, seminars and direct customer meetings, our strategic advisor team is providing thought leadership and industry and customer knowledge to senior marketing audiences across Canada and the U.S. We have also taken a lead role in reducing the impact of mail on the environment by educating marketers, mail service providers and agencies through our "go green" section on Canada Post's website, launched last spring.
- We've introduced several tools to help educate and train new users of direct mail, including an interactive online tutorial, "Admail Advisor," and our "Sorted" magazine to provide customers with simple, easy-to-use resources and tools to plan and execute an effective direct marketing campaign. Both these tools are available at canadapost.ca.

### **Introduced new and innovative direct marketing products and solutions**

- We introduced new products and services to respond to customers' needs and to enhance the value we bring to them. We increased the dimensions of our Unaddressed Admail specifications and launched a new Oversize Unaddressed Admail product that offers marketers more size flexibility and a more competitive service for marketing. We also launched a Scented AdCard™ product, a sensory direct-mail piece, providing marketers with a creative approach to differentiation.
- We have improved our Publications Mail™ product by adding an electronic return service for undeliverable items. This new feature provides publishers with timely information to update their mailing lists, thereby reducing their future distribution costs. We have also enhanced our Business Reply Mail™ product by providing more space for advertising and soliciting on the card and envelope, and relaxing the artwork specifications. This allows customers to increase responses by producing cards that are more creative, visible and colourful.

### Enhanced business process to improve the customer experience

- We made progress in 2008 in the area of customer value. We ended the year having exceeded our target by three points. We introduced measures to improve our product offering and address customer needs. We have made our online walk maps easier to use and added to the information. We simplified our processes in many areas, including a streamlined approach to adjudication of Addressed Admail. We introduced a standardized new mail delivery and handling process at depots to ensure national consistency.
- Measures introduced this year to improve performance of our Admail products continue to make delivery more predictable.

### Financial highlights

In 2008, Direct Marketing revenue was \$1,431 million, an increase of \$40 million, or 2.5%, when compared with 2007. The revenue growth was primarily attributable to an increase of 1.7% in the average revenue per piece while volumes grew by 0.9%. For further discussion of year-over-year results, see Section 8.4 – Results from Operations – Canada Post segment on page 72.

## 2.8 Purolator segment

### The business

Purolator is a strategic service provider. Its ability to focus on the business-to-business segment of the market and its ability to share aspects of its cost base, such as air line haul, allows The Canada Post Group to offer more value at lower cost than if Purolator and Canada Post operated independently.

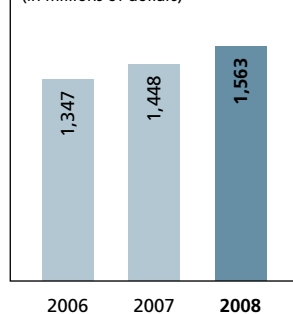
In 2008, Purolator Courier Ltd. (Purolator) was the leading overnight courier company in Canada with revenues of \$1.6 billion, or approximately 19% of Canada Post consolidated revenue of \$7.7 billion.

Purolator, owned 90.96% by Canada Post, delivers innovative products and dependable service. With 11,500 employees and a fleet of more than 4,000 vehicles, Purolator makes approximately 275 million deliveries and pickups each year.

For the second year, Purolator is very proud to be named one of Canada's 10 Most Admired Corporate Cultures in the 2008 Corporate Culture Study conducted by Waterstone Human Capital.

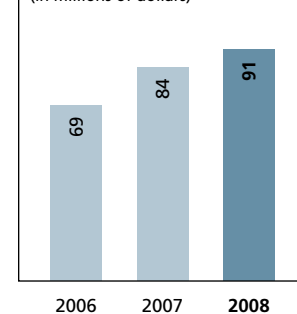
### Revenue

(in millions of dollars)

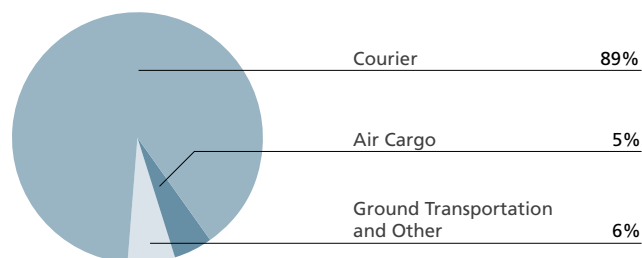


### EBT

(in millions of dollars)



### Operating revenues by market – 2008



| Operating revenues by market    | 2008 | 2007 | 2006 |
|---------------------------------|------|------|------|
| Courier                         | 89%  | 91%  | 93%  |
| Air Cargo                       | 5%   | 4%   | 3%   |
| Ground Transportation and Other | 6%   | 5%   | 4%   |

### Vision

**Purolator Courier aims to be the leading provider of integrated distribution solutions to, from and within Canada.**

### Business environment

As the country's leading provider of courier services with the largest market share (by revenue), Purolator continues to use its strong domestic position to increase its share of the northbound/southbound market.

Rapid change in the courier and transportation market continues, with larger and stronger competitors. What is more, some freight companies see courier products as an attractive new market, so there is less distinction between various industry sectors.

Globalization and industry consolidation are in part driving customer needs as they look to outsource more of their supply chain and transportation needs to reduce costs and focus on their core business. Customers are choosing suppliers based on their ability to offer creative solutions and a wider range of services as well as provide end-to-end shipment visibility and stronger integration of shipping systems with their information systems.

Innovations in information technology are dramatically and permanently changing customer expectations as well as the conduct of business and the management of transportation and distribution processes. The balance of power has shifted to customers and away from traditional transportation providers. It has led to the creation of new logistics service providers as competitors.

### Strategy

Purolator intends to continue its journey to transform the company through its core strategy and the "Purolator 2010" initiative, and to enable its employees to deliver improved service and enhance the customer experience.

Purolator's long-standing strategy includes the following elements:

- competitive advantage through investment in employees;
- sustainable market advantage through superior service and brand leadership;
- profitable growth through innovation in products and services; and
- continuous unit cost improvement through process innovation and technology.

In 2006, Purolator commenced its five-year transformation initiative, "Purolator 2010," which involves:

- the replacement of technology with new systems intended to make Purolator more customer-responsive and efficient;
- designs for new terminals to improve package sorting and delivery;
- an accelerated pace to process improvements to better Purolator's capability and effectiveness.

This transformation has required significant investment in technology, infrastructure and internal coordination. Purolator intends to continue to invest in its sorting plants and equipment, to make significant investment in its new freight business, and to further improve its cross-border capabilities to reduce operational costs and improve service. It also plans to invest significantly in its employees to ensure they have the knowledge, skills and abilities to maintain Purolator's leading position in the market.

In 2008, Purolator continued to evolve the way it manages its business. It continues to move customers over to its new customer-facing systems, to introduce new products and services, to expand coverage of premium products, to automate facilities, and to invest in automated reweigh and cube equipment.

### 2008 objectives and achievements

In 2008, Purolator completed several key milestones against its core strategy and the "Purolator 2010" initiative.

- After investing in a new state-of-the-art facility in Montréal and a new Port Kells terminal in Langley, B.C., in 2007, Purolator continued to invest in its facilities in 2008. Construction began on a significant addition to the existing hub in Richmond, B.C., while the hub remains fully operational. This state-of-the-art sorting facility will triple processing capacity, quadruple the number of unload doors, double the number of outbound doors, double the air sort capacity, and add an additional pickup and delivery sort line.
- By the end of 2008, all Purolator facilities were using new hand-held scanners. After extensive research, employee feedback and a review of industry standards, the project team chose a state-of-the-art scanner that is ergonomic, fast, durable, and has the ability to support future enhanced technology.
- Purolator continued its strategy to increase profits through new products and services. Purolator Freight™, its premium less-than-truckload (LTL) service, continued to expand capability and increased its revenues by 50%. Purolator USA continued to grow significantly with double-digit revenue growth over the past few years. In 2008, Purolator USA opened two new locations, in Philadelphia and Los Angeles, further expanding the company's reach in the U.S. market.
- The company launched Purolator Global Supply Chain Services™, which helps speed up delivery of overseas goods to store shelves. A new 106,000-square-foot facility in Richmond, B.C., was opened to serve medium-size companies importing goods from Asia but lacking their own logistics teams. As well, this facility will act as a "relief valve" for major companies when their own operations are stretched.
- Awareness of Purolator's premium service and brand leadership continues through its national advertising campaign. The 2008 campaign emphasized Purolator's reliability, flexibility and ability to provide solutions to out-of-the-ordinary shipping challenges.



## Financial highlights

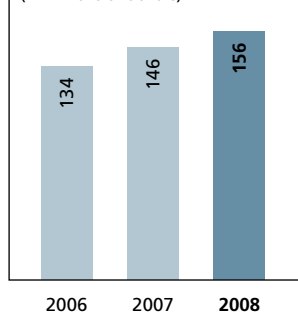
Purolator contributed \$91 million to Canada Post consolidated income before income taxes. Revenue totalled \$1,563 million, an increase of 7.4% over the previous year. *For further details, see Section 8.5 – Results from Operations – Purolator segment on page 75.*

## 2.9 Logistics segment

The Logistics segment consists of SCI Group Inc. (SCI), which is 98.74% owned by Canada Post. Our previous investment in Intelcom was sold in January 2007. The Logistics segment accounts for revenue of \$156 million, or approximately 2% of Canada Post consolidated revenue of \$7.7 billion.

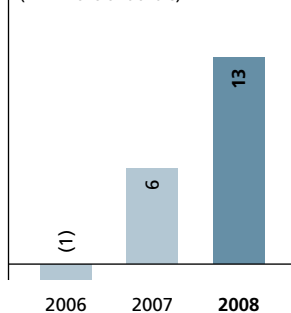
### Revenue

(in millions of dollars)



### EBT

(in millions of dollars)



## SCI Group Inc.

### The business

SCI Logistics Inc. had a corporate name change to SCI Group Inc. effective January 1, 2009. SCI expanded in March 2007 when it acquired The AMG Group. Through its subsidiaries, SCI offers order-management and inventory-management services, including order processing, inventory control, order fulfillment, reverse logistics, delivery and transportation. Each subsidiary has a specific market focus, allowing the embedding of its logistics outsourcing services within its clients' organizations, and thus enabling The Canada Post Group to offer Canadian businesses more comprehensive and end-to-end supply chain services.

### Vision

*SCI Group aims to be a leading source for global, worry-free supply chain services with local solutions, and to be differentiated by world-class solutions that make clients' complex supply chain problems simply disappear.*

## Business environment

SCI is one of the largest Canadian-owned logistics companies, although small when compared to global competitors such as UPS and DHL. While positioned in a strong and growing logistics outsourcing market, SCI Group must grow faster to keep up with the high growth rates achieved by its major competitors, which are consolidating globally to gain market share and scale in technology, back office and transport buying power. SCI Group's singular focus on the Canadian market makes it difficult to attract new large, global clients.

SCI's long-term growth and sustainability depends on its ability to provide services in markets outside Canada. Therefore, it is planning to access the U.S. market to attract and enhance its client base.

## Strategy

The strategic direction for 2009 and beyond is to continue expanding SCI's presence in the Canadian market and building a presence in the U.S. This will be done by continuing its client and corporate acquisition programs, together with an expansion of service offerings into additional lucrative industry verticals. To deliver on its commitments, profitability and value to all stakeholders, SCI intends to focus on the following strategic objectives:

- Grow by securing new clients in targeted markets
- Continue to build a culture of quality and innovation
- Leverage the capabilities of our operating companies and shared services
- Recognize corporate social responsibility through environmental sustainability stewardship programs

## 2008 objectives and achievements

In 2008, SCI continued to focus on growth by adding new clients in existing facilities, creating a culture of continuous improvement throughout the whole SCI Group, and implementing an effective performance management reporting and measurement system that allows both customers and SCI to monitor supply chain performance. In addition, SCI focused on growth through client and corporate acquisitions by working with external consulting companies in Canada and the U.S. to develop a strategy and value proposition for targeted companies.

## Financial highlights

SCI recorded income before taxes of \$14 million, an improvement of \$6 million over the prior year. The Board of Directors of SCI Group declared a dividend of \$5 million for 2008 that was paid to Canada Post in January 2009. SCI paid dividends of \$5 million and \$8 million for 2007 and 2006, respectively.

*For further details, see Section 8.6 – Results from Operations – Logistics segment on page 76.*

## 2.10 All Other segment

The All Other segment includes Innovapost Inc. (Innovapost), a joint venture between Canada Post (51%) and CGI Information Systems and Management Consultants Inc. (CGI) (49%). This segment previously included Canada Post International Limited (CPIL), which was a wholly-owned subsidiary.

### Innovapost

Innovapost services include the development, maintenance and operation of the computing and information systems required by The Canada Post Group. Innovapost provides application development and maintenance services and subcontracts infrastructure services to CGI.

Innovapost continues to bring value to the Group by reducing costs, improving service, and providing technology consulting services. It leverages its relationship with strategic partners, including CGI, to add value for its customers. Key agreements with The Canada Post Group, expiring in 2012, provide for an option to renew.

The Innovapost strategy is to assist its clients in converting savings in base operating costs to investment in new technology. In addition, Innovapost will invest in and expand its service offerings to The Canada Post Group and its customers as well as improving its internal systems, processes and capabilities, and transforming its application management and development services to world-class levels using industry standard tools, processes and methodologies.

In 2008, Innovapost continued to reduce base operating costs for its clients, passing on price efficiencies gained in application-management and infrastructure services, and keeping prices for Canada Post application-development services at 2006 levels. Innovapost achieved all its expected service levels and key corporate metrics, including customer satisfaction, employee satisfaction and service quality.

## Canada Post International Limited (CPIL)

CPIL was originally set up in 1990 to market Canada Post's technology and management expertise primarily to other postal administrations. CPIL had withdrawn from seeking new opportunities and was focusing on managing existing contracts, the most significant of which was a postal concession in the Netherlands Antilles.

CPIL owned 100% of Nieuwe Post Nederlandse Antillen N.V. (NPNA), the entity that operates the postal concession in the Netherlands Antilles. Compliance with certain terms of the agreement had been in dispute, with each party alleging defaults by the other. CPIL and the Government of the Netherlands Antilles reached an amicable agreement in December 2007. In April 2008, under the terms of this agreement, CPIL paid \$7.3 million to the Government of the Netherlands Antilles for terminating the concession 15 years early. In anticipation of this payment, CPIL had recorded a provision in the amount of \$7.4 million in 2007.

In April 2008, with the authorization of the Governor in Council under the *Financial Administration Act*, CPIL transferred all shares of NPNA to the Government of the Netherlands Antilles. Canada Post subsequently wound up and dissolved CPIL in November 2008.

## 3 Key Performance Drivers

*A discussion of the key drivers of our performance, our progress against 2008 objectives and 2009 priorities*

### 3.1 Key performance drivers

Canada Post uses a balanced scorecard management system to measure the company's progress relative to our vision and strategies, and to provide management with a comprehensive view of the business's performance. This approach ensures a balance between financial results, customer value, delivery performance and employee engagement when establishing key performance drivers and corporate priorities each year.

#### Customer value

Canada Post employs a customer value management process that uses relationship surveys and transactional questionnaires to identify what drives customer value and loyalty. These tools provide insight about our quality of service, competitive advantage and areas requiring improvement.

## Employee engagement




Each year, the Corporation conducts a survey to measure our employees' perceptions of Canada Post, their working environment, and their level of engagement. The employee survey is managed by an independent professional services firm. See Section 4.2 – *Capability to Deliver Results – Employee engagement on page 53.*

## Delivery performance






Our delivery standards require us to deliver Lettermail consistently within two business days within the same metropolitan area or community, three business days within the same province, and four business days between provinces. An independent professional services firm tests our Lettermail service by depositing mail through mailboxes and post offices, and tracking it to delivery points across the country. Canada Post also measures delivery performance for its Admail and Parcels products.

## Progress against 2008 objectives

### Legend

|  |  |  |
|--|--|--|
|  Achieved |  Partially achieved |  Not achieved |
|--|--|--|

## Customer Value

| 2008 Objectives  | 2008 Results  |
|--|---|
| Achieve Customer Value targets   |  The customer value target for the Parcels line of business was met for 2008, and the target for Admail was exceeded. The Transaction Mail line of business, however, fell short of its target despite efforts to enhance our relationships with large commercial customers and significant marketing investment to promote the value of Lettermail. |
| Commence implementation of Canada Post's physical delivery network modernization plans   |  Canada Post's network modernization program is progressing according to plan. Construction of a new Winnipeg facility, developing new operational processes and infrastructure solutions commenced and are on schedule for 2010 completion.   |
| Improve visibility of parcel tracking throughout the delivery network to increase the value of Parcels and improve customer satisfaction   |  Parcel visibility improved by expanding use of scanning equipment, activation of cellular chips in hand-held scanning terminals to enable wireless transmission of scanning data, and enhanced website track and trace messaging.   |
| Launch next generation parcels delivery confirmation solution to enhance delivery notification for our customers                           |  Pilot of portable wireless scanning terminals for letter carriers will commence in 2009 to improve timeliness of delivery notifications. Nationwide deployment will be considered on completion of the pilot.   |
| Implement Canada Post's online strategy to enhance the customer interface experience and support the growth of the online business channel |  Business website enhancements are underway to improve functionality for our customers. A new business desktop application will also make the website easier for customers to use.   |

## Financial performance

Financial performance is monitored through the line of business revenues, corporate earnings and financial ratios. For further information, see Section 1 – *Introduction and Financial Highlights on page 31 and Section 8 – Results from Operations on page 71.*

## 3.2 Progress against 2008 objectives

Canada Post employs a corporate dashboard to track and manage progress against our corporate priorities. Results are reported monthly to senior management. Here, we summarize our progress in meeting our 2008 objectives and provide an overview of our priorities for 2009.

**Progress against 2008 objectives (continued)**

**Employee Engagement**

| 2008 Objectives  | 2008 Results   |
|--|--|
| Achieve employee engagement target   | <ul style="list-style-type: none"> <li>● The 2008 Employee Engagement Index increased by three percentage points from 2007, reflecting a companywide focus on communication, respect, fairness and providing a healthy workplace.</li> </ul>   |
| Reduce accident frequency and create a healthy and safe workplace by delivering programs focused on raising safety awareness, accident prevention and adherence to safe operating practices. | <ul style="list-style-type: none"> <li>● Canada Post continues to proactively identify and control workplace hazards, and introduce programs focused on high-risk activities. While modest reductions in the number of accidents were achieved in 2008, accident frequency continues to remain at unacceptably high levels.</li> </ul> |
| Implement a new system to manage and report on accidents   | <ul style="list-style-type: none"> <li>● Development of enhanced accident reporting capabilities is underway to provide insight into strategies to further reduce accidents going forward.</li> </ul>  |
| Deliver technical and leadership development programs to increase productivity and enhance employee engagement   | <ul style="list-style-type: none"> <li>● Technical and leadership courses developed and provided to address high-priority operational and business requirements.</li> </ul>  |
| Provide more targeted and timely employee communications to ensure all employees share similar goals   | <ul style="list-style-type: none"> <li>● A targeted communications network implemented to ensure key messages are reaching targeted audiences efficiently. An in-house television network was developed and piloted in 2008, for deployment in 2009, to reinforce key messages to all employees.</li> </ul>                            |
| Develop an approach for corporate social responsibility (CSR) and begin to integrate environmental sustainability actions into Canada Post operations  | <ul style="list-style-type: none"> <li>● Board-level committee set up to oversee Canada Post's CSR strategy. Published first CSR Report to outline key targets and action plans. Several initiatives underway that incorporate CSR and environmental sustainability principles.</li> </ul>   |

**Delivery Performance**

| 2008 Objectives   | 2008 Results  |
|---|---|
| Achieve delivery service targets  | <ul style="list-style-type: none"> <li>● Lettermail delivery service target was achieved</li> <li>● Addressed Admail service target was achieved. Unaddressed Admail performance improved significantly during the year, however performance fell just short of the target</li> <li>● Parcels service fell short of expected improvement targets</li> </ul> |
| Improve Admail delivery process to further enhance on-time delivery performance and reduce cost of delivery | <ul style="list-style-type: none"> <li>● Unaddressed Admail delivery process modified, improving on-time delivery performance and reducing cost of delivery.</li> </ul>   |
| Implement strategy to increase Admail capacity to support this growing business                             | <ul style="list-style-type: none"> <li>● Programs have been developed that will improve Admail capacity. Implementation of initiatives commenced in 2008 and will be completed in 2009.</li> </ul>  |
| Ensure compliance with International "Pay for Performance" delivery requirements                            | <ul style="list-style-type: none"> <li>● International "scanning" targets met for all products. Lettermail on-time targets met. Parcels "on-time" performance fell short of targets.</li> </ul>   |

## Progress against 2008 objectives (continued)

| Financial Performance   |   |
|---|---|
| 2008 Objectives   | 2008 Results  |
| Deliver The Canada Post Group earnings commitment of \$127 million                                    | <ul style="list-style-type: none"> <li>● Consolidated income before income taxes of \$161 million exceeded plan by \$34 million.</li> </ul>   |
| Deliver Canada Post earnings commitment of \$25 million   | <ul style="list-style-type: none"> <li>● Canada Post income before income taxes of \$66 million exceeded plan by \$41 million. The shortfall in revenues was more than offset by savings generated through cost-containment actions and operational efficiencies achieved.</li> </ul> |
| Deliver Canada Post's revenue commitment  | <ul style="list-style-type: none"> <li>● The Parcels revenue target was achieved for the year. Transaction Mail and Direct Marketing revenues, however, fell short of their targets, in large part due to the economic downturn.</li> </ul>   |
| Develop options for long-term strategic revenue growth  | <ul style="list-style-type: none"> <li>● Several options driven by emerging market opportunities were developed, leveraging our existing and future capabilities. These options will continue to be refined over the coming year.</li> </ul>  |
| Deliver operational efficiencies without affecting the creation of customer value and service quality | <ul style="list-style-type: none"> <li>● Significant operational efficiencies were achieved during the year, in line with the established objectives.</li> </ul>  |

### 3.3 2009 priorities

For 2009, we must stay the course to be able to provide the quality service that Canadians expect and to remain relevant in the future. Our focus will be on ensuring the security of the mail, improving the safety of our employees, and maintaining our short- and long-term financial sustainability.

We will need to secure new sources of funding to meet our modernization imperatives and pension obligations during what will prove to be a very challenging economic period.

#### Security of the Mail

For years, Canadians have trusted us with their important communications. We are committed to preserving that trust. We are looking at every aspect of our extensive network to ensure it remains secure. Our priority is to improve the visibility of parcels throughout Canada Post's network, enhance customer access to tracking information, and update the Delivery Status and Claims processes to further improve the customer experience. These are just a few examples of actions that Canada Post plans to undertake in 2009 to make the customer experience right.

#### Safety of our Employees

The safety of our employees is paramount and we are committed to reduce the frequency of accidents. We intend to deliver programs focused on raising safety awareness, accident avoidance and prevention, and adherence to safe operating practices. Instilling a safe culture is a key element to employee engagement, which continues to be a key priority for Canada Post. In this regard, we plan to deliver national programs addressing leadership, productivity and customer-service culture. These programs are designed to ensure that our employees feel connected to our business and are better armed with what it takes to respond to our customers' needs.

#### Sustainability

As discussed earlier, we are facing a decline of our core businesses even as points of delivery – and our cost to deliver – increase by approximately 200,000 every year. Market volatility has had a severe impact on our pension assets and liabilities and, therefore, our cash available for much-needed investment. For 2009, we are facing some important challenges on many fronts, putting at risk our long-term financial self-sustainability. Canada Post is responding with tough cost-management measures to achieve our financial objectives. To ensure longer-term sustainable financial viability, we need a new financial framework developed in collaboration with our Shareholder. This framework is needed so that we are not only able to address our growing pension obligations, but we can continue our modernization imperatives if we are to be able to continue to provide service to Canadians and be relevant to our customers. We will ensure that spending commitments are within our current financial capacity.

## 4 Capability to Deliver Results

*A discussion of the issues that affect our ability to execute strategies, manage key performance drivers and deliver results*

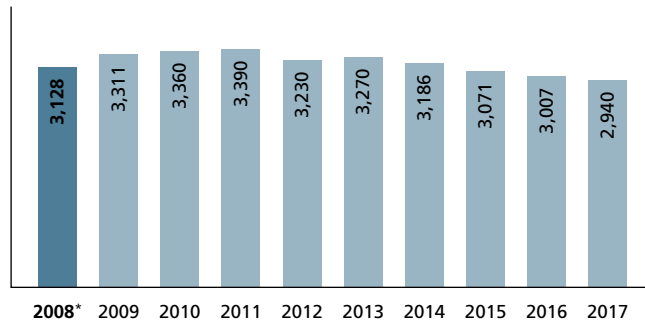
### 4.1 Employees

The Canada Post Group operates as one of Canada's largest businesses with 72,000<sup>4</sup> employees. Canada Post, a Top 100 Employer, employs approximately 59,800 people and our subsidiaries employ another 12,200.

Our company's transformation to the Modern Post depends on an engaged and highly skilled workforce. One of the biggest challenges facing Canada Post is to create a high-performing workforce in the face of skill shortages caused by an aging population, retiring baby boomers and a tightening labour market. To achieve our goal, we are focusing on recruiting the right talent, enhancing the work environment, increasing skill levels and developing future leaders.

An estimated 32,000 full-time employees will leave Canada Post between 2008 and 2017. Most employees will retire, but others will decide to leave to pursue opportunities emerging in a highly competitive labour market.

#### Full-time attrition forecast retirements and other departures



\* Forecast, including RSMCs

Note: 31,893 departures are expected by 2017 (including 23,583 retirements and 8,310 other departures). Forecast is based on retirement rates over the five-year period 1996–2000 and six-year period 2002–2007, and an average number of other departures from 2003 to 2007; includes Rural and Suburban Mail Carriers (RSMCs) – former contractors who became employees in 2004.

Despite the economic downturn in 2008, we continue to focus on employee engagement and talent management. As the economic climate changes and attrition accelerates, Canada Post must be in a strong position to acquire and develop talented leaders who can engage employees while keeping pace with customers' needs. In response, we have launched a comprehensive, multi-year plan to modernize and revitalize our national postal network and our workplace.

We have started several initiatives for talent management, leadership development and succession planning. The enhanced capability of e-recruitment and partnerships with suppliers have made it easier to recruit front-line, mid-management and executive-level employees in an increasingly competitive labour market. To address tight competition in Alberta for Rural and Suburban Mail Carriers (RSMCs), we entered into two outsourcing arrangements with suppliers to supplement recruitment activities of our Human Resources teams there.

Mentoring and training programs, such as "Leading Edge," for managers and superintendents emphasize coaching skills and serve to promote employee engagement. The new LEA 360 (Leadership Effectiveness Analysis) tool used in leadership development assesses current leadership practices against a desired leadership profile. This assessment is followed up by workshops and on-the-job assignments designed to increase leadership impact and effectiveness. Canada Post also believes in the power and importance of leadership development. In 2008, in partnership with Queen's University, Canada Post senior executives co-authored and delivered comprehensive development programs in six critical business areas: Finance, Strategy, Marketing, Sales, Operations and Human Resources; new modules will be added in 2009. These programs were well attended, highly praised, and resulted in a significant increase in engagement scores for the management team.

Canada Post has implemented an e-recruitment system for external hires and intends to use this capability in 2009 to manage the high demand for internal staffing created by attrition and employee movement. The public has responded well to this initiative and the bank of candidates continues to grow daily. For talent management and succession planning, the Corporation is now acquiring tools that will provide us with detailed talent information in real time. The talent management tools strive to bring visibility to our current talent pools and increase our capability to respond quickly in this area. These tools are intended to allow us to better target our succession planning efforts and focus our leadership and other development initiatives on the right areas.

<sup>4</sup> Employment figures include full-time and part-time paid employees, excludes temporary, casual and term employees

## 4.2 Employee engagement

### Canada Post

Employee engagement continues to be a top priority for Canada Post. We remain committed to our goal to become the best place to work in Canada, with every employee contributing to and sharing in our success. Our efforts to increase the level of employee engagement appear to be having a positive effect as seen by yearly improvements in our Employee Survey results. As well, Canada Post has been named a Top 100 Employer for the third consecutive year by Mediacorp.

In 2008, our efforts to achieve higher levels of employee engagement remained focused on respect and fairness in the workplace, strong dedication to employee health and safety, and a concerted effort to create a dialogue with our employees.

Carrying out the strategy involved extensive face-to-face communication with front-line team leaders and their employees. For the third year, the president and several senior executives held 15 Regional Forums across the country. In attendance were more than 2,500 team leaders and, for the first time since the Forums were created, more than 500 employees represented by the Canadian Union of Postal Workers. Executives shared our business results, our plans for Postal Transformation, and encouraged employees to offer their ideas about how we can improve our company's performance on health and safety, the environment and service to customers. Significantly, many vice-presidents and general managers met with small groups of employees in their workplace. More than 600 such meetings with some 10,000 employees took place in 2008. The Forums and executive visits were held to connect our front-line employees and supervisors to the Corporation by sharing our strategies and business results. Most importantly, these initiatives are designed to stimulate a dialogue with employees.

Again in 2008, our employee engagement efforts included a very strong focus on employee health and safety. Canada Post is firm in our commitment to protect our employees from hazardous situations.

Canada Post continued to strengthen our health and safety management system and delivered safety training. This included extensive communication with team leaders and employees to ensure that health and safety is a top priority. Excellent leadership is the critical element of any engagement strategy. For this reason, the Corporation continued our efforts to improve the capability of our front-line team leaders to lead effectively by providing training for supervisors and middle management.

The results of the 2008 Employee Survey suggest that our efforts to increase employee engagement have been successful. Results in the majority of categories show improvement and we achieved the target set for the Employee Engagement Index, which increased by three percentage points on a year-over-year basis. These results are encouraging, but we believe much remains to be done to achieve higher levels of engagement.

Our employee engagement strategy for 2009 remains much the same as 2008. Our plan is to continue to build a workplace characterized by fairness and respect, along with an overarching concern for the health and safety of all employees, and leadership that encourages dialogue with employees. Our focus will be on developing and supporting front-line team leaders because they play a critical role in engaging their employees and helping achieve business results.

Efforts to have meaningful dialogue with our front-line team leaders and employees will continue, including the staging of Regional Forums and executive front-line discussions. Our plan is to continue to build a culture of health and safety through employee safety training and a leadership focus on safety management. We will continue to encourage team leaders to involve employees in decisions that affect their work and workplace, and to recognize and acknowledge the contributions of employees in serving customers and improving business operations.

### Purolator

Purolator continued to invest in its employees by ensuring that they have a safe place to work with the proper tools to do their job well. Sustained investment in employee training is an ongoing part of the foundation of Purolator's success. Quarterly Pulse surveys have replaced the biannual internal effectiveness survey, providing more timely information. The information collected helps measure progress throughout the year. To ensure Purolator continues to make progress in the areas identified as opportunities for improvement, employees are asked to bring their ideas and suggestions to their managers for consideration in local action plans. By addressing the concerns on a local level, as well as on a corporate level, all can work together to make Purolator an even better place to work.

### 4.3 Collective bargaining

The future of Canada Post is dependent on all our people. Recognizing this component of success, the company is committed to maintaining a professional and effective relationship with all of our unions. Only together can the parties maintain the long-term viability of the company despite a challenging economic environment.

It was both a challenging and successful year for collective bargaining at Canada Post. The following discussion summarizes our collective agreements and our continued progress towards building successful relationships between management and labour.

#### Number of bargained employees – Canada Post

| Bargaining unit | # of represented employees* | Collective agreement expiry date |
|-----------------|-----------------------------|----------------------------------|
| CUPW (1)        | 41,281                      | January 31, 2011                 |
| CUPW-RSMC (2)   | 6,368                       | December 31, 2011                |
| CPAA (3)        | 6,380                       | December 31, 2009                |
| APOC (4)        | 3,941                       | March 31, 2009                   |
| PSAC/UPCE (5)   | 2,001                       | August 31, 2012                  |
| <b>Total</b>    | <b>59,971</b>               |                                  |

\* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2008; excludes temporary, casual and term employees

(1) CUPW = Canadian Union of Postal Workers

(2) CUPW-RSMC = Canadian Union of Postal Workers – Rural and Suburban Mail Carriers

(3) CPAA = Canadian Postmasters and Assistants Association

(4) APOC = Association of Postal Officials of Canada

(5) PSAC/UPCE = Public Service Alliance of Canada / Union of Postal Communications Employees

#### Canadian Union of Postal Workers (CUPW) – Urban Postal Operations

We are now in the second year of a four-year collective agreement with the CUPW. This union represents the largest group of employees: plant and depot workers as well as letter carriers and mail service couriers. The current collective agreement expires January 31, 2011.

#### Canadian Union of Postal Workers – Rural and Suburban Mail Carriers (CUPW-RSMC)

Canada Post and the CUPW-RSMC are currently in the fifth year of an eight-year collective agreement. This agreement contains three contractual re-openers prior to its expiry on December 31, 2011, and the parties reached agreement on the second re-opener in July 2008. It is expected that the parties will commence the negotiation process for the third and final re-opener in October 2009.

#### Union of Postal Communications Employees (UPCE)

The collective agreement between Canada Post and the UPCE expired on August 31, 2008. The parties began collective bargaining in June, but talks broke down, resulting in a work stoppage. Employees who perform clerical and administrative work, including call centres, administration, finance and engineering, participated in a five-week strike that did not have any material adverse effects on the company's financial position or results of operation. Significant contingency efforts succeeded in mitigating the impact of the strike and allowed the company to continue to meet service objectives.

The newly ratified collective agreement, which expires on August 31, 2012, included a change from the current sick leave plan to a new Short-Term Disability Plan. We expect this change to reduce the level of absenteeism significantly.

