Safer, more efficient equipment

2010 Annual Report

MAKING NECESSARY CHANGE

New delivery model

A zero-emission electric vehicle, part of our modern delivery fleet

CANADA POST POSTES CANADA

From anywhere... to anyone

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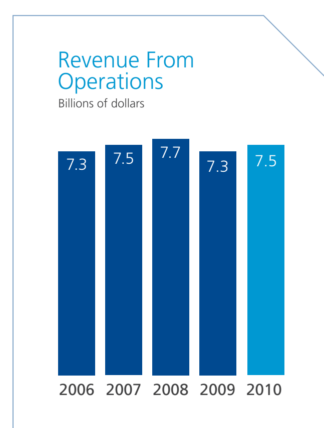
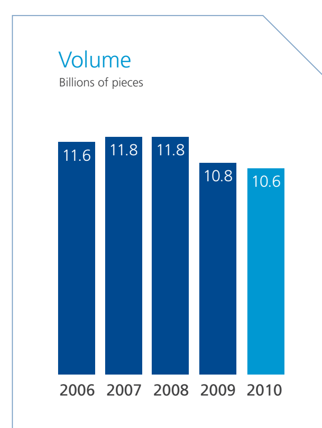
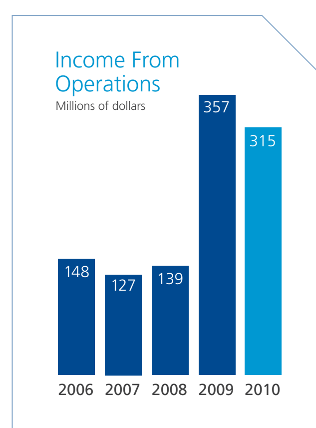
For the purposes of this report, "Canada Post" or "the Canada Post segment" refers to Canada Post's core services (Transaction Mail, Direct Marketing and Parcels lines of business) and excludes its subsidiaries Purolator Inc. (formerly known as Purolator Courier Ltd.) and SCI Group and joint venture Innovapost. "The Canada Post Group" refers to the company's core services and includes its subsidiaries and joint venture.

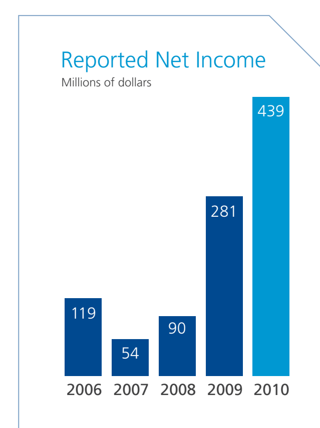
Financial and Operating Highlights – The Canada Post Group

Annual Report (in millions of dollars)		2010	2009	% Change
Operations				
Revenue from operations	As reported	$7,453	$7,312	1.9%
Income from operations	Revenue from operations – cost of operations	315	357	(11.7)%
Operating profit margin (%)	Income from operations ÷ revenue from operations	4.2%	4.9%	–
Income before income taxes	As reported	307	379	(19.0)%
Net income	As reported	439	281	56.3%
Return on equity (%)	Net income ÷ average equity	21.8%	17.0%	–
Cash from (used in) operations	As reported	(41)	134	(130.6)%
Capital expenditures	As reported	411	412	(0.1)%
Financial Position				
Cash		379	473	(19.7)%
Total assets		7,600	6,029	26.0%
Equity of Canada		2,236	1,787	25.1%









The Canada Post Group processed 10.6 billion pieces during the 12-month period. Consolidated revenue from operations reached $7.5 billion and consolidated net income totalled $439 million.

President's Message

This is a time of significant change for Canada Post—change that is necessary to sustain our service to Canadians and to create our future.

For decades, the unrivalled relevance of Lettermail™ was our bedrock. On it we built our network and workforce. In recent years, that bedrock has eroded as competing technologies have substituted for the letter, bill and statement.

To remain relevant, we must reinvent ourselves—and be nimble, competitive and courageous about it. I use "courageous" deliberately. Reinvention is demanding for any company. It is more so for a company as old and vast as the country, and whose customers—urban and rural, large and small—rightly expect quality service in the midst of massive change.

I am confident that Canada Post is up to the challenge.

Our modernization is gaining momentum; our focus on the customer is becoming sharper; and our embrace of innovation is generating new products and services. We have key assets in our great people and our incomparable retail and delivery networks. As well, our Board of Directors and our Shareholder, the Government of Canada, understand our challenges and support our strategies.

2010 confirmed the case for change.

We saw volumes decline in our most profitable business, domestic Lettermail, by 4.5 per cent, and in domestic parcels by 4.7 per cent, while Direct Marketing remained flat. Yet the number of addresses keeps growing—by an average of approximately 200,000 a year in the last few years—increasing our delivery costs. Less mail destined for more addresses year after year: if we did not change, this decline in "density" would threaten our future.

Our mandate also obliges us to remain financially self-sufficient. To do so, we again exerted tight control of our costs. Among other things, we restructured letter carrier routes to preserve efficiency as volumes declined, and, since the end of 2008, reduced the ranks of management by 15 per cent.

Despite this focus on cost control, we did not sacrifice important priorities such as training and safety. We kept our commitment to maintain our level of training despite economic pressures, and achieved our target of reducing accidents by 15 per cent in 2010. Our determination to keep employees safe is reflected in an aggressive five-year plan.

We recorded a net profit for the 16th consecutive year—but the figure of $439 million for The Canada Post Group should tempt no one to overlook our tight financial situation. Much of our profit in 2010 was attributable to a non-cash income tax benefit recorded in the Canada Post segment.

Our net profit is also small given our pension obligation, particularly since the recent financial turmoil created a large solvency deficit. We made a sizeable special payment in 2010 to help offset this deficit. The scale of the Pension Plan and funding volatility pose an ongoing risk to the Corporation's cash flow and ability to fund needed investments in modernization and growth.

Cost control alone does not lead to relevance or sustainability. We must grow. The new foundation for growth is already under construction.

Protecting the mail—and Canadians

Our business and reputation are built on our customers' trust that we will keep the mail secure. In 2010, we continued to adopt industry best practices by installing security cameras in 17 major facilities and 585,000 high-security locks on community mailboxes across Canada. We performed and supported special screening of mail during the Vancouver 2010 Olympic Winter Games and the G8 and G20 summits. In 2011, we will install more cameras, conduct threat and risk assessments of key facilities and enhance the security screening of employees and contractors who handle the mail.

“Cost control alone does not lead to relevance or sustainability. We must grow. The new foundation for growth is already under construction.“

In our $2.1-billion modernization program, we are investing in new equipment and processes that help us to compete, respond to changing volumes and market demands, and provide a platform for new and enhanced products and services.

Modernization celebrated an early milestone in 2010 with the opening of our new plant in Winnipeg, the first in 20 years. Our largest mail processing plants, in Toronto and Montréal, were also extensively “under construction” as retrofits began there and across the country.

We remain confident that modernization will achieve the expected benefits for customers, employees and our finances. Still, overhauling major plants while moving tens of millions of pieces of mail through them each day did affect service performance. I am keenly aware that customers count on excellent service performance. We are committed to this goal. Although some disruption is inevitable when a company modernizes on this scale, we are making renewed efforts to minimize it.

As a workforce, we are adapting to new roles and methods. Training is an integral part of modernization, and we continue to modify it in response to constructive feedback from employees. Our people are our strength. Our customers confirm this when we survey them. Canadian communities see it, too, in our employees’ enthusiastic support of our cause of choice—mental health—for which they helped raise $2.2 million in 2010. We were proud to be recognized early in 2011 as one of Canada’s 45 best diversity employers by Mediacorp. We will continue to build engagement and a workplace culture that is respectful and enthusiastic about embracing new opportunities.

As an issuer of stamps, we help tell the story of this fascinating country by celebrating its history and heroes. We will continue to play this important role for Canadians.

As more Canadians embrace digital technologies, we are becoming the vital bridge that links online transactions with physical deliveries.

We have been a trusted brand for 160 years in the physical delivery of letters, documents and packages. We value this trust. Through our innovative and secure web-based offerings, we will play an increasingly meaningful role in the digital lives of Canadians.

Deepak Chopra
President and Chief Executive Officer

Employee safety is our primary concern

We have developed a multi-year accident-reduction strategy to ensure we have the best processes and systems to keep employees and the public safe. In 2011, we will change how we report accidents to provide our accident frequency. This will help us compare our safety performance to other companies and know in which parts of the Corporation we need to focus our efforts. Our lost-time accident frequency in 2010 was more than six lost-time injuries per 100 employees—two to three times greater than the best performers among postal administrations. There is much room for improvement.

About Us

For 160 years, Canada Post has had the privilege—and responsibility—of playing a key role in this country's economy by providing Canadians with outstanding delivery, logistics and communication services.

As a financially self-sustaining Crown corporation, we operate as The Canada Post Group, a group of related businesses that includes affiliates Purolator and SCI Group, as well as Innovapost (a joint venture with CGI). With about 69,000 employees and almost 6,500 post offices, the Group is one of Canada's biggest employers and maintains the largest retail network in the country. In 2010, Canada Post delivered 10.6 billion pieces of mail, parcels and messages to more than 15 million addresses across Canada.

We believe in community involvement. In 2010, we raised $2.2 million for our cause of choice, mental health, and also supported literacy, the Canada Post Freestyle Team and United Way™. Each Christmas, a team of employee and retiree volunteers helps answer more than one million letters to Santa.

Through the "universal service obligation," Canada Post retains the exclusive right to provide basic postal services, including delivery of letters up to 500 grams. Letter mail continues to be our core product and a vital communication tool for our customers. However, letter mail volumes continued to decline in 2010 while the number of new addresses Canada Post has to service has risen by approximately 200,000 per year for the last five years. Together with the impact of the economic slowdown, this has put immense financial pressure on the company. Despite our exclusive market, our customers have choices and we face competitive threats in all our businesses.

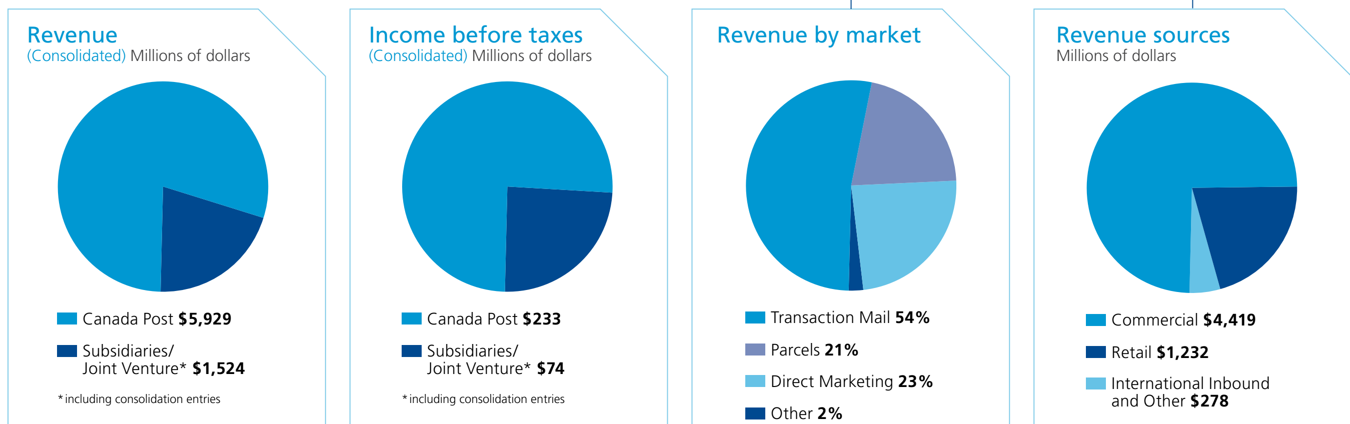
Canada Post at a glance

6,499 Post offices across Canada

15 million Addresses served in Canada

95.7% On-time delivery performance
As measured by Research & Incite Consultants, a representative sample of fabricated short/long and oversized Lettermail test pieces is weighted according to origin-destination mail volumes.

In 2010, we continued to make the changes necessary to ensure we can meet these challenges, redefine our future, meet our customers' evolving needs—and remain relevant in the lives of Canadians. We are introducing a new, more efficient mail-delivery model to much of our network and modernizing our equipment and facilities while protecting or enhancing our service to Canadians. We have been delivering mail to Canadians for 160 years and we will continue to proudly deliver to every Canadian every business day—in a way no one else can.



Key Performance Indicators

Customer Value Index – Canada Post segment

Increasing our relevance to customers is vital in order for us to gain market share and maintain profitability. Through our Customer Value Management program we identify and evaluate what drives customer loyalty in our Parcels and Direct Marketing businesses drawing from our customers' ratings of our services, products, employees and website to prioritize where we can make improvements. In 2010, Direct Marketing achieved its target but Parcels fell short of its goal. We added a new customer measure, Problem Incidence, in 2010. Our goal is to reduce the number of problems that our customers experience. Despite improvements over 2009, we missed this target by one percentage point in 2010. In 2011, we will focus on improving customer loyalty through improved service levels and product and service offerings.

Delivery service – Canada Post segment

Canada Post is undergoing many operational changes. Through modernization we are improving our ability to better serve our customers and meet our commitment for on-time delivery of mail. Although we expect benefits from these changes, we fell short of our delivery performance target of 96 per cent for Lettermail—falling short of our Lettermail target for the first time in more than 10 years—posting a 95.7-per-cent result. We were also below our targets for Addressed Admail™ and Parcels. We also set a target to improve our parcel-scanning performance and we exceeded this target in 2010. This was due to improvements to our scanning technology and processes. In 2011, we continue to focus on quality and investment initiatives to support the goal of improved service performance.

Financial performance – The Canada Post Group

Due to the lingering effects of the global economic recession and continuing Lettermail erosion, The Canada Post Group experienced another challenging fiscal year in 2010. Revenue rebounded slightly, increasing by 1.9 per cent from 2009, but still remained below the 2007 level. Expenses for the Group increased by 2.6 per cent compared to 2009 but were $412 million better than plan. Lower employee future benefits expense and continued focus on cost-containment activities in the Canada Post segment all contributed to the lower-than-planned cost of operations for the year. The Canada Post Group's income before taxes was $307 million in 2010, a decrease of 19 per cent compared to 2009 and $227 million above the plan.

Employee Engagement – Canada Post segment

In 2010 we focused on respect, fairness, the health and safety of our employees and leadership development in our employee engagement efforts. Senior executives met with front-line employees and their team leaders during visits to facilities across Canada to talk candidly about our business.Though our Engagement Index score improved by one percentage point in 2010, we fell two points short of our goal. However, our score has increased significantly since 2006. One highlight in 2010 was a four-point increase in the "recognition" category, which indicates that employees increasingly feel their efforts are recognized. In 2011 we will focus on improving employee engagement in areas of respect and fairness, customer focus and employee development. We will continue to recognize employee behaviour that supports our values and priorities.

Financial Review

Our Canada Post segment earned a profit in 2010 but faced increasing financial challenges that will continue to affect the company in 2011 and beyond.

Overview Declining volumes and a weak economic recovery from the recent global recession continued to affect the financial performance of the Canada Post segment in 2010. Electronic substitution and consolidation of bills by large-volume mailers and competitive pressures led to continued mail volume declines in our Transaction Mail and Parcels businesses.

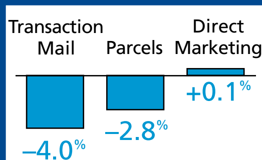
The company forecasts further volume erosion in Transaction Mail over the next five years which will put downward pressure on our profitability and cash flow. Volumes in our Parcels business also dropped due to competitive pressures and shifting consumer demand for products such as digital versions of books, music and videos, all of which they used to receive by mail. Despite cost-containment effort in our operations in 2010, we continued to face significant pressures due to our high labour and benefit costs—which are largely fixed and rising; the rising costs to service our expanding delivery network; and our cash requirements to cover the solvency deficit in our Pension Plan.

Key figures – Canada Post segment

$89M

Revenue

Revenues from operations increased slightly in 2010 by $89 million or 1.5% compared to 2009. All product lines experienced an increase in revenue mainly due to price increases.



-1.8%

Volume

Transaction Mail and Parcels volumes both declined, while Direct Marketing volumes stayed flat compared to 2009. Overall volumes were below pre-recession levels.

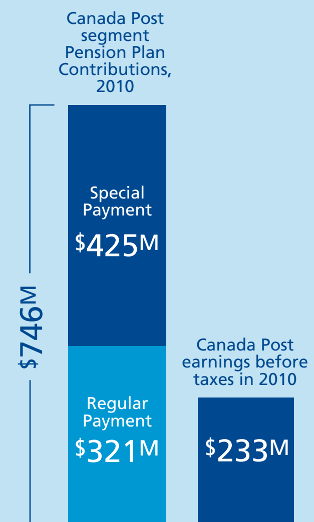
$159M

Cost

Our cost of operations rose by $159 million mainly due to an increase in employee future benefit costs. This more than offset the impacts of cost-containment efforts and productivity improvements.

Pension in perspective

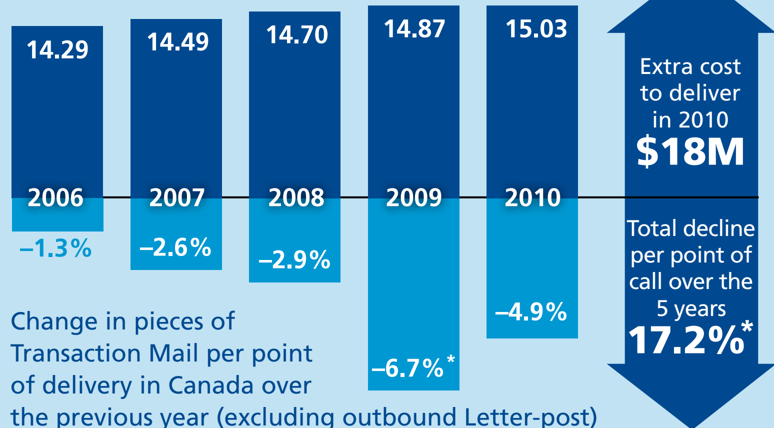
The Canada Post segment Pension Plan ("the Plan") continues to pose a significant financial burden on the company. The Plan had a liability of $16 billion at the end of 2010—more than twice the size of the revenues of the Canada Post segment. This obligation is growing in size. The market turmoil in 2008 and falling discount rates have left the Plan with both a solvency deficit of $3.2 billion and a going-concern deficit of $174 million at the end of 2010 (based on the smoothed value of assets). In 2010, the Canada Post segment made special cash contributions of $425 million to the Plan in order to begin addressing the solvency deficit, in addition to the company's normal annual pension contribution of $321 million. To put that in perspective, our total contributions to the Pension Plan in 2010 were more than three times as large as our earnings before tax in the Canada Post segment. The special pension payment was also largely responsible for the decrease in the cash generated by the Group's operating activities this year.



Our core business is in decline

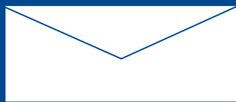
Our core Transaction Mail business has been steadily declining since 2007. Over that period, the number of addresses increased by an average of approximately 200,000 per year. The additional cost to serve the new addresses in 2010 alone was $18 million. Every year we are delivering fewer letters to more addresses at greater cost.

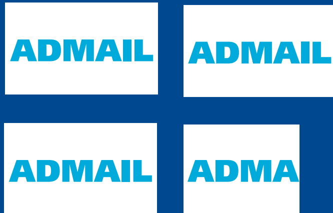
Transaction Mail = $3.2 billion in revenue
- 54% of total revenue
- 4.8 billion pieces, or 46% of total volumes



*Note: Due to a methodology change implemented in 2010, volumes for 2009 have been restated for comparability. Had 2008 volumes been restated, the decline per point of call for 2009 would have been 5.1% and the five-year decline would have been 15.9%.

Mail profitability

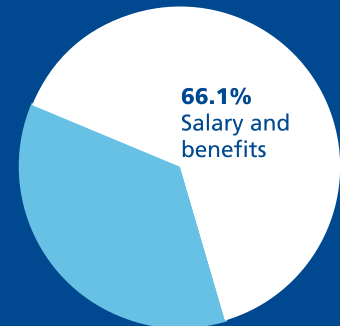




Transaction Mail is our most profitable business. We have to sell 3.7 pieces of Admail™ to make up the financial contribution of one letter.

Our labour costs are high

Salary and benefit costs amounted to close to two-thirds of Canada Post's revenues in 2010, significantly higher than many other postal operations in the developed world.



Canada Post segment revenue $5.9B

A note about our profit

Despite posting 16 years of profits, the Canada Post segment has not generated sufficient cash from operations over that period to adequately reinvest in our business, capital assets or initiatives to grow the business. In 2010, the company borrowed $1 billion on capital markets after our borrowing limit was increased by the Government of Canada. The proceeds will help fund our necessary modernization investment. But our cash provided by operating activities in 2010 in The Canada Post Group decreased by $175 million from 2009 levels mainly because of increased payments to the Pension Plan. Our increased borrowings help to enable us to fund our modernization, but in the long run we must generate sufficient levels of cash from the business to meet our obligations.

Cash provided by operating activities

-130.6%

Operations

Canada Post was built around delivering letters to Canadians—but growth from this core business is a thing of the past. In 2010, our Operations began to unveil the future.

Modernizing our network

With its $2.1-billion modernization program, Canada Post is renewing its physical and electronic network. By creating a more efficient, productive, competitive and flexible company, we are responding to the changing needs of customers.

In 2010, modernization moved from the drawing board to the plant floor, the letter carrier depot and the street. Last June in Winnipeg, we opened our first new mail processing plant in decades. Modernizing will continue to generate savings in 2011 and annual savings are expected to reach approximately $250 million by 2017.

Benefits for customers

For customers, modernization:

- creates a comprehensive, accurate address database, which means less undeliverable mail, more effective mailing campaigns and a better return on investment for customers who use Admail
- provides the foundation for new and enhanced products and services, such as the Addressed Admail service option called Machineable Presort, launched in January 2011
- gives customers moving to a new or temporary address uninterrupted service through improved mail redirection
- maintains reliable service thanks to new machines that result in less downtime
- protects affordable service thanks to increased efficiency and productivity.

Service performance

Maintaining service performance, while operating with obsolete equipment, introducing necessary changes and experiencing a wave of attrition, is a significant challenge. Installing new equipment and adopting new processes for the first time in decades—while continuing to move tens of million pieces of mail each business day—is a huge and complex task.

Customers share our expectation that we will deliver exceptional service even as we make necessary changes to ensure our competitiveness and sustainability and provide a platform for growth. Maintaining service performance as we undertake even more change will be a top priority in 2011.

Cost containment

Declining mail volumes again spurred us to reduce costs in Operations in 2010:

Productivity in plants (pieces per hour) improved by 2 per cent over 2009 and 4.6 per cent since 2008.

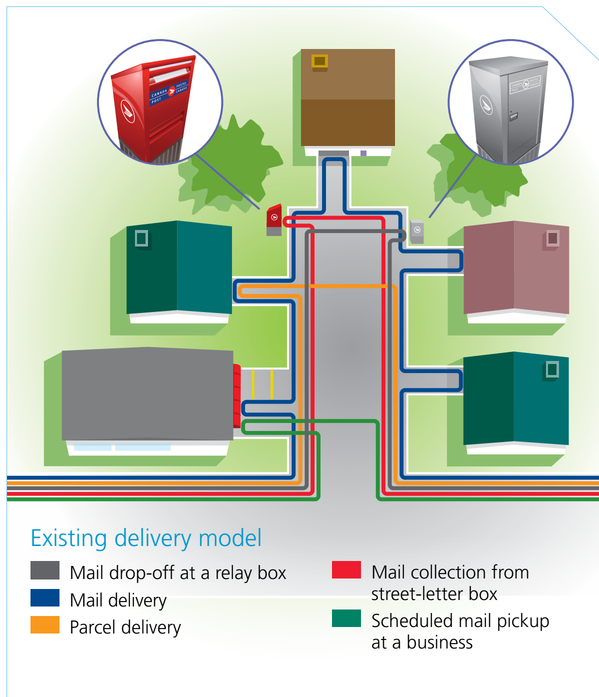
We reduced total paid hours by 2.8 million from 2009 and by a total of 9 million since 2007.

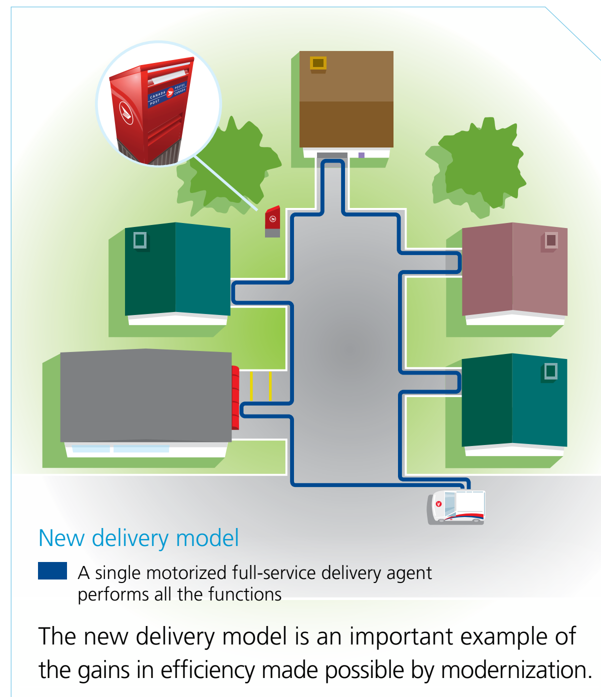
We achieved our target of reducing accidents by 15 per cent.

We saved $15.5 million in 2010 by continuing to restructure delivery routes to ensure efficiency as volumes decline.

We also made deeper structural changes:

- Realigned plants (in Kitchener, Victoria and Moncton) to lower labour costs while maintaining on-time service performance by making greater use of existing automated sorting equipment.
- Reduced supervisory ranks to rebalance the ratio of employees to supervisors in larger plants and depots while reducing labour costs.
- Announced a restructuring of Operations management to focus on the two core functions (mail processing and network, including transportation; and delivery, including collection and local retail operations) rather than on geography. This focuses teams on process excellence, efficiency and standardization, taking advantage of the new capabilities that come with modernization. The change took effect in January 2011.





The new delivery model is an important example of the gains in efficiency made possible by modernization.

New delivery model

The new delivery model will roll out in several cities in 2011. Greater automation in plants means our delivery agents can spend more time on their routes serving our customers. These delivery agents will drive our environmentally-friendly new Ford Transit Connect™ vehicles to serve routes designed for efficiency. This delivery model will reduce the number of visits Canada Post makes to a typical neighbourhood (see images above). In addition, our new fleet of fuel-efficient vehicles will reduce our emissions per kilometre.

The growing scale of change

- In 2010, we built four new depots, retrofitted five and completed one plant expansion; in 2011 we plan to open six new depots, retrofit 10 and complete two plant expansions.
- In 2010, we installed 33 new machines that can sort 41,000 letter mail pieces per hour; 49 installations are scheduled for 2011.
- The total investment in modernization in 2010 was $299 million; the planned investment for 2011 is more than $500 million.
- We implemented the new delivery model in six depots (more than 120 routes) in 2010; we plan to reach about 40 depots with 1,400 routes in 2011.

$299M

The total investment in modernization in 2010

33 new machines

In 2010, we installed new machines that can sort 41,000 mail pieces per hour

Service performance in 2011 will build on...

- Ongoing reviews of induction and transportation processes to ensure reliable, predictable service.
- Leveraging new data and information to provide better controls to identify potential exceptions to on-time performance for quick resolution.
- Additional training to support thousands of employees learning new responsibilities, tools and processes.

Lines of Business

Our business was challenged by a weak economic recovery in 2010, while electronic substitution continued to erode volumes in our largest line of business, Transaction Mail.

Transaction Mail

Transaction Mail is our core—and most profitable—line of business and continues to be negatively affected by electronic substitution. This shift has eroded the value of our exclusive privilege to deliver letters weighing up to 500 grams in Canada. In 2010, our Transaction Mail business posted its fourth consecutive year of declining volumes.

Revenue for Transaction Mail was $3.2 billion in 2010, up 1.0 per cent from $3.1 billion a year earlier. This increase was mainly due to increases in postage rates in 2010. Transaction Mail volume for the year was 4.8 billion pieces, down 4.0 per cent from 5.0 billion pieces in 2009. We forecast continued moderate volume declines over the next five years with impact on revenue mitigated in part by planned rate increases.

In ongoing efforts to better serve customers, in 2010 we introduced Machineable Mail Advisor, a new online envelope design tool that helps commercial customers design creative mailings that meet our specifications for machine processing. We also enhanced our Registered Mail™ product with more convenient prepaid versions. Unlike regular Registered Mail, the prepaid product can be dropped in any mailbox in Canada.

Our flagship Lettermail product remains a vital communication tool for Canadians and our commercial customers, despite forecasted volume declines. We are working aggressively to expand our suite of electronic solutions to meet the changing needs of our customers. Our goal is to achieve a significant market position in digital channel communications and provide secure electronic connection between Canadians and businesses.

Direct Marketing

In 2010, volumes in our Addressed Admail and Unaddressed Admail™ business rose 2.0 per cent and 0.3 per cent, respectively, from 2009 levels but were well below pre-recession levels in 2008. Overall revenue in Direct Marketing grew by 3.6 per cent in 2010. Direct mail remains a cost-effective way for advertisers to reach their customers, but as Canadians increasingly consume media on the Internet, marketers are directing more of their budgets to reach Canadians through electronic channels. Canada Post faces increased competition as we do not enjoy the same competitive advantage on electronic channels as we do through our physical delivery network.

We are addressing these changes by expanding our data offerings to enhance the value of mail and by introducing new online advertising channels for businesses to effectively target their customers. In 2010, we introduced Acquisition Admail, a new service that helps our direct-mail customers to more effectively target prospective customers. We also launched *Smart Data*™ Cleaner—an online tool that allows mailers to "clean" their mailing lists—and Canada Post Comparison Shopper, a website that helps customers shop from an extensive selection of products from hundreds of merchants in Canada and the U.S., and provides advertisers with the ability to monitor consumer response.

In 2011, we are investing to increase our value proposition to our customers and by introducing new innovative products and services that will help our customers grow their businesses.

Subsidiaries

Parcels

Our Parcels business was challenged by intense competition and the growing popularity of downloadable digital versions of books, music and videos in 2010. This affected some of our traditionally strong areas in the business-to-consumer market.

Volumes in our Parcels business declined, while revenue increased marginally, by 0.5 per cent, aided by pricing increases. We delivered 143 million parcels in 2010, five million less than the previous year.

Our future success depends on our ability to improve the quality of our service and to simplify our customer experience, while continuing to offer strong value and competitive prices. In 2010, we improved our scanning performance, deploying the first of thousands of Portable Data Terminals to our foot-route letter carriers and completing the deployment of wearable scanners to employees across our network. Our new mail-sorting plant in Winnipeg opened with a new automated packet sorter, increasing our capacity and production. We awarded a contract to FedEx Express™ Canada to provide Canada Post with international air service for outbound mail, bringing operational efficiencies, cost savings and better service to customers. We also improved our offering to small and medium businesses by reducing our volume thresholds for our On-Demand Pickup service.

Our focus for 2011 is to improve our delivery service, increase the amount of scans, and strengthen our e-commerce fulfilment capabilities by harnessing the full potential and value of The Canada Post Group.

Purolator, Canada's largest courier company and 91-per-cent-owned by Canada Post, rebounded modestly in 2010. It reported a 4.1-per-cent increase in revenue, with $1.5 billion total revenue for the year, and a 1.8-per-cent increase in volumes over 2009 levels. The company celebrated its 50th year in business in 2010. Purolator will focus on developing innovative solutions for its customers and initiatives to grow market share in 2011.

Canada Post also owns 98.7 per cent of SCI Group Inc. Although SCI is one of the largest Canadian-owned third-party logistics companies, it is small compared to its global competitors with 2010 revenue of $149 million. In 2010, SCI's focus was on growth, specifically in the health-care market segment and it improved its cost structure. In 2011, SCI plans to grow the transportation segment of the business.

Innovapost Inc., a joint venture between Canada Post (51% ownership) and CGI Information Systems and Management Consultants Inc. (49% ownership), provides information technology solutions and services to The Canada Post Group. Total revenue for 2010 was $290 million. In 2011, Innovapost is looking to expand its service offerings and expects some revenue growth as Canada Post increases its spending on application development.

Our Customers

Providing consistent and effective service that meets and exceeds our customers' expectations is critical to our success. In 2010, we continued to invest in improving their experience with Canada Post. As a result, we are now:

Tracking more parcels, more frequently

- Customers want to know where their parcels are throughout the delivery process. Canada Post has made significant investments in the past years to increase the number of scans available to customers, and make them available more quickly. In 2010, we launched several initiatives to improve our customers' ability to track their parcels on route, including the deployment of hand-held scanners to delivery employees to make scans available in real time. Canada Post's goal for every bar-coded parcel is to present a scan to customers at Induction, Sort, Out for Delivery and Delivery. The number of scans per item increased from 3.6 in 2009 to 3.7 in 2010. Overall, Canada Post has made significant progress in terms of visibility with a 61-per-cent increase in the number of scans per parcel since 2005.

Reducing problems and resolving them more effectively

- We upgraded our case-management system to provide the capability to improve our resolution of customer issues while collecting deeper insights to help us improve our service performance.

Making products and services easier to use

- We added new features and functions to our existing online tools to meet our customers' evolving needs.
- We simplified our product and specification guides and developed new online tools that are easier to use.

We are also protecting and expanding service options through our investment to modernize our company. These improvements include a more accurate address database and a new mail-preparation and presortation option for our Addressed Admail customers called Machineable Presort. The investment also gives Canada Post the capability to improve mail redirection for customers moving to a new or temporary address.

We collect feedback from customers of our Direct Marketing and Parcels lines of business to gain insight into their experience with Canada Post. The findings help us measure, improve and build customer loyalty. In 2010, sweeping but necessary change to our operations affected some aspects of customer experience—and customers told us so. Our Parcels customers told us that we fell short of their expectations in 2010, a reflection of unsatisfactory service performance results rooted in the challenge of undertaking major changes to our business while continuing to move the mail each day.

Customers also told us that we need to improve at effectively dealing with problems when they occur. In 2010, we set a target for reducing the number of customers who experienced a problem with Canada Post. Results improved for customers of our Direct Marketing products but there was no noticeable improvement for our Parcels business. This remains an area of focus in 2011.

New Products and Services

In 2010, Canada Post introduced several new and innovative products and services that will allow us to meet the changing needs of our customers and generate new revenues to help secure the company's future:

Acquisition Admail

A service for our direct-mail customers that lets them more effectively target prospective customers in specific neighbourhoods or areas.

Smart Data Cleaner

An online tool that offers businesses a free assessment of the cleanliness of their mailing files, plus an option to clean their files by correcting addresses, updating mover information, and removing duplicate records.

Background check

Canada Post works with background-checking service providers to screen potential hires/volunteers for employers and not-for-profit organizations, at 5,200 post offices across the country.

Personal Identification Number (PIN) Card Services

Allow consumers to change or reset their PINs, and reactivate lost cards at no charge on select chip-enabled cards, at some 6,000 post offices.

Visa™ gift cards

Canada Post-branded Visa gift cards that let customers load any amount from $25 to $250, right down to the cent. These are available at 3,000 post offices and are accepted wherever Visa cards are accepted, including online.

Canada Post Comparison Shopper

A website that helps customers shop from a selection of millions of products from hundreds of merchants across Canada and the U.S. The site helps customers narrow their search based on criteria that are important to them and presents an estimated "all-in" price that includes taxes, shipping, brokerage, duty and other fees.

The Canada Post application for Apple mobile devices

Customers can now track their packages and find nearby post offices on their iPhone™, iPad™ and iPod touch™ devices. Canada Post is developing a BlackBerry™ version of the application.

Prepaid Registered Mail/Government Secure Registered Mail

We now offer our Registered Mail product as a prepaid envelope with a pre-printed bar code. Unlike regular Registered Mail, it can be dropped in any mailbox. It's available to commercial and government customers mailing to Canadian destinations.

Our People, Our Communities

Corporate Social Responsibility

Corporate Social Responsibility (CSR) is our commitment to behave ethically and contribute to the health and well-being of our employees and their families, the communities we serve and the environment.

Now in its fifth year, our CSR program continues to raise awareness about the need for change at every level of the company and in the communities we serve. We know we still have a lot of work to do, but we're proud that Canada Post was once again voted one of the Best 50 Corporate Citizens in 2010 by Corporate Knights Inc., an independent media company that publishes the world's largest circulation CSR magazine.

Being socially responsible matters to our employees and our customers. As a result, CSR has become increasingly integrated into our corporate strategy and decision-making processes in areas such as sourcing management, our modernization program and new-product planning.

Our employees continue to be the backbone of many of our CSR activities, including support for one of our key efforts: our cause of choice, mental health.

In 2010, employees helped to raise $2.2 million for the Canada Post Foundation for Mental Health, surpassing our goal of $2 million. More than $1 million of this was raised through our retail campaign. This critical funding, which will be disbursed in 2011, helps front-line organizations build and enhance mental-health programs in every province of the country—and improves the quality of life for people living with mental illness.

Last year, 32 organizations, including Friends for Mental Health in Quebec, Boost Child-Abuse Prevention and Intervention in Ontario, and the Crisis Intervention and Suicide Prevention Centre of British Columbia, received grants from the Foundation that helped them to make a real difference in the quality and range of front-line services they offer. These organizations are helping young people living with depression, children who have suffered severe traumas, and families better understand mental-health issues so they can help family members.

The Foundation's fundraising work for mental health will continue in 2011. We understand that we have an opportunity to make a real difference in the lives of those suffering from mental illness. This is what drives our employees to work as hard as they do to raise money for the Foundation.

Since it was formed, the Foundation has raised a total of $4.8 million and disbursed funds to more than 50 non-profit organizations.

More detailed information about our CSR initiatives and results can be found in our Corporate Social Responsibility Report at canadapost.ca/csr.

Our Corporate Social Responsibility report, available online at canadapost.ca/csr

Raising funds and awareness to support mental-health programs across Canada

Mental-health grant helps save lives

When a suicidal person calls a crisis line they need to be heard, to be helped. Imagine the potentially devastating results if the phone line cuts out during the call.

As distress-line calls increased over the years, the volunteer-driven Crisis Intervention and Suicide Prevention Centre of British Columbia had to rely on an outdated—and sometimes unreliable—phone and database system.

That changed after the Crisis Centre received a $65,000 grant in October 2010 from the Canada Post Foundation for Mental Health. It was able to update its phone and call-log systems and create e-training modules. Now, front-line volunteers are equipped with the next generation of technology on their side.

"This money allows us to sustain our 24/7 life-saving support services," says Ian Ross, Executive Director at the Crisis Centre. "The improved phone, database and e-training systems have made the difference between life and death."

Helping B.C. residents in need of counselling with an improved phone system

Our people

With approximately 57,000* full- and part-time people, Canada Post is one of Canada's largest employers. Our people are Canada Post. They are who Canadians trust and admire.

Most of our people work collecting, processing and delivering the mail, and 96 per cent are represented by four bargaining agents, the largest of which is the Canadian Union of Postal Workers. We understand the importance and strength of Canada's heritage and cultural diversity and want our workforce to reflect the Canadian population.

The opinions of our people are important to us, and we want to know what's important to them. That is why we have surveyed all employees every year for the past five years. In our 2010 survey, employees told us that while they felt more appreciated, they remained concerned about respect, fairness and safety.

Keeping our people safe remains our top priority. We achieved our target of reducing accidents by 15 per cent in 2010, the second straight year in which we saw a decline in accidents. However, our accident frequency in 2010 was more than six lost-time accidents per 100 employees. That is two to three times the accident frequency of the best performers among postal administrations in the developed world. That is why we have introduced an aggressive multi-year strategy to improve safety performance. In 2011, we will focus on compliance, providing help to areas of the company that have more accidents and helping our senior leaders better understand what they need to do to help keep our people safe.

In 2010, we began to change the way we deliver the mail to create a more effective and efficient organization. Automated sequencing means that letter carriers have less mail to sort manually and spend more time outside delivering. This new delivery model has completely changed the way our letter carriers work. An increasing amount of work in our plants is also being performed during evening and overnight shifts. We know how challenging the pace and scope of change is for our people, and we are doing all we can to help them adapt. We are also continuing to focus on learning and development. In 2010, we delivered more than 550,000 hours of training.

* The Canada Post segment. Includes paid full-time and part-time employees. Excludes temporary, casual and term employees.

Our People, Our Communities continued

A golden Olympic moment

On February 14, 2010, Canadians witnessed a historic performance by Alex Bilodeau as he won the first gold medal by a Canadian on home soil in the men's freestyle skiing moguls at the 2010 Vancouver Olympic Winter Games.

As an official supplier to the Vancouver Games, Canada Post also made history by issuing commemorative stamps mere hours after the event. The stamp was an additional source of pride for our employees because the company has sponsored the Canadian Freestyle Ski Team since 2006.

We have sold more than 800 million Vancouver 2010-themed stamps and participated with General Mills in a campaign to send over 20,000 postcards featured on boxes of Cheerios™ to our athletes.

The Olympic stamps were just a few of the 55 stamps issued as part of our 2010 philately program. Other highlights included our issue in October of a new $10 stamp depicting the Blue Whale (*Balænoptera musculus*). The stamp is the largest in size (128 mm x 48 mm) and denomination Canada Post has ever produced.

We also continued our popular Lunar New Year series with the release in January 2010 of a stamp commemorating the Year of the Tiger.

Helping Santa answer his mail

For years, Canada Post has nurtured a partnership with one of the world's most beloved icons, Santa Claus. Through the Canada Post Santa Letter-writing Program, Santa has answered more than 18.5 million letters in 30 languages—including Braille—from children around the world since 1982. Since 2002, he's received more than 300,000 emails.

The program promotes literacy by encouraging young children to write and address letters to Santa leading up to the Christmas holiday. It also relies on the dedication and involvement of thousands of employees and retirees across the country who collectively volunteer more than 190,000 hours each year to act as "Postal Elves" and help Santa respond to his letters.

In 2010, Santa and 9,000 volunteer elves responded to 1.2 million letters and more than 43,000 emails.

Alex Bilodeau celebrates with Canada Post employees in Vancouver

Chairman's Message

2010 was a year of transition at the top for Canada Post—transition in which we managed to maintain necessary momentum at a critical time for our company.

Early in the summer, Moya Greene, our President and CEO for five years, decided to move on to the Royal Mail. Ms. Greene was responsible for many successes at Canada Post, most notably the positive change in our culture and moving ahead with the much-needed modernization of our infrastructure.

Stewart Bacon, who had recently retired, stepped in as President and CEO for seven months. With the help of the senior management team, he kept Canada Post moving forward in 2010. On behalf of the Board of Directors, I thank Mr. Bacon for providing leadership during this important stage.

The coming years will be a critical period in Canada Post's evolution. I am convinced we have found a leader with the right skill set and qualities.

In Deepak Chopra, who took office in February of this year, Canada Post is fortunate to have a new President and CEO with vast experience in the postal industry, a global outlook and a successful record of innovation and growing new business. The Board of Directors and I are confident that during Mr. Chopra's term, Canada Post will make great progress.

In 2010, Canada Post's $2.1-billion modernization program made strategic investments to address obsolescence, improve productivity and efficiency and create a platform for future growth.

The opening in Winnipeg in June of our first new plant in 20 years was a highlight of the year. Since then, modernization has brought state-of-the-art equipment and efficient new processes to more plants and depots—and to thousands of employees. 2011 will bring even greater change.

The pace is ambitious because we are eager to harvest the benefits of modernization for customers, employees and our finances. We are on track—but change this sweeping is challenging at many levels. We intend to focus on protecting on-time delivery performance, and on ensuring our front-line leaders and employees are well prepared before change reaches their workplace—and well supported when it arrives.

I am grateful to our Shareholder, the Government of Canada, and in particular our Minister, Rob Merrifield, for their support in 2010, including in the search process that led to the appointment of Mr. Chopra. As in 2009, the government allowed us to forego paying a dividend, which enabled us to reinvest in the business. Finally, we took advantage of receptive capital markets by issuing $1 billion of bonds.

The Canada Post Group's financial results highlighted the ongoing nature of Canada Post's challenges. Lingering economic uncertainty, Canadians' increased use of electronic alternatives and strong competition combined to reduce our volumes in Lettermail and Parcels and leave Direct Marketing volumes flat. Overall volumes fell to below 2007 levels. Accordingly, revenue growth was much weaker than expected.

Canada Post recorded a profit for a 16th straight year, with a consolidated net income of $439 million. Strong cost-containment efforts were a positive factor in these results. As compared to plan, our results were positively affected by a lower employee future benefit expense and a non-cash, deferred income tax benefit. These last two items have the effect of substantially overstating our true operating performance.

As Canada Post modernizes, we continue to place a strong emphasis on putting the customer first, and on leveraging our subsidiaries effectively so we can offer a full spectrum of solutions for our customers.

On behalf of the Board, I thank all of the people of Canada Post for their dedication and hard work.

Finally, Canadians still count on our traditional services while demonstrating support for our new ventures, and so I thank them for making us a valued multi-channel service provider.

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 the recruitment of senior officers and Board members;
- 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. In 2010, an interim President and Chief Executive Officer was appointed following the departure of the previous President and Chief Executive Officer and the term of one existing member was renewed. On February 1, 2011, a new President and Chief Executive Officer was appointed. The current membership constitutes a full Board. All members of the Board and the President and Chief Executive Officer are Governor-in-Council appointees. As overseer of a commercial and self-sufficient enterprise with 2010 revenue of $7.5 billion (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 devotes approximately 35 days a year to its deliberations. In 2010, the Board met 11 times. In addition, individual committees of the Board met a combined 38 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 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 Canada Post Pension Plan's $15 billion in assets, 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. 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 in companies 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 of 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 ▲★
FCA
Laval, Quebec

Robert Pletch ▲❇
Q.C.
Regina, Saskatchewan

Deepak Chopra

Ottawa, Ontario
President and CEO
Canada Post Corporation

Siân M. Matthews ❖●

Calgary, Alberta

William H. Sheffield ✿★

Vancouver, British Columbia

Denyse Chicoyne ◗
CFA, MBA
Outremont, Quebec

The Honourable Stewart McInnes ❇✖
Q.C.
Halifax, Nova Scotia

Donald Woodley ♦●

Mono, Ontario

Thomas Cryer ■★
FCA
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, 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, Health and Safety Committee
● Member of the Human Resources and Compensation Committee
★ Member of the Pension Committee

Officers of the Corporation

Deepak Chopra
President and CEO

Jacques Côté
Chief Operating Officer

Wayne Cheeseman
Chief Financial Officer

Louis F. O'Brien
Senior Vice-President
Chief Customer Officer

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

Cal Hart
Senior Vice-President
Postal Transformation

Douglas Jones
Senior Vice-President
Operations

Peter Melanson
Senior Vice-President
Sales

Marvin Rosenzweig
Senior Vice-President
Parcels

Mary Traversy
Senior Vice-President
Transaction Mail

Phil Ventura
Senior Vice-President
Strategy

Bonnie Boretsky
Vice-President
General Counsel, Corporate Secretary and Compliance

Murray Dea
Vice-President
Real Estate

Stephen Edmondson
Vice-President
Customer Service

John Farnand
Vice-President
Engineering and Postal Transformation

Douglas Greaves
Vice-President
Pension Fund and Chief Investment Officer

Susan Margles
Vice-President
Government Relations and Policy

Clary Ottman
Vice-President
Finance and Comptroller

Serge Pitre
Vice-President
Sales

Brian Wilson
Vice-President
Mail Processing and Network

Mike Garvey Corporate Auditor **Steven Galezowski** Corporate Treasurer

As of February 1, 2011

Ombudsman's Message

At the Ombudsman's Office, we're in the business of fixing broken customer trust and building confidence in the Canadian postal service.

We do this by investigating customer complaints and recommending fair and equitable solutions. In 2010, we received 4,433 requests for assistance, which resulted in us investigating 2,567 complaints and recommending 1,752 resolutions to Canada Post. Approximately 70 per cent of these resolutions required the Corporation to take corrective action to satisfactorily resolve the issues. A detailed view of the 2010 complaint investigation trends is included in our annual report, which is available on our website at www.ombudsman.postescanadapost.ca.

Our numbers, however, tell only half of the story about our office's performance and achievements in 2010. The other half of the story comes from two trustworthy sources: our customers and the National Quality Institute of Canada (NQI).

For the past two years, our customers have been rating their experiences in dealing with our office and providing valuable feedback. We use this information to continually improve every customer touch point in our operation. Our efforts have been successful. Last year, we saw a three-per-cent increase in our customers' likelihood to recommend our services to others. Our customers also gave case managers in the Ombudsman's Office an average rating of 8.7 out of 10 on the quality of their dealings with our staff. These two results tell us we are doing the right things. Our dedicated people take pride every time they right a wrong, make a difference in people's lives and take the time to listen to customers. In turn, their efforts help Canada Post do the right thing.

In October 2010, our office was honoured to receive the prestigious gold trophy for quality under the NQI's Canada Awards for Excellence program. To achieve this level of recognition in business excellence, we redesigned our operation from end to end on the premise that our customers trump all other considerations. We did this while ensuring that the basic tenets of our profession—impartiality, fairness and objectivity—were not compromised. We introduced an up-front service promise to complete and report back on investigations to our customers within eight, 10 and 20 days, depending on the nature of the complaint. Our performance against these service standards ranged from 96 per cent to 100 per cent. This has been instrumental in improving the overall customer experience.

Another noteworthy change that contributed to our success last year involves our relationship with our key stakeholder, Canada Post. Our focus on business excellence brought more visibility to our trends and complaint outcomes. This visibility enabled Canada Post to benefit from our insights, learnings and aggregate analytics, and use them to improve product and service offerings. I wish to extend my deepest appreciation to the Corporation for the remarkable collaboration and timely support it offers my team in the course of our investigations as we advocate for equitable resolutions to customer complaints.

Our office's focus on business excellence was rewarded with tangible gains in 2010—gains that directly benefit our customers and enable us to continue raising the bar as we fulfill our mandate to all Canadians.

Nicole Goodfellow

Canadian Postal Service Charter

Preamble

The Canada Post Corporation was created to provide a standard of postal service that meets the needs of the people of Canada. The Government of Canada is committed to ensuring transparency in how Canada Post provides quality postal services to all Canadians, rural and urban, individuals and businesses, in a secure and financially self-sustaining manner.

The Government has therefore established the *Canadian Postal Service Charter* to describe its expectations regarding Canada Post's service standards and related activities in providing postal services that meet the needs of consumers of postal services in Canada. These expectations are not intended to modify or derogate from Canada Post's obligations as set out in the *Canada Post Corporation Act* or any other legislation.

Universal service

1. Canada Post will maintain a postal system that allows individuals and businesses in Canada to send and receive mail within Canada and between Canada and elsewhere. Canada Post will provide a service for the collection, transmission and delivery of letters, parcels and publications.
2. The provision of postal services to rural regions of the country is an integral part of Canada Post's universal service.

Affordable rates

3. Canada Post will charge uniform postage rates for letters of similar size and weight, so that letters to Canadian addresses will require the same postage, regardless of the distance to reach the recipient.
4. As required by the *Canada Post Corporation Act*, Canada Post will charge postage rates that are fair and reasonable and, together with other revenues, are sufficient to cover the costs incurred in its operations.
5. Canada Post will provide advance notice of and publicly advertise proposed pricing changes for regulated letter mail products and consult with consumers during the rate-setting process.

Frequent and reliable delivery

6. Canada Post will deliver letters, parcels and publications five days a week (except for statutory holidays) to every Canadian address, except in remote areas where less frequent service may be necessary due to limited access to the community.
7. Canada Post will deliver to every address in Canada. This may be delivery to the door, a community mailbox, a group mailbox, a rural mailbox, a postal box, general delivery at the post office or delivery to a central point in apartment/office buildings.
8. Canada Post will deliver Lettermail:
   - Within a community within two business days;
   - Within a province within three business days; and
   - Between provinces within four business days.

Convenient access to postal services

9. Canada Post will provide an extensive network for accessing postal services that includes retail postal outlets, stamp shops and street letterboxes, as well as access to information and customer service through Canada Post's website and call centres.
10. Canada Post will provide retail postal outlets, including both corporate post offices and private dealer-operated outlets which are conveniently located and operated, so that:
    - 98 per cent of consumers will have a postal outlet within 15 km;
    - 88 per cent of consumers will have a postal outlet within 5 km; and
    - 78 per cent of consumers will have a postal outlet within 2.5 km.
11. The moratorium on the closure of rural post offices is maintained. Situations affecting Canada Post personnel (e.g., retirement, illness, death, etc.) or Canada Post infrastructure (e.g., fire or termination of lease, etc.) may, nevertheless, affect the ongoing operation of a post office.

Secure delivery

12. Canada Post will take into consideration the security and privacy of the mail in every aspect of mail collection, transmission and delivery.

Community outreach and consultation

13. Where Canada Post plans to change delivery methods, Canada Post will communicate, either in person or in writing, with affected customers and communities at least one month in advance to explain decisions and explore options that address customer concerns.
14. At least one month before deciding to permanently close, move or amalgamate corporate post offices, Canada Post will meet with affected customers and communities to jointly explore options and find practical solutions that address customer concerns.
15. Each year, Canada Post will hold an Annual Public Meeting open to the public to provide an opportunity for the public to express views, ask questions and provide feedback to Canada Post.

Responding to complaints

16. Canada Post will establish and promulgate complaint resolution processes that are easily accessible to customers and will address complaints in a fair, respectful and timely manner.
17. The Canada Post Ombudsman will investigate complaints about compliance with the *Canadian Postal Service Charter* in situations where customers remain unsatisfied after they have exhausted Canada Post's complaint resolution processes.

Reporting on performance

18. Each year in its annual report, Canada Post will report on its performance against each of the expectations in this *Canadian Postal Service Charter*.
19. In addition, Canada Post will present an overview of the delivery methods it uses in its annual report, indicating the number of addresses served with each delivery method and the financial costs associated with each method of delivery.

Reviewing the Charter

20. The Government will review the *Canadian Postal Service Charter* every five years after its adoption to assess the need to adapt the Charter to changing requirements.

Canadian Postal Service Charter: Reporting on Our Service

In September 2009, the Government of Canada announced the creation of the *Canadian Postal Service Charter* ("the *Service Charter*") that outlined the Government's expectations concerning the service provided by Canada Post.

The *Service Charter* covers issues such as our universal service obligation, postage rates, delivery expectations, access to postal services, security of the mail, outreach and consultation, and complaint-resolution procedures. The *Service Charter* does not modify Canada Post's obligations as set out in the *Canada Post Corporation Act* or any other legislation. Canada Post's compliance to the *Service Charter* for 2010 is summarized below.

Universal service

Canada Post delivered 10.4 billion pieces of mail, parcels and messages in 2010 to more than 15 million addresses in urban, rural and remote locations across Canada. In addition, Canada Post, through its membership in the Universal Postal Union, an alliance of 191 member countries around the world, provided inbound and outbound international postal services. Service to rural areas accounted for a substantial share of Canada Post's network and infrastructure, and included more than 3,800 rural corporate or dealer post offices representing more than 58 per cent of all Canada Post retail outlets, and more than 7,100 Rural and Suburban Mail Carrier routes.

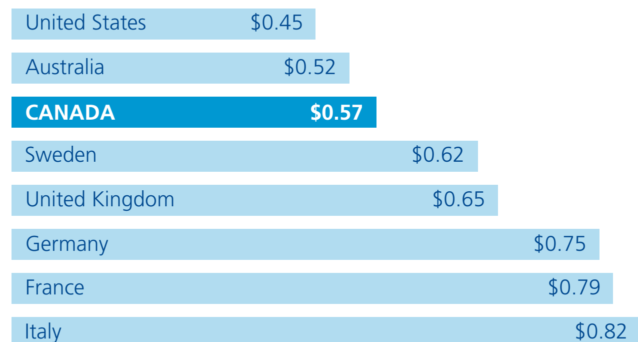
Affordable rates

Canada Post provided uniform postage rates for letters of similar size and weight, regardless of delivery distance or destination in Canada. For 2010, the company applied uniform rates of postage to the following categories of letters:

Category	Postage rate*
Standard (envelopes, cards, self-mailers) 0 to 30 g	$0.57
30 to 50 g	$1.00
Medium (envelopes, cards, self-mailers) 0 to 50 g	$1.10
Other Lettermail (non-standard and oversize) 0 to 100 g	$1.22
100 to 200 g	$2.00
200 to 300 g	$2.75
300 to 400 g	$3.00
400 to 500 g	$3.25

*All rates effective January 11, 2010

Canada's basic letter rate compared favourably with other major industrialized countries with similar density, climate and population, as shown in the chart below:



(Rates as at July 1, 2010; Canadian $ equivalent; average exchange rate for 2010)

As a means to provide universal service to all Canadians, Canada Post has an exclusive privilege to provide for the collection, processing and delivery of letters within Canada up to 500 grams. The Corporation's Annual Cost Study provides costing data that serves as the basis for ensuring that Canada Post is not competing unfairly by cross-subsidizing its competitive services with revenues from exclusive privilege services. The results of the 2010 Annual Cost Study are outlined on page 106.

Price changes for regulated Lettermail products require formal public filings for review and approval by the Government of Canada. Canada Post periodically meets with key customers and large-volume mail users to consult on rate changes. On June 26, 2010 Canada Post published in the *Canada Gazette* a regulatory proposal to increase selected regulated postage rates starting January 17, 2011. This was accompanied by a news release. Through these notifications, the Canadian public was invited to raise any concerns regarding the proposals with the Minister responsible for Canada Post. In total, there were two representations from Canadians regarding the proposed changes. The representations were taken into consideration in the preparation of the final regulatory proposal approved by the Corporation's Board of Directors. The Government granted final approval for the proposed rates on December 3, 2010.

Frequent and reliable delivery

In 2010, Canada Post provided frequent and reliable delivery to all Canadians, regardless of where they lived. Given the demographics and geography of Canada, serving some communities was challenging because of distances or natural limitations to access.

Approximately 88 per cent of Canadian households received postal delivery services to their residences, apartment buildings, immediate neighbourhoods or rural roadside postal boxes via delivery agents such as letter carriers or rural and suburban mail carriers. Of those addresses, 99.9 per cent received scheduled delivery five business days per week, subject only to unforeseen and temporary day-to-day exceptions.

About 12 per cent of Canadian households (usually located in smaller rural communities) obtained their mail at local post offices or through postal boxes located in conveniently accessible lobbies of community post offices.

Canada Post uses an independent third party to measure the delivery performance of its Lettermail service. For 2010, Canada Post's on-time performance for Lettermail delivery was 95.7 per cent.

Convenient access to postal services

Canada Post provides Canadians with an extensive network for accessing postal services in rural and urban Canada as well as through its website and customer service telephone contact centres.

In 2010, postal service was provided in Canada through:

- 6,499 post offices;
- Thousands of third-party retail locations authorized to sell postage stamps;
- Approximately 200,000 collection points throughout Canada where postal items can be deposited (not including the more than 750,000 rural mailboxes, which are also collection points).

Based on Canada Post's retail outlet network at December 31, 2010:

- 98.8 per cent of the Canadian population lived within 15 km of a post office;
- 90.2 per cent lived within 5 km;
- 78.8 per cent lived within 2.5 km.

Canada Post continued to honour the moratorium on the closure of rural post offices in 2010. As noted in the *Service Charter*, certain unforeseen situations affecting Canada Post personnel or infrastructure may affect the ongoing operations of a post office. When unforeseen situations arise that affect service in rural communities, Canada Post ensures that mail delivery continues and meets with community leaders to explore options that address their retail postal needs.

For 2010, there were 125 cases affecting Canada Post personnel or infrastructure that had an impact on post offices covered by the rural moratorium. Seventy-four cases were resolved directly by Canada Post through staffing actions. In the remaining cases, after consultation with the affected communities and community leaders:

- 14 cases were resolved through staffing of the postmaster position.
- 37 cases were resolved through provision of retail services at a nearby town while maintaining delivery services in the existing community.

Secure delivery

Canada Post has developed its information-handling and privacy-protection practices according to the requirements of the federal *Privacy Act* and in acknowledgement of the 10 Fair Information Practices for the protection of personal information outlined in federal and provincial privacy laws. Each year, Canada Post submits a report on its privacy practices to the federal government.

While Canada Post is committed to doing everything to protect our customers' privacy rights, individuals who feel their rights have been breached may contact the Canada Post Privacy Officer by mail at 2701 Riverside Dr., Suite N1110H, Ottawa ON K1A 0B1 or by email at privacy@canadapost.ca.

Canada Post commits to taking all measures necessary to protect the mail, recognizing that it holds a special position of trust and accountability for the mail it delivers on behalf of the Canadian public. The Security & Investigation Services group conducts its operations in accordance with the *Canada Post Corporation Act*, the Government Policy on Security, and other regulatory and legislative authorities with the primary objective of ensuring the appropriate protection of mail, people and assets.

Canadian Postal Service Charter: Reporting on Our Service continued

Canada Post Security & Investigation Services group continues to work collaboratively with local, provincial and national law enforcement agencies on various investigative strategies to protect the mail and prevent identity-theft-related crimes.

Community outreach and consultation

While Canada Post endeavours to maintain the existing method of delivery for the addresses it serves, circumstances may arise where changing the method of delivery is necessary, including improvements to equipment and upgrades.

For 2010, of the 15 million addresses served, fewer than 22,000 were affected by a change of delivery method.

Reason for delivery method change	Number of addresses affected
Retail outlet change (e.g. change in retail location for general delivery services)	3,165
Delivery equipment upgrade (e.g. conversion from a group mailbox to a community mailbox receptacle)	9,713
Delivery safety reasons or municipal request (e.g. movement of location of mail delivery in rural areas as a result of a mandatory response to a safety review)	8,336
Other reasons	592
TOTAL	**21,806**

Whereas the vast majority of corporate post offices maintain services within the same facilities and location from year to year, operational considerations may arise regarding the suitability of an existing facility for postal retail services. In 2010, twelve urban offices not subject to the moratorium were considered for permanent closure, moves or amalgamations. In all such cases, Canada Post consulted with affected customers and considered community input prior to implementing any proposed change. Customers are always notified of proposals affecting their post offices through notifications posted within facilities which include a solicitation for feedback. In many cases, Canada Post representatives will meet with community leaders and citizens affected by any proposed changes.

As of December 31, of the 12 cases considered, 10 are pending either completion of community consultation, final decision or implementation. One case has resulted in a permanent closure and one case resulted in a permanent move of the post office.

Canada Post held its fifth Annual Public Meeting on June 4, 2010, at the new Mail Processing Plant in Winnipeg, Manitoba. A media advisory was released in advance of the event, and the meeting was advertised on the Canada Post website as well as other media websites. Invitations were also sent to a number of stakeholders, including local and national customers, suppliers, association representatives, retail franchisers, bargaining agents, and others. Approximately 100 people attended the event, including Canada Post front-line employees, executives, Board of Directors members, bargaining agents, partners, suppliers and interested Canadians. Nearly 1,000 Canada Post employees participated through an audio webcast and for the first time, 375 people tuned into the meeting via social media services Twitter™ and Facebook™.

Responding to complaints

Canada Post strives to anticipate, respond effectively to and exceed customer needs and expectations by consistently providing prompt and professional service. The Customer Service function is under the leadership of the Chief Customer Officer. In 2010, a new case management system was implemented to improve issues tracking and incident root cause identification, and to increase standardization of call handling and problem management.

Customer Service handled 3.9 million customer calls in 2010 and 116,000 customer emails through automated services and front-line agents. Associated with these interactions were follow-up customer-service cases that included product, trace, claims and general inquiries.

The complaint-resolution process ensures that Canada Post has every opportunity to resolve customer complaints. However, in cases where Canada Post has completed its review of the complaint and the customer is not satisfied with the proposed solutions, the customer may appeal to the Canada Post Ombudsman.

The Ombudsman is the final appeal authority in the complaint-resolution process at Canada Post. The Ombudsman independently conducts investigations, questions parties involved in a dispute, determines whether Canada Post has adhered to its policies and procedures, and recommends equitable courses of action in an effort to resolve customer complaints. The Ombudsman's office won the National Quality Institute's Canada Awards for Excellence Gold Trophy in 2010. The award recognizes business excellence in quality, customer service and a healthy workplace.

A detailed view of the outcome of the Ombudsman's investigations, including any *Service Charter*-related issues, can be found in the Ombudsman's annual report, available at www.ombudsman.postescanadapost.ca.

Reporting on performance

An overview of the delivery methods by Canada Post and the estimated financial costs associated with each delivery method follows:

Delivery method	Number of addresses* (%) of total addresses	Average annual* cost per address
Door-to-door	5,102,466 (34%)	$261
Centralized point (e.g. apt. lobby lockbox)	3,659,146 (24%)	$123
Group mailbox, community mailbox, kiosk	3,681,977 (25%)	$108
Delivery facility (postal box, general delivery)	1,807,818 (12%)	$56
Rural mailbox	776,825 (5%)	$171
All methods	**15,028,232 (100%)**	**$160**

* as at Dec. 31, 2010

Canada Post and Rural Canada: Strong Together

Canada Post is proud to serve all Canadians and is the only company in Canada to maintain a physical presence in every community through our delivery and retail network. Some of our major competitors want our business but cannot replicate our network in rural Canada. In fact, they use us to reach their rural customers. We are proud to be part of the way of life in rural Canada. This is a vital part of who and what we are at Canada Post.

Since 2007, we have invested more than $230 million in rural Canada to improve and expand service, safety and security of the mail system.

Under the Rural Mail Safety Review, we have invested to ensure that our delivery network remains safe for residents and our delivery people. Nationally since 2007, we have been able to preserve delivery to almost 90 per cent of rural mailboxes reviewed under the Rural Mail Safety Review.

Other Public-Policy Programs

In addition to its universal service obligation and core postal services, Canada Post also delivers certain public-policy programs on behalf of the Government of Canada.

Food Mail

The Food Mail Program was a federal Government program that subsidized the cost of transporting nutritious, perishable food and other essential items by air to isolated northern communities that are not accessible year-round by surface or marine transportation. Under a long-standing agreement with Indian and Northern Affairs Canada ("INAC"), Canada Post in 2010 was responsible for all transportation services and the related contracting process, including entering into contracts with air carriers for various network legs across the North, managing customer agreements with shippers, and ensuring shipper compliance with program requirements. INAC provided funding to Canada Post to cover the difference between the costs incurred for shipping eligible goods and the postage paid to Canada Post by shippers.

In 2010, Canada Post shipped 21 million kilograms of goods under the Food Mail Program. Revenue generated through this program was $80 million (including $60 million of funding provided by the Government to cover the difference between postage revenue collected by Canada Post and the costs it incurred). Canada Post estimates that the foregone revenue[1] amounted to approximately $12 million.

On May 21, 2010, the Government of Canada announced that the Food Mail Program would be replaced by a new program called Nutrition North Canada which will no longer directly involve the services of Canada Post. The Canada Post Food Mail Program ends on March 31, 2011.

Government Mail and materials for the blind

The *Canada Post Corporation Act* allows for mailing of letters free of charge between citizens and the Governor General, members of Parliament, the Speakers of the Senate and House of Commons, the Parliamentary Librarian, and the Ethics Commissioner. Members of the House of Commons can also send up to four flyer mailings (through Canada Post's Unaddressed Admail service) free of charge to their constituents in any calendar year.

Canada Post also provides members of Parliament with a deeply discounted postage rate, unchanged since 1995, for Unaddressed Admail mailings over and above the four free mailings per year.

In 2010, approximately 12 million letters were mailed as Government Mail (excluding mail from constituents to parliamentarians) and MPs mailed more than 130 million Unaddressed Admail items.

The Act also provides for free mailing of materials for the blind. Today, thousands of visually impaired Canadians and many libraries across the country, including that of the Canadian National Institute for the Blind, are able to send talking books and other materials free of charge throughout Canada and around the world. In 2010, it is estimated that more than two million shipments benefited from this program.

Notwithstanding a Government appropriation of $22 million to help offset the financial impact of these programs on the company, Canada Post estimates that an additional $7 million in foregone revenue[1] resulted from these programs in 2010.

Library Book Rate

The Library Book Rate allows public and academic libraries to move books between libraries as well as between libraries and library users who do not have access to a public library due to geographic constraints or physical limitations. Canada Post's Library Book Rate allows these books to be shipped at significantly reduced postage rates. Rates have remained unchanged since 2005.

In 2010, there were a total of 775,000 shipments of books under the Library Book Rate, generating $842,000 in revenue for Canada Post. The foregone revenue for Canada Post was estimated to be $8 million for 2010. Unlike other public-policy programs delivered on behalf of the Government, Canada Post receives no appropriation or compensation of any kind from the Government to offset the discounted postage.

[1] Foregone revenue is the difference between actual compensation and the amount Canada Post would have earned at normal levels of commercial compensation.

Financial Performance

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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, 2010. 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. Financial results reported in the MD&A are rounded to the nearest million while related percentages are based on numbers rounded to the nearest thousand. The information in this MD&A is current to March 24, 2011, 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.

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.

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 64 of this MD&A* (collectively the "Risks").

To the extent the Corporation provides forward-looking information that is future-oriented financial information or a financial outlook, 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 for any other reason after this date.

1 Executive Summary

An overview of The Canada Post Group and a summary of 2010 financial results

Canada Post Corporation is one of the largest federal Crown corporations and one of the largest employers in Canada, employing either directly or through our subsidiaries about 69,000 employees. On an annual basis, our employees deliver approximately 10.6 billion pieces of mail, parcels and messages to over 15 million addresses in urban, rural and remote locations across Canada. The Canada Post segment operates the largest retail network in Canada with almost 6,500 post offices. A Crown corporation since 1981, Canada Post reports to Parliament through the Minister of Transport, Infrastructure and Communities and has a single Shareholder, the Government of Canada.

Pursuant to the *Canada Post Corporation Act*, the Corporation has a mandate to operate a postal service for Canadians, with regard to the need to conduct its operations on a financially self-sustaining basis while providing a standard of service that will meet the needs of the people of Canada. Canada Post's universal service obligation ("USO") is set out in the *Canadian Postal Service Charter*, established by the Government of Canada in 2009:

1. Canada Post will maintain a postal system that allows individuals and businesses in Canada to send and receive mail within Canada and between Canada and elsewhere. Canada Post will provide a service for the collection, transmission and delivery of letters, parcels and publications.
2. The provision of postal services to rural regions of the country is an integral part of Canada Post's universal service.

In addition to its core postal services and USO, the Corporation also delivers certain public-policy programs on behalf of the Government of Canada. Pursuant to the *Canada Post Corporation Act*, members of Parliament and certain senior government officials are allowed to send mail free of charge. The Act also provides for free mailing of materials for the blind. Canada Post also provides a discounted Library Book Rate to allow public and academic libraries to move books between libraries as well as between libraries and library users at reduced postage rates.

Canada Post is part of the global postal industry comprised of international postal operators or "Posts." All Posts have traditionally financed their USO through a legislated "exclusive privilege," or monopoly over a portion of the postal market. However, the value of the exclusive privilege is diminishing given a continued decline in traditional mail volumes and the need to deliver universal service to a growing number of addresses. In 2010, several postal administrations reported declines in letter mail volumes including the United States Postal Service ("USPS") and the United Kingdom's Royal Mail. Similarly, the Canada Post segment experienced a 4.5-per-cent decline in domestic Lettermail volumes.

The consensus among Posts is that physical-mail markets are now fully mature and mail volumes will continue to erode. The environment in which we operate continues to change and electronic substitution, competition and customers' cost-reduction efforts are driving postal industry declines. In 2010, the *Canada Post Corporation Act* was amended to remove the exclusive privilege on letters intended for delivery outside of Canada and open this market to competition. Given these pressures, continued mail-volume decline is one of Canada Post's greatest business risks.

In 2010, we continued to make strong progress on our strategic vision of building a Modern Post by implementing the following multi-year strategic initiatives:

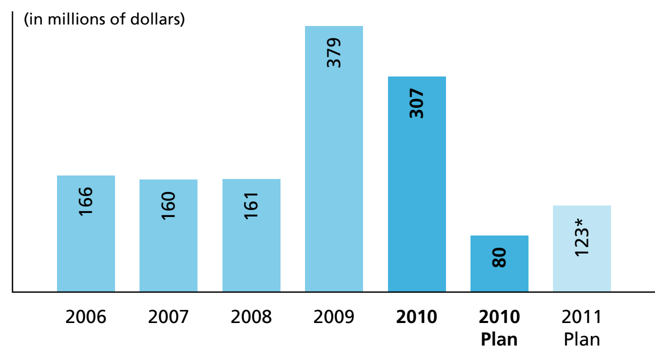
- *Engage our Employees* – Employee engagement is a top priority at Canada Post, with a goal to become the best place to work in Canada, with every employee contributing to and sharing in our success. In 2010, efforts to boost levels of employee engagement continued to concentrate on improving respect and fairness in the workplace, involving employees in decisions that affect their work, and developing leadership capabilities among our front-line team leaders. In addition, we continued to implement program, process and tool improvements for training, recruitment, talent management, leadership development and succession planning.

- *Invest in our Infrastructure* – In 2010, we continued a multi-year Postal Transformation Program to update our outdated physical and technological infrastructure. The successful implementation of Postal Transformation is essential if we are to remain financially self-sustaining in the future and meet our obligations under the *Canadian Postal Service Charter*. Postal Transformation will replace obsolete letter-processing equipment, automate manual-sorting processes, create a motorized delivery force and replace or improve current mail-processing plants. In addition to making significant improvements to our physical infrastructure, Postal Transformation will provide the platform to develop enhanced features and innovative services and deliver these to our customers. Anticipated benefits from our multi-year investments will be achieved through leveraging the coming wave of attrition, as more than half of Canada Post full-time employees are expected to retire or leave over the next 10 years, allowing us to take advantage of a window of natural attrition while respecting all provisions in our collective agreements, including commitments relating to job security.
- *Grow our Business* – While improving our cost structure through Postal Transformation and other means is vital to our financial sustainability, it is not enough. To remain a viable business in the future, we must adapt as our industry evolves and grow our revenues profitably in each of our lines of business. As growth in our Parcels line of business is linked to our ability to improve service reliability, we are focused on improving parcel visibility, delivery performance and customer service. We will also be looking to capitalize on growth in the e-commerce market by improving logistics with e-retailers, expanding parcels visibility and enhancing online interfaces. In relation to our Direct Marketing line of business, we are exploring new services and capabilities to address customer demand for greater return on their investment and to leverage evolving online and e-advertising trends. We will be pursuing a variety of data-related offerings to help marketers reach their intended customers and improve their market share. Our growth strategy for our Transaction Mail line of business strives to capture some of the migration of communications to electronic channels by offering services in the "e-space" that complement what we currently offer for physical mail. We plan to provide an integrated mail stream for physical and electronic services as we recognize the need to capture the revenue that is shifting from physical to electronic communication. A key component underlying our overall growth strategy is a renewed focus on our customers. We are developing a strategy to better tailor our products and services to our customers' needs.

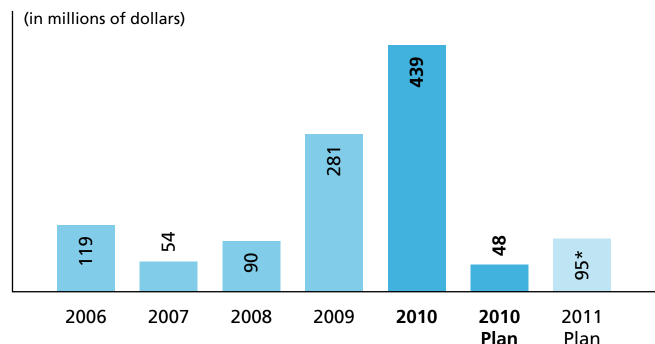
The Canada Post Group – 2010

The 2010 consolidated financial statements of Canada Post Corporation include the accounts of the Corporation, our subsidiaries Purolator, Inc. ("Purolator") and SCI Group Inc. ("SCI"), and our interest in Innovapost Inc. ("Innovapost"). These companies are collectively referred to as "The Canada Post Group."