#### Canadian Postmasters and Assistants Association (CPAA)

The current collective agreement between Canada Post and the CPAA, which represents rural post office postmasters and assistants, expires on December 31, 2009. Bargaining is expected to begin in the spring of 2009.

#### The Association of Postal Officials of Canada (APOC)

Canada Post and APOC, which represents supervisory and sales employees, began interest-based negotiations in November 2008. The current collective agreement expires on March 31, 2009.

#### Number of bargained employees – Purolator

| Bargaining unit | # of represented employees* | Collective agreement expiry date  |
|-----------------|-----------------------------|---|
| Teamsters (1)   | 8,917                       | December 31, 2011   |
| Other (2)       | 1,075                       | December 31, 2008<br>December 31, 2009<br>February 1, 2010<br>December 31, 2012 |
| <b>Total</b>    | <b>9,992</b>                |   |

\* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2008; excludes temporary, casual and term employees

(1) Teamsters = Operations

(2) Other = Clerical and administrative

In 2008, Purolator and the Canada Council of Teamsters, which represents operations personnel, entered into a new collective agreement, which was ratified in early May 2008. The agreement was reached without disruption of operations. This agreement is effective from January 1, 2008, to December 31, 2011. Purolator's strong partnership with its employees helped facilitate this mutually acceptable agreement.



Also in 2008, Purolator and a number of Teamster Local Unions, which represent some of its clerical/administrative employees in Ontario and Atlantic Canada, ratified new collective agreements. These agreements are effective from January 1, 2009, to December 31, 2012.

A number of other clerical/administrative collective bargaining agreements also expired on December 31, 2008, and bargaining for the renewal of those agreements will begin in early 2009.

#### Number of bargained employees – Logistics – SCI Group

| Bargaining unit | # of represented employees* | Collective agreement expiry date                            |
|-----------------|-----------------------------|---|
| CEP (1)         | 304                         | December 31, 2009<br>December 31, 2010<br>December 31, 2011 |

\* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2008; excludes temporary, casual and term employees  
(1) CEP = Communications, Energy and Paperworkers Union of Canada

#### 4.4 Workplace health and safety

Canada Post is committed to providing our employees with a safe and healthy workplace. Our focus in 2008 was on conducting formal health and safety audits, introducing safety leadership expectations and deploying accident prevention strategies for the most common types of accidents and high risks. We continue to build our Safety Management System and foster a safety culture. Although we did not meet our target for reducing accident frequency, progress has been made in putting health and safety programs in place.

A third party (URS) performed health and safety compliance and management system audits in 35 locations. By year's end, audits were completed. These audits include scores on various Health and Safety Management System elements based on the British Standard Occupational Health and Safety Assessment Series 18001 (BS OHSAS). The results of the audits will serve as a baseline against which we can gauge our improvement and will allow us to continue to build our Safety Management System.

As safety leadership is key to building a safety culture, safety leadership criteria were introduced in 2008 at the senior management level with clear expectations for their actions and behaviour. These criteria form part of the executive's official performance scorecard and will be introduced to all levels of management, including supervisors, in 2009.

Our most common type of accident remains what we refer to as "slips, trips and falls." In autumn 2008, we made a concerted effort to identify and eliminate on-route hazards in all regions before the snow and ice arrived. Our winter safety campaign included sending all delivery supervisors information to be shared with all employees, advice on safe processes,

guidance on footwear and anti-slip devices, and the need for mandatory on-route observations by team leaders. An extensive external safety communication campaign was developed for use on television and radio, online, and in print ads. We developed a new partnership and contest with Canadian Tire to encourage the public to clear their walkways. Canada Post put in place an accident-investigation tool to probe and pinpoint the root cause of slips, trips and falls.

Ergonomic-related injuries are also common. To better understand the risks for these injuries and to provide a mechanism to prioritize our efforts to prevent them, we developed a special ergonomic risk tool and used it to identify the highest risks. Strategies were then developed to address our top risks. A tool to investigate specifically ergonomic-related injuries was deployed to look into and identify the root cause of these accidents.

In 2008, we made great efforts to improve our current capability to analyze health and safety information and statistics, allowing for better understanding of costs, accident types and other trends needed to ensure focused strategies. These efforts will continue into 2009.

#### 4.5 Infrastructure

Up-to-date physical assets, including processing facilities and delivery and retail networks, are required to enable us to meet our service commitments and customer requirements. Investment in basic infrastructure has lagged, and significant capital expenditures are required to rejuvenate the asset base, modernize it and leverage new technologies. *This section should be read in conjunction with Section 6.3 – Investing activities on page 62 and Section 6.6 – Liquidity and capital resources on page 64.*

#### Canada Post

In 2008, Canada Post invested \$271 million in capital assets, primarily on buildings, systems and equipment.

In 2009, we plan to invest \$590 million in capital assets to maintain and replenish equipment and facilities, upgrade IT infrastructure and other systems/technology, and support business growth in key areas. Given the current economic climate, however, we intend to monitor our financial position closely and take action to mitigate any negative effects, including a reduction of capital spending, if needed.

Our Postal Transformation plan to renew our processing, delivery and technology infrastructure was approved by Canada Post's Board of Directors in October 2007. In the short term, we plan to replace aging equipment and essential items, standardize our operations, and implement a robust productivity management system. This is intended to enable us to defend our core businesses by providing more value to customers and lay the foundation for future growth.

Work began in 2008 to build a new mail processing plant in Winnipeg that will be a model for future plants across the country. The new plant will reflect the Modern Post, and will be equipped with upgraded technology and ergonomically sound, new generation equipment. It will also be more environmentally friendly, incorporating green technologies and conforming to recognized green building standards. In addition to the mail processing plant in Winnipeg, new letter carrier depots will be constructed and existing letter carrier depots will be retrofitted to support the process changes introduced by Postal Transformation. Canada Post is expecting to invest approximately \$160 million in Winnipeg for the new mail processing plant, letter carrier depots, new generation mail processing equipment, and to train employees on the new process and equipment.

Over the next five years, our plans contemplate and require further investment of up to \$2.7 billion, including \$2.3 billion in capital, on Postal Transformation. We will prioritize our investments based on the greatest need and spend only what we can afford, which at this time is estimated to be \$750 million.

The financial framework that we have proposed to the Strategic Review panel would provide the means to finance this necessary investment.

### **Purolator**

In 2008, Purolator continued its increased investment in technology, infrastructure, processes and employees, with the implementation of its business transformation strategy, "Purolator 2010." In 2008, Purolator invested \$117 million in capital infrastructure to support key milestones in the transformation, including purchase of prime real estate in the Toronto area for future expansion, expansion and automation of the Richmond, B.C., hub, a new terminal in Port Kells, B.C., extension of new hand-held scanners, and an upgrade to the existing SAP system.

In 2009, Purolator expects to slow down its investment activities. The 2010 initiative is expected to bring new strengths, increasing the reach and scope of Purolator's network, making it easier to find distribution solutions that fit customer requirements and ensure that Purolator continues to provide the customer experience that has made it Canada's largest courier.

### **4.6 Delivery**

Canada Post delivers mail to approximately 15 million addresses every business day through post office boxes, delivery to rural mailboxes, group and community mailboxes, and to the door. No other delivery company in Canada has such an expansive reach. To meet the challenge of increasing costs and a growing number of delivery points, we continue to strive to improve productivity across our network.

In urban areas, we have increased the efficiency of ongoing restructuring of letter carrier routes by using our Route Optimizer tool, introduced in 2007. This tool automates many of the tasks involved in designing routes, and ensures consistent standards and applications to create fair and equitable delivery routes for our employees. We are also continuing to implement more efficient and more ergonomically designed workstations for letter carriers to help improve sorting efficiency while providing a safer, healthier work environment.

We have also improved the quality of delivery by continuing to increase and enhance the address data in our Address Management System. In 2008, improvements to the Address Information Management System were extended to the vast majority of our letter carrier depots.

We continue to work with our employees to improve safety at the depot and on their routes. For example, we launched a national awareness campaign to minimize slips and falls and have ensured that all delivery personnel have access to anti-slip footwear aids.

Quality of delivery and on-time performance remain priorities as we met targets for our Lettermail and Addressed Admail products. We saw continued improvement in the delivery and performance of our Unaddressed Admail product, but performance for parcels still needs improvement.

In 2009, we will continue to focus on improving quality, achieving productivity gains, and enhancing employee safety. To assist us, we will also continue to improve our management systems in these three key areas.

### **4.7 Rural and suburban mail carrier health and safety**

Our rural customers, who comprise approximately 6% of 15 million Canadian addresses, receive their mail through rural mailboxes (RMBs). Continued urbanization throughout Canada has changed the flow and volume of traffic on previously quiet rural roads, resulting in potential safety hazards to Rural and Suburban Mail Carriers (RSMCs), our employees who deliver mail to these boxes. These employees have raised more than 2,200 health and safety concerns since September 2005 and 36,000 RMBs have been assessed as a result. To do this, Canada Post uses the Traffic Safety Assessment Tool (TSAT), designed by third-party experts in the field of traffic engineering and the first of its kind in North America. The tool can be used to assess any rural mailbox in any setting, and considers factors, which include road conditions, visibility and traffic volume. Seventy per cent of the boxes assessed so far met the safety criteria, allowing delivery to continue to those RMBs.

We have also undertaken a comprehensive proactive safety review of all other rural delivery routes and rural mailboxes. Approximately one-quarter of the total 843,000 rural mailboxes have been assessed to date, with completion expected over the next few years.

To avoid potential repetitive strain injuries, we hired contractors to assist rural carriers with mailbox delivery through the passenger-side window of their vehicles. A pilot project with 36 new right-hand-drive vehicles will be conducted to determine if these vehicles may constitute one long-term solution to these ergonomic concerns.

Together with the assessments, the Rural Mail Safety Review follows an elaborate community outreach process. We inform Members of Parliament about assessments in their ridings and advise them of the results and solutions adopted. We also keep municipal officials abreast of the information and consult them when choosing sites for community mailboxes. Finally, we make every effort to engage our customers throughout the review process, as their input and co-operation are vital to the success of this undertaking.

Over the next five years, the costs for assessing and resolving health and safety risks for the rural mailboxes are estimated to be \$220 million in operating costs and \$32 million in capital investment.

#### 4.8 Retail

Canada Post has the largest retail network in Canada with 6,618 post offices serving both consumers and businesses. The post office network consists of corporate-provided and managed offices and offices managed by private dealers. Stamps are also available for sale through a network of thousands of private stamp shops.

This year saw the continuation of the retail strategy outlined in previous corporate plans. We are continuing to focus on improving core services, standardizing the look and feel of post offices, and ensuring consistent access for Canadians through an expanding dealer network. For the second year, this strategy has meant Retail achieved consistently excellent results on customer surveys.

To further better the customer experience, we are proceeding to improve Retail automation. This program includes the development of a new point-of-service software and hardware platform that will be installed in the majority of the outlets in the network. The new system is already in operation in more than 300 sites in rural Canada. In 2009, we plan to extend the system to urban Canada and the rest of rural Canada. Retail automation is the foundation for future sales opportunities, including authentication services and delivery in rural Canada on behalf of retailers and courier companies (known as "last mile" delivery). Automation has also greatly improved our secure handling of financial products, such as money orders, in keeping with Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) requirements.

Canada Post has almost 4,000 post offices in diverse rural and remote locations, including people's homes. Occasionally, unforeseen events, such as resignation, retirement or fire, can affect the operation of a post office in a small community. In such circumstances, Canada Post always ensures that local mail delivery is maintained without interruption. In addition,

we explore options with community leaders to continue to meet the needs of the community. Our approach, called Community Outreach Communication, includes open consultation with federal and local officials and ensures that all parties know about these situations and can provide input. Decisions are made case-by-case as we seek to find practical solutions that satisfy the community by providing sustainable service.

#### 4.9 Internal controls and procedures

We are committed to the integrity, accuracy and reliability of financial disclosure to our stakeholders. In 2008, we continued our commitment to enhance the accountability and transparency of financial reporting. Using the framework developed by the Committee of Sponsoring Organizations (COSO), we continued to assess the design and operating effectiveness of internal controls over financial reporting. Although this assessment revealed a generally good state of internal controls, we have identified some opportunities for improvement. Remediation plans have been prioritized and are being implemented.

In 2009, we plan to implement an annual certification process on internal controls over financial reporting for the consolidated entity. This process follows the best-practices requirements of National Instrument 52-109 issued by the Canadian Securities Administrators (CSA), although, as a Crown corporation, we are not subject to the rules and regulations of the CSA.

### 5 Risk Management

*A discussion of the key risks and uncertainties inherent in our business and our approach to managing these risks*

There has been a shift in the corporate risk landscape in Canada over the last few years. As a result, in 2007 Canada Post management began to examine Enterprise Risk Management (ERM) practices and to enhance our activities in this respect. Although management at all levels already considers risks and opportunities in its business decisions, a more systematic, integrated and rigorous approach was deemed to be required to manage business risks in the future. The first step was an assessment of areas of greatest risk and identification of potential mitigation plans through workshops with senior executives, which took place in 2007 as an integral component of the corporate planning process.

Canada Post continued to implement ERM in 2008 with the establishment of formal oversight by the Audit Committee of Canada Post's Board of Directors and by our executive team. The team's responsibilities include approving ERM practices and objectives, determining the most significant risks to the Corporation, and ensuring that these risks are appropriately monitored, mitigated and managed.

We will continue to further evolve and improve our ERM processes in 2009 to better align risk assessments with industry best practices as well as the changing economy.

## 5.1 Definition of risk

Canada Post defines risk as any event or condition that could have an adverse impact on the Corporation's ability to meet our key strategic, financial and organizational objectives.

The following is a summary of the principal sources of both strategic and operational risk and uncertainty facing the Corporation and the associated risk mitigation activities.

## 5.2 Strategic risks

### Significant revenue declines

There is a risk that our revenues could decline significantly, driven largely by the current economic recession. The current economic crisis in the U.S. and around the world has led to significant economic uncertainty here in Canada. Slower economic growth could accelerate current lettermail declines, reduce parcel deliveries and affect direct marketing volumes as customers reduce discretionary spending.

Lettermail erosion in general remains a significant risk to our revenues. After predicting erosion for many years, Canada Post experienced a significant decline in lettermail volumes in 2008. Increased competition from international outbound re-mailers, shifts to electronic bill presentment, and consolidation of bills mean this erosion will likely continue. Although at this time we do not anticipate that lettermail volumes will erode sharply in the near future, there is a risk that this erosion could occur at a faster rate than forecast. As well, experience from Posts around the world suggests that volumes will continue to decline every year. At the same time, our costs continue to grow while the number of addresses increases across the country and the volume of lettermail received by each address is declining.

#### *Risk mitigation*

In an effort to combat revenue loss, Canada Post is continuing to expand its service offerings beyond the areas of vulnerability as well as aggressively providing multi-channel offerings that link the physical mail stream with the electronic channel.

Canada Post has also developed "stress-test" scenarios for our business plans, including recovery options for the short term. We will continue to monitor the general economic environment, and escalate those recovery actions as appropriate. Longer-term measures will be further defined and incorporated into upcoming business strategies and plans.

In 2008, we successfully implemented cost reduction and containment initiatives at Canada Post. In 2009, in addition to planned operational efficiencies, we are aiming to reduce planned expenditures to mitigate the effects of the economic downturn on our revenues.

### Pension deficits require significant funding

The Canada Post Pension Plan's two primary risk exposures are: (1) a decline in long-term real interest rates that increases the pension obligation on a solvency basis; and (2) below-expected

returns on the Pension Plan's assets, which reduces the assets available to meet that obligation. Both risks could require that the Corporation make larger funding contributions to the Pension Plan.

Financial markets performed poorly in 2008, resulting in the Pension Plan's return on assets being below the expected rate of return. This was somewhat offset by an increase in long-term benchmark interest rates during the year that reduced the present value of the pension obligation at the end of 2008. Overall, however, the funded status of the Canada Post Pension Plan deteriorated during 2008, leaving the Plan in a solvency deficit position at the end of the year.

The Canada Post Pension Plan's most significant concentration of credit risk was with the Government of Canada and the Provinces of Quebec and Ontario. This concentration is related primarily to the holding of \$2.3 billion of securities issued by the Government of Canada, \$451 million issued by the Province of Quebec and \$375 million issued by the Province of Ontario. Each investment portfolio within the total pension fund has a limit regarding exposure to any single corporate entity. No such entity represents more than \$140 million or 1.2% of total Plan assets. The Pension Plan's \$14 million (2007 – \$19 million) of non-bank asset-backed commercial paper will not have a material impact on the Plan.

Liquidity risk for a pension plan is the risk that more illiquid assets will need to be sold at inopportune times to meet benefit payments. Currently, the Canada Post Pension Plan receives employee and employer contributions sufficient to fund benefit payments. The Corporation does not expect to have to make special payments until 2010.

Long-term solutions for funding the pension (which is disproportionately larger than the company itself) must be resolved with the Shareholder.

*Further information is provided in Section 6.5 – Canada Post Pension Plan on page 63.*

#### *Risk mitigation*

Canada Post ensures that investment decisions are made in accordance with the Canada Post Pension Plan Statement of Investment Policies and Procedures (SIPP). The Pension Committee of the Board of Directors reviews the SIPP annually and makes any changes required as part of its support of the Board of Directors' fiduciary duty to provide oversight for the Pension Plan's investments and administration. An asset-liability study was conducted in 2008 and the Pension Plan's risk exposures were reviewed and updated as part of this study.

We have identified this risk in our submission to the Strategic Review panel and will also be making a submission to the Department of Finance in response to the discussion paper on improving the framework for federally regulated pension plans.

### **Unable to generate cash to finance Postal Transformation and other initiatives**

Significant investment is required for critical infrastructure renewal under Postal Transformation. Operating cash flows will not be sufficient to meet these requirements, so the need for increasing financing sources remains a significant risk. Currently, the amount Canada Post can borrow in the market is capped at \$300 million, subject to approval by the Minister of Finance. This borrowing limit does not match our needs. Access to outside capital is a critical step to making the investments necessary to ensure continued service by renewing our physical infrastructure, equipment and technology.

#### *Risk mitigation*

Canada Post must continue our dialogue with the Shareholder to ensure that key decisions are made by the Government in 2009 to allow us to move ahead with Postal Transformation for 2010 and beyond. Furthermore, the Corporation will only spend what it can afford, which at this time is estimated to be \$750 million.

### **Postal Transformation implementation**

The current Postal Transformation plan is extremely large and complex, which increases the risks associated with implementing on time and within budgets while still achieving the targeted cost savings. There are also risks that arise as there will be significant changes to our plants, equipment and processes. These will impact our employees and require a thoughtful and complex change management plan.

#### *Risk mitigation*

To reduce these risks, we are taking a phased implementation approach that will allow us to focus first on critical infrastructure and ensure that maximum savings are realized before proceeding with subsequent phases of the plan. We have also engaged the appropriate internal and external project management expertise. We have developed detailed change management plans for the initial phase and continue to develop plans for subsequent phases.

### **Inflexible cost structure**

There is significant risk to our financial self-sustainability driven by a limited ability to adjust our organization and infrastructure to react to changes in volume and revenues. Our current collective agreement with our largest union, the Canadian Union of Postal Workers (CUPW), does not allow us the flexibility to quickly remove significant operating costs. The agreement is one of the most complex, rigid and constraining in all of North America and contains a substantial number of cumbersome and inefficient restrictions that can both limit the quality of our service and our ability to implement change. They also shape the culture on the floor of our facilities. As a result, our labour agreement with the CUPW is both high-cost and

low-productivity. This is a key barrier to much-needed growth and diversification.

#### *Risk mitigation*

To mitigate this risk, we are removing costs where possible, as discussed earlier. We are also beginning to prepare for our next round of negotiations with the CUPW by engaging both the union and our Shareholder early in the process. The current agreement expires in early 2011.

### **Traditional view of the postal service inhibits transformation**

Canada Post has public-policy obligations that other service businesses don't have. Canada Post's legal framework requires us to provide a universal service while operating on a self-sustaining financial basis. Moreover, we are also expected and are pleased to provide services beyond the core mail service for reasons of public policy (for example, Parliamentary Mail, Library Book Rate, Food Mail Program).

Under the *Canada Post Corporation Act* and the associated regulations, a share of our business is protected from direct competition by means of our statutory exclusive privilege to collect, transport and deliver letters. The reserved market exists as a matter of public policy. It is meant to allow us a reasonable means to fund universal services to all Canadians. Within the reserved market, however, costs are rising, volumes are declining, and price increases are constrained. Our ability to replace this revenue is limited by vigorous competition in the parcels and direct marketing parts of our business.

The cost of our public obligations continues to rise, while the value of our exclusive privilege is declining. It is becoming increasingly difficult to manage these public-policy obligations without being properly compensated and without flexibility to manage price.

Transformation to more modern operating procedures is essential to deliver services at a quality level expected by Canadians and to remain viable.

#### *Risk mitigation*

To mitigate these risks, we have proposed a new financial framework that is the subject of our submission to the Strategic Review panel that would provide the framework to finance investments, protect services and provide for financial sustainability.

### 5.3 Operational risks

#### Health and safety

Safety and health concerns are a major risk for Canada Post. These concerns can be divided between accidents or injuries due to unsafe working conditions, and those due to delivery safety issues, including both Rural and Suburban Mail Carrier (RSMC) traffic-related hazards and letter carrier safety. Reducing the number of accidents for all employees continues to be a main focus.

##### *Risk mitigation*

We will be investing in our critical infrastructure through Postal Transformation, which will address many of our safety concerns. In addition, extensive work continues on assessing rural routes and implementing safe alternatives for our employees and customers as well as training to address awareness and prevention, the creation of a national safety business council, and stronger controls and accountability. For further information, see Section 4.4 – Workplace health and safety on page 55.

#### Mail security

Theft of the mail has increased in recent years because of the growing value of confidential personal information. Mail theft is a major concern for Canadians who trust Canada Post to securely deliver more than 11 billion pieces of mail each year. This trust is a very strong pillar in our brand reputation. Mail theft could result in hardship for our customers and serious damage to our reputation.

##### *Risk mitigation*

Mail security is one of our top priorities for 2009. To make the mail more secure, we are fortifying our mailboxes with new high-security locks. We place a high importance on the security of our workforce. The Corporation issues extensive security-related bulletins, policies and guidelines to our employees to mitigate the risk. We also have several physical security measures, including cameras and card access, and effective supervision of staff to reduce the opportunity for breaches. We initiated a Customer Risk Management Forum with our major customers to provide information and advice on best practices to prepare mail and minimize risk. Canada Post has a whole department dedicated to security and criminal investigations. This security force works closely with other postal administrations to stay ahead of emerging trends in criminal activity. It also partners with all levels of law enforcement agencies to investigate crime, stay ahead of the trends, and make processes more secure.

#### Business continuity

Investment in Canada Post's infrastructure has been inadequate in recent years, and the network is in need of renewal. The aging infrastructure could lead to service failures and an inability to meet future customer needs through innovation. Service failures could also result from major external events, including weather and power failures.

##### *Risk mitigation*

The Corporation is addressing this risk through the Postal Transformation plan, which encompasses major improvements to critical infrastructure to ensure continuity of service, with up to \$2.7 billion in investment over the five-year plan. We also have a business continuity plan in place and bypass plans that can be activated as appropriate.

#### Environmental sustainability

Growing environmental concerns pose a threat to our mail business. These concerns could impose changes to the way we do business, and could also bring a high level of attention to Canada Post as a participant in the mail value chain. If we do not manage these concerns, we could be affected in several ways, including decreased volumes (mostly Admail) and requirements to use different transportation solutions. Additionally, there may be other indirect adverse effects such as those resulting from damage to our reputation.

##### *Risk mitigation – Canada Post*

As part of our overall corporate social responsibility strategy, Canada Post is responding to these ever-pressing issues by instituting concrete measures to demonstrate our leadership role in sustainable development. One of our key commitments is to reduce our overall direct greenhouse gas emissions by 14% by 2012, based on our 2002 baseline of approximately 206 kilotonnes. To achieve this goal and to minimize our energy consumption, we have committed to make all our new buildings LEED™ (Leadership in Energy and Environmental Design) compliant. In 2008, eight new buildings have been registered for LEED certification, including our new Winnipeg plant.

We have also worked with the International Post Corporation (IPC) on two separate initiatives to better understand the environmental impact of the mail. First, we collaborated on an Environmental Measurement and Monitoring System that will help us monitor our carbon emissions with a common set of internationally recognized indicators within the industry. Secondly, we conducted a Life Cycle Analysis to better understand the key environmental impact of physical and electronic mail.

For our fleet, we believe the best potential for saving fuel and cutting greenhouse gases in the near term lies in two key strategies. The first is to purchase vehicles suitable for our delivery operations that have smaller engines and are more fuel-efficient. These vehicles are scheduled to replace our larger, less efficient step vans between 2010 and 2015. The second strategy is to work with manufacturers and after-market outfitters to find viable alternative vehicles, including hybrid vehicles, which will meet our operational needs.

Finally, for our various products and services, we have redesigned the paper, board and polyethylene prepaid envelopes sold under the brand names of *Priority* and *Xpresspost*. The envelopes are now made from recycled material, approved by the Forest Stewardship Council, and are carbon neutral. We also have launched the Canada Post green mail site ([canadapost.ca/green](http://canadapost.ca/green)) to educate consumers and major mail users on ways to reduce the environmental impact of their mailings.

#### *Risk mitigation – Purolator*

Purolator continues to be an industry leader with respect to investment in hybrid electric vehicles (HEVs) in its curbside delivery fleet. Its leadership position and experience with hybrid technology means Purolator has been selected to participate in a pilot test involving a new hydraulic hybrid courier delivery truck. The pilot is part of a U.S. government corporate partnership led by Westart/Calstart's Hybrid Truck Users Forum, a national, multi-year, user-driven program to assist the commercialization of heavy-duty hybrid technologies.

In 2008, Purolator participated in an effort to divert 13.4 metric tons of electronic waste from city landfill sites. More than 340 passenger vehicles dropped off unwanted computer equipment during the Purolator Recycling Drive. Purolator employees filled two five-ton trucks and one 32-foot tractor trailer and transported the electronic waste for disposal. Electronic items contain toxic substances, such as lead, cadmium and mercury, that pose serious environmental and health risks when buried in landfill sites.

#### **Attrition**

Most companies, including Canada Post, will be facing risks from attrition in the coming years. This provides an impetus to improve processes to coincide with attrition rates, but it also poses a risk around competing for skilled resources to meet the needs of the Modern Post. A major challenge will be to attract, develop and retain new employees while ensuring critical knowledge is transferred from departing employees.

#### *Risk mitigation*

Succession planning and addressing knowledge management and transfer are key mitigating strategies in this area. We are also continuing to strive to be an employer of choice through improved working conditions and strong communications.

#### **Privacy**

Increasing privacy legislation will provide a continual risk to Canada Post. The national "Do Not Call" list launched in Canada on September 30, 2008, could provide an opportunity to the Corporation, but could also pose a risk, as it will raise awareness about "Do Not Contact" issues across all channels. There are also risks that arise if there are gaps in compliance between ourselves and our customers.

#### *Risk mitigation*

Increasing our ability to target customers' preferences may allow us to combat the negative perception surrounding unsolicited advertising mail and thus mitigate this risk. We have also formed a cross-functional working group to address privacy issues and to raise awareness and understanding of privacy issues.

#### **Legal risk**

Canada Post has made no provision for the following claims. Should the ultimate resolution of these actions differ from management's assessments and assumptions, a material future adjustment to the company's financial position and results of our operations could result.

##### **a) Pay equity – PSAC**

The Public Service Alliance of Canada (PSAC) has filed a complaint against Canada Post that office clerks did not receive equal pay for work of equal value compared to postal clerks and letter carriers. The Human Rights Tribunal found Canada Post liable and ordered payment for lost wages, discounted by 50% because of poor quality of evidence. Canada Post and PSAC appealed to the Federal Court Trial Division.

In February 2008, the Federal Court Trial Division allowed Canada Post's application for judicial review to set aside the decision of the Canadian Human Rights Tribunal, and has referred the complaint back to the Tribunal with the direction that the complaint be dismissed as not substantiated according to the legal standard of proof.

The Commission and PSAC appealed the decision to the Federal Court of Appeal in March 2008. Parties are in the process of exchanging written arguments. The case will likely be heard in the fall of 2009.

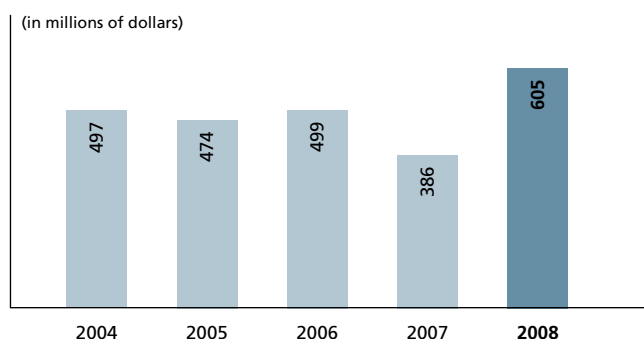
##### **b) Volumetric process – Lee Valley Tools**

A class-action suit was filed in August 2006 in the Superior Court of Ontario alleging that Canada Post violated the *Weights and Measures Act* based on Canada Post's volumetric process. This action was certified as a class action pursuant to the *Class Proceedings Act* in December 2007. Examinations for discovery on the threshold issue are expected to be completed in 2009.

## 6 Liquidity and Capital Resources

A discussion of our cash flow, liquidity and capital resources

### 6.1 Cash and cash equivalents



Canada Post held cash and cash equivalents in the amount of \$605 million at the end of 2008 – an increase of \$219 million, when compared with 2007. Cash equivalents, which consist of investments with original maturities of three months or less, are readily convertible to cash and have an insignificant risk of future changes in value. With the uncertainty created by financial market volatility in 2008, maturing investments were reinvested in cash equivalents rather than short-term securities to minimize risk.

### 6.2 Operating activities

| (in millions of dollars)              | 2008 | 2007 | Change |
|---------------------------------------|------|------|--------|
| Cash provided by operating activities | 597  | 344  | 253    |

Canada Post generated \$597 million in cash from operating activities in 2008 – an increase of \$253 million, when compared with 2007. Cash was provided primarily by the Canada Post segment (\$492 million) and the Purolator segment (\$91 million).

This increase was primarily due to:

- Changes in non-cash operating working capital increased by \$236 million, primarily salaries and benefits payable (\$129 million) and accounts payable and accrued liabilities (\$46 million). *Further details are provided in note 18 to the consolidated financial statements on page 130.*
- Payments for pension, other retirement and post-employment benefits decreased by \$56 million, when compared to 2007. This was primarily due to the cessation of employer contributions in July 2007 due to the Pension Plan's surplus position at that time. Employer contributions recommenced in November 2008 due to the decreasing return on plan assets in 2008.

- Net income increased by \$36 million, as described in Section 8 – Results from Operations on page 71.

The cash provided by the increase in net income was more than offset by the following:

- The accrual for pension, other retirement and post-employment benefits decreased by \$101 million due to non-cash gains caused by increases in the long-term interest rates used to discount the benefits' obligation for accounting purposes, higher expected long-term rate of return on plan assets, and gains resulting from plan amendments.

### 6.3 Investing activities

| (in millions of dollars)          | 2008 | 2007 | Change |
|-----------------------------------|------|------|--------|
| Cash used in investing activities | 434  | 513  | (79)   |

Cash used in investing activities decreased by \$79 million in 2008, when compared with 2007, primarily due to:

- Canada Post's net position in short-term investments from normal cash management transactions increased by \$36 million, compared with an increase of \$230 million in 2007;
- Cash used in business acquisitions and dispositions decreased by \$1 million.
  - In 2008, CPIL transferred its shares in NPNA (and related assets and liabilities) to the Government of the Netherlands Antilles. This included cash of \$5.5 million. CPIL also paid \$7.3 million for terminating the postal concession early.
  - In 2007, SCI acquired The AMG Group for \$13 million.

This was partially offset by the following:

- Investment in capital assets increased by \$60 million, as described below;
- Proceeds from the sale of capital assets decreased by \$54 million, reflecting the sale of two properties in 2007.

### Capital expenditures

| (in millions of dollars)     | 2008       | 2007       | Change    |
|------------------------------|------------|------------|-----------|
| Canada Post                  | 271        | 237        | 34        |
| Purolator                    | 117        | 83         | 34        |
| Logistics                    | 6          | 13         | (7)       |
| All Other and intersegment   | (3)        | (2)        | (1)       |
| <b>The Canada Post Group</b> | <b>391</b> | <b>331</b> | <b>60</b> |



Capital acquisitions for The Canada Post Group increased by \$60 million in 2008, when compared with 2007.

- Canada Post segment capital expenditures increased by \$34 million in 2008, when compared with 2007.
  - Real estate capital expenditures decreased by \$17 million, due to the new focus on Postal Transformation infrastructure needs;
  - Traditional asset maintenance/replenishment programs did not change, however the implementation of major Postal Transformation initiatives resulted in an expected increase in capital spending of \$31 million;
  - The three lines of business introduced new initiatives with incremental spending of \$11 million;
  - Capital spending related to sales and retail increased by \$17 million, including retail automation;
  - Spending on other infrastructure and strategic projects decreased by \$8 million.
- Purolator segment capital expenditures totalled \$117 million in 2008 – \$34 million higher than 2007 – as it continued its multi-year initiative to replace and automate its major hubs and transform its technology. Purolator's investment focused on investments in facilities, new technology, and health and safety. Purolator has now replaced its customer-facing technology platform with systems that allow it to be more responsive to customer needs, help set standards within the industry, and improve efficiency. This includes additional capability within the SAP software application system and the roll-out of its new state-of-the-art hand-held scanners. From an infrastructure perspective, Purolator continued to replace some of its older facilities with newly designed terminals to improve the flow of packages while maintaining a healthy and safe work environment.
- Logistics segment capital expenditures decreased by \$7 million in 2008, when compared to 2007, primarily due to a restructuring program in 2007 related to the contract renewal with SCI's largest customer.

## 6.4 Financing activities

| (in millions of dollars)              | 2008 | 2007 | Change |
|---------------------------------------|------|------|--------|
| Cash provided by financing activities | 56   | 56   | 0      |

There was no change in cash flows provided by financing activities in 2008, when compared with 2007.

- Dividends paid to our Shareholder decreased by \$25 million, due to the decline in 2007 net income from 2006; this was offset by:
- Transitional support, received from the Government of Canada to assist with incremental costs incurred as a result of establishing the Canada Post Pension Plan, decreased by \$25 million in 2008. The declining transitional funding will end in 2010.

## 6.5 Canada Post Pension Plan

The Canada Post Pension Plan is required to file periodic actuarial valuations with the Office of the Superintendent of Financial Institutions. These actuarial valuations are required to set out the funded status of the Canada Post Pension Plan on a going-concern and a solvency basis. If the actuarial valuation reveals a shortfall of assets to liabilities on a going-concern basis, the *Pension Benefits Standards Act, 1985* requires us to make special payments into the Canada Post Pension Plan to eliminate this shortfall over 15 years. Where the actuarial valuation reveals a shortfall of assets to liabilities on a solvency basis, then the *Pension Benefits Standards Act, 1985* requires us to make special payments into the Pension Plan to eliminate this shortfall over five years. The Minister of Finance presented the Government's solvency funding relief proposal in the November 2008 Economic and Fiscal Statement. The proposal will allow federally regulated private pension plans to extend their solvency funding payment schedule from five to ten years in respect to solvency deficiencies reported at a plan year-end from November 1, 2008, to October 31, 2009, provided that either the members and retirees agree to the extended schedule, or the difference between the five- and ten-year payment schedule is secured by a letter of credit. On January 9, 2009, the Minister of Finance released a discussion paper on improving the framework for federally regulated private pension plans. The purpose of this paper is to get the views of Canadians on issues related to the legislative framework for federally regulated pension plans, including solvency measurement, funding and contribution holidays, with the objective of making permanent changes in 2009. On January 27, 2009, the Minister of Finance tabled the 2009 Federal Budget. The Budget indicates that the temporary solvency funding relief measures proposed in the November 2008 Economic and Fiscal Statement will be put into place upon passage of the Budget; reiterates the government's intention to make permanent changes to the legislative and regulatory framework for federally regulated pension plans by the end of 2009; and proposes to change the current rule that limits asset value smoothing in solvency valuations to 110% of market value by subjecting smoothed asset values over 110% to a deemed trust in the event of bankruptcy. Allowing asset smoothing to exceed 110% of market value will reduce required contributions for many federally regulated pension plans.

The actuarial valuation for the Canada Post Pension Plan as at December 31, 2007, disclosed a going-concern surplus of \$1,257 million and a solvency surplus of \$449 million, as compared to a going-concern surplus of \$993 million and a solvency surplus of \$283 million as at December 31, 2006. In June 2007, the Board of Directors of Canada Post authorized recovery of special payments previously made to the Canada Post Pension Plan as provided in the Canada Post Pension Plan document. Special payments recovered totalled \$161 million in 2007 and \$212 million in 2008. Funds that are not contributed to the Canada Post Pension Plan will be used to make special pension funding payments, as required, or to fund future capital expenditures to modernize Canada Post. In November 2008, we resumed current service contributions to the Canada Post Pension Plan. Our total contributions to the Canada Post Pension Plan in 2008 were \$62 million.

The current estimate of the financial position of the Canada Post Pension Plan as at December 31, 2008, is a going-concern surplus of \$675 million and a solvency deficit of approximately \$1,190 million. The estimated amount of the 2009 current service contributions to the Plan is \$271 million. The Corporation is required, at a minimum, to file the next actuarial valuation for the Canada Post Pension Plan as at December 31, 2010, or at an earlier date if required under the *Pension Benefits Standards Act, 1985*. In 2009 and beyond, the Corporation intends to reintroduce smoothing of assets for solvency purposes. The reintroduction of asset smoothing, which embeds a longer-term economic cycle in our funding calculation, should make solvency payments less volatile and more predictable in the future. We do not expect to have to make special payments to the Pension Plan until 2010.

However, as small changes in discount rates can significantly affect the results of actuarial valuations prepared on a solvency basis, the Corporation will continue to monitor carefully the impact of changes in discount rates, the return on plan assets, and changes in legislation on the financial position of the Canada Post Pension Plan on both a solvency and going-concern basis.

See Section 9.1 – Critical accounting estimates on page 77.

## 6.6 Liquidity and capital resources

Canada Post manages \$1,600 million of capital, which includes equity of Canada, long-term debt and other long-term obligations.

| December 31, 2008<br>(in millions of dollars) | 2008         | 2007         |
|---|--------------|--------------|
| Equity of Canada                              | 1,507        | 1,439        |
| Long-term debt                                | 74           | 58           |
| Other long-term financial obligation          | 19           | 17           |
| <b>Total capital</b>                          | <b>1,600</b> | <b>1,514</b> |

The *Canada Post Corporation Act*, the *Financial Administration Act* ("the Acts") and directives issued pursuant to the Acts affect how the Corporation manages its capital by, among other things, setting broad objectives for the Corporation. Specifically, while maintaining basic postal service and in carrying out its objectives, the Corporation must have regard for the need to conduct its operations on a self-sustaining financial basis while providing a standard of service that meets the needs of the people of Canada. As discussed in Section 1.6 on page 35, a Multi-Year Policy and Financial Framework (Policy Framework), in place since 1998, sets financial performance targets, service standards and a price-cap formula for the domestic basic letter rate for the Corporation. A Strategic Review of the Corporation's public-policy objectives, its ability to remain financially self-sustaining and the continued relevance of the Policy Framework was conducted in 2008 and is currently under consideration by the Government of Canada. The Strategic Review is discussed further in Section 2.2 on page 36.

The Corporation's financial objectives and strategies are reviewed in the annual Corporate Plan submission, approved by the Board of Directors and then submitted to the Minister. The 2008 and 2007 Corporate Plans were approved by the Governor in Council on July 28, 2008. As of the date of this report, the 2009 Corporate Plan had not been approved by the Governor in Council.

The Corporation's objectives in managing capital are to:

- Provide sufficient liquidity to support financial obligations and operating and strategic plans;
- Maintain financial capacity and access to credit facilities to support future development of the business; and
- Generate a reasonable return to the Government of Canada in support of the objectives of the Policy Framework.

In developing the financial management plan, we consider the following significant factors:

- current and planned financial performance of the Corporation;
- financial performance of the Canada Post Pension Plan;
- amount of liquidity and working capital needed by the Corporation;
- sources of capital available to the Corporation;
- degree of financial leverage planned by the Corporation; and
- corporate tax management strategies.

## Liquidity

Canada Post requires sufficient working capital to fund its ongoing business and aims to maintain a cash balance of approximately \$200 million to support current operating activities.

The Corporation has relied on cash flow provided by operations and accumulated funds to support its financial obligations and fund its capital and strategic requirements. Indebtedness has been maintained at a low level. Ongoing initiatives, as referred to throughout this document, are included in the operating plans of each segment and are funded as part of ongoing operations.

The Corporation's financial performance weakened in 2007 and 2008, and this trend is expected to continue for at least the next two fiscal years in light of the economic downturn. These adverse economic conditions will likely affect our ability to realize the 2009 Canada Post segment revenue plan by an estimated \$250 million. To mitigate this risk and offset the expected revenue shortfall, we are taking aggressive measures to reduce costs.

As discussed in Section 6.5 – *Canada Post Pension Plan on page 63*, the Corporation did not make current service contributions to the Canada Post Registered Pension Plan during the period from July 2007 to October 2008, due to the surplus position of the Pension Plan. Funds not contributed were segregated and will be used to make future regulatory contributions to the Pension Plan or to assist with specific future cash flow requirements related to Postal Transformation. In 2008, the economic downturn had a significant negative impact on the value of the Pension Plan, leaving it in a solvency deficit position at the end of the year. As a result, the Corporation resumed making current service contributions to the Pension Plan in November 2008. It is expected that 2009 current service contributions will be \$271 million. The Corporation does not expect to have to make special payments to the Pension Plan until 2010.

As discussed in Section 2.3 – *Strategic vision on page 37*, our Postal Transformation plan would require investment of up to \$2.7 billion, including \$2.3 billion of capital expenditures over the next five years. This is in addition to the ongoing capital investment requirements of the Corporation, which total \$1 billion over the same period. The Corporation will only spend what it can afford, which at this time is expected to be \$750 million.

Based on the assessment of these factors, it is expected that the Corporation will have sufficient liquidity and will not need to borrow in 2009 to meet planned commitments and investments. As a result of the weakened economy, expected pension funding requirements and the significant increase in planned capital expenditures, the Corporation will require additional sources of cash to complete the financing of the expenditures in later years.

## Access to capital markets

Pursuant to the *Canada Post Corporation Act*, the Corporation may borrow a maximum of \$500 million from the Government of Canada's Consolidated Revenue Fund. Pursuant to *Appropriation Act (No. 3), 1996-97*, borrowing from other than the Government of Canada's Consolidated Revenue Fund is limited to \$300 million, of which no more than \$150 million can be short-term in nature. Within the above limits, the Corporation has a line of credit of \$68 million with a Canadian chartered bank and a commercial paper program that were not used during 2007 or 2008. The Canada Post Group's borrowings amounted to \$74 million as at December 31, 2008.

The Corporation's subsidiaries and joint venture also have access to financing facilities totalling \$100 million as at December 31, 2008. Of this amount, \$18 million was drawn for the purchase of equipment; this amount will be converted into capital leases in 2009.

The Corporation's borrowing plan is reviewed and approved annually by the Board of Directors, and then is submitted for approval to the Governor in Council on the recommendation of the Minister responsible for Canada Post, as part of the Corporate Plan approval process. The Minister of Finance may require that his recommendation also be obtained before the Corporate Plan is submitted to the Governor in Council for approval. In addition, the detailed terms and conditions for each borrowing must be approved by the Minister of Finance.

## Dividends

In accordance with the Policy Framework, the Corporation historically has paid an annual dividend to the Shareholder equal to 40% of the prior year's consolidated net income. Dividends paid over the past five years total \$271 million.

| (in millions of dollars) | 2008 | 2007 | 2006 | 2005 | 2004 |
|--------------------------|------|------|------|------|------|
| Consolidated net income  | 90   | 54   | 119  | 199  | 147  |
| Dividend paid            | 22   | 47   | 80   | 59   | 63   |

Due to current economic conditions and their effect on our cash position, the Corporation is reviewing its dividend policy.

## 6.7 Risks associated with financial instruments

Canada Post uses a variety of financial instruments to carry out the activities of the business, as summarized in the following table.

(in millions of dollars)

| As at December 31                | 2008             |                       |                   |              |
|----------------------------------|------------------|-----------------------|-------------------|--------------|
|                                  | Held for trading | Loans and receivables | Other liabilities | Total        |
| <b>Financial assets (note 8)</b> |                  |                       |                   |              |
| Cash and cash equivalents        | 605              |                       |                   | 605          |
| Marketable securities            | 103              |                       |                   | 103          |
| Accounts receivable              |                  | 575                   |                   | 575          |
| Segregated securities            | 862              |                       |                   | 862          |
| Other assets                     | 5                |                       |                   | 5            |
|                                  | <b>1,575</b>     | <b>575</b>            |                   | <b>2,150</b> |
| <b>Financial liabilities</b>     |                  |                       |                   |              |
| Non-interest bearing* (note 7)   |                  |                       | 732               | 732          |
| Long-term debt (note 14)         |                  |                       | 74                | 74           |
|                                  |                  |                       | <b>806</b>        | <b>806</b>   |

\* Non-interest bearing consists of financial liabilities included in accounts payable and accrued liabilities, salaries and benefits payable, and outstanding money orders

Canada Post faces a variety of risks associated with financial instruments. Investments are held for liquidity purposes or for longer terms in accordance with the investment policies of the Corporation. The Corporation does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

### Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in external market factors such as interest rates, foreign currency exchange rates and other prices, including commodities.

#### a) Interest rate risk

The Corporation's investment policy for cash and segregated financial assets carries a low probability of default. Therefore, the value and timing of cash flows (interest- and principal-related) can be determined and are not subject to significant risk.

Investments are designated as held for trading. All investments are fixed-rate debt securities and are therefore exposed to a risk of change in their fair value due to changes in interest rates. The risk is managed by maintaining a short term to maturity, and the maximum duration in the portfolio was 92 days as at December 31, 2008. The incremental return for longer-term maturities is currently considered insufficient to offset the risk of higher interest rates and associated declines in capital values. This investment decision is assessed on an ongoing basis and may be changed if longer-term rates of interest increase sufficiently.

Based on a sensitivity analysis on interest rate risk, it is expected that an increase or decrease of 50 basis points in market interest rates, with all other variables held constant, would not have a significant impact on the fair value of the Corporation's investments, at December 31, 2008, excluding non-bank-sponsored asset-backed commercial paper.

Long-term debt of \$55 million has a fixed rate and will mature in 2016. There are no prepayment terms associated with the debt.

#### b) Foreign currency risk

The Corporation's exposure to foreign currency risk arises primarily from international settlements with foreign postal administrations and from the redemption of money orders denominated in foreign currencies. The obligation to settle with foreign postal administrations is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprising the US Dollar (US\$), Japanese Yen, Sterling and Euro, whereas payment is usually denominated in US\$ or, in some circumstances, the Euro. The principle exposure is to the US\$. The effect of a 10% increase or decrease in the US\$ exchange rate on the net overall exposure after matching associated US\$ payables and receivables at the balance sheet date and with all other variables held constant would have increased or decreased net income for the year by \$6 million. There is no significant impact on net income arising from exposures to other currencies. Net exchange gains included in net income amounted to \$13 million in 2008 (\$9 million of net exchange losses in 2007).

### c) Price risk

The Corporation does not currently hold any financial instruments tied to the prices of commodities. We are examining the merits of hedging certain volatile commodities inputs such as energy.

### Credit risk

Credit risk is the risk of financial loss due to the inability of a counterparty to meet its contractual obligations.

Credit risk arises from investments in corporations and financial institutions as well as credit exposures to wholesale and commercial customers, including outstanding receivables. Sales to consumers are settled in cash or using major credit cards.

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Corporation's maximum exposure to credit risk. The Corporation does not believe it is subject to any significant concentration of credit risk.

Credit risk arising from investments is mitigated by investing with issuers who meet specific criteria and by imposing dollar limits by financial product type and debt issuer. Investments in financial institutions and corporations must have minimum ratings from two external rating agencies that are equivalent to DBRS ratings of R-1 (middle) for short-term investments and A for long-term investments. The Corporation regularly reviews the credit ratings of issuers with whom the Corporation holds investments, and disposes of investments within a specified time period when the issuer's credit rating declines below acceptable levels. Impairment losses on investments recognized during the year were \$9 million (2007 – \$8 million) as described in note 8 to the consolidated financial statements on page 112.

Credit risk associated with accounts receivable from wholesale and commercial customers is mitigated by the Corporation's large customer base, which covers substantially all business sectors in Canada. The Corporation follows a program of individual customer credit evaluation based upon financial strength and payment history, and limits the amount of credit extended when deemed necessary. The Corporation monitors customer accounts against these credit limits and the aging of past-due invoices. The Corporation establishes an allowance for doubtful accounts that reflects the estimated impairment of accounts receivable. A general provision is estimated based on prior experience with, and the past-due status of, doubtful debtors, while large accounts are assessed individually based on factors that include ability to pay and payment history.

Credit risk attributable to receivables from foreign postal administrations, other than the United States Postal Service (USPS), is generally mitigated by offsetting accounts payable to foreign postal administrations on an individual country basis, under the provisions of the Universal Postal Union (UPU). Amounts receivable from and payable to the USPS are settled independently under the bilateral agreement between Canada Post Corporation and the USPS. Estimates of receivables and payables, including monthly provisional payments, are based on statistics in regards to the weights and number of pieces exchanged by the two countries. Final settlement with each foreign postal administration can be billed a year or more after the service is performed. The Corporation maintains a provision for impairment of receivables from specific foreign postal administrations based on the period past due after billing of the final settlement.

### Asset-backed commercial paper

The market for non-bank-sponsored asset-backed commercial paper (ABCP) in Canada ceased to operate in August 2007. Since that date, no market quotations have been available. A total of \$38 million was invested in ABCP at the time of the market disruption and adjusted to an estimated fair value of \$30 million at the end of 2007. At December 31, 2008, the carrying value of the ABCP was adjusted to an estimated fair value of \$22 million. *Further details on ABCP are provided in note 8 to the consolidated financial statements on page 112.*

### Liquidity risk

Liquidity risk is the risk that a company will encounter difficulty in meeting its financial obligations as they fall due. The Corporation manages liquidity risk by maintaining cash and investments, banking facilities and reserve borrowing facilities, by monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. The Corporation's objective is to maintain a cash balance of at least \$200 million to support current operating activities. Surplus cash is invested into a range of short-term money market securities. The Corporation invests in high credit quality government or corporate securities in accordance with policies approved by the Board of Directors. *Liquidity is discussed further in Section 6.6 on page 64.*

## 6.8 Contractual obligations and commitments

A summary of the Corporation's total contractual obligations and commitments to make future payments is presented below. For further details, see notes 14 and 17 to the consolidated financial statements on pages 125 and 128 respectively.

| (in millions of dollars)            | Total        | < 1 year   | 1-3 years  | 3-5 years  | > 5 years  |
|-------------------------------------|--------------|------------|------------|------------|------------|
| Long-term debt*                     | 55           | –          | –          | –          | 55         |
| Interest on long-term debt @ 10.35% | 43           | 6          | 11         | 11         | 15         |
| Capital lease obligations           | 1            | 0          | 1          | –          | –          |
| Long-term liability**               | 18           | –          | –          | 18         | –          |
| Operating leases***                 | 1,158        | 138        | 240        | 151        | 629        |
| <b>Total</b>                        | <b>1,275</b> | <b>144</b> | <b>252</b> | <b>180</b> | <b>699</b> |

\* Long-term debt includes \$55 million of long-term bonds maturing March 2016. Interest at 10.35% is paid semi-annually

\*\* Other long-term borrowing includes an amount drawn on a credit facility expected to be converted to capital leases during 2009

\*\*\* Operating leases include the future minimum payment obligations associated with facilities, transportation equipment and other operating leases with terms in excess of one year

## 6.9 Related party transactions

As described in note 20 to the consolidated financial statements on page 131, the Corporation has a variety of transactions with related parties, both in the normal course of business and in supporting the Government of Canada's public policies.

## 6.10 Off balance sheet arrangements

In the normal course of operations, we provide indemnifications that are often standard contractual terms in favour of third parties in transactions such as purchase and sale contracts, service agreements and leasing transactions. In addition, Canada Post has entered into indemnity agreements with each of our directors and officers. These agreements do not contain specified limits on our liability for compensation to a third party incurred as a result of certain events. Therefore, it is not possible to estimate our potential future liability under these agreements. Historically, we have not made any significant payments under such indemnifications and no amounts have been accrued in our financial statements with respect to these indemnities.

Upon termination or expiration of certain agreements with Innovapost, Canada Post and Purolator have agreed to purchase the assets being used on a dedicated basis and to assume the obligations related to the purchase of those assets. Currently, we do not possess sufficient information to estimate the maximum potential future liability related to these agreements. Therefore, no amounts have been accrued in the financial statements. The terms of the agreements provide for no limitation to the maximum potential future payments.

There are no other off balance sheet arrangements that would have a material adverse effect on our liquidity, financial position or results of operations.

## 7 Financial Condition

A discussion of significant changes in our assets and liabilities between December 31, 2008, and December 31, 2007

(in millions of dollars)

| ASSETS   | 2008         | 2007         | Change     | %              | Explanation of change   |
|--|--------------|--------------|------------|----------------|---|
| Cash and cash equivalents (note 8)                   | 605          | 386          | 219        | 56.9 %         | Refer to section 6 – Liquidity and Capital Resources on page 62   |
| Marketable securities (note 8)                       | 103          | 309          | (206)      | (66.7) %       | Primarily maturing investments reinvested in cash equivalents rather than short-term securities   |
| Accounts receivable                                  | 575          | 587          | (12)       | (1.9) %        | Primarily decreased trade receivables for Canada Post and SCI Group Inc.  |
| Income tax recoverable                               | 7            | 10           | (3)        | (28.6) %       | Primarily SCI Group Inc. income taxes receivable  |
| Prepaid expenses                                     | 71           | 76           | (5)        | (6.1) %        | Primarily the reduction in retail products inventory  |
| Current portion of future income tax assets (note 9) | 23           | 20           | 3          | 15.2 %         | Primarily temporary differences on Canada Post accrued salaries and benefits  |
| <b>Total current assets</b>                          | <b>1,384</b> | <b>1,388</b> | <b>(4)</b> | <b>(0.2) %</b> |   |
| Segregated securities (note 8)                       | 862          | 632          | 230        | 36.3 %         | Primarily segregation of funds (\$208 million) made available during the first 10 months of 2008 when Canada Post was not required to make employer current service contributions to the Canada Post Registered Pension Plan. Also includes income earned on the portfolio and transitional support received from the Government of Canada relating to the establishment of the Canada Post post-retirement dental, term life and death benefit plans, partially offset by post-retirement benefit claims |
| Capital assets (note 10)                             | 2,034        | 1,855        | 179        | 9.7 %          | Primarily capital acquisitions for transformation and replenishment in excess of amortization   |
| Accrued pension benefit asset (note 11)              | 898          | 944          | (46)       | (4.9) %        | Primarily attributable to the cessation of employer contributions to the Canada Post Registered Pension Plan during the first 10 months of 2008   |
| Future income tax assets (note 9)                    | 270          | 203          | 67         | 33.3 %         | Primarily temporary differences on the Canada Post Registered Pension Plan asset and employee future benefit liability  |
| Goodwill (note 12)                                   | 124          | 124          | –          | –              |   |
| Other assets (note 13)                               | 19           | 21           | (2)        | (14.0) %       | Primarily a reduction in prepaid uniforms   |
| <b>Total assets</b>                                  | <b>5,591</b> | <b>5,167</b> | <b>424</b> | <b>8.2 %</b>   |   |

## Financial Condition (continued)

(in millions of dollars)

| LIABILITIES AND EQUITY  | 2008         | 2007         | Change     | %             | Explanation of change   |
|---|--------------|--------------|------------|---------------|---|
| Accounts payable and accrued liabilities  | 469          | 446          | 23         | 5.0 %         | Primarily increased receipt of goods and services not invoiced, partially offset by decreased trade payables for Purolator                              |
| Salaries and benefits payable   | 509          | 390          | 119        | 30.4 %        | Primarily increased accrued salaries for days outstanding and restructuring costs, and resumption of employer contributions to Canada Post Pension Plan |
| Income tax payable  | 16           | 34           | (18)       | (54.2) %      | Primarily due to decrease in income taxes owing by Canada Post and an increase in income taxes owing by Purolator                                       |
| Deferred revenue  | 145          | 153          | (8)        | (5.2) %       | Primarily decreased deferral for stamp sales, partially offset by deferred parcel revenue   |
| Outstanding money orders  | 42           | 47           | (5)        | (10.3) %      | Primarily decreased Canadian money orders outstanding; increased provisions for unredeemed money orders and US\$ money orders                           |
| Current portion of long-term debt (note 14)                                       | –            | 3            | (3)        | (87.9) %      |   |
| <b>Total current liabilities</b>  | <b>1,181</b> | <b>1,073</b> | <b>108</b> | <b>10.0 %</b> |   |
| Long-term debt (note 14)  | 74           | 55           | 19         | 33.9 %        | Primarily long-term debt related to the acquisition of capital assets by Purolator  |
| Accrued pension, other retirement and post-employment benefit liability (note 11) | 2,722        | 2,513        | 209        | 8.3 %         | Primarily attributable to the Canada Post post-retirement health care plan current year expense   |
| Future income tax liabilities (note 9)  | 30           | 24           | 6          | 24.6 %        | Primarily due to increases in temporary differences in Purolator's employee future benefit liability and capital assets                                 |
| Other long-term liabilities   | 51           | 41           | 10         | 25.4 %        | Primarily asset retirement obligations for the disposition of the Winnipeg and Edmonton plants  |
| <b>Total liabilities</b>  | <b>4,058</b> | <b>3,706</b> | <b>352</b> | <b>9.5 %</b>  |   |
| Non-controlling interest  | 26           | 22           | 4          | 19.5 %        | Minority interest on net income of Purolator  |
| Equity of Canada  | 1,507        | 1,439        | 68         | 4.8 %         | Primarily consolidated net income of \$90 million offset by the dividend of \$22 million paid to the Government of Canada                               |
| <b>Total liabilities and equity of Canada</b>                                     | <b>5,591</b> | <b>5,167</b> | <b>424</b> | <b>8.2 %</b>  |   |

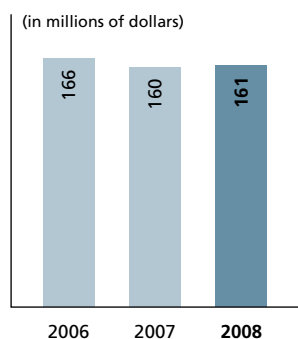


## 8 Results from Operations

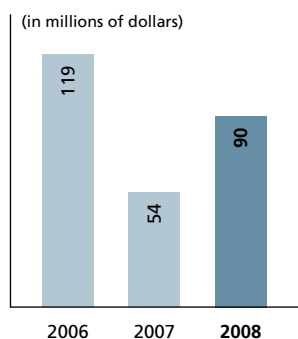
*A detailed discussion of our financial performance in 2008*

### 8.1 Consolidated trends

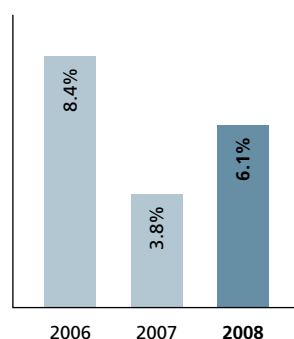
#### Consolidated income before income taxes



#### Consolidated net income



#### Return on equity



### 8.2 Consolidated results from operations

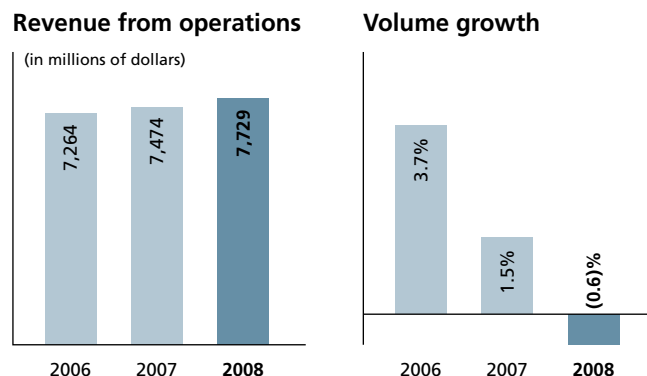
#### Consolidated income statement

Increase (decrease)

| (in millions of dollars)       | 2008  | 2007  | Change | %        |
|--------------------------------|-------|-------|--------|----------|
| Revenue from operations        | 7,729 | 7,474 | 255    | 3.0 %    |
| Cost of operations             | 7,594 | 7,346 | 248    | 3.4 %    |
| Income from operations         | 135   | 128   | 7      | 5.6 %    |
| Non-operating income (expense) | 26    | 32    | (6)    | (17.8) % |
| Income before income taxes     | 161   | 160   | 1      | 1.0 %    |
| Income tax expense             | 67    | 102   | (35)   | (34.3) % |
| Non-controlling interest       | 4     | 4     | (0)    | 10.1 %   |
| Net income                     | 90    | 54    | 36     | 66.1 %   |
| Return on equity               | 6.1%  | 3.8%  | 2.3%   |          |

The Canada Post Group reported consolidated net income of \$90 million in 2008 – an increase of \$36 million, when compared with 2007. Income from operations increased by \$7 million, primarily due to cost-containment measures implemented to offset economic pressures on revenue growth.

## Consolidated revenue from operations



Revenue from operations increased 3.0% or \$255 million in 2008, when compared with 2007, driven primarily by price. A detailed discussion of revenue by segment follows.

### Consolidated cost of operations

A strong focus on cost control and operational efficiencies again this year held cost increases in 2008 to 3.4%, when compared with 2007. A detailed discussion of cost of operations by segment follows.

### Consolidated non-operating income (expense)

Net non-operating income decreased by \$6 million in 2008, when compared with 2007.

Investment and other income decreased by \$4 million. Higher exchange gains (\$5 million) in the Purolator segment were offset by lower gains on the sale of capital assets (\$8 million) and reduced investment income (\$1 million), due to lower rates of return on the short-term portfolio. Average cash balances were higher (\$583 million in 2008 vs. \$574 million in 2007), but were offset by lower rates of return (2.88% in 2008 vs. 4.15% in 2007).

Interest and other expense increased by \$2 million.

### Consolidated income tax expense

Consolidated income tax expense decreased by \$35 million, as statutory income tax rates stabilized in 2008. Income tax expense in 2007 was unusually high due to the reduction of the long-term statutory income tax rate.

## 8.3 Operating results by segment

In 2008, performance improved in all segments, when compared to 2007, except the Canada Post segment where income before income taxes fell by \$12 million.

### Segmented results – Income before income taxes

| (in millions of dollars)     | 2008 | 2007 | 2006 | 2005 | 2004 |
|------------------------------|------|------|------|------|------|
| Canada Post                  | 66   | 78   | 99   | 250  | 197  |
| Purolator                    | 91   | 84   | 69   | 57   | 50   |
| Logistics                    | 13   | 6    | (1)  | (7)  | 5    |
| All other                    | 15   | 8    | 2    | (5)  | (8)  |
| Intersegment and unallocated | (24) | (16) | (3)  | (13) | (3)  |
| The Canada Post Group        | 161  | 160  | 166  | 282  | 241  |

Over the past five years, Purolator has increasingly contributed to the profitability of The Canada Post Group as its share of profits grew from 21% in 2004 to 57% in 2008.

## 8.4 Canada Post segment

The Canada Post segment contributed \$66 million of income before taxes to the 2008 consolidated results – a decrease of \$12 million, when compared with 2007.

Negative pressure on revenue growth caused by the economic slowdown was offset by the implementation of tactical cost reductions. The decrease in non-operating income was due mainly to lower gains from the sale of capital assets.

To offset the negative pressure on revenue, we undertook a substantial cost-savings program early in the year, reducing planned expenditures by \$150 million, over and above the \$90 million savings already in the plan. If we had not taken these extraordinary measures, Canada Post would have incurred a substantial loss.

Furthermore, if one-time transactions, primarily transitional support of \$81 million from the Government of Canada related to pension and certain ancillary benefits, were removed from the results, the Canada Post segment would have incurred an even greater loss. This transitional support ends in 2010, therefore putting more pressure on our earnings going forward.

### Canada Post summary

| (in millions of dollars)       | 2008  | 2007  | Change | %        |
|--------------------------------|-------|-------|--------|----------|
| Revenue from operations        | 6,108 | 5,955 | 153    | 2.2 %    |
| Cost of operations             | 6,088 | 5,928 | 160    | 2.7 %    |
| Income from operations         | 20    | 27    | (7)    | (26.4) % |
| Non-operating income (expense) | 46    | 51    | (5)    | (9.1) %  |
| Income before income taxes     | 66    | 78    | (12)   | (15.0) % |

Increase (decrease)

## Revenue from operations

Canada Post generated revenue from operations of \$6,108 million in 2008 – an increase of \$153 million, or 2.2%, when compared to 2007. Although volumes were down in all products except Unaddressed Admail, price increases and other non-recurring items helped generate the revenue growth. The slower economy in the last half of the year contributed the most to the volume decline, with all products significantly below expected volumes.

The \$153-million revenue increase was comprised of a \$20-million increase of revenue in Transaction Mail, a \$72-million increase of revenue in Parcels, and a \$40-million increase of revenue in Direct Marketing. Other services contributed an additional \$21 million to the increase.

## Revenue and volumes by line of business

|                         | Revenue  |       |        |         | Volume  |        |        |          |
|-------------------------|--|-------|--------|---------|---|--------|--------|----------|
|                         | (in millions of dollars / trading day adjusted per cent) |       |        |         | (in millions of pieces / trading day adjusted per cent) |        |        |          |
|                         | 2008   | 2007  | Change | %       | 2008  | 2007   | Change | %        |
| <b>Transaction Mail</b> |  |       |        |         |   |        |        |          |
| Domestic/Outbound       | 3,108  | 3,100 | 8      | (0.1) % | 5,045   | 5,116  | (71)   | (1.8) %  |
| Inbound                 | 126  | 114   | 12     | 9.7 %   | 274   | 290    | (16)   | (6.1) %  |
| Total Transaction Mail  | 3,234  | 3,214 | 20     | 0.2 %   | 5,319   | 5,406  | (87)   | (2.0) %  |
| <b>Parcels</b>          |  |       |        |         |   |        |        |          |
| Domestic/Outbound       | 1,164  | 1,105 | 59     | 4.9 %   | 122   | 123    | (1)    | (0.7) %  |
| Inbound                 | 147  | 134   | 13     | 9.5 %   | 37  | 51     | (14)   | (26.7) % |
| Total Parcels           | 1,311  | 1,239 | 72     | 5.4 %   | 159   | 174    | (15)   | (8.3) %  |
| <b>Direct Marketing</b> |  |       |        |         |   |        |        |          |
| Addressed Admail        | 635  | 621   | 14     | 1.9 %   | 1,503   | 1,525  | (22)   | (1.8) %  |
| Unaddressed Admail      | 399  | 376   | 23     | 5.6 %   | 4,061   | 3,940  | 121    | 2.7 %    |
| Publications Mail       | 289  | 285   | 4      | 0.9 %   | 522   | 535    | (13)   | (2.9) %  |
| Other                   | 108  | 109   | (1)    | (1.3) % | 56  | 66     | (10)   | (16.0) % |
| Total Direct Marketing  | 1,431  | 1,391 | 40     | 2.5 %   | 6,142   | 6,066  | 76     | 0.9 %    |
| Other revenue           | 132  | 111   | 21     | 18.7 %  | –   | –      | –      | –        |
| Total                   | 6,108  | 5,955 | 153    | 2.2 %   | 11,620  | 11,646 | (26)   | (0.6) %  |

### Transaction Mail

Overall, Transaction Mail revenue in 2008 remained relatively flat compared to 2007, at \$3,234 million. The small revenue increase of 0.2% was driven by reduced volumes of 2.0%, offset by an increase in the average revenue per piece of 1.2% and other Transaction Mail related revenue.