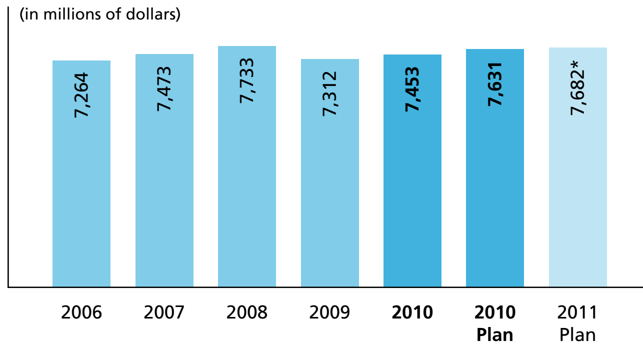
Consolidated income before income taxes



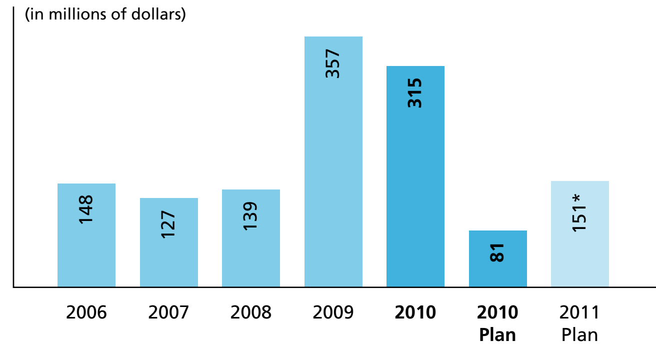
Consolidated net income



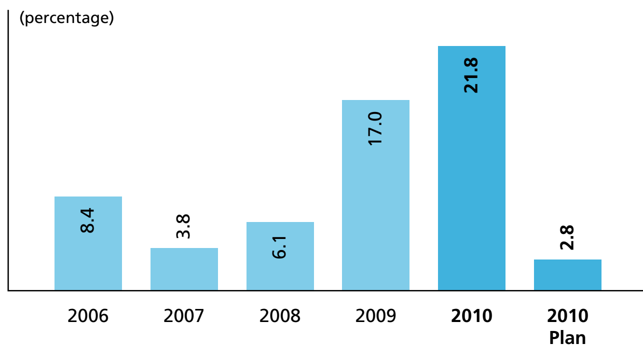
Consolidated revenue from operations



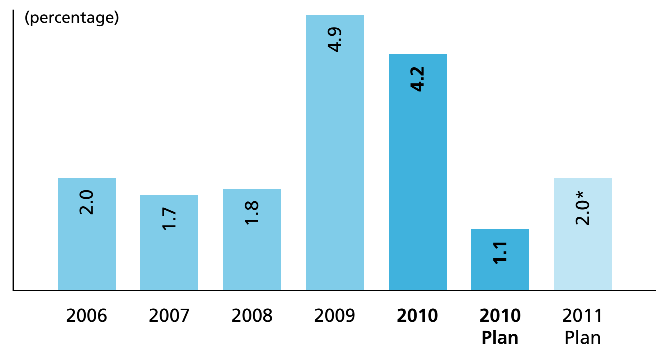
Consolidated income from operations



Return on equity of Canada



Consolidated operating margin



* Beginning on January 1, 2011, Canada Post adopted International Financial Reporting Standards ("IFRS") as the required basis of accounting. Accordingly, the Corporation will report under IFRS for the year ending December 31, 2011. The 2006 to 2010 financial results are based upon Canadian generally accepted accounting principles ("GAAP") and therefore will not be comparable to 2011.

The following table presents the Corporation's consolidated performance for the 2010 fiscal year compared to the 2010 Corporate Plan.

(in millions of dollars)

Year ended December 31	2010 Results	2010 Plan		Explanation
Consolidated				*For further information, see Section 2 – Our Business, Vision and Strategy on page 39 and Section 8 – Results from Operations on page 77*
Revenue from operations	7,453	7,631	(178)	Fell short of expectations by $178 million (Canada Post segment – $127 million) primarily due to: • Lingering effects of the recent global economic recession • Higher than expected letter mail erosion • Volume declines in the Parcels line of business due to aggressive competition and changes in customer behaviour
Cost of operations	7,138	7,550	412	Exceeded expectations by $412 million (Canada Post segment – $339 million) due to: • Continued cost-containment activities across The Canada Post Group • Lower than planned employee future benefits expense of $117 million for the Canada Post segment • Cost recovery from a proceeding on disputed costs with a supplier • Decrease in international settlement costs for outbound mail as a result of lower exchange rates
Non-operating income (expense)	(8)	(1)	(7)	Fell short of expectations by $7 million, primarily due to: • Earlier than planned issuance of a $1 billion long-term debt issue in the Canada Post segment, resulting in additional accrued interest expense
Income before income taxes	307	80	227	Excluding the $117-million unplanned employee future benefits expense reduction in the Canada Post segment, income before income taxes would have been $190 million, or $110 million higher than plan.

The following table presents the Corporation's consolidated performance for the 2010 fiscal year compared to 2009. In 2010, the Corporation recorded its 16th consecutive profit with consolidated net income of $439 million.

(in millions of dollars)

Year ended December 31	2010	2009	Change	%	Explanation of change
Consolidated income statement					*Highlights, as discussed in Section 8 – Results from Operations on page 77*
Revenue from operations	7,453	7,312	141	1.9 %*	Mainly due to price increases, offset by volume declines
Cost of operations	7,138	6,955	183	2.6 %	Primarily due to an increase in employee future benefits expense in the Canada Post segment, partially offset by cost-containment activities across The Canada Post Group
Income before income taxes	307	379	(72)	(19.0) %	
Net income	439	281	158	56.3 %	Primarily due to a non-cash income tax benefit recorded in the Canada Post segment, driven mainly by the release of a $768 million valuation allowance and hence the recognition of a previously unrecognized future income tax asset
Return on equity	21.8%	17.0%	4.8%		Higher net income in 2010
Dividends paid	0	0	0	0 %	No dividend paid to the Shareholder in recognition of the need for significant capital reinvestment to modernize the postal system
Consolidated cash flow statement					*Highlights, as discussed in Section 6 – Liquidity and Capital Resources on page 68*
Cash and cash equivalents	379	473	(94)	(19.7) %	Primarily due to the Canada Post segment's special solvency contributions to the company's funded pension benefit plans
Cash provided by operating activities	(41)	134	(175)	(130.6) %	Mainly due to an increase in payments for pension, other retirement and post-employment benefits in the Canada Post segment
Cash used in investing activities	1,025	343	682	199.2 %	Primarily due to an increase in short-term investments to manage the cash proceeds provided by the $1 billion long-term debt issue completed by the Canada Post segment
Cash provided by financing activities	972	77	895	1152.6%	Primarily due to the Canada Post segment's completion of a $1 billion long-term debt issue

* Adjusted for trading days where applicable

A new Financial Framework with updated performance targets and metrics was approved by the Government in 2009 as part of Canada Post's 2010 to 2014 Corporate Plan. The new framework supplants the former Multi-Year Policy Framework targets that had been in place for more than a decade.

The updated Financial Framework reflects Canada Post's anticipated financial position during a period of intensive investment in Postal Transformation. It is expected that this framework will be revisited and recalibrated during 2011 to reflect the implementation of International Financial Reporting Standards ("IFRS").

Financial framework: 2010–2014

Element	Definition	Target	2010 Results
Profitability			
EBITDA margin	Earnings before interest, taxes, depreciation and amortization ÷ revenue	5.0 – 7.5%	8.1 %
Return on book equity	Net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)	0 – 5%	21.8 %
Leverage			
Total debt to EBITDAR	(Total debt + long-term financial obligations$_A$) ÷ (earnings before interest, taxes, depreciation and amortization with adjustment for operating leases$_B$)	2.5x – 4.0x	2.9x
Total debt to book capital	(Total debt + long-term financial obligations$_A$) ÷ (total debt + long-term financial obligations$_A$ + equity of Canada)	45% – 65%	49.0 %
Liquidity			
(EBITDAR – Capex) ÷ interest	(Earnings before interest, taxes, depreciation and amortization with adjustment for operating leases$_B$ - Capex$_C$) / Interest$_D$	1.0x – 2.5x	4.6x
Dividend payout			
Dividend payout ratio	Dividends paid ÷ prior year net income	0% – 20% for 2010–2012 15% – 20% for 2013–2014	0 %

Notes

(A) Long-term financial obligations include asset retirement obligations, obligation to repurchase shares (Purolator) and capitalization of operating leases

(B) Operating leases are removed from earnings and capitalized using a factor of 7.0x

(C) Capex refers to estimated maintenance capital, which includes all capital purchases and capital leases but excludes approximately $37 million of capital purchases for Postal Transformation in the year

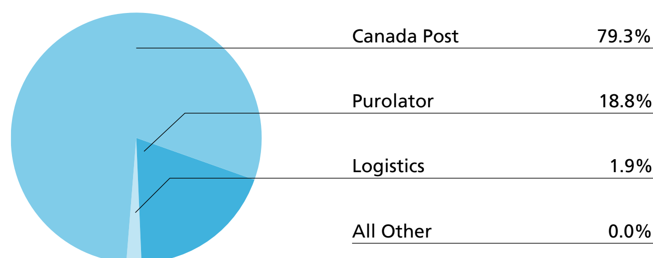
(D) Interest includes imputed interest on capitalized operating leases (calculated as one-third of lease expense)

The Canada Post Group segments – 2010

The Corporation manages its operations and determines its operating segments on the basis of the legal entities. There are three reportable operating segments. The remaining operations are combined and disclosed in the "All Other" category. The Corporation's operating segments are:

- Canada Post;
- Purolator;
- Logistics; and
- All Other.

Revenues by segment – 2010



Revenues by segment	2010	2009	2008
Canada Post	79.3%	79.6%	78.7%
Purolator	18.8%	18.5%	19.4%
Logistics	1.9%	1.9%	1.9%
All Other	0%	0%	0%

The Corporation's unconsolidated results reflect the operations of the Canada Post segment. In 2010, the Canada Post segment generated $5.9 billion in operating revenue and earned income before income taxes of $233 million. This performance reflects the results of the Canada Post segment's cost-containment efforts, offset by an increase in employee future benefits expense.

The Canada Post segment operates three lines of business: Transaction Mail, Parcels, and Direct Marketing.

Transaction Mail is our portfolio of services for creating, delivering and responding to letters, bills, statements, invoices and other forms of paper and electronic communications. The Transaction Mail line of business competes in the larger Canadian communications market that includes email, instant messaging and other means of "document" communication. Traditional letter mail volumes are being eroded by continued electronic substitution.

The Parcels line of business offers a wide range of domestic and international delivery services, differentiated by speed of delivery. Canada Post and its subsidiary, Purolator, compete in both the urgent and non-urgent shipping and delivery market. Purolator's product offering (primarily business-to-business) complements that of Canada Post (primarily business-to-consumer) and enables Canada Post to have a full parcel offering in the market.

The Direct Marketing line of business is comprised of two primary products: Addressed Admail and Unaddressed Admail (collectively referred to as "Admail products"). Admail products compete in the Canadian advertising and marketing services industry with other advertising media that range from traditional means such as print media, radio, television and newspapers to electronic channels such as websites, email and text messaging. The Direct Marketing line of business also distributes periodicals such as newspapers, magazines and newsletters.

Our subsidiaries provide additional competencies, capabilities and market reach, which enable The Canada Post Group to provide broader product and service offerings as well as complete service solutions. The synergies that our subsidiaries bring create strategic value that forms an integral part of our future growth strategy as well as our strategy to leverage our collective strengths to increase cost-effectiveness and efficiency.

In 2010, the Purolator segment generated $1.5 billion in operating revenue, and earned income before income taxes of $72 million. The Purolator segment competes within the same shipping and delivery market as Parcels, but focuses on the business-to-business ("B2B") market segment. The majority of Purolator's revenues are earned from the provision of courier services, with other revenues derived from air cargo and less-than-truckload ("LTL") services.

In 2010, the Logistics segment generated $149 million in operating revenue, and earned income before income taxes of $11 million. The Logistics segment is comprised of SCI, which designs, implements and operates efficient supply chain solutions through its operating entities, SCI Logistics, Progistix™ and First Team Transport.

The All Other segment includes the financial results of Innovapost. Virtually all of the information technology services provided by Innovapost are provided to The Canada Post Group. Accordingly, Innovapost's revenues are largely eliminated upon consolidation.

Factors that shaped our business in 2010

1. Volume declines

Uncertain economic conditions, electronic substitution and competitive pressures have led to continued mail-volume declines. In 2010, the Canada Post segment experienced a 4.5-per-cent decline in domestic Lettermail volumes. In addition, the Canada Post segment reported a 4.7-per-cent decline in domestic parcel volumes. Future mail-volume declines will be difficult to predict. We do not have the flexibility to make rapid adjustments to our infrastructure, and reduce the associated high fixed costs, to respond to fluctuations in mail volumes.

2. Competition from electronic delivery channels

Posts around the world concede that physical-mail markets are now fully mature and that electronic substitution will continue to erode mail volumes. We see increasing movement to multi-channel communications over the next few years, which will further fragment the communications market and erode our physical mail volumes. In support of our vision to maintain a dominant position in connecting Canadians both domestically and internationally, we will continue to follow an overall strategy of maintaining the core business and pursuing aggressive growth in electronic communication channels. In order to maintain the core business, we will concentrate on providing good customer experience and seek ways to make it easier for our customers to do business with us. In order to grow our business, we will focus on providing more product offerings and access, particularly in electronic format. This will provide our customers with a complete range of physical and electronic services.

3. Competition in the Canadian shipping and delivery market

The Canadian shipping and delivery market consists of three primary segments—business-to-business ("B2B"), business-to-consumer ("B2C") and consumer-sending. Growth in the B2C segment continues to be fueled by growth in the e-retailing/e-commerce industry. With a market share second only to Purolator, Canada Post has remained strong in the intensely competitive Canadian domestic market. However, global competitors such as FedEx™ and UPS continue to increase competitive actions in Canada; in addition, we have experienced a changing marketplace in a number of the industries we serve, for example, music and book downloads. These factors place additional pressure on the Parcels line of business to improve parcel visibility, delivery performance and customer service in order to defend and grow its market share.

4. Growing number of Canadian points of delivery

The number of Canadian points of delivery has grown by approximately 200,000 per year for the last five years. As a result, our network costs are increasing due to the need to provide delivery service to new addresses. Furthermore, fewer pieces of letter mail are being delivered per address due to continued mail-volume declines.

5. Canada Post segment structural cost-management strategies

Despite realizing savings from cost-containment activities implemented during 2010, the Canada Post segment's cost of operations totaled $5,719 million—a year-over-year increase of $159 million or 2.9 per cent—primarily due to an increase in employee future benefits expense. The cost of labour decreased by $56 million or 1.7 per cent, when compared to 2009, despite regular salary increases. This decrease is consistent with cost-containment programs in place since 2008, which generated significant savings due to a decrease in indirect labour and productivity improvements that realized reductions in paid hours. In 2010, in order to control rising costs and ensure the long-term health of the postal system for Canadians, we implemented structural cost-management strategies including initiating the outsourcing of a portion of our call centres to a private sector service provider and realigning the operations of the Kitchener, Victoria and Moncton mail-processing plants.

6. Canada Post segment Postal Transformation investment

The Postal Transformation Program requires a total investment of $2.1 billion and is expected to generate approximately $250 million in future annual cost savings upon full implementation and stabilization in 2017.

In 2010, construction of the new Winnipeg mail-processing plant was completed, representing a major milestone towards the building of the Modern Post. The Winnipeg plant is the first in Canada to sort mail according to the line of delivery route, a process known as sequencing. Winnipeg letter carriers are now able to spend less time sorting mail for their routes by hand in the depots and more time delivering mail to their customers.

Ongoing investments will continue to be prioritized based on the greatest need and we will spend only what we can afford. Postal Transformation is designed with maximum flexibility in mind in order to ensure that investments continue to be a prudent use of our financial resources and will provide the most benefits. An Integrated Benefits Model database has been developed to track benefits. The risks associated with each initiative are being monitored and any significant variances in the underlying assumptions used to estimate the planned financial benefits are being documented and updated. Risk and benefit assumptions will be monitored and updated throughout the program deployment.

7. Canada Post segment Pension Plan solvency deficit funding

The actuarial valuation for the Canada Post Pension Plan ("the Plan") as at December 31, 2009, using the smoothed value of Plan assets, disclosed a going-concern surplus of $568 million and a solvency deficit of $1,847[1] million. As a result of the solvency deficit, employer special solvency contributions of $425 million were made in 2010, in addition to $321 million of current service contributions.

[1] Solvency deficit when using fair value of Plan assets is approximately $3,213 million

Outlook 2011

The year 2011 will continue to pose critical challenges that must be overcome to ensure our long-term financial stability. Economic uncertainty, mail-volume erosion and competitive pressures have made it more difficult to predict future revenues, earnings and cash position.

Due to electronic substitution and aggressive competition on many fronts, we do not expect physical-mail volumes to return to previous levels; therefore, the degree of domestic Lettermail erosion is uncertain and represents a major risk going forward. Revenues are projected to grow from a lower base. The Canada Post Group's planned revenue for 2011 is $7.7 billion, which represents growth of 2.9 per cent compared to the previous year, mostly due to price increases. Planned 2011 income before income taxes is $123 million. With slim operating margins and increasing network costs due to continual increases in the number of delivery points, cost containment will continue to be a significant priority. In order to reach our earnings target, the Corporation must continue its transformational efforts to manage costs.

In the coming years, in order to remain viable, we will need to implement structural changes in addition to Postal Transformation to permanently reduce costs and improve our competitiveness. In order to respond to reduced mail volumes, we need the flexibility to make changes to our infrastructure.

Other Posts face similar challenges and many have undertaken reforms to their collective agreements in recent years, including innovative work practices to improve efficiency. The USPS is in labour contract negotiations with its unions, with the goal of reaching agreement on actions to increase workforce flexibility and reduce costs.

In our own negotiations underway with the Canadian Union of Postal Workers ("CUPW"), we are seeking changes that will position the company for sustained success, including a new Short-Term Disability Program and new processes that will help resolve disputes less expensively and on a more timely basis, grow the business and modernize operations. We are also proposing changes to the labour cost structure for future employees to make Canada Post more competitive. We strongly believe that taking a proactive approach to protecting the financial viability of the Corporation is necessary as part of our shared responsibility to employees as well as the Canadians we serve.

In October 2009, the Minister of Finance released a pension reform plan to allow Pension Plan sponsors to better manage their funding obligations within their overall business operations and reduce funding volatility. In June 2010, a number of proposed amendments were finalized, including a new standard for establishing minimum funding requirements on a solvency basis. Based on the expected actuarial valuation, special solvency contributions would amount to $652 million in 2011, on top of the estimated $357 million of current service contributions in 2011. The Corporation is awaiting regulations that will define how a letter of credit may be used to reduce the amount of special solvency contributions required as a result of the Canada Post Pension Plan's solvency deficit. The funding policy will continue to be re-evaluated based on the status of the Canada Post Pension Plan. In consultation with the Minister responsible for Canada Post and the Minister of Finance, management will consider the final form of the legislation, its liquidity position, and the financial costs and benefits in determining the required amount of special solvency contributions.

During 2010, the Corporation issued $1 billion of long-term bonds. The proceeds from this public debt issue partially secured long-term financing for Postal Transformation and effectively pre-funded 2011 cash flow requirements. Canada Post has sufficient liquidity to support operations throughout 2011, including an adequate contingency cushion to address any fluctuations in working capital, adverse changes in business results or unforeseen expenditures.

Our ability to proceed with Postal Transformation is contingent on the financial health of the Corporation, which is largely driven by economic conditions, the ability to make permanent changes to our cost structure and the funding of our pension obligations. A modernized Canada Post will remain financially self-sustaining and continue to provide the level of service that Canadians expect and deserve.

2 Our Business, Vision and Strategy

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

The Canada Post Group's business is to connect Canadians "*From anywhere… to anyone*™". Our vision for Canada Post is to be a service provider of choice—one that is relevant to Canadians' current and future needs. Our 69,000 employees deliver approximately 10.6 billion pieces of mail, parcels and messages each year to more than 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.

The company is facing some of the greatest challenges in its history as economic uncertainty, electronic substitution and competition continue to put pressure on our revenues. Accordingly, we are making some fundamental changes to our business by investing in innovation, our services and infrastructure in order to secure our future.

2.1 Trends, opportunities and threats

Global trends

Starting in the second half of 2008 and through 2010, adverse economic conditions significantly impacted the mail business of many Posts. In 2010, several postal administrations reported declines in letter mail volumes including the USPS, the United Kingdom's Royal Mail and Australia Post. Electronic substitution, competition and customers' cost-reduction efforts drove postal industry declines. The consensus is that physical-mail markets are now fully mature and letter mail volumes will continue to erode.

International Posts took different approaches in response to difficult economic conditions. Some responded by improving productivity and implementing cost-cutting initiatives, including cuts to service levels. For example, the Netherlands' TNT placed a greater emphasis on cash management and cut costs quickly and deeply while maintaining service quality and retaining customers. Other Posts, particularly in Europe, continued to grow by expanding geographically or by leveraging their core assets to grow revenues in adjacent business areas and along the value chain.

Faced with a long-term decline in traditional mail volumes, high labour costs and the need to deliver universal service to all citizens in an environment where the value of the legislated "exclusive privilege" or monopoly over a portion of the postal market is diminishing, Posts are taking action. Past strategies were focused on finding a means to manage the rising costs of the universal service obligation ("USO") and ensuring long-term sustainability. Posts' current strategies vary, depending on the extent to which they have already undertaken substantial modernization initiatives and the extent to which they operate in a modernized regulatory framework.

The European Union (EU) leads the evolution of postal markets. The European Commission recently established the European Regulators Group for Postal Services (ERGP) to deepen cooperation between postal regulators in the EU. Strengthened cooperation among independent national regulatory authorities for the postal sector is becoming imperative in view of fully open postal markets. Modernization efforts that were initially put in place in anticipation of the liberalization of domestic postal markets in 2011 are now helping to offset some of the impacts of the economic downturn and electronic substitution.

TNT is an example of a Post that is repositioning itself in the face of declines in its core business. Mail-volume declines in the Netherlands and the rest of Europe are expected to continue at an accelerated pace, driven by substitution and competition. TNT announced it will divide its business in two, creating a new company for the Express business while retaining the Mail business within TNT. The company is also planning a radical downsizing of the workforce, mostly through natural attrition, the use of part-time staff only, widespread outsourcing and reduced delivery times.

Several posts are diversifying their revenue base by moving into new non-traditional, non-postal areas to offset declines in their traditional business areas. Some Posts such as Royal Mail, Swiss Post, Australia Post, La Poste (France) and Poste Italiane have been successful in leveraging their domestic networks to offer mobility and financial services. A number of Posts, including TNT, Swiss Post and La Poste (France) will focus on the business-to-consumer ("B2C") parcels market and will develop their e-commerce activities by investing in e-retailing and offering expanded services in this area. E-commerce is one of the fastest growing retail channels in Europe and North America and is driving significant growth in B2C parcels volumes. Mobile technology is also making it easier for consumers to shop any time and anywhere. E-retailers rely on their delivery company for their logistics, and Posts are capitalizing on the opportunity to simplify the e-commerce value chain.

Deutsche Post, Austrian Post and the four Nordic Posts are examples of operators that have become leaders at home while expanding their footprint outside their domestic markets. They have improved productivity and efficiencies through network modernization and have generated new sources of revenue in areas such as logistics, technology and financial services. Posten (Sweden) and Post Danmark (Denmark) took the further step of merging, in an effort to enhance their competitiveness and benefit from economies of scale. While these Posts experienced declines in their core mail business during the recession, they were well-positioned to weather the storm.

These Posts stand in contrast to the United Kingdom's Royal Mail, which failed to modernize in the face of liberalized markets and is in serious financial difficulty. While Royal Mail's response has been slow, it is now working to address the situation. They have invested £1.6 billion in new technology and equipment, including £500 million in their last fiscal year. In October 2010, Postal Services Bill 2010–11 was introduced in the British Parliament to restructure and sell up to 90 per cent of Royal Mail. Royal Mail's subsidiary, Post Office Ltd, would continue to be owned by the Crown or moved to a mutual ownership structure. Royal Mail's pension deficit would be dealt with by transferring the historic liabilities of the Royal Mail Pension Plan to the Government.

The USPS is also in a financial crisis, as it reported a US$8.5 billion loss in 2010, higher than the US$7 billion previously forecasted. While the USPS was able to reduce its total costs by US$3 billion in 2010, on top of the US$6 billion in savings achieved in the prior year, by reducing work hours and improving operations, its ability to achieve further efficiencies is limited within its current business model. In March 2010, the USPS submitted a filing to its postal regulator, the Postal Regulatory Commission, to move from a six-day to a five-day delivery schedule in order to substantially decrease its highest cost activity and better match delivery costs with declining volumes. The USPS has not yet received approval to implement this significant change to its business model.

Canada

Canada Post continues to be profitable while facing critical challenges. Our business is under pressure on many fronts, including electronic substitution, competitive pressures, the impact of the recent economic downturn and the rising cost of our universal service obligation and other public-policy obligations. These pressures place our financial sustainability at risk.

Domestic Lettermail volume declined 4.5 per cent in 2010 for a number of reasons. Not only are emails an increasingly popular substitute for letters and cards, but businesses that use physical mail are seeking to reduce postage costs by consolidating more bills and statements into a single envelope or sending them electronically. Internet use and capabilities are increasing, and the economic downturn has put further pressure on businesses and consumers to reduce costs.

Addressed Admail volumes increased by 2.0 per cent in 2010. Admail continues to offer a high return on investment for marketers and bridges the gap between online and offline communication by delivering targeted and personalized messages. However, our Admail products are increasingly competing with online advertising for a share of marketers' budgets. Younger marketers tend to view physical direct mail as slow, non-interactive and complex. Online advertising is the fastest-growing marketing channel, and is expected to grow similar to the U.S. market, at a rate ranging from 7 per cent to 12 per cent per year from 2011 to 2014.

Economic conditions, aggressive competition and changes in consumer habits also led to a 4.7 per cent volume decline in domestic parcels in 2010. The domestic parcel market is highly competitive and includes the major global players—UPS and FedEx. These parcel competitors, who previously focused on the business-to-business ("B2B") segment, are now looking to the high-growth business-to-consumer ("B2C") market, where Canada Post holds a dominant position. UPS Canada recently announced the opening of a new distribution centre at the Calgary International Airport and expanded their Toronto distribution centre, doubling their capacity in Canada. This has increased their domestic and international competitiveness.

2.2 Strategic vision – Building the Modern Post

Our vision for Canada Post has not changed. We strive to be a service provider of choice, one that is relevant to Canadians' needs now and in the future. To achieve this vision, we must continue to build on the three imperatives that have been our focus for several years. We must engage our employees and ensure they are committed to the company's success. We must also continue to invest in our infrastructure, to be as efficient and productive as possible. Lastly, we must focus on growing our revenues and profits, both in our core business and through diversification. Investments in these areas in addition to a focus on mail security are essential to preserving Canada Post's position as the country's trusted delivery agent.

In 2008, we initiated a massive transformation program to update our outdated physical and technological infrastructure. The successful implementation of Postal Transformation is essential if we are to remain financially self-sustaining in the future. Modernizing our plants, systems, equipment, and processes is a key component in our strategy to address a multi-year trend that has seen our costs rise faster than our revenues. Building the Modern Post will enable us to meet our obligations under the *Canadian Postal Service Charter*, and deliver the new and improved products and services that Canadian businesses and consumers are demanding. Postal Transformation will help improve Canada Post's competitive advantage and better prepare us to confront the important changes happening across our industry.

Our investments in technology will provide a platform for future growth in our core business, particularly in Parcels and Direct Marketing. We are also planning to grow in adjacent and new business areas by leveraging our current capabilities and our extensive retail network.

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
- Instill a culture of performance

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

Grow the core and diversify into new, profitable revenue streams

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

Engaging our employees

We have made strong progress in our journey and laid the foundation for the transformation of our company. Our employee engagement index has increased by 13 percentage points since 2006 and we plan to maintain the momentum. We will continue to communicate with our workforce and drive a culture of performance. We will retain our focus on health and safety, where we have been making great strides in recent years. The number of accidents has decreased significantly over the past two years. This sets us up to achieve our overall goal of a 50-per-cent reduction in accidents from 2009 to 2014.

Going forward, our employee engagement strategy remains focused on building a workplace characterized by respect and fairness, customer focus and employee development. We will continue to engage in face-to-face communication with front-line team leaders and their employees through regional forums and executive front-line visits. We will continue advancing a culture of health and safety through employee safety training and a leadership focus on safety management. We encourage team leaders to involve employees in decisions that affect their work and their workplace. As well, we will continue to promote the recognition and acknowledgement of the contributions that employees make to improve customer service and business operations.

Postal Transformation

A significant component of our strategy to address our challenges is the Postal Transformation investment program, which continues to move ahead since its 2008 launch. Postal Transformation will enable us to gain important efficiencies throughout our physical network by reducing labour-intensive work. It will also provide the platform to develop enhanced features and innovative services and deliver these to our customers. Since the beginning of the program, we have invested $600 million towards a total of $2.1 billion, which will result in annual savings of approximately $250 million by 2017.

The Postal Transformation Program includes equipment modernization and new technology that will replace obsolete letter-processing equipment, automate manual-sorting processes, create a motorized delivery force and replace or improve current mail-processing plants. In addition to making significant improvements to our physical infrastructure, Postal Transformation will provide the platform to develop enhanced features and innovative services and deliver these to our customers.

As part of Postal Transformation, we opened a new plant in Winnipeg in 2010. The plant is the first in Canada to sort mail according to the line of delivery route, a process known as sequencing. Letter carriers are now able to spend less time sorting mail for their routes by hand in the depots and more time delivering mail to their customers. We re-introduced the two-bundle delivery method, which is used successfully by European postal administrations and the USPS. The implementation of this new delivery model in Winnipeg has enabled us to reduce the number of routes by 20 per cent. This new delivery model is also being implemented in other cities across the country, including Toronto and Montréal. As part of our dedication to corporate social responsibility and employee engagement, we will make sure that our investments and strategies meet sustainable environmental criteria and protect our employees' health and safety.

In the coming years, we plan to invest the remaining $1.5 billion of Postal Transformation's total $2.1 billion program cost and we are on track to realize an estimated $250 million in savings per year by 2017. We will continue to deploy Postal Transformation with prudence and to work on the projects that are the most critical and have the highest return on investment. Anticipated benefits will be achieved through leveraging attrition (i.e., not replacing people who leave), while respecting all provisions in our collective agreements, including commitments relating to job security. The majority of anticipated savings will be derived from machine sequencing of the mail to individual points of delivery in cities that generate the highest volumes of mail, thus reducing reliance on manual sortation and leveraging upcoming attrition. Additional savings will result from increased productivity of new equipment, and processing efficiencies through the implementation of new technology and world-class ergonomic methods and processes for material handling. We intend to focus on reducing operating costs in existing facilities through energy-saving initiatives, lower maintenance costs and increasing standardization in our new building designs.

Canada Post is mindful of the need to maintain our service commitment, while at the same time maximizing savings with careful placement of our investments. We will take on only those investments that are a prudent use of our financial resources and we have designed the Postal Transformation business plan with maximum flexibility in mind. We will continue to monitor our financial position in light of uncertain economic conditions and adjust spending as needed. *See Section 6.6 – Liquidity and capital resources on page 70.*

Revenue growth

While improving our cost structure through Postal Transformation is vital to our financial sustainability, it is not enough. To remain a viable business in the future, we must adapt as our industry evolves and grow our revenues profitably. We are focused on growing revenues in our core business areas and have made some progress; we need to do much more. We must continue to improve our current products and services to better meet our customers' needs today and in the future and we must also capitalize on incremental growth opportunities in both adjacent and new business areas by leveraging our current competencies and significant asset base.

Growth in our core parcels business is linked to our ability to improve service reliability and cost competitiveness. We are focused on improving parcel visibility, delivery performance and customer service. As a result of our modernization program, we are contemplating offering a number of new services that will give customers more control over how and when they receive their parcels, including flexible shipping, delivery and pick-up options. We will continue to grow the synergies among the companies in The Canada Post Group to offer value-added solutions to our customers, and will expand our international partnerships for inbound residential delivery.

Similar to other Posts, we will also be looking to capitalize on the growth in the e-commerce market by improving logistics with e-retailers, expanding parcel visibility and enhancing online interfaces such as delivery alerts, online payments and delivery or return options. In 2010, we launched the Canada Post Comparison Shopper, an online shopping portal allowing consumers to compare multiple deals from trusted merchants across the U.S. and in Canada.

In relation to Direct Marketing, we are exploring new services and capabilities to address customer demand for greater return on their investment and to leverage evolving online and e-advertising trends. We will be pursuing a variety of data-related offerings to help marketers reach their intended customers and improve their return on invested marketing dollars. These include affordable list and analytics services, full-service data-cleansing services and advanced targeting solutions.

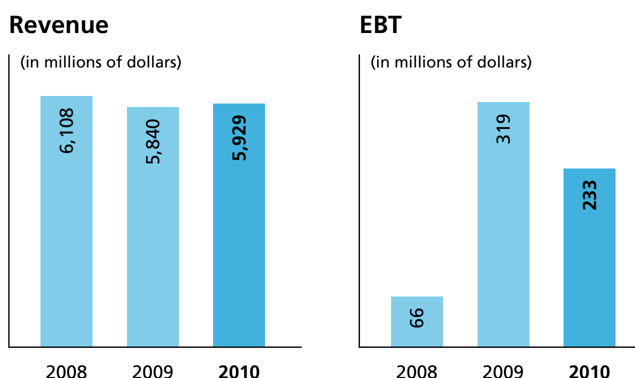
We are striving to capture some of the migration of communications to electronic channels by offering services in the "e-space" that complement what we currently offer for physical mail. We plan to provide an integrated product line for physical and electronic services as we recognize the need to capture the revenue that is shifting from physical to electronic communication. In the future, mail could be physical, electronic or both, depending on the preferences of the sender and the receiver. We are also planning to provide secure online services in areas such as secure electronic mail and electronic documents management. We are continuing to define the opportunities in this area.

A key component underlying the growth strategy is a renewed focus on our customers. We are developing a strategy to better tailor our products and services to our customers' needs. We recognize that in building a "customer-first" mentality throughout our organization, we will need to transform many of our behaviours, systems and processes, but the benefits will be significant. We will focus on improving the products and services we offer to our customers through enhanced parcel visibility and scanning, making our customer interfaces easier to use and making it easier for customers to track their deliveries. New online services will provide consumers with more control over how and when they receive their mail.

We will continue to identify, assess and pursue other growth opportunities to improve our competitive advantage and provide Canadian consumers and businesses with modern, innovative and reliable services they will use and enjoy.

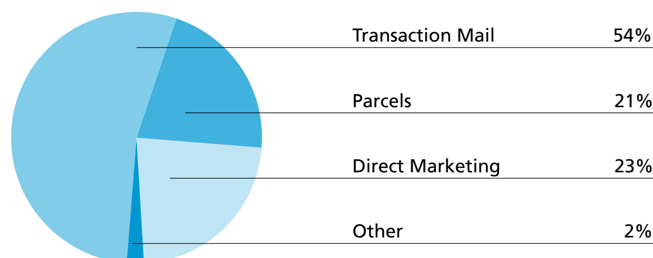
2.3 Canada Post segment

The Canada Post segment generated revenue of $5.9 billion and, after excluding intersegment revenue, represents 79 per cent of The Canada Post Group's 2010 consolidated revenue from operations of $7.5 billion.



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 – 2010



Operating revenues by market	2010	2009	2008
Transaction Mail	54%	54%	53%
Parcels	21%	22%	21%
Direct Marketing	23%	22%	24%
Other	2%	2%	2%

2.4 Canada Post – Transaction Mail

Our business

Transaction Mail is our portfolio of services for creating, delivering and responding to letters, bills, statements, invoices and other forms of paper and electronic communications. It is our most profitable line of business and offers three distinct delivery services—domestic Lettermail, U.S. and international Letter-post and epost™, our online bill-presentment service. In addition to delivery services, through our *SmartFlow* Respond and Recover services, we serve institutional clients by processing and responding to their customer communications and managing undeliverable mail. This suite of communication services includes various aspects of document creation, management, storage and retrieval.

Transaction Mail accounts for $3.2 billion or 54 per cent of the 2010 unconsolidated Canada Post segment operating revenue of $5.9 billion. The majority of Transaction Mail operating revenue is derived from traditional physical-mail delivery services, with domestic Lettermail accounting for almost 90 per cent.

Our customers include business, governments and consumers; on their behalf, we deliver across Canada, and through international postal administrations, around the globe.

Vision

Our vision is to continue to play a meaningful role in connecting Canadians both domestically and internationally in the ever-changing communications marketplace.

Business environment

Transaction Mail competes in the larger Canadian communications market that includes email, instant messaging and other means of "document" communication.

Domestic Lettermail, U.S. and international Letter-post mail volumes are threatened by continued electronic substitution. Canadians are increasingly shifting to email as a popular substitute for letters and cards. More consumers are using electronic bill-presentment services and paying their bills online. Large mailers are consolidating more bills and statements into a single envelope and encouraging the use of electronic payments. The use of electronic filing services for transactions such as income taxes is growing. The slow economic recovery has put increased pressure on businesses and consumers to look for more ways to reduce their communication costs.

In June 2009, legislation was introduced in the House of Commons to amend the *Canada Post Corporation Act* in order to remove the "exclusive privilege" on letters intended for delivery outside of Canada and open this market to competition. The legislation, which received Royal Assent on July 12, 2010, removes Canada Post's exclusive privilege on letter mail delivery outside of Canada.

Based on the above pressures, mail-volume decline is one of our greatest business risks. We do not have the flexibility to make rapid adjustments to our infrastructure, and reduce the associated high fixed costs, to respond to fluctuations in mail volumes. Fewer pieces of domestic Lettermail and mail from foreign postal administrations are being delivered per address, as shown in the table below, which illustrates the annual decline in delivered volumes and the annual increase in delivery addresses. As a result, our network costs are increasing due to the need to provide delivery service to new addresses.

Transaction Mail (excluding outbound)	2010	2009*	2008	2007
Delivered Volume Percentage Change	(3.9) %	(5.5) %	(1.6) %	(1.3) %
Delivery Addresses Percentage Change	1.0 %	1.2 %	1.4 %	1.4 %
Mail Volume Percentage Decline per Address	(4.9) %	(6.7) %	(2.9) %	(2.6) %

* In 2010, a methodology change has been implemented and 2009 has been restated for comparability. Had 2008 been restated, the 2009 delivered volume percentage change would have been (3.9) per cent and the mail volume percentage decline per point of delivery would have been (5.1) per cent.

Strategy

Past experience has shown that the Transaction Mail line of business is vulnerable to physical mail volume reductions and shifts. We are pursuing a mix of strategies to mitigate the impact of these trends, leveraging our customer knowledge, clients' trust in the Corporation as a Canadian institution and our nationwide infrastructure. We are focused on two strategic priorities:

- *Maintain our core business and revenue streams* – In 2011, we will continue working hard to provide good customer experience and seek ways to increase the value of mail to our customers; and
- *Pursue an aggressive growth strategy in new electronic solutions for consumers and mailers* – Our objective is to achieve a strong market position in digital channel communications and provide secure electronic connection between Canadians and businesses.

2010 objectives and achievements

In 2010, Transaction Mail operating revenue increased by $30 million or approximately 1.0 per cent compared to 2009, but did not meet the 2010 Corporate Plan target. In 2010, this shortfall against plan was especially evident in the continuing softness of demand from consumer and business sales at retail postal outlets. Inbound Letter-post was also negatively impacted by the exchange rate.

Improving customer experience, increasing the value of Lettermail and addressing growth objectives were supported by the following achievements in 2010:

- In order to alleviate the impact of the three-cent basic letter rate increase on small and medium-sized customers, we applied a 5.3-per-cent rebate to the first $1,000 of Lettermail purchased by all commercial contract customers in 2010.
- We expanded the Registered Mail product for our commercial customers by introducing two new prepaid offerings: Government Secure Registered Mail and Prepaid Registered Mail. In addition, we improved reporting functionality for commercial customers inducting large volumes of Registered Mail.
- Responding to commercial customers' feedback, we added a new interactive envelope design tool called Machineable Mail Advisor to the Canada Post website to help mailers design creative mailings that meet our specifications for machine processing.
- In 2010, we completed the 2009 plan to make *SmartFlow* and epost fully compliant with the Payment-Card-Industry Data Security Standard ("PCI DSS"). PCI DSS is a worldwide information security standard developed by the PCI Security Standards Council to enhance payment-card-data security. Compliance with this standard allows us to further expand our customer base in the financial sector.
- Building on improvements made to the epost website in January 2010, we extended the modifications to all of our access channels. We now provide better and more consistent user interfaces, browser support and notifications, ensuring the same look and feel and a common customer experience, irrespective of channel. A consumer survey shows support for the enhancements and that customers value the new functionality.
- We introduced a test version of a secure storage space for important financial, legal and personal documents on epost. We are planning to launch a full version of the service in 2011 that will integrate users' feedback.

2.5 Canada Post – Parcels

Our business

The Parcels line of business offers a wide range of domestic and international delivery services. Services are differentiated by the delivery destination and speed of delivery, ranging from urgent next-day delivery to non-urgent, where transit time is determined by the transportation mode of ground and/or air. Canada Post and its subsidiary, Purolator Inc. ("Purolator"), compete in both the urgent and non-urgent markets. Canada Post's domestic products include:

- Regular Parcel™ – an economical choice when urgent delivery is not required;
- Expedited Parcel™ – a service option available to high-volume commercial customers and small businesses;
- Xpresspost™ – an express service with guaranteed delivery; and
- *Priority*™ Next A.M. – a premium express service with guaranteed next-day delivery by noon for local and regional destinations and one-day delivery between major centres.

Canada Post offers the following products for international and U.S. destinations:

- International Air Parcel and International Surface Parcel – a lower-cost option when urgent delivery is not required;
- Expedited Parcel-USA – a non-express service that delivers parcels within six to 12 business days to major U.S. centres;
- Xpresspost-USA and Xpresspost-International – express services that guarantee three to five-day delivery between major U.S. centres and four to nine-day delivery to 50 other international destinations; and
- *Priority* Worldwide – a premium express service offered in conjunction with FedEx Express that guarantees time-certain delivery.

Parcels accounts for $1.3 billion or 21 per cent of the 2010 unconsolidated Canada Post segment operating revenue of $5.9 billion.

Our customers include businesses, consumers, governments, international postal administrations and other delivery companies.

Vision

Our vision is to *be the preferred provider of business-to-consumer ("B2C") logistics solutions in Canada.*

Business environment

The Canadian shipping and delivery market was valued at $5.6 billion in 2009 and consists of three primary segments—business-to-business ("B2B"), business-to-consumer ("B2C") and consumer-sending. Growth in the B2C segment continues to be fueled by growth in the e-retailing/e-commerce industry. Canada Post's dominant share of the B2C segment is supported by its vast retail and delivery network.

As a result of the recent recession, the Canadian shipping and delivery market shrank. In 2010, the market began to recover some momentum in sustaining marginal market growth. With a market share second only to Purolator, Canada Post has remained strong in the intensely competitive Canadian domestic market. Global competitors such as FedEx and UPS have continually increased their competitive actions in Canada. Customers are also changing their purchasing behaviours and are shifting some of their shipping needs from premium products such as Xpresspost to Expedited Parcel in order to reduce their shipping costs. The increased competitive landscape combined with changing customer behaviours are putting pressure on

Canada Post's ability to drive sustainable volume and revenue growth. In the current business environment, it will be critical for the Parcels line of business to invest in greater parcel visibility (scanning) as well as improve on-time delivery performance (quality) to maintain and build on its current market share.

Strategy

Parcels has a dominant position in the B2C segment, serving consumers and small businesses. Our strategic priorities are to maintain our core parcels business; grow our commercial contracts with small and medium-sized businesses; and increase our market share of inbound and outbound parcels.

By defending core areas of strength and by seizing growth opportunities, the Parcels line of business plans to grow within the shipping and delivery market. Moving forward, our ability to compete based on price will depend on achieving cost reductions, productivity gains and more extensively, through capital investment to replace obsolete parcel-processing equipment and facilities. Specific growth opportunities are discussed below.

- *Increase Share of B2C Segment* – The B2C segment is expected to grow at above market rates in correlation with the growth in Internet usage and e-retailing. Parcels plans to increase its dominant share of this growing market by leveraging its core competency in residential delivery. In addition, the efficient handling of returns ("reverse logistics") is paramount to support the continued growth of this segment. We plan to enhance and streamline our pick-up and drop-off processes for returns so that we can provide better service throughout our network.
- *Increase Share of B2B Segment* – We are continuing to focus on expanding our current business accounts and gaining new customers in order to increase our share of the B2B market. Meeting customer requirements such as access to on-demand pick-up options are crucial to further growth in this segment and we will continue to focus on improving and expanding our service offerings.
- *Increase Share of Inbound and Outbound Parcels* – As part of the Postal Transformation initiative, we are assessing the modernization of three Canada Post exchange offices located in Montréal, Toronto and Vancouver, as an option to strengthen our capabilities to handle inbound and outbound parcels. The streamlined exchange offices would improve the quality of international service and facilitate cross-border customs clearance. Pursuant to Canada Post's alliance with FedEx, we handle cross-border logistics and delivery for FedEx's SmartPost™ service, using our Borderfree™ delivery platform, which provides a seamless border crossing for FedEx's SmartPost U.S. customers, who are sending parcels to Canadian residential addresses.
- *Improve Quality and Customer Experience* – Our commitment to improving quality and the customer experience is focused on improving on-time delivery and implementing scanning and visibility improvements by increasing the frequency of scans and delivering closer to "real-time" scan data to our customers. Additional scanning will reinforce the security of the mail, provide operations with the tools to monitor service performance, and present customers with more information to track the status of their shipments.
- *Deliver More Competitive Products* – More and more, the shipping and delivery market is becoming a technology-driven business. The Parcels line of business is developing online capabilities with web service applications in order to enable application-to-application communications, making it easier for our commercial customers to access and integrate our services into their systems and positioning Canada Post as the shipper of choice.
- *Leverage Group of Companies Synergies* – Our growth strategy will require Canada Post to leverage the strengths of its subsidiaries, Purolator and SCI, to offer customers an integrated and compelling solution. A focused effort will be made to present the marketplace with shipping and delivery services, logistics and cross-border offerings that build on our Group's combined strengths in order to attract new customers, generate incremental revenue and grow market share.

2010 objectives and achievements

In 2010, Parcels operating revenue increased by $7 million or approximately 0.5 per cent compared to last year, but did not meet the 2010 Corporate Plan target. This shortfall against plan can be attributed to difficult economic conditions, low consumer confidence and a competitive marketplace. Inbound parcel revenues were also negatively impacted by the exchange rate.

In 2010, we maintained our focus on our customer-based strategy and implemented various initiatives to strengthen our position.

- In support of our ongoing parcel visibility strategy, we began the deployment of new, smaller Portable Data Terminals ("PDTs") to our letter carriers, in order to begin the elimination of paper-based delivery handling.
- Following last year's deployment of new wearable finger scanners in Vancouver and Ottawa, we continued our network deployment by providing wearable scanners to 14 other facilities across the country.
- With the 2010 opening of the new Winnipeg plant, a new automated packet-sorter was introduced. Combined with wearable scanners, this new equipment supports our improved scanning and parcel visibility strategy as well as our commitment to improving service performance and quality.

- Parcels maintained its commitment to provide easier access to on-demand pick-up services by reducing the minimum volume requirement and expanding the service offering to more areas across Canada, in support of small businesses in the B2C segment.
- We revamped Xpresspost-USA and Expedited Parcel-USA, which are southbound (Canada to USA) products. Service performance, additional scans and options were enhanced for these two products, in order to provide better service and faster delivery.

2.6 Canada Post – Direct Marketing, Advertising and Publishing

Our business

The Direct Marketing, Advertising and Publishing ("Direct Marketing") line of business is comprised of two primary products: Addressed Admail and Unaddressed Admail (collectively referred to as "Admail products"). The Addressed Admail product allows marketers to target promotional messages to specific businesses or individuals. The Unaddressed Admail product enables our customers to reach specific neighbourhoods or regions across Canada. We also distribute periodicals such as newspapers, magazines and newsletters.

Direct Marketing accounts for $1.4 billion, or 23 per cent, of the 2010 unconsolidated Canada Post segment operating revenue of $5.9 billion.

Our customers include businesses of all sizes and government. We also work with marketers, influencers and partners to provide Direct Marketing products and services.

Vision

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

Business environment

The Direct Marketing line of business remains one of the key players within the Canadian direct-marketing community. With unparalleled reach and access to more than 15 million addresses in urban and rural locations across Canada, Admail products enable our customers to grow their business by sending customized messages and offerings to highly defined target groups.

Admail products compete in the Canadian advertising and marketing services industry with other advertising media that range from traditional means such as print media, radio, television and newspapers to electronic channels such as websites, email and text messaging.

The 2009 economic downturn reduced the size of marketing budgets and drove fundamental change in how and where marketers spend their limited advertising dollars. While the economy began to recover in 2010, the proliferation of marketing channels continues to saturate the media landscape and dampen consumer response. This, in turn, is driving the need for communications to be more targeted and relevant to intended audiences. Marketers are looking for ways to improve the success of their advertising campaigns while reducing their costs. Their increased focus on extracting the highest return from their advertising expenditures has intensified the demand for lower-cost, more efficient and measurable media solutions. Accordingly, advertising budgets are shifting from mass to measurable marketing programs. Consumers are also changing the media landscape as they become more empowered and increase their ability to influence access to their private space. As well, environmental pressures are driving more marketers to adopt "green" practices and online advertising continues to grow.

In summary, as the market transforms, the need for an integrated multi-channel solution with greater analytical capabilities and increased personalization will emerge as a fundamental key to success in advertising.

Strategy

Our growth strategy continues to focus on enabling advertisers with customer-centric marketing initiatives. We intend to develop knowledge-based services and capabilities that help marketers deliver the right message to the right customer through the right channel at the right time. We plan to achieve new market share growth in advertising by concentrating on four strategic priorities:

- *Diversification and Expansion of Data Products and Marketing Analytics Services* – Equip the marketing community with improved data and analytics, through the use of marketing technologies that leverage Canada Post's unique address information. Direct Marketing will introduce affordable list and analytics services and full-service data-cleansing, providing small and medium-sized businesses with access to advanced solutions for targeting and analytics.
- *Multi-Channel Enablement* – Introduce a new highly targeted and consumer-focused online advertising channel that will serve as a dynamic meeting place for businesses and consumers. Consumers will be able to customize their profile to ensure that they only receive information that is relevant to them, based on their preferences and location.
- *Modernization and Simplification of Core Mail Products* – Ensure core mail products remain relevant in the market-place and enhance customer experience and engagement across all touch points. Direct Marketing plans to continue to monitor customer feedback and consumer trends in order to drive customer value and deliver great customer service.

- *Ensuring the Sustainability of Direct Mail* – Transform our products to leverage the Modern Post, using the new capabilities enabled by the Postal Transformation initiative to develop new product solutions. We will also continue to build a Direct Marketing "Centre of Excellence" that promotes strategic thought leadership in the industry.

2010 objectives and achievements

As the economy recovered in 2010 and advertising budgets returned, Direct Marketing operating revenue increased by $47 million or approximately 3.6 per cent compared to the prior year, and met the 2010 Corporate Plan target.

Customer satisfaction, delivery performance and financial objectives were supported by a variety of achievements in 2010.

- We introduced two new product offerings and one new service in the area of marketing analytics. In January, we launched Acquisition Admail, a list product designed to help our customers accurately target new customers. In April, we introduced New Addresses which is a unique mailing list—available only through Canada Post—that allows customers to reach new residential addresses that have just started to receive mail delivery. Finally, *Smart Data* Cleaner is a quick and easy-to-use online tool that cleans and updates customer and prospect mailing lists.
- We launched Canada Post Comparison Shopper, an online shopping website that will increase visibility for advertisers and at the same time, enable customers to find retailers, compare prices, purchase goods directly on the retailer's site and choose from a variety of delivery options.
- We maintained our presence within the industry and with our customers, providing leadership, marketing intelligence and creative solutions emphasizing the role and the value of direct marketing in a recovering economy. We added to our library of reference material and tools to assist customers in the planning and execution of their marketing campaigns. New additions included a "Direct Mail and Digital Media Research Paper" and an update to our "*Direct Marketing Sorted Magazine*" which provides insights on Direct Marketing. We also held over 50 customer information sessions, reaching more than 2,000 business customers across Canada and the U.S..
- In order to leverage the modern postal equipment being introduced by Postal Transformation, we have been consulting with the market to find opportunities to transition direct mail customers and products towards the Modern Post. For example, the vast majority of Addressed Admail is processed manually. Our goal is to shift most of this product to machineable mail, given the efficiencies that can be gained through automation. As a first step, we are implementing new processes to enhance and improve marketers' access to the machineable mail service option by introducing a Machineable Presort category at an incentive rate (launched in January 2011), simplifying the specifications that govern the service, increasing the number of induction locations and mail-testing sites, and improving the adjudication process.
- We continued to improve our website, making it easier to use by simplifying the language, and improving the navigation and content to provide customers with market and consumer preference insight and knowledge. We simplified our processes in many areas and provided tools and guides.
- We continue to reduce 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 and participation in Canadian Marketing Association initiatives.

2.7 Purolator segment

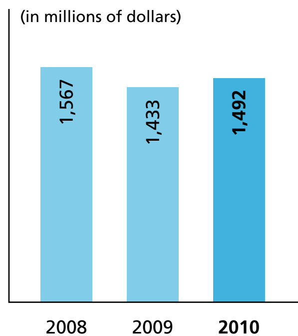
The business

In 2010, Purolator celebrated 50 years of providing distribution solutions to, from and within Canada. As Canada's largest logistics company and one of Canada's 10 Most Admired Corporate Cultures™, Purolator is committed to its customers and its 11,000 employees, including more than 3,500 couriers. From automated solutions to 24-hour pick up and delivery, Purolator provides customers with the services and customized solutions required to deliver their shipments across town or around the world whether in a pack, box or on a pallet. Purolator uses Canada's largest dedicated air express fleet and has an extensive service network, with 123 operations locations, 147 Shipping Centres, over 550 authorized Shipping Agents and more than 350 drop boxes.

Purolator has a fleet of more than 4,000 vehicles and makes approximately 275 million deliveries and pickups each year. In 2010, Purolator generated revenue of $1.5 billion and, after excluding intersegment revenue, represents 19 per cent of the 2010 Canada Post Group consolidated revenue of $7.5 billion.

Purolator is a strategic asset of Canada Post and is 91.0 per cent owned by Canada Post. Its ability to focus on the B2B segment of the market and develop synergies, such as airline haul, allows The Canada Post Group to offer more value at lower cost.

Revenue



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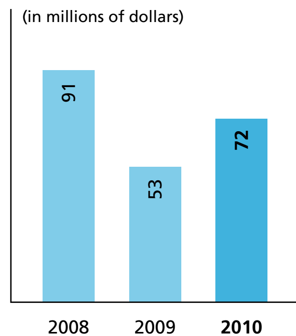
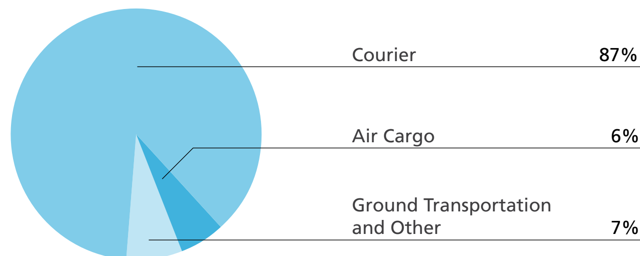


Operating revenues by market – 2010



Operating revenues by market	2010	2009	2008
Courier	87%	87%	89%
Air Cargo	6%	6%	5%
Ground Transportation and Other	7%	7%	6%

Vision

We Deliver Canada – Fully and Sustainably
Purolator is a comprehensive logistics service provider focused on delivering Canada – fully and sustainably.

Business environment

Purolator continues to be the largest logistics company in Canada. With revenue growth of 4.1 per cent in 2010, Purolator continues to hold the largest market share, by revenue, in the Canadian express market. Purolator Freight™ and Purolator's international business segments continued to see strong growth, both in terms of revenues and profitability.

Although volumes improved in 2010, the increase has not been as strong as anticipated. Customers continue to focus on cost control and customer behaviour has shifted. Research confirms that, in order to satisfy customers, a firm's offerings must span more modes of transportation—from courier services to less-than-truckload ("LTL") and trans-border LTL—as the enabler of profitable growth. Innovative, flexible technology solutions are also critical components of the total service experience being sought by customers.

Competition continues to be fierce. Globalization and industry consolidation continue to drive customer needs as they look to outsource more of their supply chain and transportation needs. More customers than ever are choosing suppliers based on their ability to offer creative solutions and a wider range of services, as well as providing end-to-end shipment visibility and stronger integration of shipping systems with their information systems.

In summary, technology innovations continue to change customer expectations as well as the conduct of business and the management of transportation and distribution processes. In order to retain its competitive advantage and differentiate itself from its competitors, Purolator must continue to maintain a strong customer focus and deliver technology improvements and innovation.

Strategy

Purolator celebrated its 50th year in business in December, 2010. The company has refined its strategy to become an externally focused, market-driven organization and will continue to be focused on profitable growth and enhancing the customer experience. Purolator's strategy includes the following strategic priorities:

- build a high-performance culture enabling its employees to help customers succeed;
- create sustainable market advantage through superior customer experience and brand leadership;
- strengthen the portfolio by continuing to invest in strategic lines of business to achieve scale and deliver profitable growth;
- grow express market share by targeting underdeveloped high-yield segments and enhancing express performance; and
- drive cost improvement by leveraging process innovation, technology and asset optimization.

Purolator has invested significantly in technology solutions over the past four years (with the "Purolator 2010" transformation) in order to create compelling customer solutions and the tools to allow the Purolator team to deliver on its promise to deliver superior, flexible distribution solutions to help businesses succeed in a changing world. Purolator will continue to invest in its future and focus on areas that enhance its overall strategy.

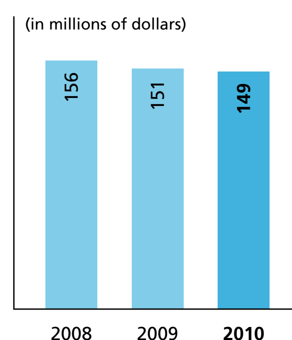
2010 objectives and achievements

In 2010, Purolator's revenues increased by $59 million or approximately 4.1 per cent compared to the previous year, but fell short of plan. During the year, Purolator migrated customers to its new customer-facing systems, implemented several new tools within the Customer Service and Sales team, increased its investment in environmentally sustainable technologies and reduced its costs without impacting service levels. Purolator also completed major milestones in support of its 2010 strategic objectives, as summarized below.

- Purolator helped deliver the Vancouver Olympic experience to the world as the official courier of the 2010 Olympic and Paralympic Winter Games. Purolator used its expertise and network to ship 1.6 million event tickets, as well as more than 100,000 packages of merchandise ordered through the Vancouver 2010 website. Purolator also provided courier and distribution services to support the day-to-day operations leading up to and during the 2010 Winter Games, including working with the Vancouver Olympic Organizing Committee ("VANOC") to provide delivery services to official VANOC venues, including the Athletes' Villages and Main Media Centre. Purolator was awarded the prestigious Vancouver 2010 Sustainability Star for the Quicksider™, a battery-operated electric vehicle that serviced various Olympic venues.
- In 2009, Purolator began testing two long combination vehicles ("LCVs") between Montréal and Toronto, as part of a pilot program initiated by the Ontario Ministry of Transportation and the Ontario Trucking Association. The pilot program allows a limited number of commercial operators to pull two full-sized trailers—referred to as LCVs—on designated highways. Purolator was one of 50 commercial fleets selected for this pilot. In April 2010, Purolator expanded its participation to include a pilot between Edmonton and Calgary.
- Beginning in November 2010, customers have a new way to connect with Purolator's Customer Care team through a new Twitter account. Customers can now go to www.twitter.com/purolatorhelp and connect themselves to a Purolator representative to get product information, shipment tracking or answers to any customer-care-related issues, all in real time. A dedicated social media team provides live support for Purolator's Twitter account.
- In November 2010, Purolator opened a new facility in Lloydminster, Alberta. The new facility replaces an existing Purolator terminal and includes additional capacity, an upgraded sortation system and a new shipping centre.
- As part of its commitment to protect and preserve the environment, Purolator added 200 hybrid electric vehicles ("HEV") to its fleet throughout the country—nearly doubling its HEV fleet, which is the largest HEV fleet of any logistics company in North America.
- For the eighth straight year, Purolator and the Canadian Football League™ ("CFL") teamed up to encourage CFL fans to help support local food banks across Canada. Since its inception in 2003, the Purolator Tackle Hunger™ program has helped deliver the equivalent of more than three million pounds of food to food banks across Canada.

2.8 Logistics segment

Revenue



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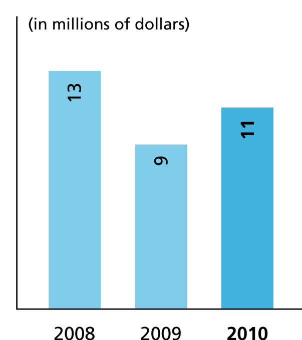


SCI Group Inc.

The business

The Logistics segment consists of SCI Group Inc. ("SCI"), which is 98.7 per cent owned by Canada Post. SCI Logistics Inc. changed its corporate name to SCI Group Inc. effective January 1, 2009. SCI helps companies reduce cost and improve service through the design, implementation and operation of efficient supply chain solutions through its operating entities, SCI Logistics, Progistix and First Team Transport.

SCI Logistics designs and operates manufacturing and retail fulfillment solutions. As a third-party logistics provider, SCI Logistics delivers coast-to-coast, door-to-door, and order-to-delivery for manufacturers and retailers with direct-to-store ("DTS"), B2C and B2B fulfillment requirements. SCI Logistics' customized solutions integrate distribution centre management, order processing, inventory control and reverse logistics.

Progistix designs and implements outsourced logistics solutions for major Canadian corporations and international companies expanding into the Canadian market. Progistix is a third-party logistics partner for companies requiring sophisticated field service logistics, critical parts network and transportation management solutions.

First Team Transport provides contracted and dedicated transportation management and services for companies with high-value products requiring time-sensitive transportation solutions.

In summary, each of SCI's operating entities has a specific market focus that allows its logistics services to be embedded within its clients' organizations, thereby enabling The Canada Post Group to offer end-to-end supply chain services to Canadian businesses. SCI generated revenue of $149 million and, after excluding intersegment revenue, represents 2 per cent of the 2010 Canada Post Group consolidated revenue of $7.5 billion.

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 Deutsche Post ("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.

Strategy

SCI's business strategy for 2011 is to focus on growth, improving processes and building capacity and competencies. Key strategic objectives that align to this strategy are:

- leverage synergies within The Canada Post Group, specifically sales and procurement;
- aggressively grow the transportation segment;
- continue to reduce the cost base through the quality program;
- shift the organizational culture and skills to support growth;
- implement corporate metrics to measure progress.

2010 objectives and achievements

In 2010, SCI's focus was on growth, specifically in the health-care market segment. SCI also improved operational and back-office cost structures by leveraging its culture of continuous improvement and monitoring supply chain performance using a performance-management reporting and measurement system. However, SCI's 2010 revenues fell short of plan.

2.9 All Other segment

The business

The All Other segment includes Innovapost Inc., ("Innovapost"), a joint venture between Canada Post (51 per cent) and CGI Information Systems and Management Consultants Inc. ("CGI") (49 per cent).

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 brings value to the Group by reducing costs, improving service, and providing business and technology consulting services. It leverages its relationship with strategic partners to add value for its customers through the implementation of technology solutions.

A key part of the Innovapost strategy is to assist clients in transforming their technology environments by creating savings in operating costs and converting them to investment in new technology. It will also improve its internal systems, processes and capabilities, and transform its application management and development services to world-class levels using industry standard tools, processes and methodologies.

During 2010, Innovapost submitted to Canada Post and Purolator proposals for the renewal of its service contracts that expire in 2012. Innovapost continues discussions with Canada Post and Purolator who had previously indicated they were not automatically renewing their agreements with Innovapost. Decisions on renewals are to be made in May 2011 for Canada Post and July 2011 for Purolator, in accordance with their agreements. Canada Post is evaluating all options.

In 2010, Innovapost continued to reduce operating costs for its clients, passing on price efficiencies gained in application management and infrastructure services. In 2010, Innovapost achieved its key corporate metrics for customer satisfaction, employee satisfaction and service quality.

3 Key Performance Drivers

A discussion of the key drivers of our performance, our progress against 2010 objectives and 2011 priorities

3.1 Key performance drivers

The Canada Post segment 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 customer value, employee engagement, delivery performance and financial results 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 58.*

Delivery performance

Our delivery standards require us to deliver domestic Lettermail items 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 domestic Lettermail service by depositing mail through mailboxes and post offices and tracking it to delivery points across the country.

Financial performance

Financial performance is monitored through the line of business revenues, corporate earnings and financial ratios. For further information, see *Section 1 – Executive Summary on page 31 and Section 8 – Results from Operations on page 77.*

3.2 Progress against 2010 objectives

Canada Post employs a corporate scorecard to track and manage progress against our corporate priorities. Results are reported monthly to senior management. Here, we summarize our progress in meeting our 2010 objectives.

Progress against 2010 objectives

Legend

●●●	Achieved
●●	Partially achieved
●	Not achieved

Customer Value		
2010 Objectives		**2010 Results**
Achieve customer-value targets	●●	The customer value target for the Direct Marketing line of business was achieved for 2010 reflecting service level improvements for Unaddressed Admail. The Parcels line of business, however, fell short of its target for the year.
Reduce the rate of problem incidence for our customers, and improve problem resolution performance at Canada Post call centres	●●	The rate of problem incidence for Admail products improved notably reflecting service level improvements for Unaddressed Admail. However, problem incidence for Parcels deteriorated slightly. The rate of problem resolution for both Admail and Parcels remained relatively unchanged during the year.
Develop a plan to identify and prioritize customer irritants to improve the customer experience	●●	Customer irritants were identified and prioritized. Implementation of initiatives to address top priority issues has commenced and will continue in 2011.
Upgrade Customer Relationship Management system to improve ability to resolve customer issues	●●	Enhancements were made to the Customer Relationship Management and telephone-integrated voice response systems. Similar enhancements were developed for the Canada Post customer relationship management online system, which went live in January 2011.
Continue to enhance visibility of parcels throughout the delivery network	●●●	Packet-scanning equipment is now deployed at all plant locations. New scanning capabilities and equipment continued to be expanded and deployed within the network to further enhance parcel-tracking capabilities for our customers.
Develop a security strategy for Canada Post to enhance security of the mail	●●	The security strategy and risk assessment were completed. Continued to expand the installation of security video cameras in our plants, and implemented enhanced security screening requirements for contractors.
Install high-security locks on mailboxes to safeguard the mail	●●●	The installation of high-security locks in street letter mailboxes and community mailboxes was completed. Installation of high-security locks at high-risk apartment mailboxes continues as risks are identified.

Progress against 2010 objectives (continued)

Employee Engagement		
2010 Objectives		**2010 Results**
Achieve employee engagement and employee customer-focus targets	●	The Employee Engagement Index results increased by one percentage point in 2010 but fell short of the target level. Improvements were noted in several key areas, most notably in employee recognition. Results for the Employee Customer Focus Index also fell short of the target level.
Create a healthy and safe workplace – achieve 15% accident-reduction target	●●●	Canada Post continues to focus on raising safety awareness with its employees. New training programs are introduced on an ongoing basis to address high-risk activities. Safety hazards continue to be promptly addressed. Accordingly, the 2010 target to reduce the number of accidents by 15 per cent was achieved.
Deliver development programs in support of Postal Transformation, leadership development, and sales effectiveness	●●●	A major focus for 2010 was training letter carriers and mail-processing employees to ensure successful implementation of Canada Post's physical delivery network modernization plans. Sales programs focused on value-based selling, and leadership programs that reinforced core competencies were delivered to enhance sales effectiveness and leadership development.
Build and implement accident-reporting system to provide timely, accurate, structured information	●	Design of a new accident-reporting and claims management system has commenced that will enable detailed accident-reporting and proactive claims management capabilities. Implementation will be completed in 2011.
Develop analytics to enable targeted accident-prevention strategies	●●	Accident 'severity' and 'probability of occurrence' models were established to assist in the development of workplace safety strategies. These models will provide predictive capabilities to proactively identify and address workplace safety hazards.
Conduct rural mailbox safety assessments	●●●	Rural mailbox safety assessments are being undertaken to assess the ability of Rural Service Mail Couriers to safely deliver mail to rural mailboxes. The assessments continue to proceed in accordance with plan, with approximately 136,000 assessments completed in 2010.
Increase customer focus with employees	●●	A communications campaign focused on "Quality" was rolled out to letter carriers and mail-processing employees across the country, under the heading "What we do matters." However, additional efforts are required to increase employees' customer focus.
Step up face-to-face communications with front-line employees	●●●	Over 400 front-line visits were conducted, providing an opportunity for letter carriers and mail-processing employees to meet face-to-face with senior executives and discuss corporate performance results and the state of the postal industry. As well, 12 regional forums and 47 front-line leaders' forums were conducted to provide business performance updates and ensure goal alignment across all employees in the company.

Progress against 2010 objectives (continued)

Delivery Performance

2010 Objectives		2010 Results
Achieve delivery-service targets	●	Canada Post is in the midst of significant change to its mail processing, delivery and transformation infrastructure. This change is essential to keep costs under control and to enable Canada Post to better serve customers in the future. During a transition of this magnitude, maintaining high-service levels is challenging. In 2010, we fell short of some delivery-performance targets, including domestic Lettermail.
Achieve parcels-scanning targets	●●●	Parcels-scanning performance exceeded targeted levels in 2010, benefiting from expanded deployment of scanning technology and equipment.
Achieve 2010 Postal Transformation milestones	●●●	The new Winnipeg plant commenced mail-processing operations in the second quarter of 2010 as scheduled. We completed our 2010 plan to transition mail delivery routes to the new delivery model, including deployment of new mail-sequencing equipment and replacement of critical infrastructure. Customers and employees are being kept apprised of all changes in a timely manner. We remain on plan for the balance of the program.
Develop and implement an Operations service and quality program to enhance service performance	●●	We developed and implemented a quality indicator and measurement reporting system to provide increased visibility within Canada Post's mail-processing operations. Results are being monitored.

Financial Performance

2010 Objectives		2010 Results
Deliver The Canada Post Group earnings commitment of consolidated income before income taxes of $110 million*	●●●	Consolidated income before income taxes was $307 million. Excluding the $117 million unplanned reduction in employee future benefits expense in the Canada Post segment, income before income taxes would have been $190 million which exceeds our 2010 commitment.
Develop growth and revenue diversification strategy to ensure the financial sustainability of the Corporation	●●	Growth and revenue diversification initiatives were developed and integrated into Canada Post's five-year Corporate Plan, including CentrSource™ and Canada Post Comparison Shopper.
Achieve new product revenue target	●●	New product revenues, while having increased significantly on a year-over-year basis, fell just short of planned levels.
Achieve Canada Post corporate cost savings commitments	●●●	Cost savings achieved through cost-containment actions and restructuring activities exceeded planned levels.
Deliver Canada Post earnings commitment of income before income taxes of $30 million**	●●●	The Canada Post segment income before income taxes was $233 million. Excluding the $117 million unplanned reduction in employee future benefits expense, income before income taxes would have been $116 million which exceeds our 2010 commitment. A shortfall in revenues was more than offset by lower-than-expected employee future benefits costs and savings generated through cost-containment actions.

* The commitment of $110 million for The Canada Post Group is higher than the Corporate Plan of $80 million
** The commitment of $30 million for the Canada Post segment is higher than the Corporate Plan of $15 million

3.3 2011 priorities

We must be able to provide the quality service that Canadians expect and to remain relevant in the future. For 2011, our priorities are to achieve our financial imperatives and focus on opportunities for revenue growth in a challenging and uncertain economic environment. We will continue with our Postal Transformation Program, health and safety improvements, quality and security of the mail initiatives and employee engagement programs.

Financial Imperatives
For 2011, we are facing some important challenges that could impact our long-term sustainability. We expect to continue growing our revenues despite the ongoing impacts of erosion on letter mail, the highly competitive parcel market, and the increasing pressures on our Direct Marketing products from alternative forms of media. To continue to remain profitable, Canada Post will continue to respond with focused cost-management measures to achieve its financial objectives. We will ensure that spending commitments are within our current financial capacity. An important priority is to successfully negotiate a new collective agreement with our largest union, the Canadian Union of Postal Workers ("CUPW"). This will enable Canada Post to continue providing products and services to Canadians at affordable and competitive rates while remaining both relevant and financially self-sustainable into the future.
Growing the Business
Paramount to our long-term sustainability is continued growth of our revenues. With many of our conventional products under pressure from e-substitutes and changing consumer trends, we must continue to offer new products and services to meet the changing customer demands. We will grow the business by leveraging The Canada Post Group's strengths and competing more effectively for major distribution and logistics contracts. We will also continue to explore and engage in new revenue opportunities to diversify our revenues outside of our core business.
2011 Postal Transformation Program
Our Postal Transformation is crucial to Canada Post's future ability to sustain service and address competitive pressures. In 2011, we will continue with our national equipment deployment, addressing the obsolescence of outdated equipment. We will continue the transformation of our delivery services through the modernization of our depot facilities and the introduction of sequenced mail to improve delivery efficiency. We are optimizing work processes to provide better service for Canadians and a safer work environment for our employees. Modest benefits began to accrue in 2009 and the amount of benefits to be generated from Postal Transformation will accelerate in 2011 as we proceed to steady-state in 2017.
Sustainability and Engagement
In 2011, management will continue its dialogue and communication with employees on its vision for a sustainable Canada Post going forward. We will continue to promote a customer focus with our employees and build a highly engaged and trained workforce to meet the challenges that lie ahead. As we strive to become a more customer-focused organization, we will introduce improved customer case management capabilities to help us better resolve customer issues, address major customer irritants, and improve the effectiveness of our customer call centres. The safety of our employees is paramount and we are committed to reducing the frequency of accidents. We intend to deliver programs focused on raising safety awareness, accident avoidance and prevention, and adherence to safe operating practices. These programs are designed to strengthen a culture of safety, accident prevention and awareness across the Corporation. We will continue to address the safety of rural mail delivery with the continuance of rural mailbox safety assessments. We will continue to improve the quality and security of the mail. Investments in the area of security, including improved detection, investigation and analytics will ensure that the mail remains safe and that Canadians continue to trust us with their important communications.

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 is one of Canada's largest businesses with approximately 69,000[2] employees. Canada Post, a four-time Top 100 Employer, a Best Diversity Employer, one of Canada's Best 50 Corporate Citizens, and a National Capital Region Top Employer, employs approximately 57,000[2] people and our subsidiaries employ another 12,000[2].

An estimated 31,000[3] full-time employees (or an average of 3,100 per year) are forecast to leave the Canada Post segment between 2011 and 2020 as a result of retirements and normal attrition due to a highly competitive labour market. In addition to retirements and voluntary departures, for every employee who leaves, another five employees, on average, will change jobs within the company. The attrition challenge is significant and represents both a risk and opportunity. High turnover due to retirements and voluntary departures create additional operating and cost pressures due to impacts on staffing, orientation, training and productivity. At the same time, attrition provides an opportunity to change the cost structure of the Corporation, recruit new employees with new skills and ideas, and reallocate human capital to meet new and emerging customer demands.

People play a critical role in the business of the Corporation. Ensuring that we have the quality and quantity of employees needed to manage and grow the broad and varied aspects of our business is pivotal to the success of Canada Post. As the Canadian economy recovers and employment rises, finding and retaining the people needed to sustain our operations will continue to be challenging. Overall recruitment challenges, changes in the relative levels of Canada Post specific knowledge, skill, and experience, and changing attitudes toward work will require increased attention to issues of employee engagement, recruitment, training, leadership development and retention. In response to these demands, Canada Post continues to work on initiatives that contribute to the creation of a high-performing workforce from the front-line to the executive level. To achieve our goal, we continue to focus on improving our employee value proposition and employer reputation, adjusting our programs and policies to reflect changing demographics and using tools such as an e-recruitment system for external and internal hires, social media and modern leadership programs.

In 2010, we continued to improve our programs, processes and tools for training, recruitment, talent management, leadership development and succession planning. These improvements enhance our ability to identify, source and develop employees with high-skill levels and leadership potential, and ensure that we have a sufficient talent pipeline to meet our current and future needs.

Continuing with the Queen's University partnership, Canada Post senior executives delivered comprehensive development programs in four critical business areas: finance, human resources, operations and strategy. These programs were well attended and well received.

A Learning Index, which forms part of the Corporate Team Incentive, is used to plan, implement, monitor and measure our training efforts in order to meet our large and complex demands for training. Manager and superintendent mentoring and training programs, such as "Leading Edge" and "CORE Supervisory Skills" were delivered to emphasize coaching skills and promote employee engagement.

In 2010, sales training focused on developing sales diagnostic skills, listening levels, and critical thinking as employees received training in either "Value Based Selling" or "Opportunity Assessment".

More than 60 new courses were developed and delivered in 2010 to support Postal Transformation, which places new demands and expectations on our front-line employees and team leaders.

The LEA 360 (Leadership Effectiveness Analysis) tool continues to be used to assess current leadership practices against a desired leadership profile and to support leadership development. These assessments are followed up by workshops, enrolment in Queen's Executive Programs, and on-the-job assignments designed to increase leadership effectiveness.

In summary, training programs continue to be developed or enhanced to keep pace with changing business requirements. Canada Post believes in the power of learning and management development as a key driver of success and is committed to developing employees with high-skill levels and leadership potential.

In 2011, we will continue to expand the use of our training and planning tools to ensure that we provide employees with the opportunity to acquire new skills, enhance performance and contribute to the success of the company.

[2] Employment figures include full-time and part-time paid employees, excludes temporary, casual and term employees

[3] 31,187 full-time departures are expected by 2020 (21,657 retirements and 9,530 other departures)

4.2 Employee engagement

Canada Post

Since 2006, employee engagement has been a top priority. Our goal is to become the best place to work in Canada, with every employee contributing to and sharing in our success.

In 2010, efforts to boost levels of employee engagement continued to concentrate on improving respect and fairness in the workplace, involving employees in decisions that affect their work, and developing leadership capabilities among our front-line team leaders.