Domestic Lettermail revenue increased by \$20 million, or 0.3%, in 2008, when compared with 2007. Volumes declined 1.3% but were offset by price increases and a change in accounting estimate relating to the revenue deferral for stamps. International outbound mail revenue decreased by \$22 million, or 13.4%, when compared with 2007. Volumes declined partially due to the strength of the Canadian dollar, which made U.S. direct entry more attractive to Canadian commercial customers than using Canada Post for mailing. Other Transaction Mail service revenue, including value-added services, grew by \$10 million.

International inbound mail revenue (postage revenue collected by other postal administrations and shared with Canada Post for delivering their mail in Canada) of \$126 million was higher than last year by \$12 million. The high value of the Canadian dollar through most of the year, plus the effects of price increases translated into higher revenue despite lower volume in 2008. Volume declines were general but particularly significant in mail coming from the U.S., reflecting the deteriorating economic condition there.

### Parcels

Parcels revenue totalled \$1,311 million in 2008, increasing \$72 million, or 5.4%, when compared with 2007.

Domestic parcels revenue increased by \$63 million, or 6.9%, over the previous year, whereas volumes remained relatively flat, with a slight decline of 0.3%. The revenue growth was primarily driven by rate action, a strong volume growth in the competitively priced commercial Expedited Parcel product, increased fuel surcharge revenue as well as increases in Food Mail revenue. This was offset somewhat by volume declines in premium products such as Xpresspost and *Priority Next A.M.*

International outbound revenue in 2008 remained relatively flat compared to 2007, with a slight decline of \$0.6 million or 0.7%. The volume decline of 3.7% was driven by weakening U.S. economic conditions and the strong Canadian dollar experienced in the early half of the year.

International inbound revenue increased by \$13 million or 9.5% over last year, mainly due to the strong Canadian dollar experienced in the early half of 2008. However, inbound volumes decreased by 14 million pieces, or 26.7%, due to declines in inbound USA Packets, which made up the majority of volumes but with a much lower average revenue rate per piece.

### Direct Marketing

Direct Marketing revenue increased by \$40 million, or 2.5%, over the prior year. Overall volumes increased by 0.9%, driven mainly by the new Oversize Unaddressed Admail product. The current economic conditions along with forecasts of recessionary pressures have affected advertising budgets. This has caused declines across virtually all key industry sectors in 2008. The financial services and the retail and manufacturing sectors were the most affected by these market conditions and have significantly reduced the level of direct marketing spending, when compared to previous years.

Our Admail products contributed \$37 million of the year-over-year growth for this business segment. Addressed Admail revenue grew by \$14 million, or 1.9%, with year-over-year volume erosion of 1.8%. Unaddressed Admail revenue grew by 5.6%, with volumes increasing by 2.7%. The introduction of our new Oversize Unaddressed Admail product was the key driver of the growth. Revenue from our Publications Mail service grew by \$4 million over the prior year. Contributing to this growth was the introduction of Undeliverable Publication Mail notification service.

### Other revenue

Other revenue increased by \$21 million, or 18.7%, in 2008, when compared with 2007. The weakening of the Canadian dollar and other currency fluctuations resulted in exchange gains of \$9.4 million from settlements with foreign postal administrations (compared with exchange losses of \$8.2 million in 2007).

### Cost of operations

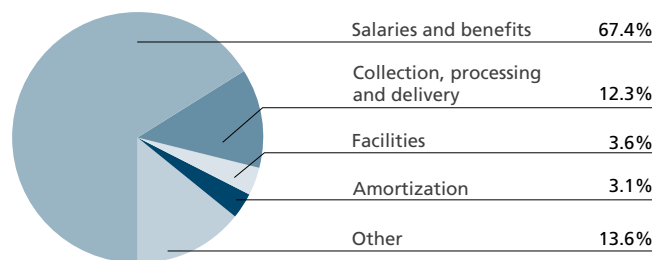
In 2008, the Canada Post segment's cost of operations totalled \$6,088 million – an increase of \$160 million, or 2.7%, over the prior year.

Increase (decrease)

| (in millions of dollars)            | 2008         | 2007         | Change     | %            |
|-------------------------------------|--------------|--------------|------------|--------------|
| Salaries                            | 3,318        | 3,221        | 97         | 3.0 %        |
| Benefits                            | 785          | 843          | (58)       | (6.9) %      |
| <b>Total salaries and benefits</b>  | <b>4,103</b> | <b>4,064</b> | <b>39</b>  | <b>1.0 %</b> |
| Collection, processing and delivery | 749          | 671          | 78         | 11.6 %       |
| Facilities                          | 217          | 213          | 4          | 1.9 %        |
| Amortization                        | 191          | 180          | 11         | 6.0 %        |
| Other                               | 828          | 800          | 28         | 3.6 %        |
| <b>Total</b>                        | <b>6,088</b> | <b>5,928</b> | <b>160</b> | <b>2.7 %</b> |

The chart below shows the breakdown of costs as a percentage of total cost of operations. Salaries and benefit costs comprise 67.4% of the total cost, demonstrating the labour-intensive nature of the business.

### Cost of operations – 2008



| Cost of operations                  | 2008  | 2007  | 2006  |
|-------------------------------------|-------|-------|-------|
| Salaries and benefits               | 67.4% | 68.6% | 68.9% |
| Collection, processing and delivery | 12.3% | 11.3% | 10.4% |
| Facilities                          | 3.6%  | 3.6%  | 3.6%  |
| Amortization                        | 3.1%  | 3.0%  | 3.2%  |
| Other                               | 13.6% | 13.5% | 13.9% |

### Cost-savings program

In 2008, we implemented a tough cost-management program to offset the revenue shortfall. We successfully reduced planned expenditures by \$150 million, including discretionary investment, advertising and travel. In addition, we achieved \$90 million of cost reductions already in the plan, mainly by reducing hours worked in our processing and delivery operations by some two million hours.

### Salaries

The cost of salaries increased by \$97 million, or 3.0%, when compared with 2007. The increase was primarily due to employee wage increases; an increase in the Corporate Team Incentive, which is based directly on company performance against predetermined business targets; and restructuring charges relating to cost containment for 2009. The addition of 200,000 new delivery addresses and higher absenteeism levels added further pressure on our processing and delivery labour costs. Again this year, significant productivity improvements in operations partially offset these rising costs.

### Employee benefits

Increase (decrease)

| (in millions of dollars)      | 2008 | 2007 | Change | %        |
|-------------------------------|------|------|--------|----------|
| Active employee benefits      | 430  | 415  | 15     | 3.6 %    |
| Retirement health benefits    | 219  | 258  | (39)   | (14.9) % |
| Pension expense               | 131  | 186  | (55)   | (29.8) % |
| Other                         | 96   | 107  | (11)   | (9.8) %  |
|                               | 876  | 966  | (90)   | (9.3) %  |
| Offset by:                    |      |      |        |          |
| Interest on segregated assets | 10   | 17   | (7)    | (38.1) % |
| Transitional funding          | 81   | 106  | (25)   | (23.5) % |
| Net benefit costs             | 785  | 843  | (58)   | (6.9) %  |

Employee benefit costs decreased by \$58 million, or 6.9%, when compared with 2007.

Post-retirement health benefits expense declined by \$39 million, primarily due to actuarial gains resulting from 2007 Plan amendments, and a decrease in amortization of actuarial losses resulting from an increase in discount rate from 2007 to 2008.

Pension expense was \$55 million lower than 2007, mainly due to an increase in the Plan assets' expected long-term rate of return from 7.0% to 7.25%, and an increase in Plan assets at December 31, 2007.

Other benefits decreased by \$11 million, reflecting the final settlement of employee termination benefits in 2007.

Benefits expense was partially offset by interest earned on segregated securities, which earned a lower rate of return in 2008, when compared with 2007, due to the volatile financial market.

Benefits expense was also reduced by transitional funding from the Government of Canada, which decreased by \$25 million in 2008. As described further in *note 2 to the consolidated financial statements on page 100*, declining transitional support is provided to assist the Corporation with the incremental costs incurred as a result of establishing the Canada Post

Pension Plan and the associated ancillary benefits. The declining transitional funding will end in 2010.

### Collection, processing and delivery

Contracted collection, processing and delivery costs increased by \$78 million in 2008, when compared with 2007. Transportation costs increased by \$47 million, primarily due to inflationary pressures on contractual rates and higher fuel costs during the first three quarters of the year. Rural mail contracted costs grew by \$15 million, mainly due to the use of contractors to cover Rural and Suburban Mail Carrier (RSMC) routes primarily in Alberta, RSMC paid assistants hired to accompany CUPW/RSMC-represented employees on their routes, and the increase in the contracted kilometres allowances. Automotive services increased by \$7 million mainly due to fuel.

### Facilities

The cost of facilities increased by \$4 million to \$217 million, primarily due to increases in contract rent.

### Amortization and impairment

Amortization and impairment expense increased by \$11 million, or 6.0%, when compared with 2007, primarily due to increased capital acquisitions relating to transformation and replenishment.

### Other expense

Total other expense, which includes program expense, information technology, administration, settlements with foreign postal administrations, retail and other costs, increased by \$28 million in 2008. A \$49-million increase in program expense was partially offset by a \$15-million decrease in information technology and a \$7-million decrease in administration.

## 8.5 Purolator segment

The Purolator segment contributed \$91 million to 2008 consolidated income before income taxes, an increase of \$7 million, when compared with 2007.

### Purolator summary

Increase (decrease)

| (in millions of dollars)       | 2008  | 2007  | Change | %      |
|--------------------------------|-------|-------|--------|--------|
| Revenue from operations        | 1,563 | 1,448 | 115    | 7.4 %  |
| Cost of operations             | 1,472 | 1,360 | 112    | 8.2 %  |
| Income from operations         | 91    | 88    | 3      | 3.1 %  |
| Non-operating income (expense) | (0)   | (4)   | 4      | 90.4 % |
| Income before income taxes     | 91    | 84    | 7      | 8.5 %  |

### Revenue from operations

Purolator revenue from operations increased by \$115 million, or 7.4%, in 2008, when compared with 2007.

This growth was primarily attributed to increases in revenue per shipment across the various lines of business. The expanding Purolator Freight and Purolator USA divisions have continued to drive volume growth and are expected to continue to grow at double-digit growth rates in 2009. Purolator's strong service levels continue to attract air cargo volumes and these revenues have also seen double-digit growth rates.

The solid revenue performance of 2008 reflects the premium service that the Purolator brand represents. With continuing service level improvements on air and ground delivery times, satisfied customers continue to support Purolator's growth.

### Cost of operations

In 2008, the cost of operations increased by \$112 million, or 8.2%, when compared to 2007. Cost pressures were significant. Salary and benefit costs increased 5% and variable operating costs rose 16%. Fuel prices continued to increase, and the ripple effect of the booming western Canadian economy on local staffing and network equilibrium continued to be a challenge that required considerable management focus. As the expanding Purolator Freight and Purolator USA divisions continue to grow at double-digit rates, costs have increased correspondingly as the infrastructure and network is solidified. The significant capital investment of the "Purolator 2010" initiative over the last few years in infrastructure, systems and people has enabled Purolator's strong growth but has also caused increases in amortization, information technology and training costs. These increases were partially offset by a 22% reduction in administration and discretionary costs.

## 8.6 Logistics segment

The Logistics segment includes the consolidated financial results of SCI Group (previously SCI Logistics).

### Logistics summary

Increase (decrease)

| (in millions of dollars)       | 2008 | 2007 | Change | %        |
|--------------------------------|------|------|--------|----------|
| Revenue from operations        | 156  | 146  | 10     | 6.4 %    |
| Cost of operations             | 143  | 140  | 3      | 2.7 %    |
| Income from operations         | 13   | 6    | 7      | 102.3 %  |
| Non-operating income (expense) | 0    | 0    | (0)    | (40.1) % |
| Income before income taxes     | 13   | 6    | 7      | 90.9 %   |

### Income before income taxes by entity

Increase (decrease)

| (in millions of dollars) | 2008 | 2007 | Change |
|--------------------------|------|------|--------|
| SCI Group                | 14   | 8    | 6      |
| Other                    | (1)  | (2)  | 1      |
| Total segment            | 13   | 6    | 7      |

### SCI Group (SCI)

SCI's financial performance improved significantly in 2008, with net income before income taxes of \$14 million, an increase of \$6 million, when compared with 2007.

Revenue from operations increased by \$10 million, primarily due to a full year of revenue from The AMG Group, which was acquired in March 2007, and from two new clients introduced in 2008. In 2008, 40% of SCI's revenue was derived from its largest customer, a decrease of 7%, when compared to 2007.

Cost of operations increased by \$4 million in 2008, when compared with 2007. This increase was attributable to a full year of costs relating to The AMG Group and new client implementations. These incremental costs were offset by lower corporate overhead costs and the accounting for the curtailment of employee future benefits. The cost reduction for employee future benefits due to the curtailment was approximately \$2 million.

## 8.7 All Other segment

The All Other segment includes the financial results of Innovapost and Canada Post International Limited (CPIL). Virtually all of Innovapost's services are provided to The Canada Post Group. Accordingly, the results of Innovapost, summarized below, are largely eliminated upon consolidation.

### All Other summary

Increase (decrease)

| (in millions of dollars)   | 2008 | 2007 | Change | %        |
|----------------------------|------|------|--------|----------|
| Revenue                    | 176  | 175  | 1      | 0.3 %    |
| from operations            |      |      |        |          |
| Cost of operations         | 162  | 168  | (6)    | (3.5) %  |
| Income from operations     | 14   | 7    | 7      | 93.6 %   |
| Non-operating income       | 1    | 1    | (0)    | (33.5) % |
| Income before income taxes | 15   | 8    | 7      | 78.3 %   |

### Income before income taxes by entity

Increase (decrease)

| (in millions of dollars) | 2008 | 2007 | Change |
|--------------------------|------|------|--------|
| Innovapost (at 51%)      | 16   | 17   | (1)    |
| CPIL                     | (1)  | (9)  | 8      |
| Total segment            | 15   | 8    | 7      |

The increase in income before income taxes of the All Other segment is primarily due to CPIL, which was wound up and dissolved in 2008. The 2007 results of CPIL include a provision of \$7.4 million to reflect the settlement with the Government of the Netherlands Antilles for early termination of the postal concession. See *Section 2.10 – All Other segment, CPIL on page 48*.

## 9 Critical Accounting Estimates and Accounting Policy Developments

*A review of critical accounting estimates and changes in accounting policies in 2008 and future years*

### 9.1 Critical accounting estimates

Our significant accounting policies are described in *note 2 to the consolidated financial statements on page 100*. The preparation of financial statements in accordance with Canadian generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The critical accounting estimates described here require us to make particularly complex or subjective judgments about matters that are inherently uncertain or where it is likely that materially different amounts could be reported under different conditions or using different assumptions.

The Audit Committee of the Board of Directors of Canada Post has reviewed the disclosures described in this section.

#### Capital assets

Capital assets, comprising property, plant and equipment and intangible assets with finite useful lives, are amortized over their useful lives. Useful lives are based on management's estimates of the periods of service provided by the assets, and are provided in *note 2 to the consolidated financial statements on page 100*. The useful lives of these assets are periodically reviewed for continued appropriateness. Due to the long lives of many of the assets, changes to the estimates used would cause significant variations in the carrying values that could result in a material impact on the consolidated financial statements.

A change in the remaining useful lives will affect the amortization expense as reported in the Corporation's results of operations. A change of one year in the composite useful life of the Corporation's capital asset base would affect annual amortization expense by approximately \$11 million (2007 – \$9 million).

Long-lived assets are tested for impairment when events or circumstances indicate that the carrying value is not recoverable from future cash flows. If future conditions were to adversely differ from management's best estimate of key economic assumptions and associated cash flows were to materially decrease, the Corporation could potentially experience future material impairment charges in respect of our capital assets.

### Goodwill

Goodwill is not amortized but is tested at least annually for impairment at the reporting unit level. Goodwill is tested by comparing the fair value of the reporting unit to its carrying value. The Purolator segment represents the significant portion of goodwill in the consolidated financial position. The estimated fair value of this reporting unit is based on a discounted cash flow analysis, which includes making assumptions and estimates in a number of areas, including future cash flows, cash flow periods, terminal values and discount rates.

In estimating future cash flows of the Purolator segment, the Corporation uses its approved plans. These plans reflect management's best estimates; however, they are subject to change as they involve inherent uncertainties that management may not be able to control. In addition, growth and profitability levels are compared to other competitors in the industry, and general economic conditions prevailing at the valuation date. The discount rate applied to the future cash flows of the Purolator segment is equal to the estimated weighted average cost of capital. In addition, the range of terminal value multiples is determined by adjusting the weighted average cost of capital by an amount reflecting a sustainable real growth rate for the reporting unit beyond the forecast period. A change in the weighted average cost of capital could have a significant impact on the estimate of the fair value of goodwill and related impairment charge, if any.

### Contingencies

Contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Disclosure is required when the occurrence of the confirming event is likely, but the amount of the loss is not estimable, or if there is a reasonable possibility that the ultimate loss will exceed the recorded provision.

Contingent liabilities are often resolved over long time periods. Further information on the Corporation's contingencies is provided in *note 17 to the consolidated financial statements on page 128*.

An estimate of the liability for grievance claims is recorded based on the estimated likelihood of making a payment on settlement of the grievance and an estimation of the settlement amount. Changes to the likelihood of settlement and the estimated payment amounts of certain grievance claims may have a material impact on the financial statements in future years.

### Pension and other retirement and post-employment benefits

The Canada Post Group sponsors plans that provide pensions and other retirement benefits for most of its employees. The Corporation believes the accounting estimates related to its employee benefit plan costs are critical accounting estimates because: (1) the amounts are based on complex actuarial calculations using several assumptions; and (2) given the magnitude of the estimated costs, differences in actual results or changes in assumptions could materially affect the consolidated financial statements.

Due to the long-term nature of these benefit plans, the calculation of expenses and obligations depends on various assumptions. These assumptions bear the risk of change as they require significant judgment and have inherent uncertainties that management may not be able to control. Other than the discount rate, the assumptions are determined by management and are reviewed annually by The Canada Post Group's actuaries.

- **Discount rates** – The Group's discount rate assumptions, which are set annually at the measurement date, are used to determine the present value of the projected benefit obligation at the end of the year and the net periodic benefit cost for the following year. The discount rate is used to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments with a rating of AA or better, would provide the necessary cash flows to pay for the benefit plans as they become due. The actuary determines the discount rate using a yield curve approach, which is based on pricing and yield information for high-quality AA-rated corporate bonds. The selected discount rate will have a cash flow pattern that resembles that of the plan being valued. The actuary determines the future benefit payments based on assumptions, which include the respective plans' demographics, retirees' profile and medical trend.
- **Expected long-term rate of return on plan assets** – The expected rate of return on plan assets assumption is based on the statement of investment policies and procedures. It is a long-term assumption for which the accuracy can only be measured over a long period based on past experience. The investment strategy for the assets in the pension plans is to maintain a diversified portfolio of assets, invested in a prudent manner to maintain the security of funds while maximizing returns within the guidelines provided in the investment policy.



- **Projected salary increases** – The rate of compensation increase is another significant assumption in the measurement of the accrued benefit obligation for pension benefit plans and some of the other non-pension benefit plans. The short-term assumptions for projected salary increases are as reflected in the current active collective agreements; otherwise an assumption of 3% is used. The long-term salary increases assumption is also 3%.
- **Corporate Team Incentive** – The Corporate Team Incentive, which is included in the pensionable earnings of the Group's major pension plan, is assumed to be paid out at 100%.
- **Demographics** – The demographic assumptions are used to project the future number of retirees and dependants from year to year who will be eligible for benefits under the benefit plans. These assumptions include expected mortality, termination and retirement experience.
- **Other assumptions** – Other assumptions are based on actual experience and management's best estimates.

Actual results that differ from the assumptions result in actuarial gains or losses, which, in accordance with the recommendations of the Canadian Institute of Chartered Accountants (CICA), are accumulated and amortized over future periods, and therefore, generally affect recognized expense and the recorded liability in future periods. The amortization of all employee future benefits other than post-employment benefits are amortized over the expected average remaining service life of the active employee group covered by the plans only to the extent that the unrecognized net actuarial gains and losses are in excess of 10% of the greater of the accrued benefit obligation and the market-related value of plan assets as at the beginning of the year. Gains or losses arising at the measurement date of post-employment benefit plans are amortized over the average duration of the respective obligations without the use of the 10% limit.

In *note 11 to the consolidated financial statements on page 118*, a table has been included that quantifies the impact of these differences in each of the last two years. These differences relate primarily to: (1) actual versus expected return on plan assets; (2) actual actuarial gains/losses incurred on the benefit obligation compared with those expected and recognized in the consolidated financial statements; and (3) actual past service costs incurred as a result of plan amendments compared with those expected and recognized in the consolidated financial statements.

The benefit obligations and associated expense are very sensitive to actuarial assumptions, namely changes in the discount rate, expected long-term return on plan assets, rate of compensation increase, and medical trend rate assumptions. A lower discount rate results in a higher benefit obligation and a lower funded status. Similarly, poor fund performance results in a lower fair value of plan assets and a lower funded status. In either situation, the cash contributions to the funded benefit plans are affected.

Sensitivity to changes in key assumptions for our principal pension plan follows:

| (in millions of dollars)                                    | Change in assumption |          |
|---|----------------------|----------|
|   | Increase             | Decrease |
| Change in discount rate of 10 basis points                  |                      |          |
| Increase (decrease) in annual pension expense               | (11)                 | 11       |
| Increase (decrease) accrued pension obligation              | (146)                | 149      |
| Change in expected return on plan assets of 25 basis points |                      |          |
| Increase (decrease) in annual pension expense               | (36)                 | 36       |

Our principal health care plan is very sensitive to the following assumptions:

| (in millions of dollars)                                   | Change in assumption |          |
|--|----------------------|----------|
|  | Increase             | Decrease |
| Change in discount rate of 10 basis points                 |                      |          |
| Increase (decrease) in annual health care expense          | (6)                  | 6        |
| Increase (decrease) accrued health care obligation         | (28)                 | 28       |
| Change in health care cost trend rates of 100 basis points |                      |          |
| Increase (decrease) in annual health care expense          | 100                  | (75)     |
| Increase (decrease) accrued health care obligation         | 359                  | (282)    |

For further details on our annual expense and obligation, see *note 11 to the consolidated financial statements on page 118*.

## Income taxes

The Corporation is subject to income tax in numerous jurisdictions and significant judgment is required in determining the provision for tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Corporation recognizes liabilities for anticipated tax issues based on estimates of the additional taxes that are likely to become due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will affect the income tax and future tax provisions in the period in which such determination is made.

Future income tax assets and liabilities are comprised of temporary differences between the carrying amount and tax basis of assets and liabilities as well as tax losses carried forward. The timing of the reversal of the temporary differences is estimated, and the tax rate substantively enacted for the period of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are based upon the amounts recorded in the financial statements and are therefore subject to accounting estimates that are inherent in those balances. The Corporation has significant deductible temporary differences. However, future tax assets have only been recorded to the extent that they are more likely than not to be realized. The deductible temporary differences that are not expected to reverse relate mainly to the accrued other retirement and post-employment benefit liability. See *note 9 to the consolidated financial statements on page 115*.

The tax basis of assets and liabilities as well as tax losses carried forward are computed based upon the applicable income tax legislation, regulations and interpretations, all of which in turn are subject to interpretation. In computing future income tax assets and future income tax liabilities, assumptions are made about their respective timing of reversal and future results of operations. These assumptions also affect classification between income taxes recoverable and future income tax assets. It is reasonable to expect that the composition of future income tax assets and future income tax liabilities may change from period to period because of the significance of these uncertainties.

If future outcomes were to adversely differ from management's best estimate of future results of operations and the timing of reversal of deductible temporary differences and taxable temporary differences, the Corporation could experience material future income tax adjustments. Such future income tax adjustments would not result in immediate cash outflows and, of themselves, would not affect the Corporation's immediate liquidity.

## 9.2 Accounting policy developments

The consolidated financial statements are prepared in accordance with Canadian GAAP as set out in the *CICA Handbook of Standards and Guidance Collection*. The impact of current year and future changes in Canadian GAAP is described below.

### Current year accounting changes

#### *Capital disclosures*

The Corporation has adopted the new recommendations of CICA Section 1535 "Capital Disclosures," which converges with recent amendments to International Financial Reporting Standard IAS 1 "Presentation of Financial Statements." Section 1535 requires an entity to disclose information about its objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, as well as its compliance with any externally imposed capital requirements.

#### *Financial instruments disclosures and presentation*

Commencing with the 2008 fiscal year, the Corporation adopted the new recommendations of CICA Section 3862 "Financial Instruments – Disclosures," issued to converge with the requirements of International Financial Reporting Standard IFRS 7 "Financial Instruments: Disclosures." As set out in *note 7 to the consolidated financial statements on page 109*, the new recommendations result in incremental disclosures, relative to those previously, with an emphasis on risks associated with both recognized and unrecognized financial instruments to which an entity is exposed during the period and at the balance sheet date, and how an entity manages those risks. The transitional provisions state that certain of the incremental disclosures need not be provided on a comparative basis in the year of adoption. The existing recommendations for financial instrument presentation were carried forward, unchanged, as CICA Handbook Section 3863.

### Future year accounting changes

#### *Goodwill and Intangible Assets*

The CICA implemented revisions to standards dealing with goodwill and intangible assets, effective for fiscal years beginning on or after October 1, 2008. Section 3064 "Goodwill and Intangible Assets," which replaced Section 3062 "Goodwill and Other Intangible Assets," gives guidance on the recognition of intangible assets as well as the recognition and measurement of internally developed intangible assets. Section 3450 "Research and Development Costs" will be withdrawn. The Corporation does not expect any material impact to the financial statements as a result of the adoption of this standard.

### 9.3 International Financial Reporting Standards (IFRS)

#### Convergence with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB)

In February 2008, the Canadian Accounting Standards Board confirmed that publicly accountable entities will be required to adopt IFRS in place of Canadian Generally Accepted Accounting Principles (GAAP) for fiscal years beginning on or after January 1, 2011. The Corporation (which meets the current definition of a publicly accountable entity) will report under IFRS in its financial statements for the year ending December 31, 2011.

#### Overview of IFRS changeover plan

We have developed and implemented an IFRS changeover plan to support the transition from Canadian GAAP to IFRS in the 2011 financial statements. We have established a multidisciplinary IFRS implementation team led by the Vice-President, Finance and Comptroller and have instituted regular progress reporting to the Audit Committee of the Board of Directors. We have engaged and are working with external advisors to facilitate an effective changeover.

The implementation plan consists of three phases. The first phase, focusing on planning and early issue identification, was completed during the year. Work on the second and third phases of the plan, covering detailed evaluations for each financial reporting area and implementation of the new standards, has commenced and will continue through 2009 and 2010.

Our IFRS changeover plan covers the various elements we are addressing as a result of this financial reporting change and its ancillary impacts on our systems, resources and key business activities.

The following table summarizes the key elements and current status of our plan.

#### Convergence with IFRS – Key plan elements

| Key activities   | Status at December 31, 2008   |
|--|---|
| <b>Financial statement preparation:</b> <ul style="list-style-type: none"> <li>Identifying differences in Canadian GAAP/IFRS accounting policies</li> <li>Selecting ongoing IFRS policies</li> <li>Selecting first-time adoption elections</li> <li>Developing financial statement presentation and disclosure format</li> <li>Preparing opening IFRS balance sheet</li> </ul>         | <ul style="list-style-type: none"> <li>Completed analysis of key differences in October 2008</li> <li>Detailed evaluation now underway covering policy and first-time adoption elections and implementation choices</li> <li>Periodic update and impact analysis provided to Audit Committee</li> </ul>   |
| <b>Financial reporting expertise:</b><br>Appropriate level of IFRS expertise to be defined and introduced for each of the following: <ul style="list-style-type: none"> <li>Core finance team</li> <li>Senior executives and Board, including Audit Committee</li> <li>Operational personnel</li> </ul>  | <ul style="list-style-type: none"> <li>An external training services provider has been engaged and a number of training sessions have been conducted with our core finance team</li> <li>Other training needs are under review and will be addressed in 2009</li> </ul>   |
| <b>Information technology:</b><br>Information technology to be IFRS compliant for all: <ul style="list-style-type: none"> <li>Systematic processing changes</li> <li>Program upgrades/changes</li> <li>Date of transition entries (IFRS 1)</li> <li>Gathering data for disclosures</li> <li>Scope of consolidation package</li> <li>Budget/plan/forecast monitoring process</li> </ul> | <ul style="list-style-type: none"> <li>The Corporation has started discussions with our IT/IS provider, Innovapost, to confirm specifications of additional systems requirements and related deadlines in order to generate IFRS compliant data from January 1, 2010, onwards</li> <li>As part of each detailed policy evaluation, the required specific system changes are under review. In particular, this includes the extent of required systems changes necessary to comply with the tracking and recording of component parts of assets</li> </ul> |

**Convergence with IFRS – Key plan elements (continued)**

| Key activities  | Status at December 31, 2008   |
|---|---|
| <b>Internal Control over Financial Reporting (ICFR):</b><br>All changes necessary to the design and operation of ICFR to be identified and implemented in order to continue to report satisfactorily following the transition to IFRS   | <ul style="list-style-type: none"> <li>The evaluation for these requirements will be conducted in 2009</li> </ul>   |
| <b>Disclosure Controls and Procedures (DC&amp;P):</b><br>All changes necessary to the design and operation of DC&P to be identified and implemented in order to continue to report satisfactorily following the transition to IFRS  | <ul style="list-style-type: none"> <li>The evaluation for these requirements will be conducted in 2009</li> </ul>   |
| <b>Business activities:</b><br>Impact of IFRS on key business activities to be evaluated, including: <ul style="list-style-type: none"> <li>Compensation plans</li> <li>Financing arrangements and requirements</li> <li>Other contractual and legal arrangements</li> <li>Capital expenditure</li> <li>Key ratios</li> </ul> | <ul style="list-style-type: none"> <li>The detailed policy evaluations and first-time evaluations consider the impact on equity on first-time adoption as well as the ongoing results of the Corporation</li> <li>As these evaluations progress, the Corporation will assess the implications to key business activities, if any</li> </ul> |

**Accounting policy and first-time adoption choices**

The table below outlines some of the financial reporting areas that we believe may have a material impact on the Corporation. This information is not intended to be a complete listing of all financial reporting impacts and is contingent, in many instances, on the policy choices and first-time adoption elections that we make. Specifically, decisions around certain first-time adoption elections could create or alleviate a material impact on opening IFRS equity. The table is based on available information at this time and relevant considerations and the related impacts may change as our assessment progresses. We will provide conclusions on material matters in future reports. A reliable estimate of the quantitative impact of these matters is not yet known.

| Topic   | Considerations   | Status at December 31, 2008   | Conclusion    |
|---|--|---|---------------|
| IAS 16 – Property, Plant and Equipment (PP&E) | <ul style="list-style-type: none"> <li>Election to restate PP&amp;E to fair value available at date of transition</li> <li>Policy choice between revaluation and cost model</li> <li>Requirement to disaggregate assets for depreciation purposes</li> </ul>                       | <ul style="list-style-type: none"> <li>Cost/benefit analysis underway</li> <li>Some benefits identified in restating some land and buildings to fair value on transition</li> <li>Expected policy choice – cost model for all assets</li> </ul> | Not yet known |
| IFRS 3 – Business Combinations                | <ul style="list-style-type: none"> <li>Election to avoid restating prior business combinations</li> </ul>  | <ul style="list-style-type: none"> <li>Based on preliminary analysis, we expect to select this IFRS 1 election</li> </ul>   | Not yet known |
| IAS 19 – Employee Benefits                    | <ul style="list-style-type: none"> <li>Various differences identified in treatment of defined benefit arrangements</li> <li>Election available on first-time adoption</li> <li>Various policy choices under IAS 19 regarding treatment of actuarial items</li> </ul>               | <ul style="list-style-type: none"> <li>Analysis is ongoing at this time</li> <li>Any decision will consider the possible changes that may result due to changes in IAS 19 that may occur in 2011 or earlier</li> </ul>                          | Not yet known |
| IAS 31 – Interests in Joint Ventures          | <ul style="list-style-type: none"> <li>Election to avoid restating prior transactions</li> <li>Current policy choice under IAS 31 regarding treatment, but new standard expected in 2009</li> </ul>  | <ul style="list-style-type: none"> <li>The Corporation is monitoring this area and will address fully pending the issuance of the new guidance</li> </ul>   | Not yet known |
| Other Areas                                   | <ul style="list-style-type: none"> <li>Other areas that could be significant include income taxes, provisions and leases. In addition, future changes in IFRS are being monitored actively and will affect our evaluations and decisions on financial reporting matters</li> </ul> |   |               |

## 10 Outlook for 2009

*Our prospects for 2009*

### 10.1 Current operating context

The year 2009 promises to be challenging for our Corporation, our competitors and our customers. The uncertainty created by the severe economic downturn and the volatility of financial markets has made it more difficult to predict future revenues, earnings and cash position.

The economic crisis is affecting Canada Post significantly in three areas: revenue and earnings, pension and employee future benefits, and Postal Transformation.