Improving respect and fairness includes a focus on employee health and safety in the workplace. Canada Post continued efforts to strengthen our health and safety leadership by providing safety leadership training to superintendents and managers to help them improve their coaching and mentoring skills. We encouraged Operations leaders to participate in safety leadership activities throughout the year to raise safety awareness and we tracked their progress at completing these activities which allowed us to achieve the 2010 target to reduce the number of accidents by 15 per cent. Efforts to involve employees in decisions that affect their work relied on extensive face-to-face communication with employees. For the fifth year, the President and Senior Vice-President of Operations participated in 12 regional forums attended by 3,500 employees in depots and plants across the country. At these forums, we shared the continuing financial challenges facing the Corporation, discussed sustainability (Postal Transformation and Canada Post Pension Plan), security of the mail, and health and safety. Executive front-line visits were especially important to involving and engaging our employees. Vice-presidents, general managers and directors met with small groups of employees in their workplaces. Approximately 400 of these executive visits took place. The forums and executive visits both aimed to connect front-line employees and supervisors to our business results by sharing our plans.

In addition, for the first year, we involved 2,800 front-line team leaders in 47 full-day meetings with their regional general manager and a member from the senior management team to inform them about the company's challenges and future direction. Teams of subject-matter experts provided detailed information on key topics including the Short-Term Disability Program, local Postal Transformation plans, negotiations with labour representatives and effective ways to communicate with employees.

To celebrate and connect the contributions employees make to our company's success, we held our third annual Employee Appreciation Day. This and other recognition programs reinforce our corporate priorities and values, help build a culture of appreciation and drive employee engagement.

The results of the 2010 Employee Survey show smaller increases in employee engagement compared to previous years. We raised the Employee Engagement Index by one percentage point, but did not meet our target, which required a two-percentage-point increase.

Our employee engagement strategy for 2011 will aim to build on progress we have made to develop respect and fairness in the workplace. We will continue to engage front-line team leaders and develop their leadership skills. We will build leadership accountability for employee engagement through scorecards that require all team leaders to: regularly involve employees in decisions that affect their work; involve their teams in survey action planning to improve issues they identified in the survey; and recognize employee contributions that support our corporate priorities, such as security of the mail. We will seek common ground through quality customer service to build employee pride and higher levels of customer satisfaction.

Purolator

Purolator continues to ensure that employees have a safe place to work and are given the proper tools to be successful. Sustained commitment to employee training is an ongoing part of the foundation of the company's success. In 2009, Purolator conducted Quarterly Pulse surveys that provided valuable information on employee morale and these surveys continue to be used to measure progress. Employees are encouraged to share their suggestions about how the company can improve in the areas of performance management, growth and development, and change management. Such feedback helps to ensure that the right steps are taken to make Purolator a better place to work. Employees also have a stake in the business since they own approximately 2 per cent of total issued share capital, through an employee share ownership plan. During the year, Purolator began engaging employees in real-time dialogue by launching an employee blog and finalized plans to conduct an in-depth employee survey in 2011.

4.3 Labour relations

Number of employees covered by collective agreements – Canada Post

Bargaining unit	# of represented employees*	Collective agreement expiry date
CUPW (1)	39,204	January 31, 2011
CUPW-RSMC (2)	6,773	December 31, 2011
CPAA (3)	6,243	December 31, 2014
APOC (4)	3,463	March 31, 2014
PSAC/UPCE (5)	1,684	August 31, 2012
Total	**57,367**	

* Includes full-time and part-time employees including those on unpaid leave, as at December 31, 2010; 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

In early 2010, the Canadian Union of Postal Workers ("CUPW") applied to the Canada Industrial Relations Board (the "Board"), requesting the establishment of a single bargaining unit for all Operations employees, excluding supervisory personnel. The CUPW is arguing that employees covered by the Urban Operations Agreement (CUPW), the rural and suburban mail carriers ("RSMC"), and the employees in semi-staff and rural post offices (Canadian Postmasters and Assistants Association or "CPAA") should be merged into a single bargaining unit. In February 2010, Canada Post filed a motion to dismiss CUPW's request. The parties will meet before the Board throughout 2011.

In regard to collective bargaining, the Corporation is exploring options to ensure that it remains relevant and competitive in the future. The decline in mail volumes continues to have a significant impact on operations and our workforce. In order to protect our future, the Corporation is investing in new equipment and finding ways to reduce costs, while continuing to maintain service to Canadians. By modernizing its operations, the Corporation is positioning itself and its employees for long-term success. Canada Post continues to engage its employees' labour representatives in dialogue to ensure they understand the challenges that the company faces.

Canada Post began negotiating a new collective agreement in October 2010 with its largest union, the CUPW, keeping our challenges in mind. The Corporation is seeking changes to the collective agreement, including a new Short-Term Disability Program and new processes that will help resolve disputes and grow the business. The dialogue between both sides is ongoing and the Corporation remains optimistic that a negotiated settlement can be reached.

Below is a summary of collective bargaining activity that occurred in 2010 with each of the employees' labour representatives.

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

The parties began negotiating a new contract in October 2010 prior to the expiry of the CUPW collective agreement on January 31, 2011. The Corporation is aiming to reach an agreement that recognizes the need for cost competitiveness for its largest group of employees, which includes a new offering for future employees. In January 2011, the CUPW applied for conciliation as provided for under the *Canada Labour Code* and the government subsequently appointed a conciliator. The Corporation and the CUPW are working to avoid a work disruption.

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

Canada Post and the CUPW-RSMC are in the final year of an eight-year collective agreement, which will expire on December 31, 2011. The parties began negotiating the final contract re-opener in November 2009, and will continue to meet into 2011 after the union referred all unresolved matters to interest arbitration. Neither party has the recourse to strike or lock out during the life of the collective agreement. Bargaining for the new collective agreement is expected to begin in the fall of 2011.

Canadian Postmasters and Assistants Association ("CPAA")

Canada Post and the CPAA, which represents rural post office postmasters and assistants, began negotiations towards a new collective agreement in May 2009, prior to the December 31, 2009 expiry. After negotiating the majority of the new agreement in 2009, CPAA referred one outstanding issue to an arbitrator for final offer selection in February 2010. The parties received a decision from the arbitrator in June 2010. The new five-year collective agreement, which includes wage increases, the implementation of the Short-Term Disability Program, and updates to various benefits, will expire on December 31, 2014. The extended life of the collective agreement is intended to provide sound labour stability.

The Association of Postal Officials of Canada ("APOC")
Canada Post and APOC are now in the third year of a five-year collective agreement, which will expire on March 31, 2014. The Association represents supervisors as well as supervisory support groups such as trainers and route measurement officers, and sales employees.

Union of Postal Communications Employees ("UPCE")
Canada Post and the UPCE are now in the third year of a four-year collective agreement, which will expire on August 31, 2012. The UPCE represents two groups of employees, those who perform administrative work, including call centres, administration, pay and production, control and reporting, as well as technical employees from finance and engineering.

Number of employees covered by collective agreements – Purolator

Bargaining unit	# of represented employees*	Collective agreement expiry date
Teamsters (1)	8,332	December 31, 2011
Other (2)	1,039	January 31, 2011 December 31, 2012 December 31, 2013
Total	**9,371**	

* Includes all full-time and part-time employees including those on unpaid leave, as at December 31, 2010; excludes temporary, casual and term employees
(1) Teamsters = operations
(2) Other = clerical and administrative

In 2010, Purolator and the Communications, Energy and Paperworkers Union, which represents clerical/administrative employees in Quebec, reached a mutually beneficial collective agreement. This agreement is effective from January 1, 2010 to December 31, 2013. Purolator's strong partnership with its employees helped facilitate this mutually acceptable agreement.

In regard to upcoming negotiations, a clerical/administrative collective bargaining agreement with the Canadian Office and Professional Employees Union in Northern Ontario expired on January 31, 2011. The operations collective bargaining agreement with The Canada Council of Teamsters will expire on December 31, 2011.

Number of employees covered by collective agreements – Logistics – SCI Group

Bargaining unit	# of represented employees*	Collective agreement expiry date
CEP (1) - Toronto	219	December 31, 2014
CEP (1) - Laval	17	December 31, 2010 (2)
CEP (1) 82Q1 - Laval	26	November 30, 2011
Total	**262**	

* Includes all full-time and part-time employees including those on unpaid leave, as at December 31, 2010; excludes temporary, casual and term employees
(1) CEP = Communications, Energy and Paperworkers Union of Canada
(2) This collective agreement expired on December 31, 2010 and will not be renewed. Effective March 31, 2011, Progistix will cease to provide warehouse and distribution services in the Province of Quebec

4.4 Workplace health and safety

In order to continue strengthening our health and safety program, Canada Post is following a multi-year strategy with a focus on building safety leadership; identifying, preventing and controlling hazards; training; and continuous improvement. Our 2010 results show ongoing improvement resulting in Canada Post achieving its target to reduce the number of accidents by 15 per cent.

Safety leadership is key to building a safety culture. In 2009, we introduced to all levels of management clear expectations on actions and behaviours related to workplace safety. These criteria were enhanced in 2010 and once again formed part of the official performance scorecard.

Slips, trips and falls and ergonomic injuries related to manual material-handling are the main causes of our workplace injuries. In 2010, the slips, trips and falls program was enhanced by the addition of supervisory coaching tools to encourage safe work behaviours for letter carriers on-route. Our efforts have resulted in a reduction in slips, trips and falls compared to 2009. Musculoskeletal-related injuries were also reduced from 2009 levels thanks in part to an innovative program that was tested this year. The program provided in-plant, one-on-one coaching to supervisors to help them better recognize good ergonomic technique and to gain the confidence to coach employees on good material-handling technique.

We have continued to make progress to address the findings arising from the audits conducted by a third party (URS) of health and safety compliance and our health and safety management system in 2008, with a particular emphasis on the top-eight risk areas identified during the audit. In 2010, we demonstrated a further 6-per-cent improvement in our score over the baseline. There is also emphasis within Postal Transformation to ensure that safety and ergonomic improvements are integrated into our future processes and equipment.

In 2011, Canada Post will continue in its efforts to ensure full compliance with statutory health and safety requirements and, in particular, will focus on several activities that by their nature pose a higher risk to Canada Post employees and contractors. Projects will be implemented to strengthen our systems used to manage compliance with regulations for higher risk activities such as working at heights, machine guarding, equipment lock-out/tag-out, motorized equipment, high-voltage electrical equipment, and confined spaces. We will continue to improve our system and reporting capabilities related to workplace safety through improvements to our data collection system. This will allow us to further understand our workers' compensation claims, costs, accident types, opportunities for accident prevention and other trends. These enhancements will ensure focused strategies and measured successful outcomes.

Our safety leadership criteria will evolve in 2011 to continue to enhance the capability of our Operations management team to manage the safety of their employees.

4.5 Infrastructure

In order to maintain our service commitments and meet customer expectations, investment in critical infrastructure is required to ensure business continuity and position us for the future. Accordingly, the implementation of the Postal Transformation Program remains a top priority as these investments will increase productivity, improve product competitiveness and support future growth. Other business-sustaining investments are also required to maintain existing assets and support our lines of business. This section should be read in conjunction with *Section 6.3 – Investing activities on page 68 and Section 6.6 – Liquidity and capital resources on page 70.*

Canada Post

In 2010, Canada Post invested $400 million in capital assets, primarily on buildings, systems and equipment.

In 2011, Canada Post plans to invest approximately $690 million in capital for land purchases, facility upgrades, equipment, technology infrastructure upgrades and other systems to support Postal Transformation as well as our growth strategy for our lines of business. Capital investment is required to build platforms to enable us to offer our customers access to a larger selection of Canada Post products and services. However, given current economic conditions, we will continue to closely monitor our financial position and change the pace of capital spending, if required, to mitigate the impact of any financial pressures.

Postal Transformation, our major infrastructure renewal plan, is crucial to Canada Post's future sustainability. Our deployment plan addresses our most critical needs to replace infrastructure, starting with the construction of the new Winnipeg mail-processing plant, which opened in 2010. This plant reflects the Modern Post and is equipped with new-generation mail-processing equipment and systems and is the company's first plant to be registered as a Leadership in Energy and Environmental Design (LEED™) building. New letter carrier depots are being constructed and a number of existing letter carrier depots are being retrofitted to support the process changes introduced by Postal Transformation.

The deployment plan also includes the replacement of obsolete letter-sorting equipment in major centres and the introduction of a new delivery model. The resulting optimization of work processes will reduce and improve the manual handling of our products, increase automation, enhance safety and provide the capability to introduce new products and services.

In 2011, the deployment plan includes continued equipment deployment and delivery transformation across the country with a focus on realizing planned benefits, while supporting successful customer transition and employee readiness.

The entire Postal Transformation Program will require a total investment of $2.1 billion and is estimated to generate approximately $250 million in annual cost savings after full implementation.

The Postal Transformation benefits management process focuses on planning, managing and achieving intended financial and non-financial benefits.

An Integrated Benefits Model database has been developed to track planned versus actual benefit outcomes. Detailed models for most benefit categories have been developed and entered into the new database. Detailed benefit measurement processes are being established to document and validate the achieved benefits, either directly or indirectly through established key performance indicators. After validation, the achieved benefits will be entered into the database to report actual results against planned benefit outcomes. Results will be tracked throughout the duration of the Postal Transformation Program, up until 2017, when steady-state benefits are expected to be fully realized.

The risks associated with each initiative are being monitored and any significant variances in the underlying assumptions used to estimate the planned financial benefits are being documented and updated. Risks and benefit assumptions will be monitored and updated throughout the program deployment.

Over the next five years, Canada Post's investment plans include up to $2.2 billion in capital projects, including $1.2 billion on Postal Transformation. Investments will continue to be prioritized based on the greatest need and we will spend only what we can afford. Postal Transformation is designed with maximum flexibility in mind in order to ensure that investments continue to be a prudent use of our financial resources and will provide the most benefits.

Purolator

In 2010, Purolator reduced its investment in technology and infrastructure in comparison to prior years, as it focused on migrating customers to the new service modalities developed as part of the "Purolator 2010" transformation strategy. Investment in process improvements and employees continued. In 2010, Purolator invested $17 million in capital to complete the migration of customers to a new shipping system; implement SalesForce.com (a system that provides Purolator's sales team with the tool they need to manage their activities); acquire equipment to improve scanning consistency; and, implement various health and safety initiatives. Purolator's 2010 vehicle purchase was financed through a capital lease facility in 2010, bringing the total capital invested in 2010 to $31 million.

In 2011, Purolator will continue to monitor its investment activities, focusing on those areas with the most potential for profitable growth, customer service improvement and employee development and engagement. A new, long-term strategy will be rolled out that will build on existing strengths, identify new opportunities, increase the reach and scope of the distribution network, and make it easier to find distribution solutions that best meet customer requirements. This will ensure that Purolator continues to provide the customer experience that has made it Canada's largest courier.

4.6 Delivery

Canada Post delivers to over 15 million addresses through post office boxes, rural mailboxes, group and community mailboxes and door-to-door. No other delivery company in Canada has such an expansive reach. However, we face critical challenges from increasing delivery costs due to an ever-increasing number of delivery points as well as declines in the number of pieces of transaction mail per delivery point. Accordingly, we remain focused on improving productivity across our vast network.

Across Canada, we continued to restructure our letter carrier routes, rural and suburban mail carriers ("RSMC") routes and mail service courier routes, which improved productivity. We also focused on controlling staffing levels and the use of supplementary hours, such as overtime and the use of casual employees.

We have increased employee awareness on the quality of our delivery operations through improved reporting of quality issues, such as scanning-equipment defects, and through front-line visits and engagement with our employees. We have continued to expand the use of Portable Data Terminals ("PDTs") on many letter carrier routes to provide more timely scanning information.

We have worked with our employees to improve safety on their routes and in the letter carrier depots, resulting in a significant reduction in the number of accidents. We have continued awareness campaigns on hazards, such as avoiding slips and falls; and provided meaningful information on a wide variety of safety-related topics. We also continue to implement more efficient, ergonomically designed workstations to help letter carriers improve sorting efficiency. In addition, we have improved uniforms, including a new high-visibility letter carrier satchel.

Delivery quality has been improved by increasing and improving the address data in our Address Management System. The Address Inventory Management ("AIM") program has been implemented in all letter carrier depots, allowing a more accurate and timely update of point-of-call information.

In 2011, building a culture of quality will be a key priority along with improving productivity, enhancing employee safety and ensuring the security of the mail. As the company embarks on its national quality program, various security activities will continue to be implemented to complement this initiative. In addition to equipping our mailboxes with new high-security locks, Canada Post will continue to highlight security issues with our employees to protect our customers' mail. Canada Post also collaborates with law enforcement agencies and other postal administrations to address this important area.

4.7 Rural and suburban mail carrier health and safety

Our rural customers receive their mail in a variety of ways, including rural mailboxes ("RMBs"), which are typically located at the end of their driveways. Rural customers represent approximately 5 per cent of 15 million Canadian addresses. Due to continued urbanization throughout Canada, rural roads have more vehicles travelling at higher speeds. This raises potential safety hazards for rural and suburban mail carriers ("RSMCs"), our employees who deliver mail to these boxes.

To evaluate this risk, Canada Post uses the Traffic Safety Assessment Tool (TSAT), which was designed by third-party experts. The tool can be used to assess any RMB in any setting and considers a combination of factors, including traffic volume and speed, road markings and geographical considerations, such as hills or curves in the road that impede vision.

To date, Canada Post has preserved delivery to 87 per cent of RMBs reviewed across Canada. Approximately 58 per cent of the total 843,000 RMBs across the country have been reviewed to date. Over the next few years, the costs for assessing and resolving health and safety risks for RMBs are estimated to be over $150 million in operating costs and approximately $15 million in capital investment.

To avoid potential repetitive strain injuries, where requested by an RSMC, we hired ergonomic assistants to assist rural mail carriers with mailbox delivery through the passenger-side window of their vehicles. A right-hand-drive vehicle pilot was completed in 2010 with positive feedback from our volunteers. We are assessing the feasibility and cost of introducing right-hand-drive vehicles.

Keeping stakeholders informed throughout the Rural Mail Safety Review is a very important and necessary part of our activities. Canada Post follows a robust Community Outreach process. Through this process, we inform Members of Parliament, municipal officials and customers of the safety review in their community and the results. We also seek their input on potential solutions such as site selection for community mailboxes. This transparency is vital to the success of the safety review.

4.8 Retail

Canadian consumers and businesses rely on Canada Post's extensive retail network, comprised of almost 6,500 post offices. The retail network consists of corporate-managed post offices, and outlets managed by private dealers. Dealer-managed outlets are particularly successful as they provide convenient access for Canadians through longer hours of operation, available parking, and locations in areas where customers shop.

The retail network includes over 3,800 rural, corporate post offices and dealer outlets in diverse 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 ensures that local mail delivery is maintained by using a process called community outreach. Community outreach includes open consultation with federal and local officials to ensure that all parties are informed and have an opportunity to provide input. Decisions are made on a case-by-case basis as we seek to find practical solutions that satisfy the community while providing sustainable service.

In the fall of 2009, the Government of Canada created the *Canadian Postal Service Charter*. The *Canadian Postal Service Charter* requires Canada Post to consult with affected communities and customers at least one month prior to making a decision to permanently close, move or amalgamate a corporate post office. During 2010, Canada Post held *Service Charter* consultations on 12 corporate post offices.

The Retail strategy evolved in 2010. While we continued to focus on our core products, we also leveraged the point-of-sale system to launch or enhance various services and programs.

An identity validation service was introduced for BackCheck™, Canada's leading and largest provider of pre-employment screening. Customers receiving a request to complete a BackCheck background check can visit a post office with high speed Internet to complete the request and have their identification verified and scanned.

A new personal identification number ("PIN") management service was launched, which allows customers to safely and securely change or reset their PIN on select chip-enabled credit cards. The PIN management service is offered in all post offices with automated point-of-sale systems, allowing financial institutions that have signed up for the service to enable their customers to easily manage their PIN information, free of charge.

The VISA Gift Card program was updated and now provides customers with the flexibility of choosing the amount that fits their budget rather than choosing between three fixed denominations. The program was expanded in the fourth quarter to over 3,000 automated post offices to maximize sales for the holiday season.

MoneyGram™ continued to grow as more automated post offices were able to perform this electronic money transfer service.

The key to the success of the above programs is that they leverage the point-of-sale system and simplify the transaction, thereby minimizing postal clerk training.

Other 2010 point-of-sale system enhancements include the Feature Products screen. It supports our new Feature Product strategy, which involves promoting the right products at the right time to allow post offices to optimize their sales. The screen has been a tremendous success as it allows each post office to monitor the results of its promotional efforts. For example, as a Feature Product, the mental health point-of-sale solicitation program raised more than $1 million in donations to the Canada Post Foundation for Mental Health, representing a year-over-year increase of more than 60 per cent.

In 2010, we continued to concentrate on improving the customer experience by completing the stabilization of the automated point-of-sale system; increasing the number of Mystery Shop visits to our post offices (to assess postal clerk performance and evaluate in-store merchandising); and introducing a territory management program (to ensure that post offices are ready to serve customers effectively).

As a major cost-containment initiative, two retail distribution warehouses were merged in August 2010, which is expected to reduce overhead costs by approximately $1 million annually upon full implementation and stabilization in 2012.

In 2011, we will continue to focus on improving in-store performance by continuing to leverage our point-of-sale system and emphasizing our Feature Product strategy.

4.9 Internal controls and procedures

Disclosure controls and procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management on a timely basis, including the President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), so that appropriate decisions can be made regarding public disclosure.

The President and CEO and the CFO have evaluated the effectiveness of the Corporation's disclosure controls and procedures related to the preparation of Management's Discussion and Analysis and the consolidated financial statements. They have concluded that the design and operation of disclosure controls were effective at December 31, 2010.

Internal control over financial reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP.

Canada Post Corporation's CEO and CFO have assessed the effectiveness of the Corporation's internal control over financial reporting as at December 31, 2010, in accordance with Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, Canada Post Corporation's CEO and CFO have determined that the Corporation's internal control over financial reporting is effective as at December 31, 2010. 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 voluntarily comply with the rules and regulations of the CSA.

Changes in internal control over financial reporting

There were no changes in internal control over financial reporting during the year ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

5 Risk Management

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

Canada Post management incorporates the consideration of risks and opportunities in decision-making at all levels. An integrated and rigorous approach to Enterprise Risk Management ("ERM") has been implemented for the Corporation. As the global postal industry continues to undergo massive structural changes, our ERM framework has helped Canada Post understand and manage the most significant risks to our business. An extensive enterprise risk and control assessment is conducted each year and is reported to senior management and the Audit Committee on a semi-annual basis.

5.1 Definition of risk

Canada Post defines risk as any event or condition that could have an unplanned effect (positive or negative) on the Corporation's ability to achieve its key strategic, financial and operational goals. Following is a summary of the principal sources of strategic and operational risk and uncertainty facing the Corporation, along with the associated mitigation strategies.

5.2 Strategic risks

Labour negotiations

The current collective agreement with our largest union, the Canadian Union of Postal Workers ("CUPW"), does not support the flexibility necessary for the company to remain competitive and effectively adapt to the structural changes ongoing in the postal industry. It contains a substantial number of restrictions that limit Canada Post's ability to change. Negotiations with the CUPW began in late 2010. The current collective agreement expired in January 2011.

Risk mitigation
Canada Post is fully engaged in the current round of negotiations. Our proposals to the CUPW are aimed at protecting the financial viability of Canada Post with limited impact to current employees. Direct communication lines have been strengthened between management and unionized employees, such as front-line visits, to ensure that the current business situation is clearly understood by all.

Significant revenue declines

Erosion of letter mail revenues, in particular, has been anticipated for some time as mailers convert to electronic communication channels. This trend is occurring in Posts around the world and has been compounded in the past two years as the global economic crisis accelerated volume declines in all core postal business areas. An amendment to the *Canada Post Corporation Act* to remove the "exclusive privilege" on letters intended for delivery outside of Canada has been approved and has opened this market to competition. New customer demands and the increasing attractiveness of electronic delivery alternatives mean that letter mail erosion can be managed but not stopped. Direct Marketing mail faces substitution risks as online advertising continues its rapid growth. The parcels market also faces greater pressures on price, delivery standards and technology as market leaders have responded to revenue declines by cutting their prices. Increased capacity and an appetite for expansion among Canada Post's main competitors have put increased pressure on the Corporation's market share.

Risk mitigation
Canada Post will continue to respond to revenue risks through prudent cost management and investment in improving core postal products to preserve their value. The protection and growth of traditional revenue sources through service improvements, pricing optimization, customer acquisition and retention programs, and product innovations remain a central focus of the management team.

Ability to develop a revenue growth and diversification strategy

Canada Post's core mail and parcel businesses face increasing pressures from electronic substitution, discretionary spending decisions by customers and competition. While we remain focused on growing our business in these core postal areas, we must also explore revenue growth from new ventures in non-traditional markets to sustain a growing delivery network and maintain mandated service to all Canadians. Resources, effective innovation, and culture are all challenges that Canada Post must address as it pursues growth opportunities.

Risk mitigation
In 2011, the Corporation will emphasize opportunities to grow revenue in the traditional postal markets. At the same time, the management team and the Board of Directors are putting greater emphasis on growing new revenue streams. Growth initiatives are being developed and implementation of the first ones (e.g. Canada Post Comparison Shopper) are underway. Canada Post is also formulating a strategy to grow revenues in new areas as a hedge to long-term shifts in mailer and consumer preferences related to traditional mail.

Achievement of full Postal Transformation benefits

Our major infrastructure renewal project, Postal Transformation, will deliver a modern and efficient physical mail network that is crucial to Canada Post's future ability to sustain service and address competitive pressures in our core business areas. The Postal Transformation Program is large and complex. There are risks to implementing this project on time and within budget, while still delivering the targeted benefits. There are also risks that arise as a result of making significant changes to our plants, equipment and processes.

Risk mitigation
With the opening of the Winnipeg plant, we have demonstrated that we are able to manage the scope and scale of a large project.

Risks remain to implementing the rest of the project across all remaining sites on time and within budgets while still achieving the targeted cost savings and other benefits. We continue to control these risks through detailed execution plans, extensive project management and active engagement with the rest of the company to ensure that expected savings can be achieved. Detailed progress reports are prepared monthly for senior management and the Board of Directors. Internal review mechanisms include the executive-level Postal Transformation Committee and a rigorous risk-management process. Impacts on employees are being managed through extensive employee engagement efforts, including consultations with our unions and employees, training and significant safety and ergonomic enhancements. In addition, an Integrated Benefits Model database has been built to track planned versus actual benefit outcomes in order to focus on those initiatives that are the most critical and have the highest return on investment.

Pension deficits require significant funding

The Canada Post Pension Plan's two inherently volatile, primary risk factors are: (1) a decline in long-term discount rates, which can increase the pension obligation on a solvency basis; and (2) below-expected returns on Canada Post Pension Plan assets, which creates a shortfall in the assets available to meet the pension obligation.

As of December 31, 2010, based on current legislation and using the smoothed value of the Plan assets, the Plan is estimated to have a going-concern deficit of approximately $174 million and a solvency deficit of approximately $3,220[4] million . Canada Post, as the Plan sponsor, is responsible for funding solvency and going-concern deficits and started making special solvency contributions to the Plan in 2010. The scale of the Canada Post Pension Plan and funding volatility pose an ongoing risk to the Corporation's cash flows and ability to fund needed investments in modernization and growth. Further information is provided in *Section 6.5 – Canada Post Pension Plan on page 69.*

Risk mitigation

On an ongoing basis, the Canada Post Pension Plan remains safe and well-managed for employees. The company continues to evaluate the pension solvency position and has implemented a pension risk management framework to support continued excellence in pension management. All 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 as a part of its fiduciary duty to provide oversight for the Canada Post Pension Plan's investments and administration. An asset-liability study was conducted in 2010 and the Canada Post Pension Plan's risk exposures will be reviewed and updated as part of this study. The Corporation is awaiting regulations that will define how a letter of credit may be used to reduce the amount of special solvency contributions required as a result of the Canada Post Pension Plan's solvency deficit.

5.3 Operational risks

Health and safety

Canada Post is concerned with health and safety risks to which our employees are exposed as they carry out their duties in our workplaces and while serving delivery routes. The main concerns include the number of accidents or injuries due to unsafe working conditions, and those related to delivery safety issues for both rural and suburban mail carrier traffic-related hazards and letter carrier safety.

Risk mitigation

Canada Post is continuing to respond to these risks. Postal Transformation will address many safety issues through the construction of new buildings, installation of new equipment, and motorization of larger segments of the delivery force. Programs have been implemented to improve safety for rural delivery, and safety will continue to be a focus during future route restructuring for all delivery agents. *For further information, see Section 4.4 – Workplace health and safety on page 60.*

Security and privacy

Breaches of security involving physical mail and our assets/facilities are of utmost concern to Canada Post; equally important are the security of employees and the safeguarding of customer, employee and business information. Any event that compromises the security of information could result in hardship for customers and serious damage to the company's reputation.

Risk mitigation

Canada Post continues to monitor and invest resources into physical security, electronic security and the protection of privacy. The Corporation issues extensive security-related bulletins, and has established clear security policies and guidelines for anyone who touches the mail including employees, contractors and authorized dealer network. Numerous physical and electronic security measures are in place to protect the mail, postal facilities, and information, including monitoring, access controls and physical layers of security. Recent investments to enhance security include fortified mailboxes and high-security locks as well as an enhanced policy and procedure to ensure all who touch the mail have the appropriate security clearance. Privacy impact assessments are conducted to ensure that new technologies, information systems and initiatives adequately protect privacy. Audits related to information security for our multi-channel products are conducted frequently to mitigate risks.

Business continuity

Canada Post's aging physical infrastructure could lead to service failures and is certainly inadequate to meet future customer needs. External elements such as extreme weather, pandemic, power failure or fire are also potential causes of service disruptions. The Corporation must also be sensitive to the possibility of loss of access to our electronic network, including customer information, due to malicious causes such as worm or virus attacks.

[4] Solvency deficit when using fair value of Plan assets is approximately $3,710 million

Risk mitigation
Postal Transformation is the Corporation's key response to business continuity risks along the physical network and will provide major improvements to critical infrastructure to ensure the continuity of postal services. The company has prepared business continuity plans to deal with critical equipment failures, risks to our electronic infrastructure and other major events that could have wide-ranging effects.

Attrition

Canada Post, like many Canadian companies, is facing attrition-related risks in the form of high rates of retirement. This is both a current and long-term problem for Canada Post. We anticipate that more than half of our full-time employee population will leave the company over the next 10 years due to retirements and normal attrition. Consequently, Canada Post faces three significant business challenges: (1) keeping pace with recruiting demands to ensure an adequate supply of trained resources needed to sustain business continuity in the areas of service, quality and cost; (2) introducing training programs and knowledge-management tools to reduce the risks associated with the high loss of knowledge, skill and experience; and (3) recruiting, developing and retaining the leadership talent needed to meet the long-term objectives of the Corporation.

Risk mitigation
Canada Post is actively managing attrition risks and opportunities through a global best practice framework for strategic workforce planning. The company has increased its emphasis on employee engagement and work environment, employment branding and recruitment, skills training and employee development, leadership development, knowledge transfer and talent management.

Environmental sustainability

Because of the nature of our physical mail network, with its reliance on fossil fuels and paper-based communications, Canada Post is exposed to environmental concerns from customers and our Shareholder. Actions arising from these concerns could take the form of consumer choice (opting out of mail), do-not-mail legislation, carbon emission regulation or accelerated electronic substitution. These would result in decreased mail volumes and increased cost of delivery.

Risk mitigation
As part of our overall corporate social responsibility strategy, Canada Post is addressing environmental concerns through a variety of investments, including Postal Transformation, and through changes to existing products. Canada Post has committed to register all new building projects for LEED certification; a total of 15 building projects have been registered for LEED certification. Of these, two letter carrier depots received certification in January 2011. Canada Post will also gradually replace a portion of its existing fleet of delivery vehicles with smaller, more fuel-efficient vehicles. We are committed to continuously improving the way we conduct our business by following leading environmental and ethical business practices. Our collaboration with the International Post Corporation on an environmental measurement and monitoring system has helped us monitor our carbon emissions with a set of internationally recognized indicators for our industry.

Purolator continues to be an industry leader with respect to investment in hybrid electric vehicles ("HEVs") in its curbside delivery fleet. In November 2010, Purolator ordered 200 additional HEVs, doubling the company's HEV fleet, which is the largest of any logistics company in North America. Purolator is committed to protecting and preserving the environment and continues to investigate new ways to reduce greenhouse gas emissions through new technologies.

Legal risk

Canada Post has determined that no provision needs to be made 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) filed a complaint in 1983 against Canada Post that office clerks did not receive equal pay for work of equal value, compared to postal clerks and letter carriers. Following a lengthy series of hearings, the complaint has been dismissed by the Canadian Human Rights Tribunal and the Federal Court of Appeal. PSAC subsequently filed application on April 23, 2010 for leave to appeal to the Supreme Court of Canada. On December 16, 2010 the Court granted leave to appeal. Subsequently, the Registrar of the Court confirmed that the hearing of the appeal will take place on November 17, 2011. The estimated potential cost to Canada Post should PSAC's claim be successful is $175 million. However, as Canada Post does not consider it likely that the claim will succeed, this amount has not been recorded in the consolidated financial statements.

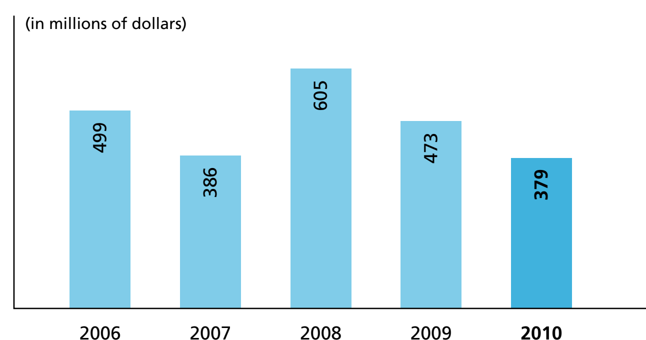
b) Volumetric process – Lee Valley Tools Ltd.
A class-action suit was commenced in October 2006 in the Superior Court of Ontario, alleging that Canada Post's volumetric process violated the *Weights and Measures Act*. Discovery, prior to a trial date, will continue into 2011.

c) Air transportation procurement – Canadian North
On December 18, 2007 Canadian North filed a Statement of Claim alleging that Canada Post conducted an unfair procurement of air transportation services to remote northern communities in relation to the Food Mail Program. The airline is seeking damages in the amount of $75 million plus $1 million in punitive damages. The parties are scheduling dates for examination for discoveries.

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 $379 million at the end of 2010—a year-over-year decrease of $94 million, primarily due to the Canada Post segment's special solvency contributions to the company's funded pension benefit plans.

6.2 Operating activities

(in millions of dollars)	2010	2009	Change
Cash provided by operating activities	(41)	134	(175)

Cash generated from operating activities was negative in 2010, representing a year-over-year decline of $175 million (mainly due to a $177 million decline from the Canada Post segment). The negative cash flow was primarily driven by an increase in payments for pension, other retirement and post-employment benefits of $485 million in the Canada Post segment. Over $400 million of these payments were related to employer special solvency contributions to the company's funded pension benefit plans. These increased payments were partially offset by a combination of higher revenue from operations, lower cash operating costs and an income tax refund in 2010.

6.3 Investing activities

(in millions of dollars)	2010	2009	Change
Cash used in investing activities	1,025	343	682

Cash used in investing activities increased by $682 million in 2010, when compared with 2009, primarily due to an increase in short-term investments of $637 million to manage the cash proceeds provided by the $1 billion long-term debt issue completed by the Canada Post segment.

Capital expenditures

(in millions of dollars)	2010	2009	Change
Canada Post	394	372	22
Purolator	17	41	(24)
Logistics	3	4	(1)
All Other and intersegment	(3)	(5)	2
The Canada Post Group	**411**	**412**	**(1)**

Capital expenditures for The Canada Post Group were flat compared with 2009, as year-over-year increases in the Canada Post segment were offset by lower spending in the Purolator segment:

- Canada Post segment capital expenditures totaled $394 million in 2010, a year-over-year increase of $22 million, primarily due to the continued implementation of Postal Transformation. In 2010, Postal Transformation increased capital spending by $77 million compared to the previous year, offset by lower spending in other areas of the business.

- Purolator segment capital expenditures totaled $17 million in 2010—$24 million lower than 2009. While Purolator intends to continue to invest in its future, the company has prioritized its objectives and will focus on areas that enhance its overall strategy. In 2010, Purolator's investments focused on the completion of customer-facing technology (designed and built as part of the Purolator 2010 Transformation project), the implementation of enhanced technology tools supporting the sales team, the completion of a new facility in Alberta and various health and safety initiatives.

6.4 Financing activities

(in millions of dollars)	2010	2009	Change
Cash provided by financing activities	972	77	895

Cash flows provided by financing activities increased by $895 million in 2010 when compared to 2009, primarily due to a $965 million increase in long-term borrowings in 2010 from the Canada Post segment's $1 billion long-term debt issue. This increase was partially offset by reduced transitional support received from the Government of Canada to assist with incremental costs incurred as a result of establishing the Canada Post Pension Plan. The transitional funding ended in the first quarter of 2010.

6.5 Canada Post Pension Plan

The Canada Post Pension Plan is required to file annual actuarial valuations with the Office of the Superintendent of Financial Institutions ("OSFI"). 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, the *Pension Benefits Standards Act, 1985* requires us to make special payments into the Canada Post Pension Plan to eliminate this shortfall over five years.

In October 2009, the Minister of Finance released a proposed reform plan for the federal private pension legislative and regulatory framework to allow Pension Plan sponsors to better manage their funding obligations within their overall business operations and reduce funding volatility. In June 2010, a number of amendments to the regulations of the *Pension Benefits Standards Act, 1985* were published and are in force since July 1, 2010. These include:

- adoption of a new standard for establishing minimum funding requirements on a solvency basis;
- introduction of a solvency margin which precludes Plan sponsors from taking contribution holidays if the margin is not met; and
- removal of the quantitative investment limits in respect of resource and real property investments.

In addition, Bill C-9, which received Royal Assent on July 12, 2010, includes several provisions relating to pensions, such as using a letter of credit to replace employer solvency payments up to a limit of 15 per cent of Plan assets and increasing the *Income Tax Act* surplus threshold from 10 per cent to 25 per cent of liabilities. Regulations to define these new measures have not yet been finalized.

The Corporation is awaiting regulations that will define how the letter of credit measure may be used to reduce special solvency contributions for Crown corporations. This measure is expected to allow Plan sponsors to use letters of credit to satisfy special solvency contributions up to a limit of 15 per cent of Plan assets.

The actuarial valuation for the Canada Post Pension Plan as at December 31, 2009, filed in May 2010 using the smoothed value of Plan assets, disclosed a going-concern surplus of $568 million and a solvency deficit of $1,847[5] million. The Corporation will file an actuarial valuation for the Canada Post Pension Plan as at December 31, 2010, based on legislation in place at the time of filing. Based on existing legislation, the current estimate of the financial position of the Canada Post Pension Plan as at December 31, 2010, when using smoothed value of Plan assets, is a going-concern deficit of approximately $174 million and a solvency deficit of approximately $3,220[6] million. Despite earning 10.4 per cent on Plan assets in 2010, well above the expected 7.25 per cent rate of return, the solvency deficit deteriorated during the year. This was a result of declining discount rates, which had the effect of increasing the present value of the Plan's future pension obligations.

[5] Solvency deficit when using fair value of Plan assets is approximately $3,213 million
[6] Solvency deficit when using fair value of Plan assets is approximately $3,710 million.

Our future cash contributions to the Canada Post Pension Plan are dependant on changes in discount rates, actual returns on Plan assets and other factors such as Plan amendments. The defined benefit pension current service contributions in 2010 were $321 million compared to $269 million in 2009. The estimated amount of the 2011 current service contributions is approximately $357 million.

Employer special solvency contributions of $425 million were made in 2010 (they were nil in 2009). Based on the expected actuarial valuation, special solvency contributions will amount to approximately $652 million in 2011. If the proposed pension measures become effective for the December 31, 2010 actuarial valuation, the Corporation may use a letter of credit to satisfy special solvency contributions up to the proposed limit of 15 per cent of Plan assets. Using a letter of credit would result in a reduction in special solvency contributions to the Canada Post Pension Plan in 2011. In consultation with the Minister responsible for Canada Post and the Minister of Finance, management will consider the final form of the legislation, its liquidity position, and the financial costs and benefits in determining the required amount of special solvency contributions.

As small changes in discount rates can significantly affect the results of actuarial valuations, the Corporation will continue to carefully monitor 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 84.*

6.6 Liquidity and capital resources

The Canada Post Group manages $3,358 million of capital, which includes equity of Canada, long-term debt and other long-term obligations.

As at December 31 (in millions of dollars)	**2010**	**2009**
Equity of Canada	2,236	1,787
Long-term debt	1,108	130
Other long-term financial obligation	14	16
Total capital	3,358	1,933

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. A new Financial Framework was established in 2009 with the objective of maintaining financial self-sustainability.

The Corporation's objectives in managing capital include maintaining sufficient liquidity to support its financial obligations and its operating and strategic plans, and maintaining financial capacity and access to credit facilities to support future development of the business.

Liquidity

In 2010, the liquidity required to support our financial obligations and fund capital and strategic requirements was provided by accumulated funds and issuance of long-term debt. The Canada Post Group began 2010 with $886 million of cash equivalents and marketable securities (excluding funds segregated for post-retirement benefit payments), which increased to $1,461 million by year-end. This increase reflects proceeds of approximately $1 billion from long-term debt issues, as discussed below under *Access to capital markets*.

Canada Post maintained segregated funds to make future special contributions to the Canada Post Pension Plan or to assist with specific future cash requirements related to significant projects to renew its operational capability. These segregated funds amounted to $143 million at the start of 2010, the entire amount of which was used during the year.

As discussed in Section 4.5 – Infrastructure – Canada Post on page 61, our investment plans over the next five years require investment in property, plant and equipment of approximately $2.2 billion, including $1.2 billion on Postal Transformation and $1 billion of ongoing capital investment. With $1,385 million of unrestricted liquid investments on hand at year end 2010, and short-term borrowing authority of $250 million, Canada Post has sufficient liquidity to support operations through 2011, including an adequate contingency cushion for fluctuations in working capital, adverse changes in business results or significant unplanned expenditures.

Access to capital markets

Pursuant to the *Canada Post Corporation Act*, the Canada Post segment may borrow a maximum of $500 million from the Government of Canada's Consolidated Revenue Fund. Pursuant to *Appropriation Act No. 4, 2009-10*, which received Royal Assent on December 15, 2009, borrowing from other than the Government of Canada's Consolidated Revenue Fund is limited to $2.5 billion. Included in this total authorized borrowing limit is a maximum of $250 million available for cash management purposes in the form of short-term borrowings.

The Canada Post Group's borrowings amounted to $1,108 million as at December 31, 2010. During 2010, Canada Post issued $1 billion of long-term bonds, consisting of $500 million of 30-year bonds paying 4.36 per cent interest and $500 million of 15-year bonds paying 4.08 per cent interest. The proceeds effectively pre-funded the 2011 liquidity requirements for Postal Transformation, and allowed the Corporation to benefit from long-term market interest rates close to historical lows. Holding substantial borrowings is a new approach for the Corporation. Management believes it can obtain all future funding needs on a timely basis, up to the $2.5-billion external financing limit, by accessing lines of credit, commercial paper or long-term debt capital markets, or specialized financing such as leasing.

Canada Post has established a detailed financing plan, compliant with the Minister of Finance's Financial Risk Management Guidelines for Crown Corporations and the Minister of Finance's Guidelines for Market Borrowings by Crown Corporations, which specifies the forms, timing, amounts, terms and costs of planned borrowings and pursuant to which 2010 financing activity was undertaken.

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. In addition, the detailed terms and conditions for each borrowing must be approved by the Minister of Finance.

The Corporation's subsidiaries and joint venture also have access to financing facilities totaling $200 million as at December 31, 2010. Of this amount, $51 million was drawn for the purchase of equipment. The subsidiaries' existing financing facilities terms have the potential to restrict upstream distributions or loans to the Corporation.

Dividends

The Corporation has historically paid an annual dividend to the Shareholder equal to 40 per cent of the prior year's consolidated net income, in accordance with targets established in the 1998 Policy Framework. However, given the Corporation's investment demand, it did not pay a dividend in 2009 in respect of 2008 earnings.

Late in 2009, a new Financial Framework was approved by the Government as part of Canada Post's 2010 to 2014 Corporate Plan. The framework includes a dividend payout ratio of 0 per cent to 20 per cent of the prior year's net income for 2010 to 2012, and a payout of 15 per cent to 20 per cent for 2013 and 2014. Consistent with the framework, Canada Post did not pay a dividend in 2010 in respect of 2009 earnings. The Government of Canada has approved the Corporation's proposal not to pay a dividend in 2011.

Dividends paid over the past five years total $149 million.

(in millions of dollars)	2010	2009	2008	2007	2006
Consolidated net income	439	281	90	54	119
Dividend paid	0	0	22	47	80

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	2010				
	Available for sale	Held for trading	Loans and receivables	Other liabilities	Total
Financial assets					
Cash and cash equivalents (note 7)	–	379	–	–	379
Marketable securities (note 7)	–	1,082	–	–	1,082
Accounts receivable (note 6)	–	–	628	–	628
Segregated securities (note 7)	499	–	–	–	499
	499	**1,461**	**628**		**2,588**
Financial liabilities					
Non-interest bearing* (note 6 (c))	–	–	–	728	728
Bonds (note 14)	–	–	–	1,051	1,051
Other long-term borrowings (note 14)	–	–	–	57	57
				1,836	**1,836**

*Non-interest bearing consists of financial liabilities included in accounts payable and accrued liabilities, salaries and benefits payable, and outstanding money orders
Note: The above note references are in relation to the Corporation's 2010 consolidated financial statements.

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 commodity prices.

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 reliably determined and are not subject to significant risk.

Investments are designated as held for trading or available-for-sale. Substantially 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 either maintaining a short term to maturity or, in the case of segregated securities, extending terms to maturity to better match certain long-term post-retirement obligations to which they are externally restricted. The average duration in the portfolio was 9 years as at December 31, 2010 (2009 – 6 years).

Based on a sensitivity analysis on interest rate risk, it is expected that an increase or decrease of 1 per cent in market interest rates, with all other variables held constant, would increase or decrease the value of the segregated securities by $42 million, which would represent a significant impact on the fair value of the Corporation's investments at December 31, 2010. Such a change in value would be partially offset by the change in value of certain long-term post-retirement obligations.

Long-term debt of $1,108 million (2009 – $130 million) includes fixed-rate debt without prepayment options and capital lease obligations. The significant increase in long-term debt is due to the issuance of bonds with aggregate principal of $1 billion to fund the Postal Transformation Program.

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 Corporation's obligation to settle with foreign postal administrations is denominated in Special Drawing Rights ("SDRs")—a basket of currencies comprising the U.S. Dollar, Japanese Yen, Sterling and Euro, whereas payment is usually denominated in U.S. Dollar. The principal exposure is to the U.S. Dollar. The effect of a 10 per cent increase or decrease in the U.S. Dollar exchange rate on the net overall exposure after matching associated U.S. Dollar 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 $5 million. There is no

significant impact on net income arising from exposures to other currencies. Net exchange losses included in earnings amounted to $4 million in 2010 (2009 – $5 million).

c) Commodity risk

The Corporation does not currently hold any financial instruments which change in value due to the prices of commodities. The Corporation is inherently exposed to fuel price increases. Using an industry-accepted practice, it partially mitigates this risk through the use of a fuel price surcharge charged on some of its products.

Credit risk

Credit risk is the risk of financial loss due to a counterparty's inability 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 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. In 2010, there was $0 impairment losses on investments (2009 – $2 million) as described in *note 6(b) to the consolidated financial statements on page 123.*

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 realizable value 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 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. Amounts receivable from and payable to the USPS are settled independently under the bilateral agreement between the Corporation and the USPS. Estimates of receivables and payables, including monthly provisional payments, are based on statistics in regard 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 uncollectible receivables from specific foreign postal administrations based on the period past due after billing of the final settlement.

a) Master Asset Vehicle II ("MAVII") notes

During the year, the Corporation disposed of non-bank-sponsored asset-backed commercial paper ("ABCP") with a carrying value of $20 million (face value of $38 million) and recorded a gain of $3 million. The Corporation held various classes of MAVII notes it received when the ABCP programs were restructured under the Montréal Accord. The Corporation no longer holds any ABCP.

Liquidity risk

Liquidity risk is the risk that a company will not be able to meet its financial obligations as they fall due. The Corporation manages liquidity risk by maintaining adequate cash reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. 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 – Liquidity and capital resources on page 70.*

6.8 Contractual obligations and commitments

A summary of the Corporation's total contractual obligations and commitments to make future payments, excluding non-interest-bearing current liabilities, is presented below. For further details, see *notes 14 and 17 to the consolidated financial statements on pages 139 and 142, respectively.*

(in millions of dollars)	Total	< 1 year	1–3 years	3–5 years	> 5 years
Bonds*	1,055	–	–	–	1,055
Interest on bonds	992	48	96	96	752
Capital lease obligations	63	16	23	18	6
Operating leases**	730	139	219	129	243
Postal Transformation contractual obligations***	284	184	100	–	–
Total	3,124	387	438	243	2,056

* Bonds constitute direct, unconditional and unsecured obligations of the Corporation and direct, unconditional obligations of the Government of Canada. Bonds include two series issued during the year, with a nominal value of $500 million each maturing in July 2040 and July 2025, respectively and $55 million of existing bonds maturing in March 2016. Interest is paid semi-annually with a coupon rate ranging from 4.08 per cent to 10.35 per cent.

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

*** In most instances, these contracts are subject to the Corporation's contractual right of termination.

6.9 Related party transactions

As described in *note 20 to the consolidated financial statements on page 145*, 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 Contingencies

In the normal course of business, we have entered into agreements that include indemnities 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, officers and certain employees. These agreements generally do not contain specified limits on our liability and therefore, it is not possible to estimate our potential future liability under these indemnities. No amounts have been accrued in our consolidated financial statements with respect to these indemnities.

When certain agreements with Innovapost expire or are terminated, Canada Post and Purolator have agreed to purchase assets being used on a dedicated basis, and to assume certain obligations and contracts related to such assets. It is not practicable, at this time, to determine the value of the assets used on a dedicated basis, nor the carrying value of the contractual obligations, at the time of expiration or termination of the agreements. Therefore, no amounts have been accrued in our consolidated financial statements.

7 Financial Condition

A discussion of significant changes in our assets and liabilities between December 31, 2010, and December 31, 2009

(in millions of dollars)

ASSETS	2010	2009	Change	%	Explanation of change
Cash and cash equivalents (note 7)	379	473	(94)	(19.7)%	*Refer to section 6 – Liquidity and Capital Resources on page 68*
Marketable securities (note 7)	1,082	270	812	300.5 %	Due to investment of cash received from Canada Post's $1 billion long-term debt issue
Accounts receivable	628	584	44	7.6 %	Mainly due to increased trade receivables for Canada Post and Purolator
Income tax recoverable	139	69	70	102.5 %	Primarily due to an expected refund generated by a loss carry-back for Canada Post
Prepaid expenses	72	76	(4)	(5.2)%	Primarily decreased inventory for Canada Post
Current portion of future income tax assets (note 9)	26	25	1	4.1 %	Mainly due to a net increase in temporary differences of Canada Post short-term liabilities and provisions
Total Current Assets	2,326	1,497	829	55.5 %	
Segregated securities (note 7)	499	654	(155)	(23.8)%	Primarily due to the drawdown of $143 million of internally restricted funds to fund pension solvency payments and Postal Transformation activities
Property, plant and equipment (note 10)	2,210	2,047	163	8.0 %	Mainly Canada Post capital acquisitions for Postal Transformation and replenishment in excess of amortization
Intangible assets (note 10)	161	169	(8)	(5.1)%	Primarily due to the amortization of software assets exceeding acquisitions
Accrued pension benefit asset (note 11)	2,063	1,335	728	54.5 %	Primarily attributable to employer pension contributions including over $400 million in employer special solvency contributions
Future income tax assets (note 9)	204	179	25	14.0 %	The net increase is primarily twofold: a decrease of temporary differences related to the Canada Post Pension Plan asset, employee future benefits and capital assets, offset by the recognition of previously unrecognized temporary differences
Goodwill (note 12)	125	125	(0)	(0.1)%	No change
Other assets (note 13)	12	23	(11)	(49.8)%	Mainly due to a reduction of assets held for sale and the sale of asset-backed commercial paper
Total Assets	7,600	6,029	1,571	26.0 %	

7 Financial Condition (continued)

(in millions of dollars)

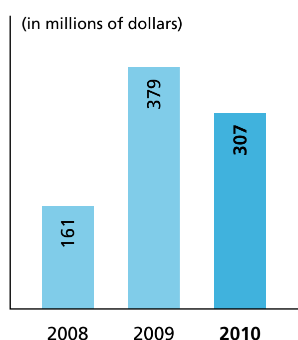
LIABILITIES AND EQUITY	2010	2009	Change	%	Explanation of change
Accounts payable and accrued liabilities	459	413	46	11.2 %	Primarily increased trade payables and sales taxes payable due to 2010 introduction of the harmonized sales tax in Ontario and British Columbia
Salaries and benefits payable	576	575	1	0.1 %	Mainly due to payout of 2009 restructuring costs, partially offset by accrued salaries for days outstanding
Income tax payable	0	2	(2)	(81.1) %	Primarily due to a net decrease in taxes payable by Innovapost
Deferred revenue	120	142	(22)	(15.4) %	Primarily due to decreased customer prepayments of services (Canada Post) and decreased deferred revenue (SCI Group)
Outstanding money orders	41	37	4	10.0 %	Increased money orders issued and outstanding
Current portion of long-term debt (note 14)	13	10	3	31.3 %	Mainly from a subsidiary's principal repayment of its capital lease obligation
Total Current Liabilities	1,209	1,179	30	2.6 %	
Long-term debt (note 14)	1,095	120	975	809.5 %	Primarily due to Canada Post's $1 billion long-term debt issue
Accrued pension, other retirement and post-employment benefit liability (note 11)	2,950	2,835	115	4.0 %	Primarily attributable to the Canada Post post-retirement health-care plan and post-employment workers' compensation costs, partially offset by benefit payments made during the year for those benefits
Future income tax liabilities (note 9)	40	36	4	12.6 %	Mainly due to an increase in temporary differences in Purolator's employee future benefits liability and capital assets
Other long-term liabilities	37	43	(6)	(13.5) %	Primarily due to amortization of deferred inducements (Canada Post) and a reduction in Purolator's other long-term liabilities
Total Liabilities	5,331	4,213	1,118	26.5 %	
Non-controlling interest	33	29	4	10.5 %	Minority interest on net income of Purolator
Equity of Canada	2,236	1,787	449	25.1 %	Consolidated net income of $439 million, primarily from Canada Post and Purolator plus $10 million other comprehensive income related to unrealized gains from Canada Post
Total Liabilities and Equity of Canada	7,600	6,029	1,571	26.0 %	

8 Results from Operations

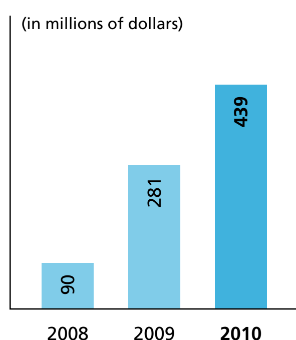
A detailed discussion of our financial performance in 2010

8.1 Consolidated trends

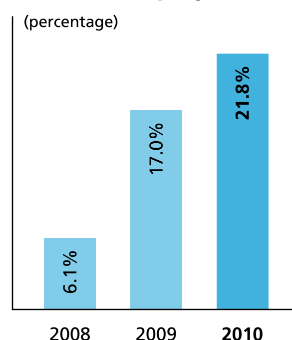
Consolidated income before income taxes



Consolidated net income



Return on equity



8.2 Consolidated results from operations

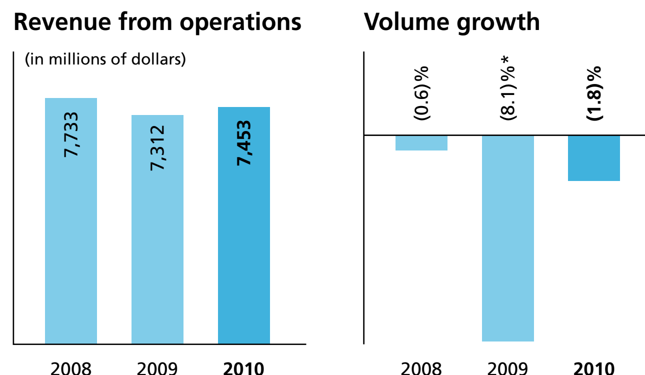
Consolidated income statement

(in millions of dollars)	2010	2009	Change	Increase (decrease) %
Revenue from operations	7,453	7,312	141	1.9 %*
Cost of operations	7,138	6,955	183	2.6 %
Income from operations	315	357	(42)	(11.7) %
Non-operating income (expense)	(8)	22	(30)	(138.0) %
Income before income taxes	307	379	(72)	(19.0) %
Income tax expense	(136)	95	(231)	(243.6) %
Non-controlling interest	4	3	1	19.5 %
Net income	439	281	158	56.3 %
Return on equity	21.8%	17.0%	4.8%	

* Adjusted for trading days where applicable

The Canada Post Group reported consolidated net income of $439 million in 2010—an increase of $158 million, when compared with 2009. The main reason for the increase in net income was a non-cash income tax benefit recorded in the Canada Post segment, driven mainly by the release of a $768 million valuation allowance and hence the recognition of a previously unrecognized future income tax asset.

Consolidated revenue from operations



* In 2010, a methodology change has been implemented for the Canada Post segment and 2009 has been restated for comparability. Had 2008 been restated, the volume percentage change to 2009 would have been (7.6) per cent.

Revenue from operations increased by $141 million or 1.9 per cent in 2010 when compared with 2009. A detailed discussion of revenue by segment follows.

Consolidated cost of operations

Cost of operations increased by $183 million or 2.6 per cent compared to last year, primarily driven by an increase in employee future benefits expense in the Canada Post segment, offset by cost-containment activities across The Canada Post Group.

Consolidated non-operating income (expense)

Non-operating expense increased by $30 million when compared with 2009 mainly due to accrued interest expense on the $1 billion long-term debt issue in the Canada Post segment.

Consolidated income tax expense

Consolidated income tax expense decreased by $231 million compared to the previous year, primarily driven by the income tax benefit recorded in the Canada Post segment.

8.3 Operating results by segment

Segmented results – Income before income taxes

(in millions of dollars)	2010	2009	2008	2007	2006
Canada Post	233	319	66	78	99
Purolator	72	53	91	84	69
Logistics	11	9	13	6	(1)
Innovapost	18	15	15	8	2
Intersegment and unallocated	(27)	(17)	(24)	(16)	(3)
The Canada Post Group	307	379	161	160	166

A detailed discussion of operating results by segment is provided below.

8.4 Canada Post segment

The Canada Post segment contributed $233 million of income before taxes to the consolidated results, a decrease of $86 million when compared with 2009. The decrease in earnings is mainly driven by an increase in employee future benefits expense, which offset cost-containment activities.

Revenues slightly rebounded in 2010 when compared with the prior year, with revenue growth of 1.5 per cent, a marked improvement from the 4.0-per-cent decline in revenues posted in 2009 when compared to 2008.

The increase in cost of operations was primarily driven by employee future benefits costs, which increased by 47.2 per cent when compared to 2009, mainly due to decreases in discount rates for accounting purposes.

The decrease in non-operating income was mainly due to accrued interest expense on our new $1 billion bond issue.

Canada Post summary

Increase (decrease)

(in millions of dollars)	2010	2009	Change	%
Revenue from operations	5,929	5,840	89	1.5 %*
Cost of operations	5,719	5,560	159	2.9 %
Income from operations	210	280	(70)	(25.2) %
Non-operating income (expense)	23	39	(16)	(40.3) %
Income before income taxes	233	319	(86)	(26.9) %

* Adjusted for trading days where applicable

Revenue from operations

Canada Post generated revenue from operations of $5,929 million in 2010—an increase of $89 million or 1.5 per cent, when compared with 2009. Volumes were down in Transaction Mail and Parcels, and remained flat for Direct Marketing. All product lines experienced an increase in revenue mainly due to price increases. The $89 million revenue increase was comprised of a $30-million increase in revenue from Transaction Mail, a $7-million increase in revenue from Parcels, a $47-million increase in revenue from Direct Marketing, and a $5-million increase from other services.

Revenue and volumes by line of business

	Revenue (in millions of dollars / trading day adjusted per cent)				Volume (in millions of pieces / trading day adjusted per cent)			
	2010	2009	Change	%	2010	2009	Change	%
Transaction Mail								
Domestic Lettermail	2,836	2,798	38	1.4 %	4,449	4,657	(208)	(4.5) %
Outbound Letter-post	177	184	(7)	(3.7) %	127	134	(7)	(5.3) %
Inbound Letter-post	118	124	(6)	(4.5) %	261	246	15	6.2 %
Other	47	42	5	11.8 %	–	–	–	–
Total Transaction Mail	3,178	3,148	30	1.0 %	4,837	5,037	(200)	(4.0) %
Parcels								
Domestic parcels	899	888	11	1.2 %	97	102	(5)	(4.7) %
Outbound parcels	196	193	3	1.6 %	12	13	(1)	(6.9) %
Inbound parcels	138	140	(2)	(1.6) %	34	33	1	4.7 %
Other	42	47	(5)	(10.8) %	–	–	–	–
Total Parcels	1,275	1,268	7	0.5 %	143	148	(5)	(2.8) %
Direct Marketing								
Addressed Admail	600	569	31	5.4 %	1,327	1,301	26	2.0 %
Unaddressed Admail	399	380	19	4.9 %	3,652	3,640	12	0.3 %
Publications Mail™	254	259	(5)	(1.8) %	445	471	(26)	(5.5) %
Business Reply Mail™ & Other mail	31	32	(1)	(4.5) %	33	37	(4)	(11.0) %
Other	71	68	3	5.2 %	–	–	–	–
Total Direct Marketing	1,355	1,308	47	3.6 %	5,457	5,449	8	0.1 %
Other revenue	121	116	5	4.1 %	–	–	–	–
Total	5,929	5,840	89	1.5 %	10,437	10,634	(197)	(1.8) %

Transaction Mail

Total 2010 Transaction Mail revenue of $3,178 million is comprised of the following four product categories: domestic Lettermail ($2,836 million); outbound Letter-post ($177 million); inbound Letter-post ($118 million); and other ($47 million).

Total 2010 Transaction Mail revenue increased by $30 million compared to 2009. This revenue growth represents a year-over-year increase of 1.0 per cent. The revenue growth was driven by an increase in the average revenue per piece of 5.1 per cent, partially offset by volume reduction of 4.0 per cent. Year-over-year changes are broken down by product category as follows:

- Domestic Lettermail revenue grew by $38 million or 1.4 per cent compared with 2009. The revenue growth was mainly due to an increase in the average revenue per piece of 6.1 per cent, partially offset by volume declines of 4.5 per cent. Retail sales volume sharply declined by 9.5 per cent, while commercial Lettermail volumes decreased by 3.3 per cent.
- Outbound Letter-post revenue (postage revenue collected from domestic customers for mail destined to other postal administrations) declined by $7 million or 3.7 per cent, compared to the previous year. The revenue decline is a result of a volume reduction of 5.3 per cent partially offset by a 1.7-per-cent increase in the average revenue per piece. The main cause of the revenue decline is a year-over-year reduction in retail revenues of $8 million, due to volume declines of 13.9 per cent.

- Inbound Letter-post revenue (postage revenue collected by other postal administrations and shared with Canada Post for delivering their mail in Canada) was lower than last year by $6 million or 4.5 per cent. A declining foreign exchange rate more than offset a 6.2 per cent or 15 million-piece increase in volumes.
- Other Transaction Mail service revenue grew by $5 million or 11.8 per cent, compared to 2009.

Parcels

Total 2010 Parcels revenue of $1,275 million is comprised of four product categories: domestic parcels ($899 million); outbound parcels ($196 million); inbound parcels ($138 million); and other ($42 million).

Total 2010 Parcels revenue grew by $7 million, representing an increase of 0.5 per cent, compared to 2009. The revenue growth was driven by an increase in the average revenue per piece of 4.4 per cent partially offset by volume reduction of 2.8 per cent. Year-over-year changes are explained below by product category:

- Domestic parcels revenue grew by $11 million or 1.2 per cent, compared with 2009. The revenue growth was due to an increase in the average revenue per piece by 6.2 per cent, which offset volume declines of 4.7 per cent. The difficult competitive and economic environment combined with the changing marketplace for a number of industries (music and book downloads) resulted in volume erosion in Expedited Parcels as well as Xpresspost.
- Outbound parcel revenue (postage revenue collected from domestic customers for parcels destined to other postal administrations) increased by $3 million or 1.6 per cent due to a new southbound parcel initiative that offers faster and more featured services to the United States at a higher price. The revenue growth offset a 6.9 per cent decrease in volume.
- Inbound parcel revenue (postage revenue collected by other postal administrations and shared with Canada Post for delivering their parcels in Canada) declined by $2 million or 1.6 per cent. Although inbound volumes were up 4.7 per cent over the previous year, the gains in revenue were more than offset by the impact of a declining foreign exchange rate.
- Other Parcels revenue declined by $5 million or 10.8 per cent, compared to 2009.

Direct Marketing

Total 2010 Direct Marketing revenue of $1,355 million is comprised of the following four product categories: Addressed Admail ($600 million); Unaddressed Admail ($399 million); Publications Mail ($254 million); Business Reply Mail & Other Mail ($31 million); and other ($71 million).

Total 2010 Direct Marketing revenue increased by $47 million or 3.6 per cent, over the prior year. The revenue increase was mainly due to a 3.2-per-cent increase in the average revenue per piece. Overall volumes remained flat with 0.1 per cent growth over the prior year. Year-over-year changes by product category are summarized as follows:

- Addressed Admail revenue showed signs of recovery in the second half of 2010, growing by $31 million or 5.4 per cent for the year. This was due to an increase in both the average revenue per piece of 3.2 per cent, and volume growth of 2.0 per cent.
- Unaddressed Admail revenue increased by $19 million or 4.9 per cent, compared to the previous year. The revenue growth is due mainly to an increase in the average revenue per piece of 4.5 per cent. Volume remained flat with a 0.3 per cent marginal increase.
- Publications Mail revenue declined by $5 million or 1.8 per cent over the prior year. The revenue decline was caused by volume erosion of 5.5 per cent, partially offset by 4.0-per-cent growth in the average revenue per piece.
- Business Reply Mail & Other Mail revenue experienced declines in both revenue and volume at 4.5 per cent and 11.0 per cent, respectively.
- Other Direct Marketing revenue increased by $3 million or 5.2 per cent, compared to 2009.

Other revenue

Other revenue increased by $5 million, or 4.1 per cent in 2010, when compared to 2009. The strengthening of the Canadian dollar resulted in foreign exchange losses of $3 million from settlements with other postal administrations (compared with foreign exchange losses of $5 million in 2009).

Cost of operations

In 2010, the Canada Post segment's cost of operations totaled $5,719 million—an increase of $159 million or 2.9 per cent over the prior year.

			Increase (decrease)	
(in millions of dollars)	2010	2009	Change	%
Labour	3,238	3,294	(56)	(1.7) %
Benefits	680	462	218	47.2 %
Total labour and benefits	3,918	3,756	162	4.3 %
Non-labour collection, processing and delivery	856	872	(16)	(1.8) %
Facilities	221	219	2	1.4 %
Amortization	219	196	23	11.4 %
Selling, administration and other	505	517	(12)	(2.4) %
Total	5,719	5,560	159	2.9 %

In order to control rising costs and ensure the long-term health of the postal system for Canadians, Canada Post initiated three structural cost management strategies in 2010, as described below.

In March 2010, Canada Post announced a restructuring of its customer contact centre operations across the country. Specifically, Canada Post initiated a plan to outsource a portion of its call centres to a private sector service provider, given that the current in-house approach costs significantly more than industry standards and is not sustainable. Canada Post remains committed to serving all of its customers and will work closely with the new service provider to ensure that service levels remain intact.

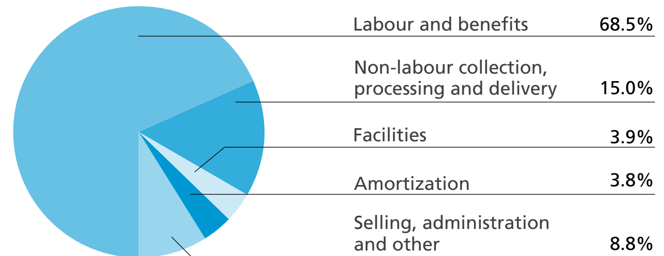
In April 2010, Canada Post announced a number of operational changes to its network, given the need to respond to declining letter mail volumes. In order to take advantage of existing capacity across the network and increase productivity, the operations of the Kitchener, Victoria and Moncton mail-processing plants were realigned:

- The processing of Admail and parcels was transferred from Kitchener to the Gateway mail-processing plant;
- The processing of letter mail and Admail was transferred from Victoria to the Vancouver letter-processing plant; and
- The processing of street letter box mail was transferred from Moncton to Saint John.

Lastly, in order to reduce its labour costs and remain successful, Canada Post implemented a new organizational model for mail collection and delivery that involved a restructuring in the jobs represented by the Association of Postal Officials of Canada ("APOC"). After discussions with APOC, the ratio of employees to supervisors was rebalanced in order to standardize spans of control and the number of supervisory positions was reduced.

The chart below shows the breakdown of each cost category as a percentage of total cost of operations. Labour and benefit costs comprise 68.5 per cent of the total cost, demonstrating the labour-intensive nature of our business.

Cost of operations – 2010



Cost of operations	2010	2009	2008
Labour and benefits	68.5%	67.6%	67.4%
Non-labour collection, processing and delivery	15.0%	15.7%	15.4%
Facilities	3.9%	3.9%	3.6%
Amortization	3.8%	3.5%	3.1%
Selling, administration and other	8.8%	9.3%	10.5%

Labour

The cost of labour decreased by $56 million or 1.7 per cent, when compared to 2009, despite regular salary increases. This decrease is consistent with cost-containment programs in place since 2008, which generated significant savings due to a decrease in indirect labour and productivity improvements that realized reductions in paid hours. The number of management and exempt employees was reduced by 7 per cent in 2010.

Benefits

Increase (decrease)

(in millions of dollars)	2010	2009	Change	%
Pension expense	45	(126)	171	136.1 %
Retirement health benefits	131	138	(7)	(5.3) %
Other employee future benefits	110	86	24	28.7 %
Interest on segregated assets	(23)	(7)	(16)	(241.5)%
Transitional funding	(13)	(56)	43	77.8 %
Total employee future benefits	250	35	215	623.7 %
Active employee benefits	418	425	(7)	(1.6) %
Other	12	2	10	401.4 %
Net benefit costs	680	462	218	47.2 %

Net benefit costs for employees increased by $218 million, or 47.2 per cent, when compared with 2009 as detailed below:

- Non-cash pension expense increased by $171 million or 136.1 per cent in 2010, mainly due to a decrease in discount rate from 7.5 per cent to 6.7 per cent which, among other things, contributed in reducing the 2010 amortization of actuarial gains to almost nil when compared to 2009.
- Non-cash post-retirement health benefits expense declined by $7 million or 5.3 per cent, primarily due to valuation gains, partly offset by losses due to a decrease in discount rate from 7.6 per cent to 6.9 per cent.
- Other employee future benefits expense increased by $24 million or 28.7 per cent, due to lower discount rates for 2010 when compared to 2009, combined with actuarial losses resulting from valuations.
- Interest on segregated assets, which partially offsets employee future benefits expense, increased by $16 million or 241.5 per cent compared to the prior year, mainly due to a change in the investment policy allowing for the purchase of long-term bonds.
- Employee future benefits expense was also reduced by transitional funding from the Government of Canada, which decreased by $43 million or 77.8 per cent in 2010. As described further in *note 2 to the consolidated financial statements on page 114*, 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 transitional funding ended in 2010.
- Benefits expense for active employees decreased by $7 million or 1.6 per cent in 2010, when compared to the prior year, due to a reduction in the number of active employees.

Non-labour collection, processing and delivery

Contracted collection, processing and delivery costs decreased by $16 million or 1.8 per cent compared to the prior year.

- Rural mail delivery costs decreased by $8 million mainly due to contract savings and full-year benefits realized from the prior year's reduced use of contractors as a result of increased staffing levels.
- International settlements costs decreased by $7 million primarily due to lower exchange rates and pay-for-performance savings.

Facilities

The cost of facilities increased by $2 million to $221 million, representing a year-over year increase of 1.4 per cent, mainly due to contract indexation and service level changes.

Amortization

Amortization expense increased by $23 million to $219 million, an 11.4-per-cent increase compared to 2009, primarily due to increased capital acquisitions relating to Postal Transformation and replenishment of the existing asset base.

Selling, administration and other expense

Total selling, administration and other expense, which includes information technology, administration, program expense, selling and other costs, decreased by $12 million or 2.4 per cent when compared to 2009. This was primarily due to cost-containment measures and a cost recovery as a result of a proceeding which disallowed some costs previously charged to Canada Post by a supplier. These decreases were offset by a $36 million increase in program expense, mainly to support Postal Transformation.

8.5 Purolator segment

The Purolator segment contributed $72 million to 2010 consolidated income before income taxes, an increase of $19 million, when compared with 2009.

Purolator summary

(in millions of dollars)	2010	2009	Increase (decrease) Change	%
Revenue from operations	1,492	1,433	59	4.1 %*
Cost of operations	1,416	1,380	36	2.7 %
Income from operations	76	53	23	41.2 %
Non-operating income (expense)	(4)	(0)	(4)	(375.2) %
Income before income taxes	72	53	19	36.1 %

* Adjusted for trading days where applicable

Revenue from operations

Revenue from each of the lines of business increased from prior years, primarily attributed to the recovering economic environment, tempered by severe competition. Purolator revenue from operations increased by $59 million or 4.1 per cent in 2010 compared with 2009. Revenues from the courier business and Purolator Freight contributed $41 million and $15 million, respectively, towards this year-over-year increase. Collaboration between Purolator and Canada Post has continued to contribute to synergies in express and air cargo volumes.

In order to meet customer expectations in an uncertain economic climate, Purolator continues to focus on improving the customer experience and maintaining service levels. Purolator's brand value is based on its premium service and a unique value proposition that offers integrated, diversified services, which will provide a foundation for future revenue growth as the economy recovers.

Cost of operations

In 2010, the cost of operations increased by $36 million or 2.7 per cent, when compared to 2009. As revenues began to recover in 2010, Purolator focused on profitable growth, obtaining greater efficiencies from its national network and leveraging asset utilization across the lines of business.

- Purolator streamlined the management team and simplified the organization structure to better utilize the national network of people, systems and physical infrastructure.
- Ground line haul costs were reduced through vendor contracts for fuel, load consolidation, route optimization, and the use of long combination vehicles ("LCVs").

Air transport costs were reduced, largely due to an increase in volumes, lower fuel prices and efficiencies introduced into the air network. Both Purolator Freight and Purolator International maintained effective cost controls as revenues increased from the prior year.

8.6 Logistics segment

The Logistics segment includes the consolidated financial results of SCI Group. The Logistics segment contributed $11 million to 2010 consolidated income before income taxes, an increase of $2 million compared to the prior year.

Logistics summary

Increase (decrease)

(in millions of dollars)	2010	2009	Change	%
Revenue from operations	149	151	(2)	(1.1) %*
Cost of operations	138	141	(3)	(2.1) %
Income from operations	11	10	1	13.9 %
Non-operating income (expense)	(0)	(1)	1	21.7 %
Income before income taxes	11	9	2	13.7 %

* Adjusted for trading days

Income before income taxes by entity

Increase (decrease)

(in millions of dollars)	2010	2009	Change
SCI Group	12	10	2
Other	(1)	(1)	0
Total segment	11	9	2

SCI Group (SCI)

SCI's financial performance improved in 2010, with income before income taxes of $12 million, an increase of $2 million, when compared with 2009.

Revenue from operations decreased by $2 million, primarily due to cost reductions passed on to clients and account attrition. In 2010, 30 per cent of SCI's revenue was derived from its largest customer (2009 – 37 per cent).

Cost of operations decreased by $3 million in 2010, when compared with 2009. This net decrease in costs is from a reduction in operational expenses such as administration, facility occupancy costs and transportation, offset by corporate restructuring and CEO transition costs.

8.7 All Other segment

The All Other segment includes the financial results of Innovapost. Virtually all of the services provided by Innovapost are provided to The Canada Post Group. Accordingly, the Corporation's proportionate share of Innovapost revenue is eliminated against the other segments' cost of operations upon consolidation. Cost of operations included in the consolidated financial statements of the Corporation includes the Corporation's proportionate share of expenses related to these services of approximately $130 million (2009 – $153 million).

All Other summary

Increase (decrease)

(in millions of dollars)	2010	2009	Change	%
Revenue from operations	148	168	(20)	(11.9) %*
Cost of operations	130	153	(23)	(15.4) %
Income from operations	18	15	3	24.3 %
Non-operating income	0	0	(0)	(43.4) %
Income before income taxes	18	15	3	23.4 %

* Adjusted for trading days where applicable

Innovapost's financial performance improved in 2010, with income before taxes of $18 million.

Revenue from operations decreased by $20 million, due to lower application development revenues from both Canada Post and Purolator. Cost of operations decreased by $23 million in 2010, when compared to 2009. This decrease primarily reflected the lower project activity in application development.

9 Critical Accounting Estimates and Accounting Policy Developments

A review of critical accounting estimates and changes in accounting policies in 2010 and future years

9.1 Critical accounting estimates

Our significant accounting policies are described in *note 2 to the consolidated financial statements on page 114*. 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 114*. 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 could result in a material impact on the consolidated financial statements.