Planned net income before income taxes for 2009 for The Canada Post Group is \$117 million. The economic downturn is having a negative effect on revenues, which could result in an estimated shortfall of \$250 million against plan within the Canada Post segment. This is combined with the continued growth of public-policy obligations at Canada Post, driven by new addresses in our delivery network. With very narrow margins, the Corporation needs to be highly vigilant in controlling discretionary costs and finding new operational efficiencies if we are to reach our profitability target. Accordingly, we have implemented a significant cost-management program to offset the projected revenue shortfall and protect our earnings.

In addition to the above, income before income taxes is expected to be artificially inflated in 2009, due to an unplanned net non-cash gain of more than \$270 million mainly relating to an increase in the rate used to discount the pension and other benefits obligations for accounting purposes. This situation could change again significantly in 2010 if interest rates were to decline.

The downturn in the financial markets had a significant negative impact on the value of the Canada Post Pension Plan in 2008, leaving it in a solvency deficit position at year-end. The Corporation resumed making current service contributions to the Pension Plan in November 2008, and these are expected to total \$271 million in 2009. We do not expect to have to make special payments until 2010.

Much of our ability to remain viable depends on the modernization of mail operating procedures. This requires the investment described in *Section 2.3 – Strategic vision on page 37*. Our ability to proceed with Postal Transformation beyond the critical investment currently underway is contingent on the financial health of the Corporation, which will largely be driven by the state of the economy and the Canada Post Pension Plan, as discussed earlier.

The Corporation, through the Strategic Review panel, is engaged in a dialogue with the Shareholder to establish a new financial framework that will allow Canada Post to proceed with this modernization, to ensure that steps are taken to maintain the financial self-sufficiency of Canada Post and to provide an acceptable level of service to Canadians.

In spite of these challenges, Canada Post remains confident that our management focus on cost controls, development of new products and services, and business improvements from our investment in the Modern Post will continue to position us well for the future.

### 10.2 Economic outlook

The Canadian economy is experiencing a recession that started in the last quarter of 2008 and is expected to continue through 2009. Economists are not of one view regarding the length or the depth of the economic recession. Points of view range from an improvement in the last half of 2009 to no improvement until the end of 2011, with recent GDP forecasts ranging from declines of 0.5% to 2.5%. As a result, after minimal growth of 0.5% in 2008, we are forecasting real GDP to decline by 2.0% in 2009, followed by a modest recovery in 2010. Thereafter, real GDP growth is expected to return to a more normal growth path of between 2.5% and 2.8%.

Inflation as measured by the consumer price index (CPI) was 2.4% in 2008 and is forecast to slow to 0.4% in 2009, largely due to significant declines in energy prices. Inflation is expected to average 2% a year over the period from 2009 to 2013. At this level of inflation, the current price-cap formula will not trigger the much-needed Lettermail price increase of one cent.

Short-term interest rates have fallen substantially as the Bank of Canada attempts to cushion Canada's economy from the negative effects of the global economic turmoil, the U.S. recession as well as the impact of the financial crisis on credit availability. Over the plan period, the prime lending rate is expected to average just over 4% per year.

Points of delivery are expected to increase by approximately 200,000 each year, adding significant costs to delivery operations.

## Economic outlook

|                                  | 2009  | 2010 | 2011 | 2012 | 2013 |
|----------------------------------|-------|------|------|------|------|
| <b>Economic (% change)</b>       |       |      |      |      |      |
| Real Gross Domestic Product      | (2.0) | 2.0  | 2.8  | 2.7  | 2.5  |
| Inflation (Consumer Price Index) | 0.4   | 2.0  | 2.1  | 2.2  | 2.0  |
| Prime Lending Rate (%)           | 2.8   | 2.8  | 4.1  | 5.1  | 6.0  |
| <b>Demographic (% change)</b>    |       |      |      |      |      |
| Total population growth          | 0.9   | 0.9  | 0.8  | 0.8  | 0.7  |
| Households growth                | 1.5   | 1.3  | 1.2  | 1.2  | 1.2  |

### Sources:

The economic outlook is based on the most recent Statistics Canada data, the December 2008 Canadian Outlook of The Conference Board of Canada and the March 2009 Global Insight Macro Economic forecast. Forecasts from the major banks and the Bank of Canada were also used for the first two years of the forecast. The demographic indicators are based on actual data from Statistics Canada and projections from Global Insight and Canada Post.

## 10.3 Canada Post segment

In addition to general economic factors, our outlook takes into account that competition, already powerful, will intensify across all our businesses as we and our competitors harness the forces of technology, globalization and customer empowerment.

### Transaction Mail

Pressure on the Transaction Mail line of business continued in 2008, as evidenced by the decrease in physical mail volume. We expect sustained decline as mailers continue to adopt electronic alternatives and businesses look for ways to reduce costs through mail consolidation, especially in light of the prevailing economic downturn.

Lettermail remains an important part of the set of options available to businesses and governments for communication with their own customers/citizens. With increasing demand for a wider, more integrated range of communication alternatives, Canada Post's service complement of Lettermail plus epost and other electronic delivery services, along with the SmartFlow Document Management Services suite, becomes more relevant and valuable.

Increasing our connection with Canadians is central to our ability to serve our customers. In the coming years, we plan to continue expanding our electronic services, giving Canadians the choice of how they receive their mail.

### Parcels

As the current recession affects customers' shipping behaviour, expectations for Parcels growth in 2009 remain relatively low. Because our competitors are quickly adopting new technologies, we will need to make continued investments to remain relevant. We must maintain our focus on delivering a premium customer experience while balancing our financial commitment to our stakeholders. Parcel visibility is the foundation for all our future growth plans, so the Parcels line of business will continue with its plan to add scanners and improve our data transmission technologies. We will continue our efforts to systematically eliminate inefficiencies across the network to control costs, based on two years of success in doing so.

The uncertain economic conditions will be a major factor in how our customers adapt and change their shipping profile with us. Service performance will remain a key focus, as this is a clear factor in how customers choose among several competitors.

## Direct Marketing

We anticipate a flattening of the Direct Marketing line of business for 2009. Advertising and marketing budgets are being contracted in response to the current economic conditions. Forecasts of recessions are causing businesses to look closely at traditional media spend, and to find lower cost and more effective means of advertising. We believe our core Admail products are positioned to offer measurability, high return on investment and more personalized communications. These fundamental characteristics are critical in a time where every dollar spent must be accounted for and measured. We will continue to build the platforms for our future, and further improve the relevance and effectiveness of direct mail by introducing new data products and services. We will offer our customers tools and products to improve their customer lists, thus increasing response and return on investment.

We will continue to provide leadership by demonstrating to our customers the impact and effectiveness of direct mail by cultivating strategic relationships with our key customers, and by providing guidance and easy-to-use tools to our new direct marketing customers.

## 10.4 Purolator segment

Considering the reality of the current global economy, 2008 was a reasonably good year for Purolator. Purolator's annual volumes grew marginally while major competitors experienced double-digit declines.

Nevertheless, the last two months of 2008 saw accelerating volume deterioration. Purolator expects this will continue for an extended period of time, throughout 2009 and likely into 2010. Faced with this new reality, Purolator intends to be even more aggressive in reducing costs and easing the impact of the declining revenue in the Canadian express market by continuing to focus on growth areas.

Purolator's plans for 2009 aim to effectively allocate resources, reduce costs, increase revenue, and maintain profitability without compromising service levels or potential for long-term success. It is vitally important to remain focused on providing exceptional service to customers, especially during these difficult times.

Keeping costs in line with volume and revenue is critical to remaining profitable in 2009 and being in a strong position when the economy starts to grow again.

## 10.5 Logistics segment

The economic downturn in Canada is having a slight, but noticeable, effect on growth. This is visible with cost pressures facing current clients. In response to meeting client expectations for cost reductions and positioning for future new client growth, SCI management has focused on increased attention to continuous improvement and quality management programs. These programs, which were launched in late 2008, will generate increased productivity and lower infrastructure costs, both of which will position SCI to be more competitive.

Global players are involved with larger opportunities through leverage at international head offices while SCI is only seeing smaller opportunities (up to \$5 million), which are all within Canada only. SCI's long-term growth and sustainability depend on its ability to provide services in markets outside Canada through direct acquisitions and global partners.

## 10.6 All Other segment

Innovapost will continue to drive improvements to information technology and management across The Canada Post Group. Along with improving its internal capabilities, processes and controls, Innovapost also intends to concentrate on expanding its service offerings and capabilities.

Innovapost revenues depend on the level of information technology activity at Canada Post and Purolator. In 2009, revenue is expected to decline as Canada Post and Purolator reduce the pace of technology investment compared to 2008 while continuing to require savings in their base operating costs.

*From anywhere... to anyone™*, Lettermail™, epost™, SmartFlow™, Priority™, Xpresspost™, Small Packet™, Borderfree™, Addressed Admail™, Unaddressed Admail™, AdCard™, Publications Mail™ and Business Reply Mail™ are trademarks of Canada Post Corporation.

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## HISTORICAL FINANCIAL INFORMATION

| (unaudited, in millions of dollars)  | 2008  | 2007  | 2006  | 2005   | 2004   |
|--|-------|-------|-------|--------|--------|
| <b>OPERATIONS</b>  |       |       |       |        |        |
| Revenue from operations  | 7,729 | 7,474 | 7,264 | 6,944  | 6,651  |
| Cost of operations   | 7,594 | 7,346 | 7,116 | 6,681  | 6,413  |
| Income from operations   | 135   | 128   | 148   | 263    | 238    |
| Per cent of revenue from operations  | 1.8 % | 1.7 % | 2.0 % | 3.8 %  | 3.6 %  |
| Non-operating income   | 26    | 32    | 18    | 19     | 3      |
| Income before income taxes   | 161   | 160   | 166   | 282    | 241    |
| Income tax expense   | 67    | 102   | 44    | 80     | 93     |
| Net income before non-controlling interest                                 | 94    | 58    | 122   | 202    | 148    |
| Non-controlling interest in net income of subsidiaries                     | 4     | 4     | 3     | 3      | 1      |
| Net income   | 90    | 54    | 119   | 199    | 147    |
| Return on equity of Canada   | 6.1 % | 3.8 % | 8.4 % | 15.0 % | 12.1 % |
| <b>BALANCE SHEET</b>   |       |       |       |        |        |
| <b>Assets</b>  |       |       |       |        |        |
| Current*   | 1,384 | 1,388 | 1,470 | 1,468  | 1,290  |
| Segregated securities  | 862   | 632   | 469   | 446    | 505    |
| Capital assets*  | 2,034 | 1,855 | 1,731 | 1,693  | 1,753  |
| Accrued pension benefit asset  | 898   | 944   | 1,010 | 784    | 497    |
| Other*   | 413   | 348   | 319   | 228    | 286    |
| Total assets*  | 5,591 | 5,167 | 4,999 | 4,619  | 4,331  |
| <b>Liabilities and equity of Canada</b>                                    |       |       |       |        |        |
| Current*   | 1,181 | 1,073 | 1,185 | 1,117  | 1,109  |
| Accrued pension, other retirement<br>and post-employment benefit liability | 2,722 | 2,513 | 2,247 | 1,973  | 1,818  |
| Other liabilities  | 155   | 120   | 115   | 119    | 137    |
| Non-controlling interest   | 26    | 22    | 19    | 16     | 13     |
| Equity of Canada   | 1,507 | 1,439 | 1,433 | 1,394  | 1,254  |
| Total liabilities and equity of Canada*                                    | 5,591 | 5,167 | 4,999 | 4,619  | 4,331  |
| <b>ACQUISITION OF CAPITAL ASSETS</b>                                       |       |       |       |        |        |
| Land and buildings   | 145   | 110   | 65    | 42     | 48     |
| Other capital assets*  | 246   | 221   | 241   | 126    | 176    |
|  | 391   | 331   | 306   | 168    | 224    |

\* Comparative figures have been reclassified in order to conform to the presentation adopted in 2008.

## HISTORICAL FINANCIAL INFORMATION

|   | 2008  | %<br>Change | 2007  | %<br>Change | 2006  | %<br>Change | 2005* | %<br>Change | 2004  |
|---|-------|-------------|-------|-------------|-------|-------------|-------|-------------|-------|
| <b>LINE OF BUSINESS DIMENSIONS</b>                                    |       |             |       |             |       |             |       |             |       |
| <b>REVENUE FROM OPERATIONS</b>  |       |             |       |             |       |             |       |             |       |
| (unaudited, in millions of dollars/<br>trading day adjusted per cent) |       |             |       |             |       |             |       |             |       |
| <b>Transaction mail</b>   |       |             |       |             |       |             |       |             |       |
| Domestic mail/mail to<br>foreign postal administrations**             | 3,108 | (0.1) %     | 3,100 | (0.2) %     | 3,093 | 3.5 %       | 2,988 | 3.2 %       | 2,919 |
| Mail from foreign postal administrations***                           | 126   | 9.7 %       | 114   | 0.1 %       | 114   | (4.1) %     | 119   | (9.2) %     | 132   |
| Canada Post segment   | 3,234 | 0.2 %       | 3,214 | (0.2) %     | 3,207 | 3.2 %       | 3,107 | 2.6 %       | 3,051 |
| All other segments  | –     | –           | –     | (100.0) %   | 4     | (1.9) %     | 4     | 73.6 %      | 3     |
| Elimination of intersegment   | (5)   |             | (5)   |             | (6)   |             | (5)   |             | (7)   |
| The Canada Post Group   | 3,229 | 0.2 %       | 3,209 | (0.3) %     | 3,205 | 3.2 %       | 3,106 | 2.8 %       | 3,047 |
| <b>Parcels</b>  |       |             |       |             |       |             |       |             |       |
| Domestic mail/mail to<br>foreign postal administrations**             | 1,164 | 4.9 %       | 1,105 | 3.8 %       | 1,061 | (0.9) %     | 1,069 | 8.5 %       | 994   |
| Mail from foreign postal administrations***                           | 147   | 9.5 %       | 134   | (0.6) %     | 134   | 33.0 %      | 101   | 45.7 %      | 70    |
| Canada Post segment   | 1,311 | 5.4 %       | 1,239 | 3.3 %       | 1,195 | 2.1 %       | 1,170 | 10.9 %      | 1,064 |
| Purolator segment   | 1,563 | 7.4 %       | 1,448 | 7.1 %       | 1,347 | 7.4 %       | 1,254 | 9.3 %       | 1,156 |
| Logistics segment   | 156   | 6.4 %       | 146   | 8.3 %       | 134   | (6.1) %     | 143   | 5.0 %       | 137   |
| All other segments**  | –     | –           | –     | –           | –     | (100.0) %   | 2     | (64.6) %    | 5     |
| Elimination of intersegment   | (97)  |             | (84)  |             | (61)  |             | (56)  |             | (42)  |
| The Canada Post Group   | 2,933 | 6.3 %       | 2,749 | 4.7 %       | 2,615 | 4.0 %       | 2,513 | 9.2 %       | 2,320 |
| <b>Direct marketing</b>   |       |             |       |             |       |             |       |             |       |
| Addressed Admail™   | 635   | 1.9 %       | 621   | 6.1 %       | 583   | 9.9 %       | 530   | 4.1 %       | 513   |
| Unaddressed Admail™   | 399   | 5.6 %       | 376   | 10.3 %      | 339   | 14.4 %      | 297   | 11.4 %      | 269   |
| Publications Mail™  | 289   | 0.9 %       | 285   | 3.2 %       | 275   | 4.3 %       | 263   | 5.3 %       | 252   |
| Other**   | 108   | (1.3) %     | 109   | 7.5 %       | 101   | 10.1 %      | 92    | 3.0 %       | 90    |
| Canada Post segment   | 1,431 | 2.5 %       | 1,391 | 6.7 %       | 1,298 | 9.8 %       | 1,182 | 6.0 %       | 1,124 |
| All other segments**  | –     | –           | –     | –           | –     | –           | –     | –           | –     |
| The Canada Post Group   | 1,431 | 2.5 %       | 1,391 | 6.7 %       | 1,298 | 9.8 %       | 1,182 | 6.0 %       | 1,124 |
| <b>Other revenue</b>  |       |             |       |             |       |             |       |             |       |
| Canada Post segment   | 132   | 18.7 %      | 111   | (16.1) %    | 131   | 2.8 %       | 128   | (9.8) %     | 143   |
| All other segments  | 176   | 0.3 %       | 175   | 1.2 %       | 173   | (1.4) %     | 175   | (4.5) %     | 184   |
| Elimination of intersegment   | (172) |             | (161) |             | (158) |             | (160) |             | (167) |
| The Canada Post Group   | 136   | 7.6 %       | 125   | (14.7) %    | 146   | 2.4 %       | 143   | (9.9) %     | 160   |
| <b>Revenue from operations</b>  |       |             |       |             |       |             |       |             |       |
| Canada Post segment   | 6,108 | 2.2 %       | 5,955 | 1.7 %       | 5,831 | 4.4 %       | 5,587 | 4.7 %       | 5,382 |
| Purolator segment   | 1,563 | 7.4 %       | 1,448 | 7.1 %       | 1,347 | 7.4 %       | 1,254 | 9.3 %       | 1,156 |
| Logistics segment   | 156   | 6.4 %       | 146   | 8.3 %       | 134   | (6.1) %     | 143   | 5.0 %       | 137   |
| All other segments  | 176   | 0.3 %       | 175   | (1.4) %     | 177   | (2.3) %     | 181   | (4.8) %     | 192   |
| Elimination of intersegment   | (274) |             | (250) |             | (225) |             | (221) |             | (216) |
| The Canada Post Group   | 7,729 | 3.0 %       | 7,474 | 2.5 %       | 7,264 | 4.6 %       | 6,944 | 5.3 %       | 6,651 |

## HISTORICAL FINANCIAL INFORMATION

|  | 2008   | %<br>Change | 2007   | %<br>Change | 2006   | %<br>Change | 2005*  | %<br>Change | 2004   |
|--|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|
| <b>LINE OF BUSINESS DIMENSIONS</b>                                   |        |             |        |             |        |             |        |             |        |
| <b>VOLUME</b>  |        |             |        |             |        |             |        |             |        |
| (unaudited, in millions of pieces/<br>trading day adjusted per cent) |        |             |        |             |        |             |        |             |        |
| <b>Transaction mail</b>  |        |             |        |             |        |             |        |             |        |
| Domestic mail/mail to<br>foreign postal administrations              | 5,045  | (1.8) %     | 5,116  | (1.3) %     | 5,161  | 0.8 %       | 5,122  | 1.3 %       | 5,099  |
| Mail from foreign postal administrations***                          | 274    | (6.1) %     | 290    | (6.8) %     | 310    | (6.2) %     | 331    | 6.1 %       | 314    |
| Canada Post segment  | 5,319  | (2.0) %     | 5,406  | (1.6) %     | 5,471  | 0.3 %       | 5,453  | 1.5 %       | 5,413  |
| Elimination of intersegment  | (6)    |             | (7)    |             | (7)    |             | (7)    |             | (7)    |
| The Canada Post Group  | 5,313  | (2.0) %     | 5,399  | (1.6) %     | 5,464  | 0.3 %       | 5,446  | 1.5 %       | 5,406  |
| <b>Parcels</b>   |        |             |        |             |        |             |        |             |        |
| Domestic mail/mail to<br>foreign postal administrations              | 122    | (0.7) %     | 123    | (0.2) %     | 123    | (8.1) %     | 134    | (3.3) %     | 139    |
| Mail from foreign postal administrations***                          | 37     | (26.7) %    | 51     | (2.2) %     | 51     | 135.4 %     | 22     | 37.7 %      | 16     |
| Canada Post segment  | 159    | (8.3) %     | 174    | (0.7) %     | 174    | 12.0 %      | 156    | 0.9 %       | 155    |
| Purolator segment  | 143    | 0.2 %       | 142    | 1.5 %       | 140    | 0.3 %       | 139    | 4.4 %       | 134    |
| Elimination of intersegment  | (3)    |             | (2)    |             | (2)    |             | (2)    |             | (1)    |
| The Canada Post Group  | 299    | (4.6) %     | 314    | 0.1 %       | 312    | 6.4 %       | 293    | 2.4 %       | 288    |
| <b>Direct marketing</b>  |        |             |        |             |        |             |        |             |        |
| Addressed Admail™  | 1,503  | (1.8) %     | 1,525  | 3.3 %       | 1,470  | 5.0 %       | 1,400  | 2.1 %       | 1,383  |
| Unaddressed Admail™  | 4,061  | 2.7 %       | 3,940  | 5.4 %       | 3,722  | 9.1 %       | 3,411  | 8.1 %       | 3,180  |
| Publications Mail™   | 522    | (2.9) %     | 535    | (0.4) %     | 536    | 0.8 %       | 531    | (0.8) %     | 540    |
| Other  | 56     | (16.0) %    | 66     | 9.5 %       | 60     | (7.4) %     | 65     | (8.2) %     | 71     |
| The Canada Post Group  | 6,142  | 0.9 %       | 6,066  | 4.4 %       | 5,788  | 7.0 %       | 5,407  | 5.4 %       | 5,174  |
| <b>Total Volume</b>  |        |             |        |             |        |             |        |             |        |
| Canada Post segment  | 11,620 | (0.6) %     | 11,646 | 1.5 %       | 11,433 | 3.8 %       | 11,016 | 3.4 %       | 10,742 |
| Purolator segment  | 143    | 0.2 %       | 142    | 1.5 %       | 140    | 0.3 %       | 139    | 4.4 %       | 134    |
| Elimination of intersegment  | (9)    |             | (9)    |             | (9)    |             | (9)    |             | (8)    |
| The Canada Post Group  | 11,754 | (0.6) %     | 11,779 | 1.5 %       | 11,564 | 3.7 %       | 11,146 | 3.4 %       | 10,868 |
| <b>EMPLOYMENT****</b>  |        |             |        |             |        |             |        |             |        |
| Full-time employees  | 61,368 | (0.3) %     | 61,557 | 0.8 %       | 61,064 | 1.1 %       | 60,405 | (1.6) %     | 61,409 |
| Part-time employees  | 10,632 | (2.8) %     | 10,937 | 1.2 %       | 10,805 | (2.0) %     | 11,028 | (3.8) %     | 11,465 |
| Total employees  | 72,000 | (0.7) %     | 72,494 | 0.9 %       | 71,869 | 0.6 %       | 71,433 | (2.0) %     | 72,874 |
| <b>MAIL NETWORK</b>  |        |             |        |             |        |             |        |             |        |
| Post offices   | 6,618  | 0.1 %       | 6,614  | 0.2 %       | 6,602  | (1.8) %     | 6,724  | (1.0) %     | 6,795  |
| Points of delivery (in thousands)                                    | 14,696 | 1.4 %       | 14,493 | 1.4 %       | 14,293 | 1.7 %       | 14,053 | 1.8 %       | 13,808 |
| Pickup points (in thousands)   | 1,008  | (0.7) %     | 1,015  | (0.3) %     | 1,019  | 0.0 %       | 1,018  | 2.2 %       | 997    |

\* The 2005 Canada Post segment revenues and volumes have been restated to reflect the 2006 change in methodology that now allocates the sales of commemorative stamps to transaction mail and parcels. The % change from 2004 to 2005 on transaction mail without this change is 2.0% and 1.0% for revenues and volumes respectively (no significant impact on parcels).

\*\* The 2004 to 2007 revenues were restated to reflect minor realignments made in 2008 between lines of business.

\*\*\* In 2005, Canada Post redesigned and increased sampling activity to achieve statistical validity and improved receipt verification reports and processes for international mail settlements. The scope of this initiative was subsequently expanded to include a joint effort with the United States Postal Service (USPS) to modify and improve the processes and procedures governing mail settlement between the two organizations. As a result of this, the inbound mail 2006 values are not comparable to the prior years.

\*\*\*\* Includes paid full-time and part-time employees and excludes temporary, casual and term employees.

## 90 ADDITIONAL INFORMATION

The following chart presents the financial ratios over the past five years:

| Consolidated Ratios<br>(unaudited)                                   | Policy<br>Framework | 2008    | 2007    | 2006    | 2005    | 2004      |
|--|---------------------|---------|---------|---------|---------|-----------|
| <b>Profitability</b>   |                     |         |         |         |         |           |
| (1) Return on equity of Canada                                       | 11.0 %              | 6.1 %   | 3.8 %   | 8.4 %   | 15.0 %  | 12.1 %    |
| (2) Operating profit margin  |                     | 1.8 %   | 1.7 %   | 2.0 %   | 3.8 %   | 3.6 %     |
| (3) Productivity   | 97.0 %              | 98.2 %  | 98.3 %  | 98.0 %  | 96.2 %  | 96.4 %    |
| <b>Leverage</b>  |                     |         |         |         |         |           |
| (4) Total debt to total capital                                      | 40.0 %              | 5.8 %   | 4.9 %   | 4.9 %   | 5.8 %   | 7.8 %     |
| (5) Cash flow to debt  |                     | 643.7 % | 459.6 % | 366.0 % | 246.8 % | (122.4) % |
| <b>Liquidity</b>   |                     |         |         |         |         |           |
| (6) Current ratio  |                     | 1.17    | 1.29    | 1.24    | 1.31    | 1.16      |
| (7) Gross interest coverage  |                     | 13.67   | 12.47   | 14.58   | 25.62   | 21.29     |
| <b>Investment</b>  |                     |         |         |         |         |           |
| (8) Cash flow to capital expenditures                                |                     | 152.8 % | 104.0 % | 87.9 %  | 126.7 % | (58.1) %  |
| (9) Capital asset investment rate                                    |                     | 8.1 %   | 5.7 %   | 6.7 %   | 3.5 %   | 5.1 %     |
| <b>Dividend payout</b>   |                     |         |         |         |         |           |
| (10) Dividend payout ratio   | 25.0 %              | 40.0 %  | 40.0 %  | 40.0 %  | 40.0 %  | 40.0 %    |
| Dividend payout ratio once return<br>on equity of Canada $\geq$ 11 % | 40.0 %              |         |         |         |         |           |

(1) Net income  $\div$  ((equity of Canada beginning of year + equity of Canada end of year)  $\div$  2)

(2) Income from operations  $\div$  revenue from operations

(3) Cost of operations  $\div$  revenue from operations

(4) (Total debt + long-term financial obligation)  $\div$  (total debt + long-term financial obligation + equity of Canada)

(5) Cash flows from operating activities  $\div$  (total debt + long-term financial obligation)

(6) Current assets  $\div$  current liabilities

(7) Income from operations  $\div$  (interest expense + long-term financial expense)

(8) Cash flows from operating activities  $\div$  cash acquisition of capital assets

(9) (Acquisition of capital assets – proceeds from sale of capital assets)  $\div$  ((cost of capital assets beginning of year + cost of capital assets end of year)  $\div$  2)

(10) Dividend  $\div$  net income

## AUDITORS' REPORT ON ANNUAL COST STUDY CONTRIBUTION ANALYSIS

To the Board of Directors

Canada Post Corporation

We have audited the Annual Cost Study Contribution Analysis of Canada Post Corporation for the year ended December 31, 2008, prepared in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis. This financial information is the responsibility of the Corporation's management and has been prepared using Canada Post Corporation segment revenues and expenses contained in note 22 to the audited consolidated financial statements for the year ended December 31, 2008, and other unaudited operational data extracted from Canada Post Corporation's systems. Our responsibility is limited to expressing an opinion, based on our audit, on the financial information resulting from the application of the Cost Methodology.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial information is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial information. An audit also includes assessing the application of the methodology used and significant estimates made by management, as well as evaluating the overall presentation of the financial information.

We did not perform any audit work on the validity of the methodology nor on Canada Post's operational systems and special studies that yield operational data used to allocate costs to products.

In our opinion:

- (a) the Annual Cost Study Contribution Analysis presents fairly, in all material respects, the contribution of services by lines of business and the contribution by exclusive privilege, competitive and concessionary services for the year ended December 31, 2008, in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis, and using Canada Post Corporation segment revenues and expenses contained in note 22 to the audited consolidated financial statements for the year ended December 31, 2008, and other unaudited operational data extracted from Canada Post Corporation's systems; and
- (b) using the Cost Methodology described in the notes, Canada Post Corporation did not cross-subsidize its competitive services group by using revenues protected by exclusive privilege for the year ended December 31, 2008.

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants  
Ottawa, Canada  
March 25, 2009

## ANNUAL COST STUDY CONTRIBUTION ANALYSIS

**Canada Post Corporation**

The Annual Cost Study provides costing data that serves as the basis for ensuring that Canada Post Corporation is not competing unfairly by cross-subsidizing its competitive services with revenues from exclusive privilege services.

In conjunction with external experts, Canada Post Corporation maintains a costing methodology based on the principles of long-run incremental costs, which was designed to leverage the structure of an activity-based costing system. Canada Post Corporation applies this methodology each year in its Annual Cost Study for cost attribution purposes.

The methodology, which is summarized in the notes to the Annual Cost Study Contribution Analysis on page 93, recognizes that some costs are caused by the provision of individual services or groups of services while others are common costs of Canada Post Corporation's infrastructure. Approximately 63% of the total non-consolidated costs of Canada Post Corporation are assigned to individual services or groups of services in the Annual Cost Study.

As the Annual Cost Study Contribution Analysis indicates, for the year ended December 31, 2008, the competitive grouping of services generated positive long-run incremental contribution. Under the methodology in the Annual Cost Study, a positive long-run incremental contribution for the competitive grouping of services establishes that this grouping of services has not been cross-subsidized using revenues from exclusive privilege services.

**Annual Cost Study Contribution Analysis**

**Year ended December 31, 2008**

(in millions of dollars)

**I – Long-Run Incremental Contribution of exclusive privilege, competitive, and concessionary services**

|  | Exclusive<br>Privilege | Competitive          | Concessionary     | Other               | Total                  |
|--|------------------------|----------------------|-------------------|---------------------|------------------------|
| Revenue from operations  | \$ 3,794               | \$ 1,894             | \$ 194            | \$ 226              | \$ 6,108               |
| Long-run incremental costs                                     | \$ (2,058)             | \$ (1,464)           | \$ (192)          | \$ (132)            | \$ (3,846)             |
| <b>Long-run incremental contribution to the fixed costs</b>    | <b>\$ 1,736</b><br>46% | <b>\$ 430</b><br>23% | <b>\$ 2</b><br>1% | <b>\$ 94</b><br>41% | <b>\$ 2,262</b><br>37% |
| Unallocated fixed costs  |                        |                      |                   |                     | \$ (2,242)             |
| <b>Contribution before the under noted items</b>               |                        |                      |                   |                     | <b>\$ 20</b>           |
| Investment and other income                                    |                        |                      |                   |                     | \$ 54                  |
| Interest and other expense                                     |                        |                      |                   |                     | \$ (8)                 |
| <b>Income from the Canada Post segment before income taxes</b> |                        |                      |                   |                     | <b>\$ 66</b>           |

**II – Long-Run Incremental Contribution by line of business**

|  | Transaction<br>Mail    | Parcels              | Direct<br>Marketing  | Other               | Total                  |
|--|------------------------|----------------------|----------------------|---------------------|------------------------|
| Revenue from operations  | \$ 3,234               | \$ 1,311             | \$ 1,431             | \$ 132              | \$ 6,108               |
| Long-run incremental costs                                     | \$ (1,652)             | \$ (1,087)           | \$ (897)             | \$ (100)            | \$ (3,736)             |
| <b>Long-run incremental contribution to the fixed costs</b>    | <b>\$ 1,582</b><br>49% | <b>\$ 224</b><br>17% | <b>\$ 534</b><br>37% | <b>\$ 32</b><br>24% | <b>\$ 2,372</b><br>39% |
| Unallocated fixed costs  |                        |                      |                      |                     | \$ (2,352)             |
| <b>Contribution before the under noted items</b>               |                        |                      |                      |                     | <b>\$ 20</b>           |
| Investment and other income                                    |                        |                      |                      |                     | \$ 54                  |
| Interest and other expense                                     |                        |                      |                      |                     | \$ (8)                 |
| <b>Income from the Canada Post segment before income taxes</b> |                        |                      |                      |                     | <b>\$ 66</b>           |

The accompanying notes are an integral part of the Annual Cost Study Contribution Analysis.

# NOTES TO ANNUAL COST STUDY CONTRIBUTION ANALYSIS

Year ended December 31, 2008

## 1. General

The Annual Cost Study calculates the long-run incremental contribution from exclusive privilege services, competitive services and concessionary services. The long-run incremental contribution is defined as the revenues from such services, less their long-run incremental cost.

## 2. Cost methodology

- a) **Long-run incremental cost** • The cost methodology employed by Canada Post Corporation measures the long-run incremental cost of individual services and groups of services according to the current operating plan. Long-run incremental cost is the total annual cost caused by the provision of a service.
- b) **Activity-based** • Services provided by Canada Post Corporation are analyzed to determine the various activities involved in their fulfillment. Each activity is then analyzed to determine the causal relationship between the costs of the activity and the services that require the performance of that particular activity. Service volumes or other data are used to attribute those activity costs to services.
- c) **Attribution principles** • The relationship between the cost of resources and the activities performed and between the activities performed and the services delivered are identified using the principles of causality and time horizon. Those activity costs which are incurred because of the provision of a service are attributed to that service. Activity costs which cannot be attributed to the provision of a service but which are common to a specific group of services are attributed at that higher level of aggregation. The remaining business sustaining or common fixed costs are "unallocated fixed costs".
- d) **Source data** • The source of the financial data used to produce the Annual Cost Study results is the Canada Post Corporation general ledger revenues and costs. Operational time, volume and weight/cubage data are used to attribute general ledger costs to activities and activity costs to services. Operational volume data is used to determine revenue by services. Where operational data is not available, an appropriate proxy is used to make the attribution.
- e) **Reconciliation to financial records** • Total revenues and costs considered in the Annual Cost Study are agreed to the total revenues and expenses forming the Canada Post Corporation segment of the audited consolidated financial statements, which have been reported on by another firm of chartered accountants.
- f) **Cross-subsidization test** • Under the Cost Methodology in the Annual Cost Study a positive long-run incremental contribution (revenue exceeds long-run incremental cost) for a line of business, and competitive grouping of services establishes that the grouping of services has not been cross-subsidized using revenues from other services or groups of services.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

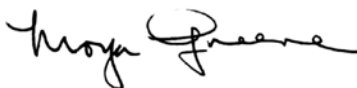
Management is responsible for the consolidated financial statements and all other information presented in this Annual Report. The *Financial Administration Act* and regulations require the consolidated financial statements to be prepared in accordance with Canadian generally accepted accounting principles. Where appropriate, the consolidated financial statements include amounts based on management's best estimates and judgments. Financial information presented elsewhere in this Annual Report is consistent with the consolidated financial statements.