In 2010, the Corporation has decided to apply component accounting to its buildings in order to facilitate the Corporation's future transition to International Financial Reporting Standards ("IFRS"). Component accounting is available under Canadian GAAP but is a more explicit requirement under IFRS. Component accounting requires that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item be depreciated separately if there is a difference between the useful lives or depreciation methods of the different parts. Buildings were the only category of property, plant and equipment of the Corporation where management identified significant parts with different useful lives. With the help of external advisors, management identified six different components with five different useful lives for the Corporation's buildings. The new amortization periods of the building components range between 10 to 65 years, whereas the Corporation previously amortized buildings over 15, 30 and 40 years. The changes in the estimated useful lives due to the componentization of buildings resulted in a $4 million decrease in amortization expense in 2010, with a $3 million decrease for 2011.

In 2009, management undertook an assessment of the estimated remaining useful life of its major asset classes to ensure closer alignment with the requirements of IFRS IAS 16 "Property, Plant and Equipment." As a result, estimated useful lives for several classes of vehicles were extended on a prospective basis in 2009 to better align the amortization method to the usage pattern of the vehicles. These changes in estimates resulted in an $11 million decrease in amortization expense in 2009, with a $6 million decrease for 2010.

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 142.*

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 consolidated 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 benefits 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 Canada Post 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 average long-term salary increase assumption of three per cent is used.
- **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 per cent.
- **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 unrecognized net actuarial gains and losses for service-related defined benefit plans 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 per cent 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 for event-driven defined benefit plans are amortized over the average duration of the respective obligations without the use of the 10-per-cent limit.

In *note 11 to the consolidated financial statements on page 131*, 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.

Sensitivity to changes in key assumptions for our principal Pension Plan on a prospective basis are as follows:

	Change in assumption	
(in millions of dollars)	Increase	Decrease
Change in discount rate of 50 basis points		
Increase (decrease) in annual pension expense	(39)	42
Increase (decrease) accrued pension obligation	(1,117)	1,251
Change in expected return on Plan assets of 50 basis points		
Increase (decrease) in annual pension expense	(78)	78

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

	Change in assumption	
(in millions of dollars)	Increase	Decrease
Change in discount rate of 50 basis points		
Increase (decrease) in annual health-care expense	(6)	6
Increase (decrease) accrued health-care obligation	(178)	201
Change in health-care cost trend rates of 100 basis points		
Increase (decrease) in annual health-care expense	48	(34)
Increase (decrease) accrued health-care obligation	446	(350)

For further details on our annual expense and obligation, see *note 11 to the consolidated financial statements on page 131*.

Income taxes

The Corporation is subject to income tax in numerous jurisdictions and significant judgment is required in determining the provision for income 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 current 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 consolidated financial statements and are therefore subject to accounting estimates that are inherent in those balances. The Corporation has significant deductible temporary differences and related future tax assets. In prior years, a valuation allowance was applied in order to recognize only tax assets that were more likely than not to be realized. In 2010, management released the valuation allowance related to accrued other retirement and post-employment benefit liabilities as the realization of the future tax asset was determined to be more likely than not based on the Corporation's profitability. The recognition of this asset in 2010 resulted in a $192 million decrease in future tax expense. See *note 9 to the consolidated financial statements on page 129*.

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. Income taxes are recognized in the income statement except to the extent that they relate to items recognized directly in other comprehensive income or equity, in which case the tax is recognized in other comprehensive income, or equity.

If future outcomes were to adversely differ from management's best estimate of future profitability 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.

Adoption of new accounting standards

There were no new standards adopted by the Corporation in the current year.

The Corporation indicated in 2009 that it would consider the early adoption, effective January 1, 2010, of CICA Section 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests" in the event of any business acquisitions undertaken in 2010, to be more closely aligned with IFRS and to mitigate the impact of adopting IFRS at the January 1, 2011 changeover date. Due to the fact that no business acquisitions occurred during the year, the Corporation did not adopt the above-mentioned sections in the current year, and will be applying IFRS to future acquisitions.

Future year accounting changes

As a publicly accountable entity, the Corporation is required to adopt IFRS for fiscal years beginning on or after January 1, 2011. The Corporation will issue consolidated financial statements in accordance with IFRS as issued by the International Accounting Standards Board ("IASB") beginning with the second quarter ending July 2, 2011, with comparative information.

9.3 International Financial Reporting Standards ("IFRS")

Transition to 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 as the required basis of accounting under Canadian generally accepted accounting principles ("GAAP") for fiscal years beginning on or after January 1, 2011. In October 2009, the Public Sector Accounting Board approved an amendment to the scope of public sector accounting standards, which confirms that government business enterprises ("GBEs") will be required to follow IFRS for periods beginning January 1, 2011. Accordingly, the Corporation, which meets the current definition of a GBE, will report under IFRS in its financial statements for the year ending December 31, 2011. These financial statements will include an opening IFRS balance sheet as at January 1, 2010 and full IFRS comparative information for the year ended December 31, 2010. The Corporation is also expecting to comply with the *Financial Administration Act* amendment effective April 1, 2011, which requires the preparation and publication of quarterly financial reports by parent Crown corporations. Therefore, the Corporation will issue its first quarterly financial statements in accordance with IFRS for its second quarter ending July 2, 2011.

Overview of IFRS changeover plan

In 2008, we developed and started to implement an IFRS changeover plan to support the transition from Canadian GAAP to IFRS in the 2011 financial statements. We established a multidisciplinary IFRS implementation team led by the Vice-President, Finance and Comptroller, and instituted regular progress reporting to the Audit Committee of the Board of Directors. An IFRS Steering Committee was also established to provide oversight of, and insights into the overall IFRS changeover process. We have engaged and are working with external advisors to facilitate an effective changeover.

The changeover plan consists of three phases. The first phase, completed in 2008, focused on planning and early issue identification. Work on the second and third phases of the plan, covering detailed evaluations for each financial reporting area and implementation of the new standards was largely completed in 2010, along with finalizing the detailed evaluation phase and focusing on implementation activities.

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 changeover plan.

Convergence with IFRS – Key plan elements

Key activities	Status at December 31, 2010
Financial statement preparation: • Identifying differences between Canadian GAAP and IFRS accounting policies • Selecting ongoing IFRS policies • Selecting first-time adoption elections • Preparing opening IFRS balance sheet • Developing financial statement presentation and disclosure format	• Analysis of key differences completed in 2008 • Detailed evaluation substantially completed for all reporting areas, covering policy and first-time adoption elections and implementation choices in 2010 • First-time adoption elective exemption decisions analyzed and costs and benefits of each exemption considered, with a number of conclusions reached and decisions finalized in 2010 • Approval of policy choices and elective exemptions has been formalized in early 2011 • Financial statement presentation and opening IFRS balance sheet, in accordance with the requirements of IFRS 1 and IAS 1 "Presentation of Financial Statements" to be finalized in 2011
Financial reporting expertise: Appropriate level of IFRS expertise to be defined and introduced for each of the following: • Core finance team • Senior executives and Board, including Audit Committee • Operational personnel	• Several technical training sessions delivered to our core finance team • Periodic status updates delivered to our senior executives, the Board of Directors and Audit Committee • Several information sessions on implementation issues conducted with key operational personnel and other functional areas • Training needs are continuously reviewed and training will continue to be provided in 2011, as required
Information technology: Information technology to be IFRS compliant for: • Systematic processing changes • Program upgrades/changes • Date of transition entries (IFRS 1) • Gathering data for disclosures • Consolidation reporting process • Budget/plan/forecast monitoring process	• Impact of the conversion on our accounting systems evaluated • Detailed plans developed to address any required system upgrades and necessary changes • All system changes completed by the end of 2010 • Internal planning and budgeting impacts considered
Internal Control over Financial Reporting ("ICFR"): All changes necessary to the design and operation of ICFR to be identified and implemented in order to maintain the integrity of the ICFR and to report satisfactorily following the transition to IFRS	• Requirements for changes to the design and operation of ICFR due to IFRS transition have been considered, documented and implemented, resulting in no fundamental changes
Disclosure Controls and Procedures ("DC&P"): All changes necessary to the design and operation of DC&P to be identified and implemented in order to maintain the integrity of the DC&P and to report satisfactorily following the transition to IFRS	• DC&P have been reviewed and no fundamental changes in the disclosure controls or procedures have been identified for IFRS reporting
Business activities: Impact of IFRS on key business activities to be evaluated, including: • Compensation plans • Financing arrangements and requirements • Other contractual and legal arrangements • Capital expenditures • Key ratios	• We assessed the impacts of adopting IFRS on our covenants and other contractual arrangements • No material compliance matters have been identified at this time • We are finalizing our assessment of the impacts on our compensation plans and key ratios

Impact of adoption of IFRS

Overview

First-time adoption of IFRS requires that the Corporation reassess its current accounting policies and make any required changes to meet IFRS requirements. These policies will form the ongoing basis of accounting for the Corporation. First-time adoption also requires that, upon initial application, these policies are retrospectively applied subject to some elective or prescribed areas where prospective application is either permitted or required. The following commentary discusses how the Corporation's accounting policies are expected to change upon transition to IFRS and the expected impact of the policy changes. Based on the standards expected to be in effect at December 31, 2011, the Corporation determined its optional elections and accounting policy choices and received formal approval from its Board of Directors in early 2011. The Corporation will continue to monitor any additional changes required or available (through early adoption where permitted) during 2011 as new and amended standards are issued by the IASB.

First-time adoption of IFRS

The initial application of IFRS requires that the Corporation follow the requirements of IFRS 1 "First-time Adoption of IFRS" ("IFRS 1") in the preparation of its financial statements. Although the general requirement of IFRS 1 is a retrospective application without the use of hindsight, this is subject to certain elective exemptions that provide an alternative implementation basis. The Corporation currently expects to exercise the following IFRS 1 elective exemptions, with the corresponding pre-tax impacts, where applicable:

Employee benefits

Under IFRS 1, a first-time adopter may elect to recognize all cumulative actuarial gains and losses in equity at the date of transition. The Corporation plans to apply this exemption to its defined benefit plans resulting in the recognition of all previously unrecognized actuarial gains and losses at the date of transition. Without this election, full retrospective application of IAS 19 "Employee Benefits" ("IAS 19") would require extensive actuarial calculations for disclosure purposes. Further, the Corporation believes that this will result in the most meaningful information given that under our proposed IFRS policy we will recognize actuarial gains and losses for post-employment benefit plans through equity on a go-forward basis. Transition adjustments related to the recognition of actuarial gains and losses, which will result in a decrease in the defined pension benefit asset as well as an increase in the defined benefit liability, are expected to reduce the opening IFRS equity position by $1,193 million.

IFRS 1 also provides a first-time adopter with relief from certain disclosures required under IAS 19 for periods prior to the date of transition to IFRS. The Corporation plans to apply this exemption and will provide these disclosures from the date of transition onwards.

Deemed cost

A first-time adopter, under IFRS 1, may elect to establish a "deemed cost" as its opening balance for items of property, plant and equipment. This election may be applied on an asset-by-asset basis. The Corporation plans to apply this IFRS 1 elective exemption to measure a select few buildings and land with some unique characteristics at their fair values at January 1, 2010, and use those fair values as their deemed cost. This is expected to result in a net decrease in the carrying amount of these assets of $85 million with a corresponding decrease in the opening IFRS equity position. This is also expected to result in lower future depreciation charges for these assets than under Canadian GAAP. According to our latest calculations, the expected difference resulting from the reduction of the carrying value of assets under IFRS is a $1-million decrease in depreciation expense and a corresponding increase in 2010 pre-tax net income, compared to Canadian GAAP.

Business combinations

Under IFRS 1, a first-time adopter may elect to avoid restatement of prior business combinations and apply IFRS 3 "Business Combinations" ("IFRS 3") prospectively from January 1, 2010. Certain related requirements are attached to this election, including the requirement for a goodwill impairment test. We expect to adopt IFRS 3 prospectively and therefore business combinations prior to the transition date will not be restated. As required by the elective exemption, a goodwill impairment test has been completed at the date of transition. No impairment has been identified as a result of the impairment test and no other adjustments have been identified as a result of this election.

Leases

Under IFRS 1, a first-time adopter is not required to apply IFRIC 4 "Determining whether an Arrangement contains a Lease" ("IFRIC 4") to those arrangements to which the same type of determination has been applied under a previous GAAP. With the exception of the transitional and effective date provisions, IFRIC 4 is aligned with the Canadian GAAP guidance on the same topic (Emerging Issues Committee Abstract No. 150); therefore, the Corporation is able to and plans to apply this transitional provision to arrangements within the scope of IFRIC 4 where the requirements of the exemption have been met.

Cumulative translation differences
A first-time adopter, under IFRS 1, may make an election to deem the cumulative translation differences for all foreign operations to be zero at the date of transition to IFRS. The Corporation plans to apply this exemption in order to avoid having to determine cumulative currency translation differences in accordance with IAS 21 "The Effects of Changes in Foreign Exchange Rates", from the date a foreign operation was formed at one of our subsidiaries. The expected adjustment to opening IFRS equity as a result of the application of this exemption is not significant.

Financial instruments
Subject to certain criteria, IFRS 1 allows for the designation of a previously recognized financial asset as available-for-sale and a financial asset or liability as fair value through profit or loss at the date of transition. The Corporation plans to apply this IFRS 1 elective exemption to designate cash equivalents and marketable securities as fair value through profit or loss, and to designate segregated securities as available-for-sale, in order to maintain the same measurement basis as under Canadian GAAP.

Decommissioning liabilities included in the cost of property, plant and equipment
IFRS 1 allows an entity to measure existing decommissioning liabilities included in the cost of property, plant and equipment using information existing at the date of transition to IFRS. The Corporation plans to apply this IFRS 1 exemption, using information existing at January 1, 2010.

Capitalized borrowing costs
IFRS 1 allows first-time adopters to use the transitional provisions set out in IAS 23 "Borrowing Costs" ("IAS 23"). The Corporation plans to apply these transitional provisions and elect the effective date of January 1, 2010 for the application of IAS 23.

We expect to apply the elections described above in preparing our first financial statements under IFRS, based on the information available at this time and exemptions currently available under IFRS 1. As we complete our IFRS changeover procedures, additional information may be identified that could require us to reassess our decisions and their impact. Furthermore, changes to the standards and early adoption considerations, which will be monitored throughout 2011, could also result in changes to our current assessment.

Significant changes in accounting policies

The following disclosure highlights significant accounting policy choices that we are expecting to adopt upon changeover to IFRS, as well as other mandatory accounting policy changes that are expected to have an impact on the Corporation's opening IFRS balance sheet. We are also providing, where applicable, the impact of the accounting policy choices and mandatory accounting policy changes on the expected pre-tax net income of the Corporation for 2010, to demonstrate how significant differences between Canadian GAAP and IFRS are expected to affect net income for the year ended December 31, 2010. The additional disclosure of the conversion impact on the 2010 pre-tax net income set forth below is based on the information contained in our latest Corporate Plan as the 2010 IFRS financial results have not yet been finalized. Therefore, the final results will inevitably differ from the amounts disclosed herein.

Property, plant and equipment
IAS 16 "Property, Plant and Equipment" permits a choice between the revaluation model and the cost model. The Corporation plans to apply the cost model, consistent with its current accounting policy. As discussed above, the Corporation plans to apply the IFRS 1 exemption to value-selected buildings and land at fair value upon transition and to use the fair value as deemed cost. This election is only to be applied to a handful of buildings and land; the great majority of property, plant and equipment will continue to have the same cost basis as under Canadian GAAP. Going forward, the cost model is to be applied to all property, plant and equipment, regardless of previous revaluations.

Employee benefits

Recognition of actuarial gains and losses
Actuarial gains and losses arise as a result of changes in the value of the defined benefit obligation and Plan assets due to actual experience being different than expected and changes in actuarial assumptions. IAS 19 "Employee Benefits" ("IAS 19") allows an entity to immediately recognize actuarial gains and losses resulting from post-employment benefit plans in full as they arise, either in income or in other comprehensive income, or to recognize them over a longer period by systematic amortization through income. The latter approach is consistent with the Corporation's current policy.

Under IFRS, the Corporation is expecting to recognize all actuarial gains and losses from its post-employment benefit plans, such as its pension and post-employment health plans, in other comprehensive income ("OCI") without recycling to profit and loss in subsequent periods. While this policy may create greater volatility on the balance sheet, it is aligned with the proposed direction of the IASB with respect to immediate recognition of actuarial gains and losses. Actuarial gains and losses from other long-term employee benefit plans, such as the Corporation's sick leave plan and the workers' compensation benefits, will be recorded directly in income, as this is the only option under the current standard. Since the Corporation plans to recognize all cumulative actuarial gains and losses at the transition date through equity as permitted by the respective IFRS 1 exemption, there is no further impact on transition from this change in accounting policy.

The actuarial gain or loss relating to the Corporation's post-employment benefit plans in 2010 is to be recorded in OCI under IFRS. The resulting IFRS adjustments to OCI are still under computation at this time. The additional loss to be recognized under IFRS in 2010 for long-term employee benefit plans was expected to be $9 million at the time of the Corporate Plan preparation, and therefore would reduce Canadian GAAP pre-tax net income by the same amount.

Expected return on Plan assets

Expected return on Plan assets is a component of pension expense. Under Canadian GAAP, the expected return on Plan assets is based on the expected long-term rate of return on Plan assets and the fair value or market-related value of Plan assets. Conversely, IFRS requires the expected return on plan assets to be based on market expectations (using the expected long-term rate of return on Plan assets), at the beginning of the period. While there is no impact on equity upon transition to IFRS, the elimination of the use of a market-related value (referred to as the smoothed fair value of assets over five years) is expected to increase the pension expense and decrease the 2010 Canadian GAAP pre-tax net income by $121 million.

Asset limit valuation allowance and minimum funding requirement liability

Similar to Canadian GAAP, IFRS prescribes a valuation allowance to limit the recognition of the pension benefit asset to the amount which is recoverable. The valuation allowance is determined by taking into account the economic benefit available to the Corporation from surplus refunds or from reductions in future contributions. In addition, under IFRS, the minimum funding requirements may give rise to a further reduction of the pension benefit asset or the creation of a liability to cover an existing shortfall on a funding basis, with respect to services already provided. Upon transition, this is expected to result in a $46-million reduction in the opening IFRS equity position. There was no amount previously recognized under Canadian GAAP.

Past service cost and unrecognized funding excess

Past service cost arises from changes to benefits to be provided to employees and represents changes to the obligation for employee services rendered in prior periods. IAS 19 requires the vested portion of the benefits to be recognized immediately through profit or loss, and the unvested portion to be recognized over the average period until employees become fully eligible for the benefit. This is a change from Canadian GAAP, where the total impact of such changes is recognized over the expected average remaining service period up to full eligibility.

The funding excess, resulting from the *Federal Public Sector Pension Reform* effective October 1, 2000, represents the assets transferred in excess of the related obligations from the Government of Canada to the Corporation's Pension Plan. IAS 19 requires this excess to be accounted for as a reduction of expense immediately, whereas under Canadian GAAP, it is recognized on a straight-line basis over the expected average remaining service period of active employees covered by the Pension Plan at the time of the transfer.

Upon transition, the expected result of the earlier recognition of the above items under IFRS compared to Canadian GAAP is an increase to equity in the opening IFRS balance sheet of $98 million. As for the 2010 IFRS net income, the amounts recognized under Canadian GAAP are reversed, since the fully vested amounts relating to past service cost and the unrecognized funding excess are recognized in equity upon transition to IFRS. In addition, for one collective agreement, plan amendments during the year resulted in immediate recognition of fully vested negative past service cost under IFRS in 2010. The net expected IFRS adjustment for 2010 for the above items is a reduction of $40 million to Canadian GAAP pre-tax net income.

Attribution period
In determining the present value of the defined benefit obligation and current service costs for post-employment benefits, the actuarial method used attributes benefits to periods of service as prescribed by the Plan's formula. In some circumstances, where no significant benefits are earned by further service or where benefits are earned in later years of service, the attribution period under IFRS can differ from Canadian GAAP. The Corporation's post-employment term life and death benefit plans have terms that reduce the length of attribution period used under IFRS from the attribution period used under Canadian GAAP. This results in an expected increase in the related defined benefit obligation by $34 million and a corresponding decrease in equity upon transition to IFRS. The Corporation is also determining whether benefits that are earned in later years of service for the Corporation's post-employment health, dental and other health plans, would result in an adjustment upon transition to IFRS. This adjustment would require complex actuarial calculations and is still under computation at the current time.

Other long-term employee benefits
IAS 19 has a broader scope than Canadian GAAP comparable guidance (CICA Section 3461) and includes non-vesting benefits paid to employees while they are still in active service, such as obligations related to sick leave. Under IFRS, the obligation and the related expense are required to be recognized as employees render service giving rise to these entitlements. Discounting is required where the benefit is long-term in nature.

Under the sick leave plan in effect on the transition date, accumulated sick days can only be used by the employee under qualifying circumstances, and can not be paid out. IFRS requires that an obligation for short-term or long-term compensated accumulating absences be recorded as service is rendered by the employee. Canadian GAAP did not require recognition of an obligation for our sick leave plan; consequently, sick leave has previously been disclosed only as a contingent liability, and the cost of sick leave benefits was recognized as incurred. Upon transition to IFRS, a sick leave obligation of $236 million is expected to be recognized based on expected future usage of this benefit, thereby reducing the opening IFRS equity by the corresponding amount.

An additional liability for long-service awards of $2 million, and a corresponding decrease in equity are also expected to be recognized upon transition to IFRS.

For 2010, the expected IFRS adjustment relating to other long-term employee benefits is an increase of $14 million to Canadian GAAP pre-tax net income.

Leases
The measurement and recognition criteria under IAS 17 "Leases" ("IAS 17") are largely in line with the previous Canadian GAAP standard, CICA Section 3065 "Leases"; however, IAS 17 removes the "bright-line" criteria for determining if a lease is capital in nature (finance lease). The Corporation's classification of leases between finance leases (formerly capital leases) and operating leases is not expected to change upon transition to IFRS.

IAS 17, however, does differ from CICA Section 3065 in the treatment of gains arising from a sale and operating leaseback transaction. Under Canadian GAAP, when the leaseback is classified as an operating lease, any profit or loss arising on the sale is deferred and amortized in proportion to rental payments over the lease term. In contrast, under IAS 17, if a sale and leaseback transaction results in an operating lease and the transaction is established at fair value, any profit or loss is to be recognized immediately.

Consequently, upon transition to IFRS, the equity is expected to increase by $5 million to recognize the unamortized gain on a sale and operating leaseback transaction that occurred in 2009. Since all of the gain is recognized in equity upon transition to IFRS, in order to arrive at IFRS net income for 2010, the amortized gain recognized for the year is to be reversed in the amount of $1 million, thereby reducing Canadian GAAP pre-tax net income by this amount.

Provisions, contingent liabilities and contingent assets
IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37") provides guidance on liability recognition for a number of non-financial liabilities for which the outcome and/or related costs are subject to uncertainty. This requires some change from the current policy for such matters, since the measurement and recognition criteria differ in some respects under Canadian GAAP. Specifically, IAS 37 establishes a lower recognition threshold for liabilities and requires both contractual and constructive liability recognition. As well, the two accounting frameworks differ in the use of discount rates in the computation of decommissioning liabilities.

These differences are expected to decrease equity by $1 million upon transition to IFRS.

Income taxes

Changes to the opening balance sheet require that a corresponding deferred tax asset or liability be established based on the resulting differences between the IFRS carrying value of assets and liabilities and their associated tax bases. Based on the adjustments discussed above, the resulting effect is an expected increase of $374 million in the deferred tax asset and the opening IFRS equity on transition. Since this amount is directly tied to the adjustments upon transition to IFRS, any changes in the expected adjustments will trigger a change in the deferred tax adjustment.

Non-controlling interest

Under Canadian GAAP, non-controlling interests in equity are classified as a separate component between liabilities and equity on the balance sheet and as a component of net income within the income statement. Conversely, under IFRS, non-controlling interests in the Corporation are to be classified as a component of equity separate from the equity of Canada and are not included in net earnings, but rather presented as an allocation of net earnings. Since the IFRS adjustments of our subsidiaries directly affect the amount allocated to non-controlling interest, an offsetting entry is required to be made upon transition to IFRS to the equity of Canada and to non-controlling interest to represent the non-controlling share of the IFRS adjustments. The allocation of the IFRS adjustments to non-controlling interest is expected to result in a $6 million increase to the equity of Canada and a corresponding decrease to non-controlling interest. The resulting IFRS non-controlling interest of $23 million is to be presented as part of total equity under IFRS, thereby increasing the opening IFRS equity position by this amount.

Reconciliation of Equity from Canadian GAAP to IFRS

On a voluntary basis, we have provided a reconciliation of equity from Canadian GAAP to IFRS as at the transition date of January 1, 2010, as shown in the following schedule. This schedule summarizes the currently known and expected impacts of our adoption of IFRS on the opening IFRS equity position. In preparing the reconciliation, we applied the optional IFRS 1 exemptions and the optional and mandatory accounting policy changes, as discussed above. The reconciliation includes all differences identified to date, using the standards and interpretations currently issued and expected to be effective at the end of the Corporation's first annual IFRS reporting period, December 31, 2011.

Standards and circumstances may change throughout 2011, and could result in the Corporation not taking certain optional IFRS 1 exemptions or not adopting certain accounting policies. Accordingly, this reconciliation does not constitute our official IFRS 1 reconciliation note and the actual opening IFRS equity position could differ from what is expected and presented below.

As at January 1 (in millions of dollars)	**2010**
Equity of Canada under Canadian GAAP	1,787
Differences increasing (decreasing) reported equity of Canada:	
Employee benefits	
Net actuarial losses	(1,193)
Asset limit and minimum funding requirement	(46)
Past service cost and funding excess	98
Attribution period *	(34)
Other long-term employee benefits	(238)
Property, plant and equipment	(85)
Leases	5
Foreign exchange	–
Provisions	(1)
Deferred tax impact	374
Non-controlling interest impact	6
Equity of Canada under IFRS	673
Reclassification of non-controlling interest to equity under IFRS	29
Adjustment to non-controlling interest for share of IFRS adjustments	(6)
Total Equity under IFRS	**696**

* The adjustment related to attribution period for the Corporation's post-employment health, dental and other health plans is currently under computation and is not reflected in the equity reconciliation.

Future changes to IFRS

IFRS 1 requires that the accounting policies used by the Corporation in the opening IFRS balance sheet be based upon IFRS, effective at December 31, 2011. The Corporation monitors IASB developments to ensure that the impact of any potential or actual changes to IFRS is appropriately considered in its changeover plan. Some potential changes to areas of particular significance for the Corporation are discussed below. Due to the transition to IFRS made by many entities, the IASB has decided that in order to avoid placing an additional burden on these entities, major IASB projects completed in 2010 will not take effect before January 1, 2012 and those completed in 2011 will not become mandatory before January 1, 2013.

Interest in joint ventures
IAS 31 "Interests in Joint Ventures" currently permits either proportionate consolidation or the equity method to account for interests in joint ventures. The Corporation accounts for its joint venture interest in Innovapost using proportionate consolidation. The IASB exposure draft proposes to eliminate the option to proportionately consolidate certain types of joint venture interests.

The effective date of the new standard is still to be determined; however, the IASB has indicated a target date of the first quarter of 2011 for the issuance of the amended standard, implying an earliest possible effective date of January 1, 2013.

Provisions, contingent liabilities and contingent assets
In January 2010, the IASB published an exposure draft containing proposed amendments to IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37"). The proposed amendments deal with the measurement of liabilities and, specifically, mandate the use of expected values to measure single obligations, as well as measure obligations involving services by reference to the price a contractor would charge to undertake the service, irrespective of the entity's intentions with regard to settling the obligation.

The effective date of the proposed amendments is not known at this time; however, the IASB has indicated that it plans to issue a revised exposure draft for all of IAS 37 in the second half of 2011, with the new standard to be issued in 2012 at the earliest, with the effective date unknown.

Post-employment benefits (including pensions)
In April 2010, the IASB published an exposure draft containing proposed amendments to *Defined Benefit Plans*, which is part of IAS 19 "Employee Benefits" ("IAS 19"). The proposed amendments deal with the immediate recognition of defined benefit costs, the use of the discount rate to determine the expected return on asset and other presentation and disclosure changes.

The IASB has indicated a target date of mid-2011 for the issuance of the amended IAS 19, which would result in the earliest possible effective date of January 1, 2013.

Leases
The IASB published an exposure draft in August 2010 to amend IAS 17 "Leases" ("IAS 17"). The exposure draft contains significant changes in lease accounting, which require recognition of assets and liabilities in the balance sheet for all types of lease agreements, and not just finance leases as required by the current standard. This change would likely result in a significant adjustment to both our assets and liabilities upon adoption of the new standard, in addition to requiring significant work effort for many organizations, including the Corporation.

The IASB has indicated a target date of June 2011 for the issuance of the amended IAS 17, which would result in the earliest possible effective date of January 1, 2013.

10 Outlook for 2011

Our prospects for 2011

10.1 Economic outlook

Although world economies have begun to recover from the recession, significant uncertainty remains. The risk of a setback in the recovery is still uncomfortably high. On a global basis, the economic recovery is evolving largely as expected, although the European debt crisis continues to be the biggest threat which could delay or reverse the economic recovery.

In Canada, the recovery is proceeding at a moderate pace with an estimated 2.9-per-cent expansion in 2010, an improvement from the 2.5-per-cent decline registered in 2009. Consensus among forecasters is that Canadian economic growth will slow down to 2.6 per cent in 2011 and range between 2.7 per cent and 3.0 per cent from 2012 to 2015. Concerns remain that a combination of disappointing productivity performance and persistent strength in the Canadian dollar could dampen the expected recovery.

Inflation dynamics in Canada have been broadly in line with forecasters' expectations. In 2010, Canada's Consumer Price Index ("CPI") grew at 1.8 per cent mainly due to lower energy prices, but as fuel prices increase, it will likely keep headline inflation around the targeted 2.0 per cent range over the period 2011 to 2015. Forecasters expect to see fuel prices continue to rapidly increase in the coming years as the global economy strengthens. As a major user of fuel for its transportation network, The Canada Post Group has had to manage significant costs associated with higher gasoline, diesel and aviation fuel prices in recent years.

In 2010, households increased 1.0 per cent across Canada. Housing starts are expected to continue to grow by 182,000 per year adding costs to delivery operations.

Economic outlook

	2011	2012	2013	2014	2015
Economic (% change)					
Real Gross Domestic Product	2.6%	2.8%	3.0%	2.9%	2.7%
Inflation (Consumer Price Index)	2.1%	2.0%	2.1%	2.0%	2.0%
Demographic (% change)					
Total population growth	1.0%	0.8%	1.2%	0.9%	1.1%
Households growth	1.2%	1.2%	1.2%	1.2%	1.2%

Sources: All projections are based on the January 2011 Global Insight Macro Economic forecast. Forecasts of GDP, CPI and total points of delivery also consider projections from the five major Canadian banks and The Bank of Canada.

10.2 The Canada Post Group outlook

The year 2011 will continue to pose critical challenges that must be overcome to ensure our long-term financial stability. Economic uncertainty, mail-volume erosion and competitive pressures have made it more difficult to predict future revenues, earnings and cash position.

Due to electronic substitution and aggressive competition on many fronts, we do not expect physical-mail volumes to return to previous levels. Domestic Lettermail volumes remain uncertain. Therefore, revenues are projected to grow from a lower base. The Canada Post Group's planned revenue for 2011 is $7.7 billion, which represents growth of 2.9 per cent compared to the previous year, mostly due to price increases. Planned 2011 income before income taxes is $123 million. With slim operating margins and increasing network costs due to continual increases in the number of delivery points, cost containment will continue to be a significant priority. In order to reach our earnings target, the Corporation must continue to control discretionary costs, find new operational efficiencies and implement structural cost management strategies.

In the coming years, in order to remain viable, we will need to implement structural changes in addition to Postal Transformation to permanently reduce costs and improve our competitiveness. In order to respond to reduced mail volumes, we need the flexibility to make changes to our infrastructure.

The world's Posts are facing similar challenges and many have undertaken reforms to their collective agreements in recent years, including innovative work practices to improve efficiency. The USPS is in labour contract negotiations with its unions, with the goal of reaching agreement on actions to increase workforce flexibility and reduce costs.

In our own negotiations underway with the Canadian Union of Postal Workers ("CUPW"), we are seeking changes that will position the company for sustained success, including a new Short-Term Disability Program and new processes that will help resolve disputes, grow the business and modernize operations. We are also proposing changes to the labour cost structure for future employees to maintain operations at a cost we can afford. We strongly believe that taking a proactive approach to protecting the financial viability of the Corporation is necessary as part of our shared responsibility to employees as well as the Canadians we serve.

In October 2009, the Minister of Finance released a pension reform plan to allow Pension Plan sponsors to better manage their funding obligations within their overall business operations and reduce funding volatility. In June 2010, a number of proposed amendments were finalized, including a new standard for establishing minimum funding requirements on a solvency basis. Based on the expected actuarial valuation, the Corporation would need to contribute approximately $652 million in special solvency payments, on top of the estimated $357 million of current service contributions in 2011. The Corporation is awaiting regulations that will define how a letter of credit may be used to reduce the amount of special solvency contributions required as a result of the Canada Post Pension Plan's solvency deficit. In consultation with the Minister responsible for Canada Post and the Minister of Finance, management will consider the final form of the legislation, its liquidity position, and the financial costs and benefits in determining the required amount of special solvency contributions.

During 2010, the Corporation issued $1 billion of long-term bonds. The proceeds from this public debt issue partially secured long-term financing for Postal Transformation and effectively pre-funded 2011 cash flow requirements. Canada Post has sufficient liquidity to support operations throughout 2011, including an adequate contingency cushion to address any fluctuations in working capital, adverse changes in business results or unforeseen expenditures.

Our ability to proceed with Postal Transformation is contingent on the financial health of the Corporation, which is largely driven by economic conditions, the ability to make permanent changes to our cost structure and the funding of our pension obligations. A modernized Canada Post will remain financially self-sustaining and continue to provide the level of service that Canadians expect and deserve.

The Canada Post Group segments – 2011

Canada Post:

- *Transaction Mail* – We see increasing movement to multi-channel communications over the next few years, which will further fragment the communications market and erode our physical-mail volumes. In support of our vision to maintain a dominant position in connecting Canadians both domestically and internationally in the ever-changing communications marketplace, we will continue to follow an overall strategy of maintaining the core business and pursuing aggressive growth in electronic communication channels. In order to maintain the core business, we will concentrate on providing good customer experience and seek ways to make it easier for our customers to do business with us. In order to grow our business, we will focus on providing more product offerings and access, particularly in electronic format. This will provide our customers with a complete range of physical and electronic services.
- *Parcels* – Given economic projections, we are anticipating a recovery in the shipping and delivery market. We will focus on maintaining our strength in the B2C and B2B segments while reinforcing our majority share of the consumer-sending segment by leveraging our retail network. In order to achieve organic and market share growth, a continued investment in our delivery infrastructure specifically aimed at improving on-time delivery performance as well as increased network visibility will be crucial to respond to the new competitive landscape. The combination of anticipated economic growth as well as sustained investment in our delivery network gives us a positive outlook on 2011 with the expected return of positive volume growth in our core parcel products. With the Canadian dollar expected to remain at or above parity with the U.S. dollar, inbound parcel volumes should see a return to healthy growth.
- *Direct Marketing* – Advertising and marketing budgets are expected to recover in 2011. As the economy stabilizes and consumer confidence strengthens, marketers will re-engage and focus their attention once more on revenue expansion and acquisition strategies. The use of data for better targeting, combined with the availability of digital channels, will continue to drive multi-channel integration. In 2011, we will introduce a new highly targeted and consumer-focused online advertising channel. We believe our new data products, coupled with our core Admail products, will enable marketers to reach their target audience through more personalized communications and to measure their return on investment. We will also continue to provide direct marketing leadership and expertise by demonstrating the impact and effectiveness of Admail products by cultivating strategic relationships with new and existing customers.

Purolator – In 2011, Purolator will be externally driven and market-focused, ensuring it delivers on its commitments to its customers and employees. The Company will focus its efforts on profitable growth in all lines of business, continue to investigate areas of efficiencies and maintain cost controls as efforts are made to regain market volume.

Logistics – In 2011, SCI's profitability is expected to decline due to the expiry of a long-term contract. This represents approximately $4 million in revenue and income before taxes. Although SCI cannot entirely mitigate this impact in 2011, efforts will be made to aggressively grow contract logistics and the transportation segment and reduce cost structures by promoting continuous improvements, quality and innovation throughout SCI.

All Other – Innovapost will continue to promote improvements to information technology and management across The Canada Post Group. Along with improving its internal capabilities, processes and controls, Innovapost also intends to achieve contract renewals with key clients and to concentrate on expanding service offerings and capabilities. Innovapost revenues depend on the level of information technology activity at Canada Post and Purolator. In 2011, revenue is expected to be stable as Canada Post and Purolator increase the pace of technology investment compared to 2010, offset by continuing activities to achieve savings in their base operating costs.