In support of its responsibilities, management established a system of internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable financial information in accordance with the *Financial Administration Act* and regulations, as well as the *Canada Post Corporation Act* and regulations and by-laws of the Corporation. Internal audits examine and evaluate the application of the Corporation's policies and procedures and the adequacy of the system of internal controls.

The Board of Directors has delegated responsibility for oversight of the financial reporting process to the Audit Committee. The Committee acts on behalf of the Board of Directors in fulfilling the Board's responsibilities, which are prescribed by Section 148 of the *Financial Administration Act*. The Audit Committee is entirely constituted of non-executive directors and currently composed of five members who are therefore independent in accordance with the Corporation's standards of independence. The Audit Committee is responsible for reviewing the consolidated financial statements and the Annual Report and for meeting with management, internal auditors and external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee meets not less than four times a year, focusing in particular on the areas of financial reporting, risk management and internal control.

The Board of Directors on the recommendation of the Audit Committee approves the consolidated financial statements.

Canada Post Corporation is a Crown corporation included since 1989 in Part II of Schedule III of the *Financial Administration Act*. The Auditor General of Canada and KPMG LLP were appointed as joint auditors of the Corporation for the year ended December 31, 2008, in accordance with the *Financial Administration Act*. The Auditor General and KPMG LLP audit the consolidated financial statements and report to the Audit Committee of the Board of Directors, as well as the Minister of Transport, Infrastructure and Communities.



President and Chief Executive Officer

March 6, 2009



Chief Financial Officer



## AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

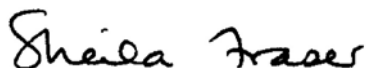
To the Minister of Transport, Infrastructure and Communities,

We have audited the consolidated balance sheet of Canada Post Corporation as at December 31, 2008 and the consolidated equity of Canada statement, the consolidated income statement and the consolidated cash flow statement for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, except for the changes in accounting policies adopted in the current year as explained in Note 3 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Corporation and its wholly-owned subsidiaries that have come to our notice during our audit of the consolidated financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canada Post Corporation Act* and regulations, the by-laws of the Corporation and its wholly-owned subsidiaries and the government directives issued pursuant to section 89 of the *Financial Administration Act*.



Sheila Fraser, FCA  
Auditor General of Canada

Ottawa, Canada  
March 6, 2009



Chartered Accountants, Licensed Public Accountants

## CONSOLIDATED BALANCE SHEET

| <b>As at December 31</b>   | <b>2008</b>     | <b>2007</b>     |
|--|-----------------|-----------------|
| <small>(in millions of dollars)</small>  |                 |                 |
| <b>Assets</b>  |                 |                 |
| <b>Current assets</b>  |                 |                 |
| Cash and cash equivalents (note 8)   | \$ 605          | \$ 386          |
| Marketable securities (note 8)   | 103             | 309             |
| Accounts receivable (note 7)   | 575             | 587             |
| Income tax recoverable   | 7               | 10              |
| Prepaid expenses   | 71              | 76              |
| Current portion of future income tax assets (note 9)                                     | 23              | 20              |
| <b>Total current assets</b>  | <b>1,384</b>    | <b>1,388</b>    |
| <b>Segregated securities</b> (note 8)  | <b>862</b>      | <b>632</b>      |
| <b>Capital assets</b> (note 10)  | <b>2,034</b>    | <b>1,855</b>    |
| <b>Accrued pension benefit asset</b> (note 11)   | <b>898</b>      | <b>944</b>      |
| <b>Future income tax assets</b> (note 9)   | <b>270</b>      | <b>203</b>      |
| <b>Goodwill</b> (note 12)  | <b>124</b>      | <b>124</b>      |
| <b>Other assets</b> (note 13)  | <b>19</b>       | <b>21</b>       |
| <b>Total assets</b>  | <b>\$ 5,591</b> | <b>\$ 5,167</b> |
| <b>Liabilities and equity of Canada</b>  |                 |                 |
| <b>Current liabilities</b>   |                 |                 |
| Accounts payable and accrued liabilities   | \$ 469          | \$ 446          |
| Salaries and benefits payable  | 509             | 390             |
| Income tax payable   | 16              | 34              |
| Deferred revenue   | 145             | 153             |
| Outstanding money orders   | 42              | 47              |
| Current portion of long-term debt (note 14)  | -               | 3               |
| <b>Total current liabilities</b>   | <b>1,181</b>    | <b>1,073</b>    |
| <b>Long-term debt</b> (note 14)  | <b>74</b>       | <b>55</b>       |
| <b>Accrued pension, other retirement and post-employment benefit liability</b> (note 11) | <b>2,722</b>    | <b>2,513</b>    |
| <b>Future income tax liabilities</b> (note 9)  | <b>30</b>       | <b>24</b>       |
| <b>Other long-term liabilities</b>   | <b>51</b>       | <b>41</b>       |
| <b>Total liabilities</b>   | <b>4,058</b>    | <b>3,706</b>    |
| <b>Non-controlling interest</b>  | <b>26</b>       | <b>22</b>       |
| <b>Equity of Canada</b>  | <b>1,507</b>    | <b>1,439</b>    |
| <b>Total liabilities and equity of Canada</b>  | <b>\$ 5,591</b> | <b>\$ 5,167</b> |

Commitments and contingencies (notes 1 and 17)  
 Conditional asset retirement obligations (note 15)

The accompanying notes are an integral part of these consolidated financial statements.

**Approved on behalf of the Board:**



Chairman of the Board of Directors



Chairperson of the Audit Committee

## CONSOLIDATED EQUITY OF CANADA STATEMENT

| Year ended December 31<br>(in millions of dollars)                       | 2008            | 2007            |
|--|-----------------|-----------------|
| <b>Contributed capital</b>   | <b>\$ 1,155</b> | <b>\$ 1,155</b> |
| <b>Retained earnings</b>   |                 |                 |
| Balance, beginning of year   | 284             | 278             |
| Transition adjustments on adoption<br>of financial instruments standards | –               | (1)             |
| Net income   | 90              | 54              |
| Dividend (note 16)   | (22)            | (47)            |
| Balance, end of year   | 352             | 284             |
| <b>Equity of Canada</b>  | <b>\$ 1,507</b> | <b>\$ 1,439</b> |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED INCOME STATEMENT

| Year ended December 31<br>(in millions of dollars)                                      | 2008            | 2007            |
|---|-----------------|-----------------|
| <b>Revenue from operations</b>  | <b>\$ 7,729</b> | <b>\$ 7,474</b> |
| <b>Cost of operations</b>   |                 |                 |
| Salaries  | 3,932           | 3,809           |
| Benefits, net of transitional support of \$81 million (2007 – \$106 million) (note 11e) | 907             | 960             |
| Non-labour collection, processing and delivery  | 1,278           | 1,132           |
| Facilities  | 303             | 292             |
| Amortization and impairment   | 237             | 214             |
| Other   | 937             | 939             |
| Total cost of operations  | <u>7,594</u>    | <u>7,346</u>    |
| <b>Income from operations</b>   | <b>135</b>      | <b>128</b>      |
| <b>Non-operating income (expense)</b>   |                 |                 |
| Investment and other income   | 38              | 42              |
| Interest and other expense  | (12)            | (10)            |
| Non-operating income, net   | <u>26</u>       | <u>32</u>       |
| Income before income taxes  | 161             | 160             |
| <b>Income tax expense (note 9)</b>  | <b>67</b>       | <b>102</b>      |
| Net income before non-controlling interest  | 94              | 58              |
| Non-controlling interest in net income of subsidiaries                                  | 4               | 4               |
| <b>Net income</b>   | <b>\$ 90</b>    | <b>\$ 54</b>    |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED CASH FLOW STATEMENT

| Year ended December 31<br>(in millions of dollars)                            | 2008          | 2007          |
|---|---------------|---------------|
| <b>Operating activities</b>   |               |               |
| Net income  | \$ 90         | \$ 54         |
| Adjustments to reconcile net income to cash provided by operating activities: |               |               |
| Accrued pension, other retirement and post-employment benefits                | 476           | 577           |
| Pension, other retirement and post-employment benefit payments                | (221)         | (277)         |
| Transitional support offsetting pension reform incremental costs              | (81)          | (106)         |
| Amortization and impairment   | 237           | 215           |
| Future income tax benefit   | (64)          | (23)          |
| Gain on sale of capital assets  | (2)           | (10)          |
| Proceeds from long-term incentive   | 8             | 7             |
| Other income not affecting cash, net  | 11            | -             |
| Change in non-cash operating working capital (note 18)                        | 143           | (93)          |
| Cash provided by operating activities   | 597           | 344           |
| <b>Investing activities</b>   |               |               |
| Business acquisitions or dispositions (note 5)                                | (13)          | (14)          |
| Acquisition of securities   | (3,392)       | (3,970)       |
| Proceeds from sale of securities  | 3,356         | 3,740         |
| Acquisition of capital assets   | (391)         | (331)         |
| Proceeds from sale of capital assets  | 7             | 61            |
| Other investing activities, net   | (1)           | 1             |
| Cash used in investing activities   | (434)         | (513)         |
| <b>Financing activities</b>   |               |               |
| Transitional support received from the Government of Canada                   | 81            | 106           |
| Repayment of long-term debt   | (3)           | (4)           |
| Dividend paid   | (22)          | (47)          |
| Other financing activities, net   | -             | 1             |
| Cash provided by financing activities   | 56            | 56            |
| <b>Net increase (decrease) in cash and cash equivalents</b>                   | <b>219</b>    | <b>(113)</b>  |
| <b>Cash and cash equivalents, beginning of year</b>                           | <b>386</b>    | <b>499</b>    |
| <b>Cash and cash equivalents, end of year</b>                                 | <b>\$ 605</b> | <b>\$ 386</b> |

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(December 31, 2008)

### 1. Incorporation, Business Activities and Directives

Established by the *Canada Post Corporation Act* ("the Act") in 1981, Canada Post Corporation ("the Corporation") is a Crown corporation included in Part II of Schedule III to the *Financial Administration Act* and is an agent of Her Majesty. The Corporation's head office is located in Ottawa, Ontario, Canada.

The Corporation operates a postal service for the collection, transmission and delivery of messages, information, funds and goods both within Canada and between Canada and places outside Canada. While maintaining basic customary postal services, the Act requires the Corporation to carry out its statutory objects, with regard to the need to conduct its operations on a self-sustaining financial basis while providing a standard of service that will meet the needs of the people of Canada and that is similar with respect to communities of the same size.

Under the Act, the Corporation has the sole and exclusive privilege (with some exceptions) of collecting, transmitting and delivering letters to the addressee thereof within Canada. Other lines of business, not covered by the exclusive privilege, include parcels and direct marketing products and services. The Corporation's subsidiaries offer courier, transportation and logistics services. Innovapost, a joint venture, provides information technology services to The Canada Post Group.

In December 2006, the Corporation was issued two directives pursuant to section 89 of the *Financial Administration Act*.

The Corporation was directed to continue its financial contribution to the Publications Assistance Program until March 31, 2009. This financial contribution shall not exceed \$15 million per year (note 21).

The Corporation was also directed to restore and maintain its mail delivery at rural roadside mailboxes that were serviced by the Corporation on September 1, 2005, while respecting all applicable laws. In 2007 and 2008, the Corporation continued assessing the safety risks related to all the rural roadside mailboxes, initially focusing on those mailboxes affected by the directive.

### 2. Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Canadian generally accepted accounting principles require management to make complex or subjective judgments related to estimates and assumptions based on existing knowledge that affect reported amounts and disclosures in the consolidated financial statements and accompanying notes. The significant areas requiring the use of management estimates and assumptions include: useful lives of capital assets; fair value measurement; pension, other retirement and post-employment benefits; income taxes; conditional asset retirement obligations; measuring the impairment of long-lived assets and goodwill; and assessing the resolution of contingent liabilities. Actual results may differ from those estimates. In light of the unprecedented conditions of the current global and Canadian economy, and the general inability to forecast its impacts, it is reasonably possible that management's reassessments of these and other estimates and assumptions in the near term, as well as actual results, could require a material change in reported amounts and disclosures in the consolidated financial statements of future periods.

Certain comparative figures have been reclassified in order to conform to the presentation adopted in 2008.

## 2. Significant Accounting Policies (continued)

A summary of the significant accounting policies used in these consolidated financial statements follows:

- (a) Consolidation** • These consolidated financial statements include the accounts of the Corporation and its subsidiaries, as well as its proportionate share of the accounts of its joint ventures (collectively referred to as “The Canada Post Group”). The results of any subsidiary or joint venture acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Effective January 1, 2009 the name of SCI Logistics Inc. was changed to SCI Group Inc. As at December 31, 2008, Purolator Courier Ltd (Purolator) and SCI Group Inc. (SCI) are the principal subsidiaries of the Corporation, and Innovapost Inc. (Innovapost) is the only joint venture. On April 3, 2008, a subsidiary of the Corporation, Canada Post International Limited (CPIL), transferred all of the shares of its subsidiary Nieuwe Post Nederlandse Antillen N.V. (NPNA) to the Government of the Netherlands Antilles, thereby terminating early the concession agreement to provide postal and postbanking services in the Netherlands Antilles. Subsequently, on November 19, 2008 the Corporation wound up CPIL. The operations of CPIL and NPNA were not significant to the Corporation.
- (b) Financial instruments** • All financial assets are classified as (i) held for trading, (ii) held to maturity investments, (iii) loans and receivables or (iv) available for sale. All financial liabilities are classified as (i) held for trading or (ii) other financial liabilities. The classification depends on the nature and purpose of the financial instruments and is determined at the time of initial recognition.

Financial instruments are recognized at fair value initially; subsequent measurement depends on the classification of the financial instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred, and the Corporation has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the contractual obligation is discharged, cancelled or has expired.

The Canada Post Group’s financial instruments consist of the following:

- (b.1)** All **investments** are financial assets designated as held for trading and, therefore, are measured at estimated fair value when presented on the consolidated balance sheet. With the exception of illiquid securities (note 8), fair value is determined directly by reference to quoted market prices, and may not be realized on sale. Investments are initially recognized at the settlement date and changes in fair value are recognized as they occur. When investments are segregated to manage defined benefit plans, the interest income and gains and losses are recorded in benefit costs, whereas in all other cases, interest income and gains and losses are recorded in investment and other income.

Investments are divided into four categories for separate presentation on the consolidated balance sheet. Each category is defined as follows:

- **Cash equivalents** are highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value. Therefore, cash equivalents consist of investments with maturities of three months or less from the date of acquisition.
- **Marketable securities** are investments with initial maturities greater than three months. Marketable securities are classified as current assets since reasonably prompt liquidation is possible.
- **Illiquid securities** are investments that are not traded actively and would be difficult to sell.
- **Segregated securities** are segregated funds invested by the Corporation. Although the liquidity of segregated securities varies, only the portion related to a current liability is presented as a current asset.

## 2. Significant Accounting Policies (continued)

**(b.2) Accounts receivable** are financial assets classified as loans and receivables. These financial assets are subsequently measured at amortized cost using the effective interest method, less any impairment. Where the time value of money is not significant due to their short-term settlement, accounts receivable are carried at the original invoice amount less allowances for doubtful accounts.

Trade receivables that are known to be uncollectible are written off when identified. An allowance for doubtful accounts is established when there is objective evidence that the Corporation will not be able to collect all amounts due according to the original terms of trade receivables. The amount of the allowance is the difference between the receivable's carrying amount and the estimated future cash flows. Credit losses and subsequent recoveries are recognized in the income statement within "other cost of operations".

**(b.3) Accounts payable and accrued liabilities, salaries and benefits payable and outstanding money orders** include other financial liabilities as well as obligations created by statutory requirements imposed by governments and other non-financial liabilities. After initial recognition at fair value, other financial liabilities are measured at amortized cost using the effective interest method. Where the time value of money is not significant due to their short-term settlement, the other financial liabilities are carried at payment or settlement amounts.

**(b.4) Long-term debt** instruments are classified as other financial liabilities and initially recognized at fair value, net of any transaction costs. After initial recognition, long-term debt instruments are measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any transaction costs, and any discount or premium on settlement. Interest expense on long-term debt is recognized in interest and other expense.

**(c) Capital assets** • Property, plant and equipment and intangible assets other than goodwill are referred to collectively as capital assets. The carrying value of capital assets is calculated as follows:

**(c.1) Cost** • Capital assets acquired or developed internally are initially recorded at cost, with the exception of property, plant and equipment transferred from the Government of Canada on incorporation in 1981 that were recorded at their estimated fair value at that date. Assets acquired under capital leases are initially recorded at the present value of the minimum lease payments at the inception of the lease. Fair values of land and buildings were determined by independent appraisals, based on existing use of the land at the time and amortized replacement cost of the buildings. Fair value for other assets was based on amortized replacement cost or original cost less estimated amortization.



## 2. Significant Accounting Policies (continued)

- (c.2) **Amortization** • Amortization commences when the assets are placed into service and is recognized over the estimated useful lives of the assets, using the following methods:

| Type of asset                                  | Amortization method | Amortization period or rate   |
|--|---------------------|---|
| Buildings                                      | Straight-line       | 15, 30 and 40 years   |
| Leasehold improvements                         | Straight-line       | Initial fixed lease term plus period of first renewal option  |
| Plant equipment                                | Straight-line       | 5 to 20 years   |
| Vehicles:                                      |                     |   |
| Passenger and light-duty commercial            | Declining balance   | Annual rate of 30%  |
| Other  | Straight-line       | 3 to 10 years   |
| Sales counters, office furniture and equipment | Straight-line       | 3 to 20 years   |
| Other equipment                                | Straight-line       | 5 to 20 years   |
| Software                                       | Straight-line       | 3 to 5 years  |
| Customer contracts                             | Straight-line       | Term of contract plus period of renewal options, maximum of 10 years in 2008  |
| Customer relationships                         | Straight-line       | Estimated period of future benefit, based on historical experience and future projections of customer business, maximum of 20 years in 2008 |

Assets held under capital leases are amortized over the period of the lease.

- (c.3) **Asset retirement obligations** • Asset retirement obligations associated with the retirement of property, plant and equipment are recorded when those obligations result from the acquisition, construction, development or normal operation of the assets. Conditional asset retirement obligations are legal obligations to perform an asset retirement activity for which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Corporation. The Corporation recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The liability is initially measured at fair value, and is subsequently adjusted each period to reflect the passage of time through accretion expense and any changes in the estimated future cash flows underlying the initial fair value measurement. The associated costs are capitalized as part of the carrying value of the related asset and amortized over its remaining life.
- (c.4) **Impairment** • Capital assets that are held for use are reviewed for impairment whenever events or changes in circumstances indicate that their net carrying value may not be recoverable from estimated undiscounted future cash flows generated by their use and eventual disposition. For the purpose of assessing recoverability, capital assets are grouped at the lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities which the Corporation has identified as the corporate entities included in the consolidated financial statements. If it is determined that the net carrying value is not recoverable, an impairment loss is recognized during the year and presented with amortization expense. The impairment loss is equal to the amount by which the net carrying value of the asset exceeds its fair value, determined using the expected present value of future cash flows.
- (c.5) **Capital assets to be disposed of by sale** • Capital assets classified as held for sale are included in Other Assets (note 13) on the consolidated balance sheet, and recognized at the lower of carrying amount or fair value less disposal costs. A write-down to fair value less disposal costs is recorded as a charge to net income and no further amortization is recorded.

## 2. Significant Accounting Policies (continued)

- (d) **Goodwill** • Goodwill, arising on the acquisition of a business, represents the excess of the cost of acquisition over The Canada Post Group's interest in the net fair value of the identifiable assets and liabilities of the business recognized at the date of acquisition. Goodwill is initially recognized at cost and is subsequently measured at cost less any accumulated amortization and impairment losses. Goodwill is not amortized but is instead tested for impairment annually, or more frequently if events and circumstances indicate that there may be impairment.

For the purpose of impairment testing, goodwill is allocated to reporting units. Reporting units comprise business operations with similar economic characteristics and may represent either an operating segment or a business unit within an operating segment. Potential impairment is identified when the carrying value of a reporting unit, including the allocated goodwill, exceeds its fair value. Fair value of the reporting unit is determined using the expected present value of future cash flows. Goodwill impairment is measured as the excess of the net carrying value of the reporting unit's allocated goodwill over the implied fair value of the goodwill, based on the fair value of the assets and liabilities of the reporting unit. An impairment loss is recognized in the year in which it is determined.

- (e) **Revenue recognition** • The Canada Post Group's revenue is mostly derived from providing the products and services that comprise the three lines of business: Transaction Mail, Parcels and Direct Marketing. Transaction Mail includes the physical and electronic delivery of bills, invoices, notices and statements. Parcels include regular parcels, all expedited delivery and courier services, as well as transportation and third-party logistics services. The third line of business, Direct Marketing, includes Addressed Admail™, Unaddressed Admail™ and Publications Mail™, such as newspapers and periodicals. Other mail products and services include money orders and postal box rentals, as well as retail and philatelic products.

Revenue is recognized when the service has been rendered, goods have been delivered or work has been completed. Revenue from meter customers, for which services have not been rendered prior to year end, is deferred based on a sampling methodology that closely reflects the meter resetting practices of customers. Similarly, payments received in advance are deferred until services are rendered or products are delivered and customer acceptance given. Deferred revenue is also recorded when resellers are billed for postal products shipments prior to the Corporation rendering the related services to customers.

The Canada Post Group may enter into arrangements with subcontractors to provide services to customers. If The Canada Post Group acts as the principal in such an arrangement, the amount billed to the customer is recognized as revenue. Otherwise, the net amount retained (i.e. the amount billed to the customer less the amount paid to the subcontractor) is recognized as revenue.

When no identifiable and separable benefit is received by The Canada Post Group in return for consideration given to a customer, such as a benefit that might arise in a customer loyalty program, the consideration is recorded as a reduction of revenue rather than as an expense.

- (f) **Incentive and lease inducement** • The incentive received upon signing of a 10 year outsourcing contract in 2002 was deferred, and is being amortized on a straight-line basis over the term of the contract. Lease inducements are also deferred, and are amortized on a straight-line basis over the initial fixed lease term. Amortization of the incentive is presented as reduction of other cost of operations while amortization of the lease inducements is presented as reduction of facilities expense. The current portion of the deferred incentive and lease inducement is presented in deferred revenue, and any remaining unamortized balance is presented in other long-term liabilities.

## 2. Significant Accounting Policies (continued)

(g) **Defined pension, other retirement and post-employment benefit plans** • The obligation for providing defined pension, other retirement and employee termination benefit plans is recognized over the period of employee service. However, the obligation for providing workers' compensation benefits and the continuation of certain benefits for employees on long-term disability is recognized when the event triggering the obligation occurs. Therefore, defined benefit plans can be divided into two types as follows:

(g.1) **Service-related defined benefit plans** • The estimated costs and accrued benefit obligations are determined annually, on an actuarial basis, using the projected benefit method prorated on service. For accounting purposes, accrued benefit obligations and fair value of plan assets are measured annually as at December 31.

The actuarial calculations include management's best estimate of the rates of return on plan assets, inflation, rates of compensation increase, retirement age, rates of employee disability, mortality, growth rates of health care costs and dental costs, as applicable. The expected long-term rates of return on plan assets are based on historical long-term returns provided by various asset categories weighted according to each pension plan's targeted asset allocations. The discount rates used to value the accrued benefit obligations are determined by reference to market conditions at year end, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the respective accrued benefit obligations.

Defined benefit costs include, as applicable, the estimated cost of employee benefits for current year's service, interest on accrued benefit obligations, expected return on plan assets, gain or loss on curtailment or settlement, expense recognized for special termination benefits and adjustments to allocate actuarial gains (losses), plan amendments, transitional obligation and funding excess to different years consistent with the long-term nature of employee future benefits.

To calculate the expected return on plan assets, these assets are valued at market-related values, whereby actuarial gains (losses) on plan assets for a year are recognized on a straight-line basis over five years.

Actuarial gains (losses) on plan assets for a year arise from the difference between the actual return on plan assets and the expected return. Actuarial gains (losses) on the accrued benefit obligations arise from the differences between actual and expected experience and changes in the assumptions used to determine the accrued benefit obligations. For each plan, the unrecognized net actuarial gain or loss exceeding 10% of the greater of the accrued benefit obligation or the market-related value of plan assets at the beginning of the year is recognized over the average remaining service period of active employees. Actuarial estimates indicate that the average remaining service periods of active employees covered by service-related defined benefit plans are as follows:

| As at December 31       | 2008                        |                           | 2007                        |                           |
|-------------------------|-----------------------------|---------------------------|-----------------------------|---------------------------|
|                         | Pension<br>benefit<br>plans | Other<br>benefit<br>plans | Pension<br>benefit<br>plans | Other<br>benefit<br>plans |
| Canada Post Corporation | 11 years                    | 5 to 11 years             | 11 years                    | 5 to 11 years             |
| Purolator               | 12 to 14 years              | N/A                       | 11 to 14 years              | N/A                       |
| SCI                     | 5 to 11 years               | 14 years                  | 15 years                    | 17 years                  |
| Innovapost              | 9 years                     | N/A                       | 9 years                     | N/A                       |

Past service costs arising from plan amendments are recognized on a straight-line basis over the expected average remaining service period of employees active on the date of amendment, up to the date of full eligibility.

On October 1, 2000, the Corporation assumed responsibility for a defined benefit provincial health insurance premium retirement plan and applied the accounting standards on employee future benefits to this obligation on a prospective basis. The transitional obligation, representing the unrecognized deficit in the plan at that date, is recognized on a straight-line basis over 8 years, being the expected average remaining service period, up to the date of full eligibility, of employees expected to receive benefits as of that date.

## 2. Significant Accounting Policies (continued)

The funding excess, resulting from the *Federal Public Sector Pension Reform* effective October 1, 2000, represents the excess amount of the assets, transferred from the Government of Canada to the Corporation's pension plan, over the obligations assumed for the defined benefit pension plan. The funding excess is recognized on a straight-line basis over 11 years, being the expected average remaining service period of active employees covered by the pension plan as of that date.

The asset and liability recorded in the consolidated balance sheet represent the cumulative difference between the defined benefit costs and the total cash payments for the defined benefit plans.

- (g.2) Event-driven defined benefit plans** • The same methodology and assumptions as service-related defined benefit plans apply, except for the following:
- The projected benefit method is not prorated on service since the obligations are recognized when the event triggering the obligation occurs;
  - Management's best estimate also takes into account the experience and assumptions of provincial workers' compensation boards;
  - Actuarial gains (losses) are recognized over the average duration of the accrued benefit obligation; and
  - Actuarial estimates indicate that the average duration of the accrued benefit obligations ranges from 3 to 9 years (2007 – from 3 to 9 years).
- (h) Defined contribution and multiemployer pension plans** • Employer contributions to the defined contribution and multiemployer pension plans are expensed as incurred.
- (i) Transitional support from the Government of Canada** • The Government of Canada, as part of the *Federal Public Sector Pension Reform*, committed to provide declining transitional support to assist the Corporation with the incremental costs incurred as a result of establishing the Canada Post Corporation Pension Plan and the associated ancillary benefits. Receipt of the transitional support is conditional on the Corporation maintaining other retirement enhancements similar to those offered to the *Public Service Superannuation Act* participants and, also, the Corporation showing visible commitment and progress towards achieving the financial and service performance objectives set out in the Policy Framework and reflecting them in future corporate plans. Therefore, transitional support is accounted for only when received. The entire amount of transitional support is deferred and drawn down on a first-in, first-out, basis to cover the incremental costs incurred. The draw down from deferred transitional support is recorded as a reduction of expense.
- The Corporation is scheduled to receive the remaining \$69 million of transitional support over the next two years as follows: \$56 million in 2009; and \$13 million in 2010.
- (j) Income taxes** • Future income tax assets and future income tax liabilities are recognized for the tax effect of the difference between the carrying values and tax basis of assets and liabilities. Future income tax assets are recognized for deductible temporary differences, for unused tax losses and income tax reductions to the extent that it is more likely than not that future income tax assets will be realized. Income tax assets and income tax liabilities are measured using substantively enacted income tax rates and income tax laws. These amounts are reassessed each year in the event of changes in income tax rates. Each change resulting from a revaluation is recognized in the financial results of the year of change.
- Scientific research and experimental development ("SR&ED") tax credits are recorded using the cost reduction method, whereby the credits are recorded as a reduction of current cost of operations or property, plant and equipment, when there is reasonable assurance that the SR&ED tax credit will be realized.
- (k) Foreign currency translation** • Transactions in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect the rates of exchange in effect at the balance sheet date. All exchange gains and losses are included in determining net income for the current year.

### 3. Changes in Accounting Policies

The Canada Post Group has prospectively adopted the following Canadian Institute of Chartered Accountants ("CICA") accounting standards effective January 1, 2008. These new standards relate to disclosure and presentation only and did not have any effect on financial results:

- (a) **Capital disclosures** • A new section 1535 "Capital Disclosures" converges with amendments to International Financial Reporting Standard IAS 1 "Presentation of Financial Statements". Section 1535 requires an entity to disclose information about its objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, as well as its compliance with any externally imposed capital requirements. These additional disclosures are included in note 16.
- (b) **Financial instruments disclosures and presentation** • The CICA issued new section 3862 "Financial Instruments – Disclosures" that improves the disclosure requirements in superseded Handbook Section 3861 "Financial Instruments – Disclosure and Presentation", and places an increased emphasis on risk disclosures. Entities are required to provide both qualitative and quantitative information about exposures to risks arising from financial instruments, including market, credit and liquidity risks. These additional disclosures are included in note 7. The transitional provisions state that certain of the incremental disclosures need not be provided on a comparative basis in the year of adoption. The existing recommendations for the presentation of financial instruments were carried forward unchanged in new CICA Handbook Section 3863 "Financial Instruments – Presentation".

### 4. Recent Accounting Pronouncements Requiring Implementation in Future Years

- (a) **Goodwill and Intangible Assets** • In February 2008, the CICA issued new Section 3064 "Goodwill and Intangible Assets" replacing Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". The new standard is effective for fiscal years beginning on or after October 1, 2008. The Accounting Standards Board ("AcSB") also amended Section 1000 "Financial Statement Concepts" and Accounting Guideline AcG 11 "Enterprises in the Development Stage". The new and amended guidance clarifies that costs may only be deferred when they relate to an item that meets the definition of an asset. The practice of matching revenues and expenses remains appropriate only for allocating the cost of an asset that is consumed in generating revenue over multiple reporting periods. New Section 3064 provides extensive guidance on when expenditures qualify for recognition as intangible assets. These recommendations, which will be adopted by The Canada Post Group on January 1, 2009, are not expected to have a significant effect on the consolidated financial statements.
- (b) **International Financial Reporting Standards ("IFRS")** • In February 2008, the AcSB confirmed that publicly accountable entities will be required to adopt IFRS in place of Generally Accepted Accounting Principles ("GAAP") for fiscal years beginning on or after January 1, 2011. The Corporation (which meets the current definition of a publicly accountable entity) will report under IFRS in its financial statements for the year ending December 31, 2011.

The Corporation has developed and implemented an IFRS changeover plan to support the transition from Canadian GAAP to IFRS in the 2011 financial statements. It has established a multi-disciplinary IFRS implementation team and instituted regular progress reporting to the Audit Committee of the Board of Directors.

The implementation plan consists of three phases. The first phase, focusing on planning and on early issue identification, was completed during the year. Work on the second and third phases of the plan, covering detailed evaluations for each financial reporting area and implementation of the new standards, has commenced and will continue through 2009 and 2010. The impact on the Corporation's financial results has not yet been determined.

## 5. Significant Business Acquisitions

There were no significant business acquisitions in 2008.

On March 30, 2007, a subsidiary of the Corporation, SCI, acquired all of the outstanding common shares of AMG Logistics Inc., First Team Transport Inc. and Partnership Inc. (collectively referred to as "The AMG Group") for a total cost of \$13 million, which was paid in cash. The AMG Group provides logistics and transportation services in the small to medium enterprise market. Goodwill recognized in the transaction amounted to \$3 million and was assigned to the Logistics segment (note 12). Intangible assets acquired consist of customer contracts and relationships of \$10 million.

## 6. Regulation of Customer Postage Rates

The Corporation establishes customer postage rates through regulations under the *Canada Post Corporation Act* ("the Act") for domestic Lettermail™ and international Letter-post items, as well as fees for certain other services such as Registered Mail. These regulations are subject to approval by the Government of Canada, the sole shareholder and, therefore, a related party of the Corporation. The Act permits the Corporation to offer rates that differ from regulated rates under certain circumstances, such as when the customer agrees to mail in bulk.

The Act states that regulated postage rates must be fair and reasonable, and consistent so far as possible with providing revenue, together with any revenue from other sources, sufficient to defray the costs incurred by the Corporation in the conduct of its operations under the Act. The domestic basic letter rate prescribed under the *Letter Mail Regulations* is determined by a price-cap formula, which limits increases to 66.67% of increases in the Consumer Price Index, implemented no more than once a year. In 2008, there was no increase in the domestic Lettermail rate (January 2007 – from \$0.51 to \$0.52). Effective January 12, 2009, the rate increased by 2 cents to \$0.54.

The regulated pricing approval process requires that proposed rate changes be published in the *Canada Gazette* to provide interested persons with 60 days to make representations to the Minister responsible for Canada Post. These representations are considered by the Corporation's Board of Directors. Subsequently, the final form of the proposed rate changes is approved by the Board of Directors and submitted to the Minister responsible for Canada Post for approval by the Government of Canada, specifically the Governor in Council. The rate changes are deemed approved 60 days after submission to the Governor in Council, unless the Governor in Council previously approved or refused to approve the changes.

Under the provisions of the Act, the Corporation is required to provide services free of charge for certain Government mailings and for mailing of materials for the blind. The Government of Canada provides compensation to the Corporation in respect of these services (note 20).

The fact that postage rates for certain products and services are subject to regulation does not affect the application of Canadian generally accepted accounting principles to these consolidated financial statements.

Revenue from products and services charged to customers at regulated rates comprises 31% (2007 – 33%) of the Canada Post segment revenue.

## 7. Nature and Extent of Risks From Financial Instruments

### Financial risk factors

The Corporation's financial instruments are exposed to a variety of financial risks: market risk (including interest rate risk and foreign currency risk), credit risk and liquidity risk. Risk management for investment activities is carried out by the Corporate Treasury function. Investments are held for liquidity purposes, or for longer terms, to achieve returns consistent with the investment policies approved by the Board of Directors. The Corporation has various other financial instruments such as accounts receivable, accounts payable, salaries payable and money orders, which arise directly from operations. The Corporation does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Risk management strategies are likely to evolve in response to future conditions and circumstances, including the effects and consequences resulting from the current economic downturn. These future strategies may not fully insulate the Corporation in the near term from adverse effects, the more significant of which relate to liquidity and capital resources as well as exposure to credit losses.

### (a) Market risk

Market risk is the potential for loss that may arise from changes in external market factors such as interest rates, foreign currency exchange rates and other prices, such as commodities.

#### (i) Interest rate risk

The Corporation's investments are designated as held for trading. All investments are fixed-rate debt securities and are therefore exposed to a risk of change in their fair value due to changes in interest rates. The risk is managed by maintaining a short term to maturity, and the maximum duration in the portfolio was 92 days as at December 31, 2008. The incremental return for longer term maturities is currently considered insufficient to offset the risk of higher interest rates and associated declines in capital values. This investment decision is assessed on an ongoing basis and may be changed if longer term rates of interest increase sufficiently.

The Corporation has performed sensitivity analysis on interest rate risk using a 50 basis point increase or decrease, which represents management's assessment of the reasonably possible change in interest rates given the nature and term to maturity of the outstanding investments. An increase or decrease of 50 basis points in market interest rates, with all other variables held constant, would not have a significant impact on the fair value of the Corporation's investments, excluding non-bank-sponsored asset-backed commercial paper, at December 31, 2008. Please refer to note 8(b) for sensitivity analysis on non-bank-sponsored asset-backed commercial paper. The Corporation's fixed-rate long-term debt will mature in 2016. There are no prepayment terms associated with the debt.

#### (ii) Foreign currency risk

The Corporation's exposure to foreign currency risk mostly arises from international settlements with foreign postal administrations and from the redemption of money orders denominated in foreign currencies. The Corporation's obligation to settle with foreign postal administrations is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprising the US Dollar ("US\$"), Japanese Yen, Sterling and Euro, whereas payment is usually denominated in US\$ or, in some circumstances, the Euro. The Corporation's principle exposure is to the US\$. The effect of a 10% increase or decrease in the US\$ exchange rate on the balance sheet date, all other variables held constant, would have increased or decreased net income for the year by \$6 million. There is no significant impact on net income arising from exposures to other currencies. Net exchange gains included in net income amounted to \$13 million (2007 – \$9 million of net exchange losses).

### (b) Credit risk

Credit risk refers to the risk that a counterparty to a financial instrument will default on its contractual obligations resulting in financial loss to the Corporation. Credit risk arises from investments in corporations and financial institutions, as well as credit exposures to wholesale and commercial customers, including outstanding receivables. Sales to consumers are settled in cash or using major credit cards.

## 7. Nature and Extent of Risks From Financial Instruments (continued)

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Corporation's maximum exposure to credit risk. The Corporation does not believe it is subject to any significant concentration of credit risk.

Credit risks arising from investments are mitigated by investing with issuers who meet specific criteria, and the imposition of dollar limits by financial product type and debt issuer. Investments in financial institutions and corporations must have minimum ratings from two external rating agencies that are equivalent to Dominion Bond Rating Service (DBRS) ratings of R-1 (middle) for short-term investments and A for long-term investments. The Corporation regularly reviews the credit ratings of issuers with whom the Corporation holds investments, and disposes of investments within a specified time period when the issuer's credit rating declines below acceptable levels. Impairment losses on investments recognized during the year were \$9 million (2007 – \$8 million) as described in note 8.

Credit risk associated with accounts receivable from wholesale and commercial customers is mitigated by the Corporation's large customer base which covers substantially all business sectors in Canada. The Corporation follows a program of individual customer credit evaluation based upon financial strength and payment history, and limits the amount of credit extended when deemed necessary. The Corporation monitors customer accounts against these credit limits and the aging of past due invoices. The Corporation establishes an allowance for doubtful accounts that reflects the estimated impairment of accounts receivable. A general provision is estimated based on prior experience with, and the past due status of, doubtful debtors, while large accounts are assessed individually based on factors that include ability to pay and payment history. Despite the worsening economy in 2008, the Corporation has not experienced any increase in bad debts. The Corporation proactively examines accounts on a stratified account basis, and has increased its vigilance and credit monitoring due to the current economy. Weekly monitoring of aged receivables and day's sales outstanding has revealed no significant change in the trend of the aging of receivables.

Credit risk attributable to receivables from foreign postal administrations, other than the United States Postal Service ("USPS"), is generally mitigated by offsetting accounts payable to foreign postal administrations on an individual country basis, under the provisions of the Universal Postal Union (UPU). Amounts receivable from and payable to the USPS are settled independently under the bilateral agreement between Canada Post Corporation and the USPS. Estimates of receivables and payables, including monthly provisional payments, are based on statistics in regards to the weights and number of pieces exchanged by the two countries. Final settlement with each foreign postal administration can be billed a year or more after the service is performed. The Corporation's provision for impairment of receivables from specific foreign postal administrations is based on the period past due after billing of the final settlement.

The following table sets out details of the age of receivables and the allowance for doubtful accounts:

| <b>Trade and Other Receivables</b>              | <b>2008</b>   |
|---|---------------|
| <small>(in millions of dollars)</small>         |               |
| Trade accounts receivable:                      |               |
| Current   | \$ 338        |
| 1–15 days past due                              | 71            |
| 16–30 days past due                             | 26            |
| Over 30 days past due                           | 22            |
| Allowance for doubtful accounts                 | (11)          |
| Trade accounts receivable – net                 | \$ 446        |
| Receivables from foreign postal administrations | 76            |
| Other receivables                               | 53            |
| Accounts receivable                             | <b>\$ 575</b> |

Impairment losses on accounts receivable recognized during the year were \$7 million.



## 7. Nature and Extent of Risks From Financial Instruments (continued)

### (c) Liquidity risk

Liquidity risk is the risk that a company will encounter difficulty in meeting its financial obligations as they fall due. The Corporation manages liquidity risk by maintaining cash and investments, banking facilities and reserve borrowing facilities, by monitoring forecasted and actual cash flows and matching the maturity profiles of financial assets and liabilities. The Corporation's objective is to maintain a cash balance of at least \$200 million to support current operating activities. Surplus cash is invested into a range of short-term money market securities. The Corporation invests in high credit quality government or corporate securities in accordance with policies approved by the Board of Directors.

The Corporation's borrowing plan is reviewed and approved annually by the Board of Directors and then is submitted for approval to the Governor in Council on the recommendation of the Minister responsible for Canada Post, as part of its Corporate Plan approval process. The Minister of Finance may require that his recommendation also be obtained before the Corporate Plan is submitted to the Governor in Council for approval. In addition, the detailed terms and conditions for each borrowing must also be approved by the Minister of Finance. Pursuant to the *Canada Post Corporation Act*, the Corporation may borrow a maximum of \$500 million from the Government of Canada's Consolidated Revenue Fund. Pursuant to *Appropriation Act No. 3, 1996-97*, borrowing from other than the Government of Canada's Consolidated Revenue Fund is limited to \$300 million. Of this, no more than \$150 million can be short-term in nature.

Although the Corporation's level of indebtedness has been maintained at a low level, the Corporation would consider increasing its indebtedness to support the financing of future capital expenditures. The Canada Post Group's borrowings amounted to \$74 million as at December 31, 2008 (2007 – \$58 million), of which \$74 million (2007 – \$55 million) was long-term. Within the above limits, the Corporation has a line of credit of \$68 million with a Canadian chartered bank and a commercial paper program that were not used during 2007 or 2008.

The Corporation's subsidiaries and joint venture also have access to financing facilities totalling \$100 million as at December 31, 2008. Of this amount \$18 million was drawn for the purchase of equipment; this amount will be converted into capital leases in 2009.

The following table sets out details of the Corporation's remaining contractual maturities for its financial liabilities. The amounts represent the undiscounted cash flows of financial liabilities based on the earliest date on which the Corporation can be required to pay. The table includes both principal and interest cash flows.

#### 2008

(in millions of dollars)

|                          | Weighted average<br>effective interest rate | Less than<br>1 year | 1–5 years | More than<br>5 years | Total  |
|--------------------------|---|---------------------|-----------|----------------------|--------|
| Non-interest bearing*    |   | \$ 731              | \$ 1      | \$ –                 | \$ 732 |
| Non-redeemable bonds     | 10.35%                                      | 6                   | 23        | 69                   | 98     |
| Other borrowings         | Prime                                       | –                   | 18        | –                    | 18     |
| Capital lease obligation | 6.8%  | –                   | 1         | –                    | 1      |
|                          |   | \$ 737              | \$ 43     | \$ 69                | \$ 849 |

\* Non-interest bearing consists of financial liabilities included in accounts payable and accrued liabilities, salaries and benefits payable and outstanding money orders.

### (d) Fair values of financial instruments

The fair values of financial assets and liabilities not otherwise disclosed in the consolidated financial statements are determined as follows:

The fair value of the following items approximate their carrying values due to their expected short-term settlement: accounts receivable; other financial liabilities included in accounts payable and accrued liabilities; other financial liabilities included in salaries and benefits payable; and outstanding money orders.

## 8. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities

### (a) Nature and extent of investments

The nature and extent of the investments for each category are as follows:

| As at December 31<br>(in millions of dollars)              | Remaining term to maturity * |                   |                   | 2008          | 2007          |
|--|------------------------------|-------------------|-------------------|---------------|---------------|
|  | Within<br>3 months           | 3 to<br>12 months | One to<br>9 years | Total         | Total         |
| <b>Cash and cash equivalents</b>                           |                              |                   |                   |               |               |
| Cash   | \$ 90                        | \$ –              | \$ –              | \$ 90         | \$ 95         |
| Money market instruments issued by:                        |                              |                   |                   |               |               |
| Government of Canada                                       | 400                          | –                 | –                 | 400           | –             |
| Provincial governments                                     | 40                           | –                 | –                 | 40            | 92            |
| Financial institutions                                     | 60                           | –                 | –                 | 60            | 110           |
| Corporations   | 15                           | –                 | –                 | 15            | 89            |
| <b>Total cash and cash equivalents</b>                     | <b>\$ 605</b>                | <b>\$ –</b>       | <b>\$ –</b>       | <b>\$ 605</b> | <b>\$ 386</b> |
| <b>Marketable securities</b>                               |                              |                   |                   |               |               |
| Money market instruments issued by:                        |                              |                   |                   |               |               |
| Government of Canada                                       | \$ 38                        | \$ 65             | \$ –              | \$ 103        | \$ 263        |
| Provincial governments                                     | –                            | –                 | –                 | –             | 20            |
| Financial institutions                                     | –                            | –                 | –                 | –             | 23            |
| Corporations   | –                            | –                 | –                 | –             | 3             |
| <b>Total marketable securities</b>                         | <b>\$ 38</b>                 | <b>\$ 65</b>      | <b>\$ –</b>       | <b>\$ 103</b> | <b>\$ 309</b> |
| <b>Illiquid securities</b>                                 |                              |                   |                   |               |               |
| Non-bank-sponsored asset-backed commercial paper (note 13) | \$ –                         | \$ –              | \$ 5              | \$ 5          | \$ 7          |
| <b>Segregated securities</b>                               |                              |                   |                   |               |               |
| Money market instruments issued by:                        |                              |                   |                   |               |               |
| Cash   | \$ 1                         | \$ –              | \$ –              | \$ 1          | \$ –          |
| Government of Canada                                       | 599                          | 92                | –                 | 691           | 392           |
| Provincial governments                                     | 88                           | –                 | –                 | 88            | 27            |
| Financial institutions                                     | 50                           | –                 | –                 | 50            | 126           |
| Corporations   | 15                           | –                 | –                 | 15            | 64            |
| Non-bank-sponsored asset-backed commercial paper           | –                            | –                 | 17                | 17            | 23            |
| <b>Total segregated securities</b>                         | <b>\$ 753</b>                | <b>\$ 92</b>      | <b>\$ 17</b>      | <b>\$ 862</b> | <b>\$ 632</b> |

\*Remaining term to maturity classifications are based on the contractual maturity of the investments or expected maturities for non-bank-sponsored asset-backed commercial paper.

All money market instruments and bonds held as at December 31, 2008 were issued by Canadian entities at fixed interest rates or discounted values. The weighted average effective interest rate as at December 31, 2008 was 1.3% for money market instruments (2007 – 4.4%). In 2007, the weighted average effective interest rate for bonds was 3.7%.

## 8. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities (continued)

### (b) Fair value of non-bank-sponsored asset-backed commercial paper

At December 31, 2008, the Corporation held non-bank-sponsored asset-backed commercial paper ("ABCP") issued by two trusts with an original cost and principal amount of \$38 million and a fair value of \$22 million. These investments matured during the months of September and October 2007 but, as a result of liquidity issues in the ABCP market, did not settle on maturity. The ABCP in which the Corporation has invested has not traded in an active market since mid-August 2007, and, as at December 31, 2008, there were no market quotations available. As a result, the Corporation has classified its ABCP as long-term assets, either in illiquid securities or segregated securities.

In September 2007, the Pan-Canadian Investors Committee ("the Committee") was formed to propose a solution to the liquidity problem affecting the ABCP and oversee the proposed restructuring process. On March 17, 2008, the Committee for ABCP filed proceedings for a plan of compromise and arrangement ("the Plan") under the *Companies Creditors Arrangement Act* (Canada) (CCAA) with the Ontario Superior Court (the "Court"). On March 20, 2008, the Committee issued an Information Statement containing details about the proposed restructuring. The Court granted the Plan Implementation Order allowing implementation of the agreement on January 12, 2009, and the restructuring closed on January 21, 2009. The exchange of restructured ABCP notes was completed on January 21, 2009 and the first payment of interest accrued between August 2007 and August 31, 2008 was paid on the same day.

Based on the information contained in the Information Statement and other public information available at December 31, 2008, the Corporation estimated that, of the \$38 million of ABCP in which the Corporation has invested, comprising \$18 million issued by Whitehall Trust and \$20 million in Rocket Trust Series A, it would receive upon completion of the restructuring in January 2009:

- \$35 million of senior Master Asset Vehicle MAV II Class A-1 and A-2 notes and subordinated Class B and Class C notes as follows:

|           |              |
|-----------|--------------|
| Class A-1 | \$24 million |
| Class A-2 | \$8 million  |
| Class B   | \$2 million  |
| Class C   | \$1 million  |

Class A-1, Class A-2 and Class B notes will bear interest at the Bankers' Acceptance ("BA") rate less 0.50% and Class C notes will bear interest at the BA rate plus 20%. These notes have legal maturity dates in 2056 but the expected repayment date of the Class A-1 and A-2 notes is January 22, 2017. The senior notes (Class A-1 and Class A-2) have been rated "A" by Dominion Bond Rating Service ("DBRS") while the subordinated notes (Classes B and C) are unrated.

- \$3 million represented by assets that included exposure to US sub-prime mortgages. On restructuring the Corporation is likely to receive long-term floating rate notes that are unlikely to be rated.

There is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the ABCP. The Corporation's estimate of the fair value of ABCP was determined using a discounted cash flow technique, based on the best available information as at December 31, 2008. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the Committee.

The significant assumptions used in the valuation model at December 31, 2008 based on expected maturities at January 22, 2017 include:

|                                |           |
|--------------------------------|-----------|
| Weighted average interest rate | 1.58%     |
| Weighted average discount rate | 9.43%     |
| Credit losses                  | Up to 50% |

## 8. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities (continued)

Based on this analysis, a further impairment of the total fair value of ABCP of \$9 million was recorded in 2008 (2007 – \$8 million), offset by interest receivable for the period from August 2007 to August 2008 of \$1 million. The Corporation's valuation of the ABCP was based on its assessment of the conditions as at December 31, 2008, which may change in subsequent periods. The most important assumptions in determining the fair value of ABCP are the discount rate and coupon interest rates assigned to the new notes. A 1% increase (decrease) in the weighted average discount rate or a 1% decrease (increase) in the weighted average interest rate would result in a decrease (increase) in the estimated fair value of ABCP held by the Corporation of approximately \$2 million.

The expected year of maturity, rating assigned by DBRS, estimated fair value, and par value of notes received by the Corporation under MAVII on January 21, 2009 do not differ significantly from the estimates as at December 31, 2008. Continuing uncertainties regarding the development of a market for ABCP, the amount and timing of interest and principal payments, the value of the assets that underlie the ABCP, and the credit and liquidity risks associated with the restructured notes could give rise to further changes in the fair value of the Corporation's investment in ABCP, although this would not result in a significant impact on the Corporation's future earnings. The liquidity disruption in the Canadian market for ABCP has had no significant impact on the Corporation's operations since the Corporation holds sufficient cash to meet all of its financial, operational and regulatory obligations.

### (c) Income from investments

Interest income and gains and losses on cash and cash equivalents, marketable and illiquid securities amounted to \$18 million (2007 – \$26 million). Interest income and gains and losses on segregated securities amounted to \$18 million (2007 – \$18 million). The portion of income relating to the defined benefit plans was \$10 million (2007 – \$16 million) and was used to offset benefit costs. The remaining \$8 million (2007 – \$2 million) relates to internally restricted funds and was recognized in investment and other income.

### (d) Segregated securities

Funds have been segregated as follows:

| <b>As at December 31</b><br>(in millions of dollars) | <b>2008</b>   | <b>2007</b>   |
|--|---------------|---------------|
| Other retirement dental and life insurance benefits  | \$ 511        | \$ 497        |
| Internally restricted funds                          | 351           | 135           |
| <b>Total segregated securities</b>                   | <b>\$ 862</b> | <b>\$ 632</b> |

Funds were segregated either to conform with externally imposed restrictions or in anticipation of future cash flow requirements as explained below:

- External restrictions were imposed on other retirement dental and life insurance benefit plans repatriated through the *Federal Public Sector Pension Reform*. These defined benefit plans are partially funded by the transitional support and, therefore, the Corporation is obligated to use these funds exclusively for related benefit payments.
- The Corporation has segregated certain funds in anticipation of future cash flow requirements. These segregated funds will be used either for significant projects to renew the future operational capability of the Corporation or required regulatory contributions to the Corporation's pension plan in the event of either a solvency or going-concern shortfall.

## 9. Income Taxes

On March 27, 1994, the Corporation became a prescribed Crown corporation for tax purposes and, as such, is subject to federal income taxation under the *Income Tax Act*. The Corporation's subsidiaries and joint venture are subject to federal and provincial income taxes.

The sources of the temporary differences giving rise to net future income tax assets (liabilities) are as follows:

| <b>As at December 31</b><br>(in millions of dollars)           | <b>2008</b>   | <b>2007</b>   |
|--|---------------|---------------|
| <b>Net future income tax assets</b>                            |               |               |
| Capital assets   | \$ 6          | \$ 13         |
| Salaries and benefits payable                                  | 20            | 15            |
| Accrued pension, other retirement and post-employment benefits | 213           | 148           |
| Other  | 24            | 23            |
| <b>Net future income tax assets</b>                            | <b>\$ 263</b> | <b>\$ 199</b> |
| <b>Presented in the consolidated balance sheet as:</b>         |               |               |
| Future income tax assets:                                      |               |               |
| Current  | \$ 23         | \$ 20         |
| Long-term  | 270           | 203           |
| Total future income tax assets                                 | 293           | 223           |
| Future income tax liabilities:                                 |               |               |
| Long-term  | (30)          | (24)          |
| <b>Net future income tax assets</b>                            | <b>\$ 263</b> | <b>\$ 199</b> |

Deductible temporary differences for which no future income tax assets have been recognized amount to \$768 million (2007 – \$780 million) and relate mainly to the accrued other retirement and post-employment benefit liability. These differences are not expected to reverse in the foreseeable future.

**9. Income Taxes (continued)**

The major components of the income tax expense are as follows:

| <b>Year ended December 31</b><br>(in millions of dollars) | <b>2008</b>  | <b>2007</b>   |
|---|--------------|---------------|
| Current income tax expense                                | \$ 131       | \$ 125        |
| Future income tax expense (benefit) relating to:          |              |               |
| Origination and reversal of temporary differences         | (64)         | (42)          |
| Reduction in tax rate                                     | –            | 19            |
| <b>Income tax expense</b>                                 | <b>\$ 67</b> | <b>\$ 102</b> |

A reconciliation of the income tax expense, related to income before income taxes, to the amount of income tax using the statutory federal tax rate follows:

| <b>Year ended December 31</b><br>(in millions of dollars)                           | <b>2008</b>  | <b>2007</b>   |
|---|--------------|---------------|
| Income before income taxes  | \$ 161       | \$ 160        |
| Federal income taxes at parent's statutory tax rate                                 | \$ 48        | \$ 52         |
| Subsidiaries and joint venture's provincial income taxes less federal tax abatement | 4            | 3             |
| (Increase) decrease in future income taxes resulting from:                          |              |               |
| Previously unrecognized losses carried forward                                      | (3)          | –             |
| Reduction in future tax rate  | 12           | 40            |
| Other   | 6            | 7             |
| <b>Income tax expense</b>   | <b>\$ 67</b> | <b>\$ 102</b> |

## 10. Capital Assets

As at December 31

(in millions of dollars)

2008

2007

|   | Cost            | Accumulated<br>amortization<br>and<br>impairment | Net<br>carrying<br>value | Cost            | Accumulated<br>amortization<br>and<br>impairment | Net<br>carrying<br>value |
|---|-----------------|--|--------------------------|-----------------|--|--------------------------|
| <b>Property, plant and equipment</b>              |                 |  |                          |                 |  |                          |
| Land  | \$ 259          | \$ –   | \$ 259                   | \$ 214          | \$ –   | \$ 214                   |
| Buildings   | 1,801           | 1,024  | 777                      | 1,718           | 971  | 747                      |
| Leasehold improvements                            | 201             | 133  | 68                       | 185             | 123  | 62                       |
| Plant equipment                                   | 975             | 738  | 237                      | 924             | 689  | 235                      |
| Vehicles  | 219             | 152  | 67                       | 215             | 133  | 82                       |
| Sales counters, office furniture<br>and equipment | 339             | 257  | 82                       | 346             | 278  | 68                       |
| Other equipment                                   | 799             | 478  | 321                      | 739             | 447  | 292                      |
| Assets under development                          | 70              | –  | 70                       | 10              | –  | 10                       |
| <b>Total property, plant and equipment</b>        | <b>4,663</b>    | <b>2,782</b>                                     | <b>1,881</b>             | <b>4,351</b>    | <b>2,641</b>                                     | <b>1,710</b>             |
| <b>Intangible assets</b>                          |                 |  |                          |                 |  |                          |
| Software  | 418             | 326  | 92                       | 382             | 290  | 92                       |
| Software under development                        | 52              | –  | 52                       | 42              | –  | 42                       |
| Customer contracts and relationships              | 27              | 18   | 9                        | 27              | 16   | 11                       |
| <b>Total intangible assets</b>                    | <b>497</b>      | <b>344</b>                                       | <b>153</b>               | <b>451</b>      | <b>306</b>                                       | <b>145</b>               |
| <b>Total capital assets</b>                       | <b>\$ 5,160</b> | <b>\$ 3,126</b>                                  | <b>\$ 2,034</b>          | <b>\$ 4,802</b> | <b>\$ 2,947</b>                                  | <b>\$ 1,855</b>          |

Amortization of property, plant and equipment amounted to \$196 million in 2008 (2007 – \$172 million) while amortization of intangible assets amounted to \$41 million (2007 – \$34 million).

During the year, The Canada Post Group invested \$391 million (2007 – \$331 million) in capital assets, comprising \$342 million (2007 – \$258 million) of property, plant and equipment and \$49 million (2007 – \$73 million) of intangible assets.

As at December 31, 2008, a net carrying value of \$1 million included in sales counters, office furniture and equipment is held under a capital lease.

## 11. Pension, Other Retirement and Post-Employment Benefit Plans

### (a) Description of benefit plans

The Corporation has a number of funded and unfunded defined benefit plans that provide pension, other retirement and post-employment benefits for most of its employees. Unfunded plans are plans where benefits are paid directly by the Corporation. With funded plans, funds are transferred to external trusts and the benefits are paid directly from these trusts. The Corporation's defined benefit pension plan is a funded plan based on length of pensionable service, the average of the best five consecutive years of pensionable salary and retirement age. The plan provides for retirement pension, survivor's pension or a refund after termination of employment or death. Pension benefits are covered by the registered pension plan and the retirement compensation arrangement, for benefits in excess of statutory limits as defined under the *Income Tax Act*. Pension benefits in pay are indexed annually. Both the Corporation's contributions and the employees' contributions to the external trusts are made in accordance with the provisions of the plan. In addition, the Corporation's contributions are determined by actuarial valuations, in compliance with the requirements of regulatory authorities, to ensure that the external trusts have sufficient assets to pay pension benefits when employees retire.

Other retirement defined benefit plans include unfunded health care, dental and life insurance plans. The post-employment defined benefit plans include unfunded employee termination benefits and health and dental coverage for employees receiving long-term disability benefits. The benefit costs covered by the Corporation and the costs assumed by employees and retirees are determined in accordance with the rules of each plan and the provisions of labour contracts.

By the end of 2006, the Corporation's employee termination benefit plan was fully curtailed. The curtailment of the plan froze the employees' entitlement based on the accumulation of years of service as of the curtailment date, and further benefit entitlements based on years of service was discontinued. On curtailment, employees were given the option of settlement by receiving the cash value of their accrued termination benefit or the option of deferring receipt of their benefit until departure, at which time the benefit would reflect their base salary at retirement or their base salary at the curtailment date if they resign or are terminated. Most employees chose the option of settlement. The settlement payments were made for the members of each bargaining group, and non-union employees, at different times during the period from 2004 to 2007, resulting in a settlement loss being recognized in each of these years. In 2007, a settlement loss of \$9 million was recognized and the plan was fully settled.

The Corporation is subject to the *Government Employees Compensation Act* and, therefore, is not mandatorily covered under any provincial workers' compensation act. The Corporation is a self-insured employer, responsible for workers' compensation benefits incurred since incorporation. The Corporation's unfunded obligation for workers' compensation benefits is based on known awarded disability and survivor pensions and other potential future awards for accidents that occurred up to the measurement date. Workers' compensation benefits are provided according to the respective provincial workers' compensation legislation. Benefit entitlements in the three Territories are based on the Alberta legislation.

Purolator has a number of funded defined benefit pension plans. The defined benefit plans are based either on length of pensionable service and salary paid each year or on negotiated benefit rates, depending on the type of employees. Since these defined benefit plans are subject to the maximum pension payable under the *Income Tax Act*, a supplementary pension plan, based on length of pensionable service and final average salary, is offered to designated employees. Purolator also provides pension benefits to eligible employees through a defined contribution plan. Plan members are not required nor permitted to contribute to the defined benefit pension plans.



## 11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Certain employees of SCI presently belong to a pension plan sponsored by SCI's former owner, Bell Canada. The BCE Inc. Pension Plan is a non-contributory, defined benefit pension plan that provides for benefits based on length of pensionable service and final average salary. Pension benefits in pay are indexed annually. The assets of the pension plan are invested in units of the BCE Master Trust Fund with Royal Trust acting as trustee. However, in 2001 the Corporation entered into a Share Purchase Agreement with Bell Canada whereby the employees of SCI started participating in a new pension plan, disengaged from Bell Canada. The pension plan assets and liabilities for pensions and related benefits accrued at the date of change of ownership will be transferred to the new pension plan on completion of the related actuarial valuations, pending regulatory approval. The amounts of assets and liabilities included in these consolidated financial statements represent current estimates of the amounts to be transferred to the new Pension Plan, adjusted for all activity subsequent to the change of ownership. The estimate of the transfer amount relating to plan assets includes management's best estimate of the effect of certain events related to the BCE Inc. Pension Plan that occurred prior to the purchase of SCI by the Corporation. The estimate was revised in 2007 based on a report provided by BCE Corporate Services. The amounts to be transferred into the new, separate Pension Plan will be finalized and transferred over only when regulatory approval has been obtained. In 2005, a supplementary pension plan was created for designated employees to replace the current plan, whereby employees who reach the maximum pension payable from the registered plan would receive the excess pension payable by SCI. The results for this plan are included with those of the regular plan. After the acquisition, a defined contribution provision was added to SCI's pension plan.

The other retirement benefit plans pertaining to SCI's employees consist of medical and dental benefits, and life insurance after retirement. SCI pays the full cost of these benefits, except for the dental plan which is paid 100% by the retirees who choose this coverage.

Innovapost has a funded defined benefit pension plan. Like the Corporation, pension benefits that are not permissible in the registered pension plan are provided by a retirement compensation arrangement. Pension benefits, based on length of pensionable service and average pensionable salary, are indexed according to the annual increase in the consumer price index. Employer and employees' contributions are made in accordance with the plan. After October 31, 2002, no new members are eligible to join Innovapost's pension plan.

**11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)****(b) Obligations and assets**

A reconciliation of the defined benefit plan obligations, defined benefit plan assets and the funded status of the defined benefit plans to the amounts recorded in the consolidated balance sheet follows:

| Year ended, and as at, December 31<br>(in millions of dollars)             | 2008                        |                           | 2007                        |                           |
|--|-----------------------------|---------------------------|-----------------------------|---------------------------|
|  | Pension<br>benefit<br>plans | Other<br>benefit<br>plans | Pension<br>benefit<br>plans | Other<br>benefit<br>plans |
| <b>Accrued benefit obligations</b>   |                             |                           |                             |                           |
| Balance, beginning of year   | \$ 14,208                   | \$ 3,215                  | \$ 13,729                   | \$ 3,327                  |
| Current service cost   | 447                         | 107                       | 449                         | 111                       |
| Interest cost  | 803                         | 180                       | 736                         | 176                       |
| Employee contributions   | 188                         | –                         | 183                         | –                         |
| Benefits paid  | (391)                       | (105)                     | (324)                       | (133)                     |
| Actuarial gains  | (3,531)                     | (900)                     | (564)                       | (149)                     |
| Plan amendments  | 12                          | (6)                       | –                           | (119)                     |
| Curtailement   | –                           | (2)                       | (1)                         | –                         |
| Settlement   | (4)                         | –                         | –                           | 2                         |
| <b>Balance, end of year</b>  | <b>11,732</b>               | <b>2,489</b>              | <b>14,208</b>               | <b>3,215</b>              |
| <b>Plan assets</b>   |                             |                           |                             |                           |
| Fair value, beginning of year  | 15,180                      | –                         | 14,928                      | –                         |
| Reduction in estimated amount of surplus<br>transfer from BCE Inc.         | –                           | –                         | (11)                        | –                         |
| Actual return on plan assets   | (2,909)                     | –                         | 263                         | –                         |
| Employer regular contributions   | 98                          | –                         | 129                         | –                         |
| Employer special solvency contributions                                    | 13                          | –                         | 12                          | –                         |
| Employee contributions   | 188                         | –                         | 183                         | –                         |
| Benefits paid  | (391)                       | –                         | (324)                       | –                         |
| Settlement   | (4)                         | –                         | –                           | –                         |
| <b>Fair value, end of year</b>   | <b>12,175</b>               | <b>–</b>                  | <b>15,180</b>               | <b>–</b>                  |
| <b>Funded status of defined benefit plans – surplus (deficit)</b>          | <b>443</b>                  | <b>(2,489)</b>            | <b>972</b>                  | <b>(3,215)</b>            |
| Unrecognized net actuarial (gain) loss                                     | 506                         | (53)                      | 63                          | 904                       |
| Unrecognized past service costs (credits)                                  | 25                          | (166)                     | 16                          | (190)                     |
| Unrecognized transitional obligation                                       | –                           | –                         | –                           | 3                         |
| Unrecognized funding excess  | (89)                        | –                         | (121)                       | –                         |
| <b>Net amount recognized for:</b>  |                             |                           |                             |                           |
| Defined benefit plans  | 885                         | (2,708)                   | 930                         | (2,498)                   |
| Defined contribution plans   | (1)                         | –                         | (1)                         | –                         |
| <b>Total amount recognized</b>   | <b>\$ 884</b>               | <b>\$ (2,708)</b>         | <b>\$ 929</b>               | <b>\$ (2,498)</b>         |
| <b>Presented in the consolidated balance sheet as:</b>                     |                             |                           |                             |                           |
| Accrued pension benefit asset  | \$ 898                      | \$ –                      | \$ 944                      | \$ –                      |
| Accrued pension, other retirement and post-employment<br>benefit liability | (14)                        | (2,708)                   | (15)                        | (2,498)                   |
| <b>Total amount presented</b>  | <b>\$ 884</b>               | <b>\$ (2,708)</b>         | <b>\$ 929</b>               | <b>\$ (2,498)</b>         |

## 11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

### (c) Benefit plans in a deficit position

Included in the above accrued benefit obligations and fair value of plan assets at year end are the following amounts with respect to plans that are in a deficit position:

| As at December 31<br>(in millions of dollars)    | 2008                        |                           | 2007                        |                           |
|--|-----------------------------|---------------------------|-----------------------------|---------------------------|
|  | Pension<br>benefit<br>plans | Other<br>benefit<br>plans | Pension<br>benefit<br>plans | Other<br>benefit<br>plans |
| Accrued benefit obligations                      | \$ 57                       | \$ 2,489                  | \$ 323                      | \$ 3,215                  |
| Plan assets                                      | 44                          | –                         | 273                         | –                         |
| Funded status of defined benefit plans – deficit | \$ (13)                     | \$ (2,489)                | \$ (50)                     | \$ (3,215)                |

### (d) Investment objective and plan asset allocations

The Board of Directors of the Corporation adopts and reviews at least annually a Statement of Investment Policies and Procedures (“SIPP”) addressing the manner in which the Corporation’s pension plan assets will be invested. Investment principles and beliefs are revisited periodically to ensure that changes to the investment policies may be made if warranted. The Corporation believes that an investment portfolio with an appropriate asset allocation, the target portfolio, can over the long-term achieve the investment objective of ensuring that sufficient assets will be available to meet the obligations of the pension plan as they come due. Under the current SIPP, it is recognized that it is not always desirable to have the investment portfolio exactly match the long-term asset target allocation and therefore minimum and maximum asset category limits have been established.

The Corporation’s investment objective for its pension plan assets is to achieve a long-term rate of return, net of administrative expenses, which exceeds inflation by at least 4.75%. Investments are made according to criteria and limitations set by the Board of Directors and applicable legislation. Allowable types of investment, individual investment limits, portfolio investment limits, maturity limits and minimum credit quality ratings are set by the Board to reduce the level of risk and provide diversification between industry sectors, geographic/economic areas and management styles. The asset allocations, by asset category, of the Corporation’s pension plan are as follows:

| As at December 31                      | 2008   |        | 2007   |
|--|--------|--------|--------|
|  | Target | Actual | Actual |
| Cash and money market instruments      | 1 %    | 3 %    | 5 %    |
| Bonds                                  | 36 %   | 38 %   | 30 %   |
| Canadian equities                      | 24 %   | 22 %   | 28 %   |
| U.S. equities                          | 20 %   | 17 %   | 16 %   |
| International equities                 | 15 %   | 14 %   | 17 %   |
| Real estate                            | 3 %    | 5 %    | 3 %    |
| Other assets less liabilities          | 1 %    | 1 %    | 1 %    |
| Pension plan assets of the Corporation | 100 %  | 100 %  | 100 %  |

The pension plan assets of Purolator, SCI and Innovapost are governed by similar investment objectives and policies and account for 2% (2007 – 2%) of the total plan assets of \$12,175 million (2007 – \$15,180 million).

Total plan assets include \$2,338 million (2007 – \$2,147 million) in money market instruments and bonds issued by the Government of Canada, its agencies and other Crown corporations and \$122 million (2007 – \$112 million) in refundable taxes held by the Canada Revenue Agency.

**11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)****(e) Costs**

The elements of employee future benefit costs recognized in the year are as follows:

| Year ended December 31<br>(in millions of dollars)         | 2008                |              |                       | 2007                |              |                       |
|--|---------------------|--------------|-----------------------|---------------------|--------------|-----------------------|
|  | Incurred<br>in year | Adjustments* | Recognized<br>in year | Incurred<br>in year | Adjustments* | Recognized<br>in year |
| <b>Pension benefit plans</b>                               |                     |              |                       |                     |              |                       |
| Current service cost                                       | \$ 447              | \$ –         | \$ 447                | \$ 449              | \$ –         | \$ 449                |
| Interest cost  | 803                 | –            | 803                   | 736                 | –            | 736                   |
| Return on plan assets                                      | 2,909               | (3,976)      | (1,067)               | (263)               | (683)        | (946)                 |
| Actuarial (gains) losses on<br>accrued benefit obligations | (3,531)             | 3,532        | 1                     | (564)               | 567          | 3                     |
| Plan amendments  | 12                  | (9)          | 3                     | –                   | 1            | 1                     |
| Curtailment gain   | –                   | –            | –                     | (1)                 | –            | (1)                   |
| Settlement loss  | 1                   | –            | 1                     | –                   | –            | –                     |
| Amortization of funding excess                             | –                   | (32)         | (32)                  | –                   | (32)         | (32)                  |
| Defined benefit costs                                      | 641                 | (485)        | 156                   | 357                 | (147)        | 210                   |
| Defined contribution costs                                 | 5                   | –            | 5                     | 2                   | –            | 2                     |
| Multiemployer defined benefit costs                        | –                   | –            | –                     | 1                   | –            | 1                     |
| Total pension benefit costs                                | 646                 | (485)        | 161                   | 360                 | (147)        | 213                   |
| Transitional support from<br>the Government of Canada      | (35)                | –            | (35)                  | (63)                | –            | (63)                  |
| Net pension benefit costs                                  | \$ 611              | \$ (485)     | \$ 126                | \$ 297              | \$ (147)     | \$ 150                |
| <b>Other benefit plans</b>                                 |                     |              |                       |                     |              |                       |
| Current service cost                                       | \$ 107              | \$ –         | \$ 107                | \$ 111              | \$ –         | \$ 111                |
| Interest cost  | 180                 | –            | 180                   | 176                 | –            | 176                   |
| Actuarial (gains) losses on accrued<br>benefit obligations | (900)               | 957          | 57                    | (149)               | 228          | 79                    |
| Plan amendments  | (6)                 | (24)         | (30)                  | (119)               | 104          | (15)                  |
| Curtailment gain   | (2)                 | –            | (2)                   | –                   | –            | –                     |
| Settlement loss  | –                   | –            | –                     | 9                   | –            | 9                     |
| Amortization of<br>transitional obligation                 | –                   | 3            | 3                     | –                   | 4            | 4                     |
| Defined benefit costs                                      | (621)               | 936          | 315                   | 28                  | 336          | 364                   |
| Return on segregated securities                            | (10)                | –            | (10)                  | (16)                | –            | (16)                  |
| Transitional support from<br>the Government of Canada      | (46)                | –            | (46)                  | (43)                | –            | (43)                  |
| Net other benefit costs                                    | \$ (677)            | \$ 936       | \$ 259                | \$ (31)             | \$ 336       | \$ 305                |

\* Adjustments to allocate costs to different years so as to recognize the long-term nature of employee future benefits.

## 11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

### (f) Assumptions

The assumptions used in measuring the costs and accrued benefit obligations for the Corporation's significant defined benefit plans were as follows:

| As at December 31   | 2008                        |                           | 2007                        |                           |
|---|-----------------------------|---------------------------|-----------------------------|---------------------------|
|   | Pension<br>benefit<br>plans | Other<br>benefit<br>plans | Pension<br>benefit<br>plans | Other<br>benefit<br>plans |
| Accrued benefit obligations:                                      |                             |                           |                             |                           |
| Discount rate   | 7.5%                        | 7.6%                      | 5.6%                        | 5.5%                      |
| Long-term rate of compensation increase                           | 3.0%                        | 3.0%                      | 3.0%                        | 3.0%                      |
| Benefit costs:  |                             |                           |                             |                           |
| Discount rate   | 5.6%                        | 5.5%                      | 5.3%                        | 5.3%                      |
| Expected long-term rate of return on plan assets                  | 7.25%                       | N/A                       | 7.0%                        | N/A                       |
| Long-term rate of compensation increase                           | 3.0%                        | 3.0%                      | 3.0%                        | 3.0%                      |
| Assumed health care cost trend rates:                             |                             |                           |                             |                           |
| Initial health care cost trend rate                               | N/A                         | 8.9%                      | N/A                         | 8.8%                      |
| Cost trend rate declines to                                       | N/A                         | 5.3%                      | N/A                         | 5.3%                      |
| Year that the rate reaches the rate it is<br>assumed to remain at | N/A                         | year 10                   | N/A                         | year 10                   |

### (g) Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have had the following effects for 2008:

| (in millions of dollars)                    | Increase | Decrease |
|---|----------|----------|
| Total of current service and interest costs | \$ 52    | \$ (39)  |
| Accrued benefit obligations                 | \$ 360   | \$ (283) |

The above sensitivities are hypothetical and must be used with caution. Changes in amounts based on a one-percentage-point variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in amounts may not be linear. The sensitivities have been calculated independently of changes in other key assumptions. Changes in one factor may result in changes in another, which could amplify or reduce certain sensitivities.

## 11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

### (h) Total cash payments

Cash payments for pension, other retirement and post-employment benefits are as follows:

| Year ended December 31<br>(in millions of dollars)                       | 2008   | 2007   |
|--|--------|--------|
| Benefits paid directly to beneficiaries for unfunded other benefit plans | \$ 105 | \$ 133 |
| Employer regular contributions to funded pension benefit plans           | 98     | 129    |
| Employer special solvency contributions to funded pension benefit plans  | 13     | 12     |
| Total cash payments for defined benefit plans                            | 216    | 274    |
| Contributions to defined contribution plans                              | 5      | 2      |
| Contributions to multiemployer defined benefit plan                      | –      | 1      |
| Total cash payments  | \$ 221 | \$ 277 |

The actuarial valuations of the defined benefit pension plans for funding purposes are required to be filed at least every three years and annually when a solvency shortfall has occurred. At the end of 2007, the Corporation's registered pension plan was in a funding excess position, both on a solvency and going-concern basis. The Corporation's contribution holiday that started in 2007 was continued until October 31, 2008 when registered pension plan contributions were resumed. If future actuarial valuations for funding purposes result in a going-concern or solvency deficit, the Corporation would be required to make special payments to the plan over periods specified by regulatory authorities. The most recent actuarial valuations for funding purposes, and the next required actuarial valuations, are as of the following dates:

|                         | Most recent<br>actuarial valuation<br>for funding purposes | Next required<br>actuarial valuation<br>for funding purposes |
|-------------------------|--|--|
| Canada Post Corporation | December 31, 2007  | December 31, 2010  |
| Purolator               | December 31, 2007  | December 31, 2008  |
| SCI                     | December 31, 2006  | December 31, 2009  |
| Innovapost              | December 31, 2007  | December 31, 2010  |

## 12. Goodwill

The changes in the carrying amount of goodwill are as follows:

| Year ended December 31<br>(in millions of dollars) | 2008                   |                      |                      | 2007   |        |
|--|------------------------|----------------------|----------------------|--------|--------|
|  | Canada Post<br>segment | Purolator<br>segment | Logistics<br>segment | Total  | Total  |
| Balance, beginning of year                         | \$ –                   | \$ 121               | \$ 3                 | \$ 124 | \$ 123 |
| Acquisition  | –                      | –                    | –                    | –      | 4      |
| Impairment   | –                      | –                    | –                    | –      | (3)    |
| Balance, end of year                               | \$ –                   | \$ 121               | \$ 3                 | \$ 124 | \$ 124 |

In 2007, the Corporation recorded a \$3 million impairment charge, which represented all the goodwill related to epost™.

### 13. Other Assets

| As at December 31<br>(in millions of dollars) | 2008         | 2007         |
|---|--------------|--------------|
| Assets held for sale                          | \$ 1         | \$ 2         |
| Illiquid securities (note 8)                  | 5            | 7            |
| Other   | 13           | 12           |
| <b>Total other assets</b>                     | <b>\$ 19</b> | <b>\$ 21</b> |

The Corporation has classified several properties as held for sale at the end of 2008. It is anticipated that the carrying amount of the properties will be fully recovered through the sale proceeds. The property held for sale at the end of 2007 was sold during the year as anticipated. A gain of \$3 million was recorded on the disposition.

### 14. Long-Term Debt

| As at December 31<br>(in millions of dollars)   | 2008         |                | 2007       |                |
|---|--------------|----------------|------------|----------------|
|   | Fair value   | Carrying value | Fair value | Carrying value |
| Non-redeemable bonds maturing March 2016, interest at 10.35% payable semi-annually on March 15 and September 15             | \$ 79        | \$ 55          | \$ 78      | \$ 55          |
| Notes due to BCE Emergis Inc., plus accrued interest at the Bank of Canada overnight rate plus 1%, matured in December 2008 | –            | –              | 3          | 3              |
| Other long-term borrowing, interest at Bank of Canada prime rate, repayment term five years                                 | 18           | 18             | –          | –              |
| Capital lease obligation, expiring 2011, net of implicit interest at rates between 5.7% and 8.4%                            | 1            | 1              | –          | –              |
| <b>Total long-term debt</b>   | <b>98</b>    | <b>74</b>      | <b>81</b>  | <b>58</b>      |
| Less current portion  | –            | –              | 3          | 3              |
| <b>Long-term portion</b>  | <b>\$ 98</b> | <b>\$ 74</b>   | <b>78</b>  | <b>\$ 55</b>   |

Fair value of long-term bonds is estimated by reference to quoted market prices of similar bonds. The scheduled repayment date of these bonds is March 2016. There are no prepayment terms associated with this debt.

The other long-term borrowing of one of the Corporation's subsidiaries represents an amount drawn on a credit facility as at December 31, 2008, which is expected to be converted to capital leases during 2009. The term of the facility is for a period of five years. The fair value of this borrowing approximates its carrying value as a result of the floating interest rate at the Bank of Canada prime rate.

The capital lease obligations will be repaid in equal monthly installments over a period of 36 months.

The effective interest rate as at December 31, 2008 was 10.5% (2007 – 10.5%) for the non-redeemable bonds and 6.8% for the capital lease obligations. Interest expense on long-term debt amounted to \$6 million (2007 – \$6 million).

## 15. Conditional Asset Retirement Obligations

Certain of the Corporation's owned buildings have asbestos-containing materials which the Corporation will be obligated to remove and dispose of in a special manner should the property undergo major renovations or demolition. As a result of the longevity of the Corporation's buildings where asbestos exists, ongoing asbestos management programs, and the fact that the Corporation does not have plans for major changes that would require the removal of asbestos, the timing of the removal of the asbestos is indeterminable. The fair value of a conditional asset retirement obligation associated with asbestos removal can be reasonably estimated only when the Corporation has sufficient information to estimate the timing of the settlement of the obligation.

As of December 31, 2008, the Corporation has recognized conditional asset retirement obligations associated with asbestos removal for properties which are planned to be disposed of by sale. These conditional asset retirement obligations are expected to be transferred to the prospective purchasers of the properties on the date of sale. For the remaining properties with asbestos-containing materials, the Corporation does not have sufficient information as of December 31, 2008 to reasonably estimate the fair value of the conditional asset retirement obligations. Similarly, the fair value of conditional asset retirement obligations associated with site restoration after permanent removal of a community mailbox from a location is not reasonably estimable due to indeterminate settlement dates. The Corporation will continue to assess its ability to estimate the fair values of its asset retirement obligations at each future reporting date.

The Corporation estimates that the undiscounted cash flows required to transfer its recognized conditional asset retirement obligations approximate \$11 million. The sales of the properties are expected to occur within the next three years, and the estimated cash flows have been discounted at a credit-adjusted risk-free rate of 4.2%. The present values of the Corporation's conditional asset retirement obligations at December 31, 2008, totalling \$10 million, are included in other long-term liabilities. No asset retirement obligations were recorded in 2007.

## 16. Capital Management

The Corporation is subject to the *Canada Post Corporation Act* and the *Financial Administration Act* ("the Acts") and any directives issued pursuant to the Acts. These Acts affect how the Corporation manages its capital by, among other things, setting broad objectives for the Corporation. Specifically, while maintaining basic postal service and in carrying out its objectives, the Corporation must have regard for the need to conduct its operations on a self-sustaining financial basis while providing a standard of service that meets the needs of the people of Canada. In December 1998, the Government of Canada approved a Multi-Year Policy and Financial Framework ("Policy Framework") that set financial performance targets, service standards and a price-cap formula for the domestic basic letter rate, for the Corporation. A strategic review of the Corporation's public policy objectives, its ability to remain financially self-sustaining and the continued relevance of the 1998 Policy Framework was conducted in 2008, and is currently under consideration by the Government of Canada.



## 16. Capital Management (continued)

The Corporation defines and computes its capital as follows:

| As at December 31<br>(in millions of dollars) | 2008            | 2007            |
|---|-----------------|-----------------|
| Equity of Canada                              | \$ 1,507        | \$ 1,439        |
| Long-term debt                                | 74              | 58              |
| Other long-term financial obligation          | 19              | 17              |
| <b>Total capital</b>                          | <b>\$ 1,600</b> | <b>\$ 1,514</b> |

The Corporation's objectives in managing capital are to:

- Provide sufficient liquidity to support its financial obligations and its operating and strategic plans;
- Generate a reasonable return to the Government of Canada in support of the objectives of the Policy Framework; and
- Maintain financial capacity and access to credit facilities to support future development of the business.

In 2008 and 2007, the Corporation relied on cash flow provided by operations and accumulated funds to support its financial obligations and fund its capital and strategic requirements. Indebtedness has been maintained at a low level. Since 2007, the Corporation has segregated funds for specific future cash flow requirements. These segregated funds would be drawn only for significant projects related to the renewal of the Corporation's operational capabilities or to make regulatory contributions to the Corporation's pension plan.

The Corporation's ability to obtain additional capital is subject to market conditions and pursuant to the provisions of the Acts. The limitations on the borrowings of the Corporation and its access to credit facilities are outlined in the discussion of liquidity risk in Note 7 (c). Pursuant to the *Financial Administration Act, Part X*, the Corporation must indicate its intention to borrow money in the annual Corporate Plan, or in an amendment thereto, which are subject to the approval of the Board of Directors and the Governor in Council. In addition, the detailed terms and conditions of any specific long-term borrowing transaction must be approved by the Minister of Finance. The Corporation does not intend to borrow additional capital within the next twelve months however, financing the Postal Transformation program will likely involve borrowing in the longer term. The timing of future borrowings is not determinable. The *Canada Post Corporation Act* provides for the establishment of a share capital structure giving the Corporation the ability to raise funds through the issuance of shares to the Government of Canada and to the Corporation's employees, however no such shares have been issued.

The declaration, amount and payment of a dividend to the Government of Canada are subject to the Acts. Consistent with the objectives set out in the 1998 Policy Framework, dividends have been paid at 40% of the prior year's net income since 2004, when the Policy Framework objective to exceed an 11% return on equity was first reached. On May 17, 2007, a dividend of \$47 million was paid and on May 15, 2008, the dividend paid was \$22 million.

The Corporation's financial objectives and strategies as stated above have remained substantially unchanged over the last two years. These objectives and strategies are reviewed in the annual Corporate Plan submission, approved by the Board of Directors. The Corporation's 2008 and 2007 Corporate Plans were approved by the Governor in Council on July 28, 2008. As of March 6, 2009, the Corporation's 2009 Corporate Plan had not been approved by the Governor in Council.

The Corporation and its subsidiaries and joint venture are not subject to any externally imposed capital requirements.

## 17. Commitments and Contingencies

- (a) Two complaints have been filed with the Canadian Human Rights Commission ("the Commission") alleging discrimination by the Corporation concerning work of equal value.

One complaint was filed by the Public Service Alliance of Canada ("PSAC") in 1983, retroactive to October 16, 1981, when Canada Post Corporation became a Crown corporation. The Commission referred the complaint to the Canadian Human Rights Tribunal ("the Tribunal") in 1992. The Tribunal rendered its decision on October 7, 2005, concluding that the Corporation had participated in "systemic discrimination" in the setting of wages for a group of PSAC members contrary to Section 11 of the *Canadian Human Rights Act*.

The Corporation appealed the decision of the Tribunal to the Federal Court Trial Division on October 7, 2005, claiming that the Tribunal had not only incorrectly applied and interpreted the law, but had also reached its conclusions in the face of substantial evidence that there had been no violation of Section 11 of the *Canadian Human Rights Act*.

On November 18, 2005, PSAC commenced its own appeal in the Federal Court against the decision.

The appeals were heard in the Federal Court Trial Division in November 2007 and January 2008. On February 21, 2008, the Federal Court Trial Division released its decision allowing Canada Post Corporation's application for judicial review setting aside the decision of the Tribunal and referred the complaint back to the Tribunal with the direction that the complaint be dismissed as not substantiated according to the legal standard of proof. PSAC's appeal against the decision of the Tribunal was dismissed.

On March 18, 2008, PSAC appealed the decision of the Federal Court Trial Division to the Federal Court of Appeal. On March 25, 2008, the Commission also appealed this decision to the Federal Court of Appeal. The parties exchanged written Memoranda of Fact and Law in October and November of 2008. It is anticipated the appeal will be heard in the Federal Court of Appeal in the fall of 2009.

Another complaint was filed by the Canadian Postmasters and Assistants Association initially in December 1982, seeking retroactivity to October 16, 1981. In December 1991, the Commission decided not to deal with the complaint. This complaint was refiled in November 1992. The Commission did not fully investigate the complaint. It did attempt to mediate/conciliate a resolution to the complaint without success. On February 28, 2006, the most recent conciliator recommended to the Commission that the Commission decline to deal with the complaint at this time because the complaint is one that could more appropriately be dealt with under the *Canada Labour Code*. There have been no new developments.

The outcome of these complaints is not currently determinable and as a result no provision has been recorded in the consolidated financial statements. Settlement, if any, arising from resolution of these matters, is presently planned to be recovered in future postal rates (as determined in accordance with the *Canada Post Corporation Act*) and/or from the Government of Canada.

- (b) The Corporation and Purolator have made certain commitments that apply upon expiration or termination of certain agreements with Innovapost. These agreements were signed for a 10 year period that commenced in 2002, with an optional renewal period of five years. The Corporation and Purolator have agreed to purchase the assets, used on a dedicated basis at the time of expiration or termination of the agreements, for an amount equal to net book value and shall be required to assume certain obligations related to the purchase of these assets. In addition, on expiration or termination of the agreements, Innovapost shall have the obligation to transfer or assign to the Corporation or Purolator any contract applicable to the services provided to the Corporation or Purolator, respectively; however, should Purolator terminate its agreement for a specific event, as described in the agreement, it has the option to reject the transfer or assignment of these contracts. It is not practicable, at this time, to determine the value of assets used on a dedicated basis, nor the carrying value of the contractual obligations, at the time of expiration or termination of the agreements.

The terms of the agreements provide for no limitation to the maximum potential future payments under the above commitments, and the Corporation and Purolator do not currently possess sufficient information to estimate the maximum potential future liability.

## 17. Commitments and Contingencies (continued)

(c) CPIL and its subsidiary entered into an agreement with the Government of the Netherlands Antilles to provide postal and postbanking services, to the residents of the five islands that comprise the Netherlands Antilles, for a 20 year period that commenced in May 2003. Compliance with certain terms of the agreement for the concession was in dispute, with each party alleging defaults by the other. A number of meetings were held in 2007 with the Government of the Netherlands Antilles, with the objective of negotiating an amicable settlement. As a result of these meetings, the parties signed a Memorandum of Understanding in December 2007 and a Settlement Agreement in January 2008. The appropriate authorization under the *Financial Administration Act* was obtained in February 2008.

As per the terms and conditions set out in the Settlement Agreement, in April 2008, CPIL transferred 100% of the shares in its subsidiary, Nieuwe Post Nederlandse Antillen N.V., to the Government of the Netherlands Antilles and paid \$7 million as full and final settlement.

(d) In the normal course of business, the Corporation has entered into agreements that include indemnities in favour of third parties. In addition, the Corporation has entered into indemnity agreements with each of its directors, officers and certain employees to indemnify them, subject to the terms of these agreements, against claims and expenses incurred by them as a result of serving as a director or officer of the Corporation or as a director, officer or in a similar capacity of another entity at the request of the Corporation.

These agreements generally do not contain specified limits on the Corporation's liability and, therefore, it is not possible to estimate the potential future liability under these indemnities. No amounts have been accrued in the consolidated financial statements with respect to these indemnities.

(e) The Corporation is involved in various claims and litigation in the normal course of business. Provisions are recorded when and if losses are likely and amounts can be reasonably estimated.

(f) The Corporation's employees are permitted to accumulate unused sick leave. However, such leave entitlements do not vest and can be used only in the event of illness. The amount of accumulated sick leave entitlements which will become payable in future years cannot reasonably be determined. Payments of sick leave benefits are included in the cost of operations.

(g) The future minimum lease payments with respect to facilities, transportation equipment and other operating leases with terms in excess of one year, are as follows:

(in millions of dollars)

|                     |    |       |
|---------------------|----|-------|
| 2009                | \$ | 138   |
| 2010                |    | 129   |
| 2011                |    | 111   |
| 2012                |    | 87    |
| 2013                |    | 64    |
| 2014 and thereafter |    | 629   |
| Total               | \$ | 1,158 |

Included in the above commitments are leases in the amount of \$27 million with a related party, the Government of Canada, for premises used in postal operations (2007 – \$15 million).

(h) In the normal course of business, the Corporation enters into contractual arrangements for the supply of goods and services over periods extending beyond one year. Disbursements largely depend on future, volume-related requirements and are subject to the Corporation's contractual rights of termination.

## 18. Cash Flow Information

Year ended December 31

2008

2007

(in millions of dollars)

### Change in non-cash operating working capital

|   |      |        |
|---|------|--------|
| Decrease (increase) in accounts receivable                                | \$ 6 | \$ (6) |
| Decrease in net income tax payable  | (13) | (37)   |
| Increase (decrease) in accounts payable and accrued liabilities           | 38   | (8)    |
| Increase (decrease) in salaries and benefits payable                      | 119  | (10)   |
| Decrease in deferred revenue  | (9)  | (27)   |
| Net increase (decrease) in other non-cash operating working capital items | 2    | (5)    |

|       |        |         |
|-------|--------|---------|
| Total | \$ 143 | \$ (93) |
|-------|--------|---------|

### Supplementary information

|                 |        |        |
|-----------------|--------|--------|
| Interest paid   | \$ 8   | \$ 6   |
| Income tax paid | \$ 142 | \$ 163 |

## 19. Joint Venture

The Corporation has a 51% ownership interest in Innovapost, The Canada Post Group's primary information technology service provider. Virtually all of Innovapost's services are provided to The Canada Post Group based on consideration contractually established and agreed to by the related party. Cost of operations included in the consolidated financial statements of the Corporation, includes approximately \$310 million (2007 – \$283 million) of expenses related to these services. The Corporation's proportionate share of the assets and liabilities of Innovapost at year end is \$75 million (2007 – \$63 million) and \$49 million (2007 – \$37 million), respectively.

## 20. Related Party Transactions

The Corporation had the following transactions with related parties in addition to those disclosed elsewhere in these consolidated financial statements:

**(a) Government of Canada, its agencies and other Crown corporations** • The Government of Canada provides compensation to the Corporation to partially offset foregone postage revenue from Government free mail services and mailing of materials for the blind (note 6). In addition, pursuant to an agreement with the Department of Indian Affairs and Northern Development, the Government of Canada compensates the Corporation for the difference between the Corporation's cost of shipping eligible goods under the Food Mail Program and the applicable postage paid by shippers. Compensation payments from the Government of Canada amounting to \$78 million (2007 – \$68 million) are included in revenue from operations.

In addition, the Corporation has other transactions with the Government of Canada, its agencies and other Crown corporations in the normal course of business at commercial prices and terms.

For the year ended December 31, 2008, the amounts of accounts receivable and deferred revenue from these related parties are \$41 million (2007 – \$24 million) and \$4 million (2007 – \$5 million), respectively.

**(b) Directors** • In the normal course of business, the Corporation may interact with companies whose directors or officers are directors of the Corporation. The affected directors always recuse themselves from all discussions and decisions related to transactions between the companies. Such cases of company interaction occurred during the year with Telus Corporation. In 2008, the Corporation provided services to Telus Corporation of \$51 million (2007 – \$88 million). Services received from Telus Corporation in 2008 amounted to \$3 million (2007 – \$5 million).

**(c) Other** • During the year, a subsidiary of the Corporation had business transactions with a company controlled by a minority shareholder of that subsidiary. The minority shareholder is also a director of the subsidiary. This company provided air services to the subsidiary in the amount of \$109 million (2007 – \$107 million). These transactions were made at prices and terms comparable to those given to other suppliers of the subsidiary.

## 21. Publications Assistance Program

Under the Government of Canada's Publications Assistance Program, the Government and the Corporation have subsidized a portion of the distribution costs incurred by eligible publishers of eligible publications using the Corporation's Publications Mail™ service. Although subsidy payments payable to eligible publishers vary over the Government's fiscal year, the Government's contribution to the Program was capped at \$45 million in its fiscal year 2008/2009 (\$45 million in 2007/2008). The Corporation's contribution to the Program was capped at \$15 million in 2008/2009 (\$15 million in 2007/2008) and is included in cost of operations. As directed by the shareholder, Canada Post will continue its financial contribution to the Program fund until March 31, 2009.

## 22. Segmented Information

The Corporation manages its operations and, accordingly, determines its operating segments on the basis of the legal entities. Three reportable operating segments have been identified: Canada Post, Purolator and Logistics. The Logistics segment is comprised of SCI.

The Canada Post segment provides transaction mail, parcels and direct marketing services, as well as other mail products and services. The Purolator segment derives its revenues from specialized courier services. The Logistics segment provides third-party logistics services in supply chain management and, from March 30, 2007, transportation services in the small to medium enterprise market.

Operating segments below the quantitative thresholds, for determining reportable operating segments, are combined and disclosed in the "all other" category. Their revenues are attributable to information technology services and, in 2007, to postal/postbanking services in the Netherlands Antilles.

The accounting policies of the operating segments are the same as those described in the significant accounting policies (note 2).

Transactions occur between the operating segments at commercial prices and terms comparable to those given to other customers and suppliers and without subsidy between the operating segments. On a consolidated basis, no individual external customer's purchases account for more than 10% of total revenues.

In 2007 the Logistics segment recorded \$3 million of restructuring costs related to the restructuring plan approved in 2006.

### Year ended, and as at, December 31, 2008

(in millions of dollars)

|   | Canada<br>Post | Purolator | Logistics | All<br>other | Elimination of<br>intersegment | The Canada<br>Post Group |
|---|----------------|-----------|-----------|--------------|--------------------------------|--------------------------|
| Revenue from external customers                         | \$ 6,084       | \$ 1,495  | \$ 147    | \$ 3         | \$ –                           | \$ 7,729                 |
| Intersegment revenue                                    | 24             | 68        | 9         | 173          | (274)                          | –                        |
| Revenue from operations                                 | \$ 6,108       | \$ 1,563  | \$ 156    | \$ 176       | \$ (274)                       | \$ 7,729                 |
| Income (loss) before the undernoted items               | \$ 211         | \$ 131    | \$ 20     | \$ 16        | \$ (6)                         | \$ 372                   |
| Amortization and impairment                             | (191)          | (40)      | (7)       | (2)          | 3                              | (237)                    |
| Investment and other income                             | 54             | 4         | –         | 1            | (21)                           | 38                       |
| Interest and other expense                              | (8)            | (4)       | –         | –            | –                              | (12)                     |
| Income (loss) by segment                                | \$ 66          | \$ 91     | \$ 13     | \$ 15        | \$ (24)                        | 161                      |
| Unallocated amounts and<br>adjustments in consolidation |                |           |           |              |                                | (4)                      |
| Income tax expense                                      |                |           |           |              |                                | (67)                     |
| Net income  |                |           |           |              |                                | \$ 90                    |
| Assets by segment                                       | \$ 5,096       | \$ 689    | \$ 88     | \$ 240       | \$ (523)                       | \$ 5,590                 |
| Unallocated amounts and<br>adjustments in consolidation |                |           |           |              |                                | 1                        |
| Total assets  |                |           |           |              |                                | \$ 5,591                 |
| Acquisition of capital assets                           | \$ 271         | \$ 117    | \$ 6      | \$ 1         | \$ (4)                         | \$ 391                   |

## 22. Segmented Information (continued)

Year ended, and as at, December 31, 2007

(in millions of dollars)

|   | Canada<br>Post | Purolator | Logistics | All<br>other | Elimination of<br>intersegment | The Canada<br>Post Group |
|---|----------------|-----------|-----------|--------------|--------------------------------|--------------------------|
| Revenue from external customers                         | \$ 5,933       | \$ 1,389  | \$ 137    | \$ 15        | \$ –                           | \$ 7,474                 |
| Intersegment revenue                                    | 22             | 59        | 9         | 160          | (250)                          | –                        |
| Revenue from operations                                 | \$ 5,955       | \$ 1,448  | \$ 146    | \$ 175       | \$ (250)                       | \$ 7,474                 |
| Income (loss) before the undernoted items               | \$ 207         | \$ 118    | \$ 11     | \$ 9         | \$ (4)                         | \$ 341                   |
| Amortization and impairment                             | (180)          | (30)      | (5)       | (2)          | 2                              | (215)                    |
| Investment and other income                             | 57             | –         | –         | 1            | (16)                           | 42                       |
| Interest and other expense                              | (6)            | (4)       | –         | –            | –                              | (10)                     |
| Income (loss) by segment                                | \$ 78          | \$ 84     | \$ 6      | \$ 8         | \$ (18)                        | 158                      |
| Unallocated amounts and<br>adjustments in consolidation |                |           |           |              |                                | (2)                      |
| Income tax expense                                      |                |           |           |              |                                | (102)                    |
| Net income  |                |           |           |              |                                | \$ 54                    |
| Assets by segment                                       | \$ 4,734       | \$ 617    | \$ 102    | \$ 237       | \$ (522)                       | \$ 5,168                 |
| Unallocated amounts and<br>adjustments in consolidation |                |           |           |              |                                | (1)                      |
| Total assets  |                |           |           |              |                                | \$ 5,167                 |
| Acquisition of capital assets                           | \$ 238         | \$ 83     | \$ 13     | \$ 2         | \$ (5)                         | \$ 331                   |