HISTORICAL FINANCIAL INFORMATION

(unaudited, in millions of dollars)	**2010**	2009	2008	2007	2006
OPERATIONS					
Revenue from operations	**7,453**	7,312	7,733	7,473	7,264
Cost of operations	**7,138**	6,955	7,594	7,346	7,116
Income from operations	**315**	357	139	127	148
Per cent of revenue from operations	**4.2 %**	4.9 %	1.8 %	1.7 %	2.0 %
Non-operating income (expense)	**(8)**	22	22	33	18
Income before income taxes	**307**	379	161	160	166
Income tax benefit (expense)	**136**	(95)	(67)	(102)	(44)
Net income before non-controlling interest	**443**	284	94	58	122
Non-controlling interest in net income of subsidiaries	**4**	3	4	4	3
Net income	**439**	281	90	54	119
Other comprehensive income (loss), net of tax	**10**	(1)	–	–	–
Comprehensive income	**449**	280	90	54	119
Return on equity of Canada	**21.8 %**	17.0 %	6.1 %	3.8 %	8.4 %
BALANCE SHEET					
Assets					
Current	**2,326**	1,497	1,384	1,388	1,470
Segregated securities	**499**	654	862	632	469
Capital assets	**2,371**	2,216	2,034	1,855	1,731
Accrued pension benefit asset	**2,063**	1,335	898	944	1,010
Other	**341**	327	413	348	319
Total assets	**7,600**	6,029	5,591	5,167	4,999
Liabilities and equity of Canada					
Current	**1,209**	1,179	1,181	1,073	1,185
Accrued pension, other retirement and post-employment benefit liability	**2,950**	2,835	2,722	2,513	2,247
Other liabilities	**1,172**	199	155	120	115
Non-controlling interest	**33**	29	26	22	19
Equity of Canada	**2,236**	1,787	1,507	1,439	1,433
Total liabilities and equity of Canada	**7,600**	6,029	5,591	5,167	4,999
ACQUISITION OF CAPITAL ASSETS					
Land and buildings	**131**	65	145	110	65
Other capital assets	**280**	347	246	221	241
	411	412	391	331	306

HISTORICAL FINANCIAL INFORMATION

	2010	% Change	2009[3]	% Change	2008	% Change	2007	% Change	2006
LINE OF BUSINESS DIMENSIONS									
REVENUE FROM OPERATIONS (unaudited, in millions of dollars / trading day adjusted per cent)									
Transaction Mail									
Domestic Lettermail	**2,836**	**1.4 %**	2,798	[3]	2,914	0.3 %	2,894	0.5 %	2,869
Outbound Letter-post (to other postal administrations)	**177**	**(3.7) %**	184	[3]	144	(13.4) %	166	(11.5) %	187
Inbound Letter-post (from other postal administrations)	**118**	**(4.5) %**	124	(1.2) %	126	9.7 %	114	0.1 %	114
Total Mail	**3,131**	**0.8 %**	3,106	(2.1) %	3,184	(0.1) %	3,174	(0.2) %	3,170
Other	**47**	**11.8 %**	42	(14.5) %	50	24.5 %	40	7.1 %	37
Canada Post segment[1]	**3,178**	**1.0 %**	3,148	(2.3) %	3,234	0.2 %	3,214	(0.2) %	3,207
All Other segment	**–**		–		–		–	(100.0) %	4
Elimination of intersegment	**(4)**		(4)		(5)		(5)		(6)
The Canada Post Group	**3,174**	**1.0 %**	3,144	(2.3) %	3,229	0.2 %	3,209	(0.3) %	3,205
Parcels									
Domestic parcels	**899**	**1.2 %**	888	(2.5) %	915	6.9 %	852	4.6 %	812
Outbound parcels (to other postal administrations)	**196**	**1.6 %**	193	(3.2) %	200	(0.7) %	201	(1.8) %	204
Inbound parcels (from other postal administrations)	**138**	**(1.6) %**	140	(4.4) %	147	9.5 %	134	(0.6) %	134
Total Mail	**1,233**	**0.9 %**	1,221	(2.8) %	1,262	5.9 %	1,187	2.8 %	1,150
Other	**42**	**(10.8) %**	47	(4.6) %	49	(5.9) %	52	14.1 %	45
Canada Post segment[1]	**1,275**	**0.5 %**	1,268	(2.9) %	1,311	5.4 %	1,239	3.3 %	1,195
Purolator segment	**1,493**	**4.1 %**	1,433	(7.9) %	1,563	7.4 %	1,448	7.1 %	1,347
Logistics segment	**149**	**(1.1) %**	151	(3.2) %	156	6.4 %	146	8.3 %	134
Elimination of intersegment	**(113)**		(108)		(97)		(84)		(61)
The Canada Post Group	**2,804**	**2.2 %**	2,744	(6.1) %	2,933	6.3 %	2,749	4.7 %	2,615
Direct Marketing									
Addressed Admail	**600**	**5.4 %**	569	(10.1) %	635	1.9 %	621	6.1 %	583
Unaddressed Admail	**399**	**4.9 %**	380	(4.3) %	399	5.6 %	376	10.3 %	339
Publications Mail	**254**	**(1.8) %**	259	(9.9) %	289	0.9 %	285	3.2 %	275
Business Reply Mail & Other mail	**31**	**(4.5) %**	32	(17.4) %	39	(4.0) %	41	(5.5) %	43
Total Mail	**1,284**	**3.5 %**	1,240	(8.6) %	1,362	2.6 %	1,323	6.2 %	1,240
Other	**71**	**5.2 %**	68	(1.0) %	69	0.3 %	68	17.2 %	58
The Canada Post segment[1] / Group	**1,355**	**3.6 %**	1,308	(8.2) %	1,431	2.5 %	1,391	6.7 %	1,298
Other revenue									
Canada Post segment	**121**	**4.1 %**	116	(11.4) %	132	18.7 %	111	(16.1) %	131
Purolator segment[2]	**(1)**	**(82.2) %**	(0)	(109.2) %	4	617.5 %	(1)	(8,356.2) %	(0)
All Other segment	**148**	**(11.9) %**	168	(4.4) %	176	0.3 %	175	1.2 %	173
Elimination of intersegment	**(148)**		(168)		(172)		(161)		(158)
The Canada Post Group	**120**	**3.9 %**	116	(16.8) %	140	11.9 %	124	(15.2) %	146
Revenue from operations									
Canada Post segment	**5,929**	**1.5 %**	5,840	(4.0) %	6,108	2.2 %	5,955	1.7 %	5,831
Purolator segment	**1,492**	**4.1 %**	1,433	(8.2) %	1,567	7.8 %	1,447	7.1 %	1,347
Logistics segment	**149**	**(1.1) %**	151	(3.2) %	156	6.4 %	146	8.3 %	134
All Other segment	**148**	**(11.9) %**	168	(4.4) %	176	0.3 %	175	(1.4) %	177
Elimination of intersegment	**(265)**		(280)		(274)		(250)		(225)
The Canada Post Group	**7,453**	**1.9 %**	7,312	(5.1) %	7,733	3.1 %	7,473	2.5 %	7,264

HISTORICAL FINANCIAL INFORMATION

	2010	% Change	2009[3]	% Change	2008	% Change	2007	% Change	2006
LINE OF BUSINESS DIMENSIONS									
VOLUME (unaudited, in millions of pieces / trading day adjusted per cent)									
Transaction Mail									
Domestic Lettermail	**4,449**	**(4.5) %**	4,657	[3]	4,937	(1.3) %	4,982	(0.9) %	5,010
Outbound Letter-post (to other postal administrations)	**127**	**(5.3) %**	134	[3]	108	(19.5) %	134	(12.0) %	151
Inbound Letter-post (from other postal administrations)	**261**	**6.2 %**	246	(9.8) %	274	(6.1) %	290	(6.8) %	310
Canada Post segment	**4,837**	**(4.0) %**	5,037	[3]	5,319	(2.0) %	5,406	(1.6) %	5,471
Elimination of intersegment	**(5)**		(5)		(6)		(7)		(7)
The Canada Post Group	**4,832**	**(4.0) %**	5,032	[3]	5,313	(2.0) %	5,399	(1.6) %	5,464
Parcels									
Domestic parcels	**97**	**(4.7) %**	102	(5.8) %	108	(0.3) %	108	(0.2) %	108
Outbound parcels (to other postal administrations)	**12**	**(6.9) %**	13	(6.2) %	14	(3.7) %	15	0.1 %	15
Inbound parcels (from other postal administrations)	**34**	**4.7 %**	33	(10.6) %	37	(26.7) %	51	(2.2) %	51
Canada Post segment	**143**	**(2.8) %**	148	(6.9) %	159	(8.3) %	174	(0.7) %	174
Purolator segment	**141**	**1.8 %**	138	(3.0) %	143	0.2 %	142	1.5 %	140
Elimination of intersegment	**(1)**		(2)		(3)		(2)		(2)
The Canada Post Group	**283**	**(0.3) %**	284	(4.9) %	299	(4.6) %	314	0.1 %	312
Direct Marketing									
Addressed Admail	**1,327**	**2.0 %**	1,301	(13.1) %	1,503	(1.8) %	1,525	3.3 %	1,470
Unaddressed Admail	**3,652**	**0.3 %**	3,640	(10.0) %	4,061	2.7 %	3,940	5.4 %	3,722
Publications Mail	**445**	**(5.5) %**	471	(9.4) %	522	(2.9) %	535	(0.4) %	536
Business Reply Mail & Other mail	**33**	**(11.0) %**	37	(34.1) %	56	(16.0) %	66	9.5 %	60
The Canada Post segment / Group	**5,457**	**0.1 %**	5,449	(10.9) %	6,142	0.9 %	6,066	4.4 %	5,788
Total Volume									
Canada Post segment	**10,437**	**(1.8) %**	10,634	[3]	11,620	(0.6) %	11,646	1.5 %	11,433
Purolator segment	**141**	**1.8 %**	138	(3.0) %	143	0.2 %	142	1.5 %	140
Elimination of intersegment	**(6)**		(7)		(9)		(9)		(9)
The Canada Post Group	**10,572**	**(1.8) %**	10,765	[3]	11,754	(0.6) %	11,779	1.5 %	11,564
EMPLOYMENT[4]									
Canada Post segment	**56,917**	**(3.0) %**	58,665	(1.9) %	59,808	(1.3) %	60,606	0.3 %	60,404
Purolator segment	**10,979**	**0.1 %**	10,970	(0.6) %	11,038	2.0 %	10,818	2.2 %	10,582
Logistics segment	**1,043**	**(6.3) %**	1,113	(3.6) %	1,154	7.9 %	1,070	29.1 %	829
All Other segment	**–**	**0.0 %**	–	0.0 %	–	0.0 %	–	(100.0) %	54
The Canada Post Group	**68,939**	**(2.6) %**	70,748	(1.7) %	72,000	(0.7) %	72,494	0.9 %	71,869
MAIL NETWORK									
Post offices	**6,499**	**(0.5) %**	6,532	(1.3) %	6,618	0.1 %	6,614	0.2 %	6,602
Points of delivery (in thousands)	**15,028**	**1.0 %**	14,874	1.2 %	14,696	1.4 %	14,493	1.4 %	14,293
Pick-up points (in thousands)[5]	**976**	**(1.9) %**	994	(1.3) %	1,008	(0.7) %	1,015	(0.3) %	1,019

[1] 2006 and 2007 revenues were restated to reflect minor realignments made in 2008 between lines of business. In addition the groupings within the lines of business have been expanded for all years.
[2] The 2006 to 2008 revenues for the Purolator segment were restated to include foreign exchange gains and losses.
[3] In 2010 a methodology change has been implemented and 2009 has been restated for comparability. Had 2008 been restated the volume per cent change to 2009 for Transaction Mail would have been (3.6)% for Domestic Lettermail, (5.7)% for Outbound Letter-post (to other postal administrations) and (4.0)% for Canada Post segment. The change for the total Canada Post segment would have been (7.7)% and (7.6)% for The Canada Post Group. The comparable change to revenue would have been (1.9)% for Domestic Lettermail and (6.0)% for Outbound Letter-post (to other postal administrations).
[4] Includes paid full-time and part-time employees and excludes temporary, casual and term employees.
[5] Includes rural mailboxes (RMBs), which are collection points for customers with this mode of delivery.

ADDITIONAL INFORMATION

In 2009, following the Strategic Review of Canada Post, the Government of Canada approved a new five-year Financial Framework for the Corporation that sets out financial performance targets for 2010 to 2014. The new Financial Framework replaces the Policy Framework that had been in place since 1998 (Note 16).

The following chart presents the financial ratios for 2010 under the new Financial Framework:

Consolidated Ratios* (unaudited)		Financial Framework	**2010**
Profitability			
(1) EBITDA margin		5.0% - 7.5%	**8.1 %**
(2) Return on book equity		0% - 5%	**21.8 %**
Leverage			
(3) Total debt to EBITDAR		2.5x - 4.0x	**2.9x**
(4) Total debt to book capital		45% - 65%	**49.0 %**
Liquidity			
(5) (EBITDAR - capex) ÷ interest		1.0x - 2.5x	**4.6x**
Dividend payout			
(6) Dividend payout ratio			
	2010-2012	0% - 20%	**0.0 %**
	2013-2014	15% - 20%	
Based on Canadian GAAP			

(1) Earnings before interest, taxes, depreciation and amortization ÷ revenue
(2) Net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)
(3) (Total debt + long-term financial obligations) ÷ (earnings before interest, taxes, depreciation and amortization with adjustment for operating leases)
(4) (Total debt + long-term financial obligations) ÷ (total debt + long-term financial obligations + equity of Canada)
(5) (Earnings before interest, taxes, depreciation and amortization with adjustment for operating leases - capex) ÷ interest
(6) Dividend paid ÷ prior year's net income

Notes:
Long-term financial obligations include asset retirement obligations, obligation to repurchase shares (Purolator) and capitalization of operating leases.
Operating leases removed from earnings and capitalized using a factor of 7.0x.
Capex refers to estimated maintenance capital, which includes all capital purchases and capital leases, but excludes approximately $37M of capital purchases for Postal Transformation in the year.
Interest includes imputed interest on capitalized operating leases (calculated as 1/3 of lease expense).

* In future annual reports (2011 and beyond) this table will be produced under IFRS only. Some of the ratios may need to be re-examined under IFRS.

The following chart presents the financial ratios for the four years from 2006 to 2009 under the former Policy Framework:

Consolidated Ratios (unaudited)	Policy Framework	2009	2008	2007	2006
Profitability					
(1) Return on equity of Canada	11.0 %	17.0 %	6.1 %	3.8 %	8.4 %
(2) Operating profit margin		4.9 %	1.8 %	1.7 %	2.0 %
(3) Productivity	97.0 %	95.1 %	98.2 %	98.3 %	98.0 %
Leverage					
(4) Total debt to total capital	40.0 %	7.6 %	5.8 %	4.9 %	4.9 %
(5) Cash flow to debt		90.3 %	644.6 %	459.6 %	366.0 %
Liquidity					
(6) Current ratio		1.27	1.17	1.29	1.24
(7) Gross interest coverage		55.65	14.12	12.47	14.58
Investment					
(8) Cash flow to capital expenditures		32.1 %	153.0 %	104.0 %	87.9 %
(9) Capital asset investment rate		7.2 %	8.1 %	5.7 %	6.7 %
Dividend payout					
(10) Dividend payout ratio	25.0 %	0.0 %	40.0 %	40.0 %	40.0 %
Dividend payout ratio once return on equity of Canada ≥ 11%	40.0 %				

(1) Net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)
(2) Income from operations ÷ revenue from operations
(3) Cost of operations ÷ revenue from operations
(4) (Total debt + long-term financial obligations) ÷ (total debt + long-term financial obligations + equity of Canada)
(5) Cash flows from operating activities ÷ (total debt + long-term financial obligations)
(6) Current assets ÷ current liabilities
(7) Income from operations ÷ (interest expense + long-term financial expense)
(8) Cash flows from operating activities ÷ cash acquisition of capital assets
(9) (Acquisition of capital assets - proceeds from sale of capital assets) ÷ ((cost of capital assets beginning of year + cost of capital assets end of year) ÷ 2)
(10) Dividend ÷ net income

AUDITOR'S 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, 2010, prepared in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis. This financial information has been prepared by management using Canada Post Corporation segment information contained in note 22a to the audited consolidated financial statements for the year ended December 31, 2010, and other unaudited operational data extracted from Canada Post Corporation's systems.

Management's Responsibility for the Annual Cost Study Contribution Analysis

Management is responsible for the preparation of the Annual Cost Study Contribution Analysis in accordance with their Annual Cost Methodology and for the conclusion, based the results of the analysis thereof, that the competitive grouping of services has not been cross-subsidized using revenues from exclusive privilege services. Management is also responsible for such internal control as management determines is necessary to enable the preparation of the financial information that it is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the overall presentation of the financial information. We did not perform any audit work on the underlying methodology nor on Canada Post's operational systems and special studies that yield operational data used to allocate costs to products.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion:

(a) The Annual Cost Study Contribution Analysis is prepared, in all material respects, in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis, using Canada Post Corporation segment information contained in note 22a to the audited consolidated financial statements for the year ended December 31, 2010, and other unaudited operational data extracted from Canada Post Corporation's systems; and

(b) Management's conclusion, using the Cost Methodology described in the notes, that Canada Post did not cross-subsidize its competitive services using revenues protected by exclusive privilege for the year ended December 31, 2010 is appropriate.

Basis of Accounting and Use

Without modifying our opinion, we draw attention to the introduction to the notes to the Annual Cost Study Contribution Analysis which describes the basis of accounting for the Annual Cost Study Methodology. The analysis is prepared to demonstrate that the competitive grouping of services has not been cross-subsidized using revenues from exclusive privilege services. As a result, the Annual Cost Study Contribution Analysis may not be suitable for another purpose.

PricewaterhouseCoopers LLP
Chartered Accountants, Licensed Public Accountants
Ottawa, Canada
March 23, 2011

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 below, 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.

As the Annual Cost Study Contribution Analysis indicates, for the year ended December 31, 2010, 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, 2010

(in millions of dollars)

I - Long-Run Incremental Contribution of exclusive privilege, competitive, and concessionary services

The following analysis is based on the assignment of 63% of the total non-consolidated costs of Canada Post Corporation to individual services or groups of services.

	Exclusive Privilege	Competitive	Concessionary	Other	Total
Revenue from operations	$ 3,522	$ 2,105	$ 104	$ 198	$ 5,929
Long-run incremental costs	$ (1,904)	$ (1,463)	$ (99)	$ (145)	$ (3,611)
Long-run incremental contribution to the fixed costs	**$ 1,618**	**$ 642**	**$ 5**	**$ 53**	**$ 2,318**
	46%	30%	5%	27%	39%
Unallocated fixed costs					$ (2,108)
Contribution before the under noted items					**$ 210**
Investment and other income					$ 49
Interest and other expense					$ (26)
Income from the Canada Post segment before income taxes					**$ 233**

II - Long-Run Incremental Contribution by line of business

The following analysis is based on the assignment of 61% of the total non-consolidated costs of Canada Post Corporation to individual services or groups of services.

	Transaction Mail	Parcels	Direct Marketing	Other	Total
Revenue from operations	$ 3,178	$ 1,275	$ 1,355	$ 121	$ 5,929
Long-run incremental costs	$ (1,598)	$ (984)	$ (834)	$ (77)	$ (3,493)
Long-run incremental contribution to the fixed costs	**$ 1,580**	**$ 291**	**$ 521**	**$ 44**	**$ 2,436**
	50%	23%	38%	36%	41%
Unallocated fixed costs					$ (2,226)
Contribution before the under noted items					**$ 210**
Investment and other income					$ 49
Interest and other expense					$ (26)
Income from the Canada Post segment before income taxes					**$ 233**

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, 2010

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 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 four 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, 2010, 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

Chief Financial Officer

March 24, 2011

INDEPENDENT AUDITORS' REPORT

To the Minister of Transport, Infrastructure and Communities

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Canada Post Corporation, which comprise the consolidated balance sheet as at December 31, 2010, and the consolidated income and comprehensive income statement, consolidated equity of Canada statement and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

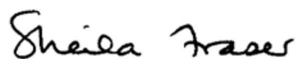
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canada Post Corporation as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, we report that, in our opinion, Canadian generally accepted accounting principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of Canada Post 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 Canada Post Corporation and its wholly-owned subsidiaries and the directives issued pursuant to section 89 of the *Financial Administration Act*.



Sheila Fraser, FCA
Auditor General of Canada

March 24, 2011
Ottawa, Canada

Chartered Accountants, Licensed Public Accountants

CONSOLIDATED BALANCE SHEET

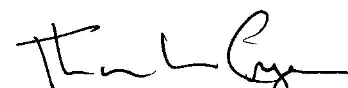
As at December 31 (in millions of dollars)	**2010**	2009
Assets		
Current assets		
Cash and cash equivalents (note 7)	**$ 379**	$ 473
Marketable securities (note 7)	**1,082**	270
Accounts receivable (note 6)	**628**	584
Income tax recoverable	**139**	69
Prepaid expenses	**72**	76
Current portion of future income tax assets (note 9)	**26**	25
Total current assets	**2,326**	1,497
Capital assets (note 10)		
Property, plant and equipment	**2,210**	2,047
Intangible assets	**161**	169
	2,371	2,216
Other assets		
Segregated securities (note 7)	**499**	654
Accrued pension benefit asset (note 11)	**2,063**	1,335
Future income tax assets (note 9)	**204**	179
Goodwill (note 12)	**125**	125
Other long-term assets (note 13)	**12**	23
Total assets	**$ 7,600**	$ 6,029
Liabilities and equity of Canada		
Current liabilities		
Accounts payable and accrued liabilities	**$ 459**	$ 413
Salaries and benefits payable	**576**	575
Income tax payable	**–**	2
Deferred revenue	**120**	142
Outstanding money orders	**41**	37
Current portion of long-term debt (note 14)	**13**	10
Total current liabilities	**1,209**	1,179
Long-term debt (note 14)	**1,095**	120
Accrued pension, other retirement and post-employment benefit liability (note 11)	**2,950**	2,835
Future income tax liabilities (note 9)	**40**	36
Other long-term liabilities	**37**	43
Total liabilities	**5,331**	4,213
Non-controlling interest	**33**	29
Equity of Canada	**2,236**	1,787
Total liabilities and equity of Canada	**$ 7,600**	$ 6,029

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:

Chairperson of the Board of Directors



Chairperson of the Audit Committee

CONSOLIDATED EQUITY OF CANADA STATEMENT

Year ended December 31 (in millions of dollars)	**2010**	2009
Contributed capital	**$ 1,155**	$ 1,155
Retained earnings		
Balance, beginning of year	**633**	352
Net income	**439**	281
Balance, end of year	**1,072**	633
Accumulated other comprehensive income (loss)		
Balance, beginning of year	**(1)**	–
Other comprehensive income (loss)	**10**	(1)
Balance, end of year	**9**	(1)
Total retained earnings and accumulated other comprehensive income (loss)	**1,081**	632
Equity of Canada	**$ 2,236**	$ 1,787

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME AND COMPREHENSIVE INCOME STATEMENT

Year ended December 31 (in millions of dollars)	**2010**	2009
Revenue from operations	**$ 7,453**	$ 7,312
Cost of operations		
Labour	**3,854**	3,893
Benefits, net of transitional support of $13 million (2009 – $56 million) (note 11e)	**806**	579
Non-labour processing, collection and delivery	**1,308**	1,319
Facilities	**308**	306
Amortization	**276**	246
Selling, administration and other	**586**	612
Total cost of operations	**7,138**	6,955
Income from operations	**315**	357
Non-operating income (expense)		
Investment and other income	**22**	29
Interest and other expense	**(30)**	(7)
Non-operating income (expense), net	**(8)**	22
Income before income taxes	**307**	379
Income tax benefit (expense) (note 9)	**136**	(95)
Net income before non-controlling interest	**443**	284
Non-controlling interest in net income of subsidiaries	**4**	3
Net income	**$ 439**	$ 281
Other comprehensive income (loss), net of tax		
Unrealized gains (losses) on available-for-sale financial assets arising during the year	**13**	(1)
Reclassification adjustments for gains included in net income	**(3)**	–
Change in unrealized gains (losses) on available-for-sale financial assets	**10**	(1)
Other comprehensive income (loss)	**10**	(1)
Comprehensive income	**$ 449**	$ 280

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

Year ended December 31 (in millions of dollars)	**2010**	2009
Operating activities		
Net income	**$ 439**	$ 281
Adjustments to reconcile net income to cash provided by operating activities:		
Accrued pension, other retirement and post-employment benefits	**310**	122
Pension, other retirement and post-employment benefit payments	**(923)**	(446)
Transitional support offsetting pension reform incremental costs	**(13)**	(56)
Amortization	**276**	246
Future income tax expense (benefit)	**(25)**	90
Gain on sale of capital assets	**(11)**	(19)
Proceeds from long-term inducements	**2**	3
Other income not affecting cash, net	**(18)**	(8)
Change in non-cash operating working capital (note 18)	**(78)**	(79)
Cash provided by (used in) operating activities	**(41)**	134
Investing activities		
Business acquisitions	**–**	(1)
Acquisition of securities	**(2,019)**	(3,173)
Proceeds from sale of securities	**1,393**	3,221
Acquisition of capital assets	**(411)**	(412)
Proceeds from sale of capital assets	**19**	32
Other investing activities, net	**(7)**	(10)
Cash used in investing activities	**(1,025)**	(343)
Financing activities		
Transitional support received from the Government of Canada	**13**	56
Repayment of long-term debt	**(45)**	(23)
Proceeds from long-term borrowing	**1,010**	45
Dividend paid to non-controlling interest	**(1)**	–
Other financing activities, net	**(5)**	(1)
Cash provided by financing activities	**972**	77
Net decrease in cash and cash equivalents	**(94)**	(132)
Cash and cash equivalents, beginning of year	**473**	605
Cash and cash equivalents, end of year	**$ 379**	$ 473

The accompanying notes are an integral part of these consolidated financial statements.

(December 31, 2010)

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 at 2701 Riverside Drive, 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. As directed by the Government of Canada, the Corporation continued its financial contribution to the Program until March 31, 2009; no further financial contribution was made to the Program since that time (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 2010, 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 ("GAAP"). Canadian GAAP 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. It is reasonably possible that management's reassessments of these and other estimates and assumptions in the near term, as well as actual results, may result in a significant 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 2010.

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 March 3, 2011, the name of Purolator Courier Ltd was changed to Purolator, Inc. As at December 31, 2010, Purolator, Inc. ("Purolator") and SCI Group Inc. ("SCI") are the principal subsidiaries of the Corporation, and Innovapost Inc. ("Innovapost") is the only joint venture.

2. Significant Accounting Policies (continued)

(b) Financial instruments • Upon initial recognition, all financial assets are classified based on the nature and purpose of the financial instruments, or designated by the Corporation as (i) held for trading, (ii) held to maturity investments, (iii) loans and receivables or (iv) available-for-sale. All financial liabilities are classified or designated as (i) held for trading or (ii) other financial liabilities.

Financial instruments are initially recognized at fair value; 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) Cash equivalents and marketable securities are designated as held for trading. These investments are principally used to manage cash flow requirements while maximizing return on investment. Cash equivalents consist of investments with maturities of three months or less while marketable securities have maturities of twelve months or less from the date of acquisition.

Interest income, changes in fair value and realized gains and losses are recorded in investment and other income.

(b.2) Segregated securities are designated as available-for-sale and consist of funds segregated to manage certain defined benefit plans (Note 7(c)). Interest income and realized gains and losses on sale of available-for-sale investments are included in benefit costs. Changes in fair value are included in other comprehensive income until the investment is sold or otherwise derecognized. Although the liquidity of segregated securities varies, only the portion offsetting related current liabilities is presented as a current asset.

All transactions for cash equivalents, marketable securities and segregated securities are recognized at the settlement date and changes in fair value are recognized as they occur.

(b.3) 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 recorded 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 recorded amount and the estimated future cash flows. Credit losses and subsequent recoveries are recognized in the consolidated income and comprehensive income statement within selling, administration and other cost of operations.

(b.4) Accounts payable and accrued liabilities, salaries and benefits payable and outstanding money orders are classified as other financial liabilities and include obligations created by statutory requirements imposed by governments as well as 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.

2. Significant Accounting Policies (continued)

(b.5) 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, but will not exceed the leased asset's fair value.

(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	10, 20, 25, 30 and 65 years
Leasehold improvements	Straight-line	Lease term or the asset's economic useful life
Plant equipment	Straight-line	5 to 20 years
Vehicles:		
Passenger	Declining balance	Annual rate of 30%
Other	Straight-line	3 to 12 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 7 years
Customer contracts	Straight-line	Term of contract plus period of renewal options, maximum of 5 years
Customer relationships	Straight-line	Estimated period of future benefit, based on historical experience and future projections of customer business, maximum of 20 years

Assets held under capital leases are amortized over the period of the lease.

In order to facilitate the future transition to International Financial Reporting Standards, the Corporation applied component accounting to buildings in 2010, resulting in changes in the estimated useful life of buildings. Six different components with five different useful lives were established for buildings, with useful lives ranging between 10 to 65 years, compared to previous amortization periods of 15, 30 and 40 years. The changes in the estimated useful lives due to the componentization of buildings resulted in a $4 million decrease in amortization expense in 2010, with a $3 million decrease for 2011.

2. Significant Accounting Policies (continued)

(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 present value of expected 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 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.

(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. 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.

2. Significant Accounting Policies (continued)

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. 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 difference between the amount billed to the customer and 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.

(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 selling, administration and 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.

(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.

2. Significant Accounting Policies (continued)

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	**2010**		2009	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Canada Post Corporation	11 years	5 to 11 years	11 years	5 to 11 years
Purolator	10 to 14 years	N/A	12 to 14 years	N/A
SCI	5 to 11 years	6 years	5 to 11 years	14 years
Innovapost	8 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.

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 8 years (2009 – from 3 to 8 years).

2. Significant Accounting Policies (continued)

(h) Defined contribution pension plans • Employer contributions to the defined contribution 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.

In 2010, the Corporation received $13 million, which represents the final transitional support amount.

(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 they will be realized. The carrying value of future income tax assets is adjusted, if necessary, by the use of a valuation allowance to reflect the amount that is considered more likely than not to 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 revenue for the current year.

3. Adoption of New Accounting Standards

The Corporation indicated in the prior year that it would, in the event of business acquisitions in 2010, consider the early adoption of CICA Section 1582 "Business Combinations," Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests," to be more closely aligned with International Financial Reporting Standards and to mitigate the impact of adopting IFRS at the January 1, 2011 changeover date. Due to the fact that no business acquisitions occurred during the year, the Corporation did not adopt the above-mentioned sections in the current year, and will be applying IFRS to future acquisitions.

4. Accounting Pronouncements Requiring Implementation in Future Years

International Financial Reporting Standards ("IFRS")

In February 2008, the Accounting Standards Board ("AcSB") confirmed that publicly accountable entities will be required to adopt IFRS as the required basis of accounting under Canadian generally accepted accounting principles ("GAAP") for fiscal years beginning on or after January 1, 2011. In October 2009, the Public Sector Accounting Board approved an amendment to the scope of public sector accounting standards, which confirms that government business enterprises ("GBE") will be required to follow IFRS for periods beginning January 1, 2011. The Corporation, which meets the current definition of a GBE, will report under IFRS in its financial statements for the year ending December 31, 2011. These financial statements will include an opening balance sheet at January 1, 2010 and full IFRS comparative information for the year ended December 31, 2010.

The Corporation developed and implemented an IFRS changeover plan to support the transition from Canadian GAAP to IFRS in the 2011 financial statements. It established a multi-disciplinary IFRS implementation team and instituted regular progress reporting to the Audit Committee of the Board of Directors.

The changeover plan consists of three phases. The first phase, focusing on planning and early issue identification, was completed in 2008. Work on the second and third phases of the plan, covering detailed evaluations for each financial reporting area and implementation of the new standards, was largely completed in 2010, along with finalizing the detailed evaluation phases and focusing on implementation activities. The Corporation continues to assess the impact of its transition to IFRS, based on information available at this time.

5. Regulation of Customer Postage Rates

The Corporation establishes customer postage rates for domestic Lettermail and U.S. and international Letter-post items, as well as fees for certain other services such as Registered Mail, through regulations under the *Canada Post Corporation Act* ("the Act"). These regulations are subject to approval by the Government of Canada, the sole Shareholder and, therefore, a related party of the Corporation. The Act states that regulated postage rates must be fair and reasonable, and consistent so far as possible with providing a 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 Act requires that proposed regulations be published in the *Canada Gazette* to provide interested persons with a reasonable opportunity to make representations to the Minister responsible for Canada Post. These representations are considered by the Corporation's Board of Directors when determining the final form of the proposed rate changes. Once approved by the Board of Directors, the regulations are submitted to the Minister responsible for Canada Post for approval by the Government of Canada, specifically the Governor in Council. Regulations submitted for Governor in Council consideration are deemed approved 60 days after the Clerk of the Privy Council receives them, unless the Governor in Council has previously approved or refused to approve them.

5. Regulation of Customer Postage Rates (continued)

In October 2009, the Government of Canada approved regulations that set the domestic basic letter rate ("BLR") for a five-year period. Under this new pricing plan, the BLR increased by 3 cents to 57 cents in January 2010, and will increase by 2 cents each year after that through 2014. Government approval is sought on a yearly basis for increases to the remaining regulated products for domestic Lettermail and U.S. and international Letter-post items. Government approval was received in December 2010 to increase rates for these products effective January 2011.

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.

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 partial 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 30% (2009 – 31%) of the Canada Post segment revenue (note 22).

6. 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, foreign exchange risk and commodity risk), credit risk and liquidity risk. Risk management for investment activities is carried out by the Corporate Treasury function under policies approved by the Board of Directors. Investments are held for liquidity purposes, or for longer terms, to achieve the highest possible rate of return in the long term 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 changes in the economic environment. 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.

6. Nature and Extent of Risks from Financial Instruments *(continued)*

(a) Market risk

Market risk is the potential for loss that may arise from changes in external market factors, such as interest rates, foreign exchange rates and commodities prices.

(i) Interest rate risk

The Corporation's investments consist of cash and cash equivalents, marketable securities and segregated securities. The Corporation's investments are designated as held for trading or available-for-sale. Substantially all investments are fixed-rate debt securities and are therefore exposed to a risk of change in their fair value for changes in interest rates. The risk is managed by either maintaining a short term to maturity or, in the case of segregated securities, extending terms to maturity to better match certain long-term post-retirement obligations to which they are externally restricted. The average duration in the portfolio was 9 years as at December 31, 2010 (2009 – 6 years).

The Corporation has performed a sensitivity analysis on interest rate risk using a 1-per-cent increase or decrease, which represents management's assessment of a reasonably possible change in interest rates given the nature and term to maturity of the outstanding investments. An increase or decrease of 1 per cent in market interest rates, with all other variables held constant, would increase or decrease the value of the segregated securities by $42 million, at December 31, 2010. Such change in value would be partially offset by the change in value of certain long-term post-retirement obligations. Substantially all of the Corporation's long term debt has fixed interest rates with prepayment terms at a premium to fair value.

(ii) Foreign exchange risk

The Corporation's exposure to foreign exchange 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 U.S. Dollar ("US$"), Japanese Yen, Sterling and Euro, whereas payment is usually denominated in US$. The Corporation's principal exposure is to the US$. The effect of a 10% increase or decrease in the prevailing US$ exchange rate at December 31, 2010, all other variables held constant, would have increased or decreased net income for the year by $5 million. There is no significant impact on revenue arising from exposures to other currencies. Net exchange losses included in revenue amounted to $4 million (2009 – $5 million).

(iii) Commodity risk

The Corporation is inherently exposed to fuel price increases. It partially mitigates this risk through the use of a fuel price surcharge charged on some of its products. This practice is an industry-accepted and long-standing risk mitigation technique that brings the risk to an acceptable level.

(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.

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.

6. Nature and Extent of Risks from Financial Instruments (continued)

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. There was no impairment loss on investments recognized during the year (2009 – $2 million).

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 realizable value 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 continued weakness in certain sectors of the Canadian economy, the Corporation's bad debt expense has remained consistent with prior years. Weekly monitoring of aged receivables and day's sales outstanding has indicated 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 the 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 uncollectible 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:

Trade and Other Receivables **As at December 31** (in millions of dollars)	**2010**	**2009**
Trade accounts receivable:		
Current	$ 422	$ 360
1-15 days past due	63	58
16-30 days past due	18	18
Over 30 days past due	17	24
Allowance for doubtful accounts	(12)	(12)
Trade accounts receivable – net	$ 508	$ 448
Receivables from foreign postal administrations	91	86
Other receivables	29	50
Accounts receivable	**$ 628**	$ 584

Impairment losses on accounts receivable recognized during the year were $4 million (2009 – $6 million).

6. Nature and Extent of Risks from Financial Instruments (continued)

(c) Liquidity risk

Liquidity risk is the risk that a company will not be able to meet its financial obligations as they fall due. The Corporation manages liquidity risk by maintaining adequate cash reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. 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 subsequently 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 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. 4, 2009-10*, the Corporation is authorized to borrow other than from the Crown an aggregate outstanding amount not exceeding $2.5 billion, in accordance with the terms and conditions approved by the Minister of Finance.

Within these limits, the Corporation's long-term debt amounted to $1,108 million as at December 31, 2010 (2009 – $130 million). The significant increase in long term debt is due to the issue of bonds with aggregate principal of $1 billion to fund the Postal Transformation Program. The Corporation has an approved short-term borrowing limit of $250 million for cash management purposes, of which $15 million was used to issue letters of credit.

The Corporation's subsidiaries and joint venture also have access to financing facilities totalling $200 million and of this amount, $51 million (2009 – $69 million) was drawn as at December 31, 2010.

The following table details 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.

As at December 31
(in millions of dollars)

					2010	2009
	Weighted average effective interest rate	Less than 1 year	1–5 years	More than 5 years	**Total**	Total
Non-interest bearing*		$ 728	$ –	$ –	$ 728	$ 681
Bonds, Series 1	4.39%	22	87	1,045	1,154	–
Bonds, Series 2	4.12%	20	82	704	806	–
Non-redeemable bonds	10.6%	6	23	58	87	93
Other borrowings	Prime + 1%	–	–	–	–	25
Capital lease obligations	4%	16	41	6	63	55
		$ 792	**$ 233**	**$ 1,813**	**$ 2,838**	$ 854

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

Liquidity risk is also affected by the Corporation's management of debt and equity levels that is summarized in note 16.

7. Cash and Cash Equivalents, Marketable Securities and Segregated Securities

(a) Cash and cash equivalents, marketable securities and segregated securities consist of the following:

As at December 31 (in millions of dollars)	2010	2009
Cash and cash equivalents		
Cash	$ 94	$ 126
Money market instruments issued by:		
Government of Canada	–	50
Provincial governments	48	35
Financial institutions	126	187
Corporations	111	75
Total cash and cash equivalents	**$ 379**	$ 473
Marketable securities		
Money market instruments issued by:		
Government of Canada	$ 530	$ 168
Provincial governments	160	102
Financial institutions	289	–
Corporations	103	–
Total marketable securities	**$ 1,082**	$ 270
Illiquid securities		
Master Asset Vehicle II (“MAVII”) (note 13)*	$ –	$ 4
Segregated securities		
Cash	$ 22	$ 14
Money market instruments issued by:		
Government of Canada	–	92
Provincial governments	–	51
Bonds issued by:		
Government of Canada	121	98
Provincial governments	169	167
Corporations	187	216
Master Asset Vehicle II*	–	16
Total segregated securities	**$ 499**	$ 654

* During the year, the Corporation disposed of non-bank sponsored asset backed commercial paper (“ABCP”) with a carrying value of $20 million (face value of $38 million) and recorded a gain of $3 million. The Corporation held various classes of MAVII notes it received when the ABCP programs were restructured under the Montréal Accord and were included with other assets: illiquid securities and segregated securities. The Corporation no longer holds any ABCP which is subject to the Montréal Accord.

The remaining term to maturity at December 31, 2010 is twelve months or less with the exception of segregated bond securities that, if held to maturity, have terms expiring over a 32-year period.

All money market instruments and bonds held as at December 31, 2010 were issued by Canadian entities at fixed interest rates or discounted values. The weighted average effective interest rate as at December 31, 2010 was 1.1% for money market instruments (2009 – 0.3%) and 4.0% for bonds (2009 – 3.7%).

7. Cash and Cash Equivalents, Marketable Securities and Segregated Securities (continued)

(b) Income from investments

Interest income and gains and losses on cash and cash equivalents and marketable securities amounted to $8 million (2009 – $3 million). Interest income and gains and losses on segregated securities amounted to $23 million (2009 – $8 million) and is presented as a reduction of benefit costs.

(c) Segregated securities

Funds have been segregated as follows:

As at December 31 (in millions of dollars)	**2010**	2009
Other retirement dental and life insurance benefits	$ 499	$ 511
Internally restricted funds	–	143
Total segregated securities	**$ 499**	$ 654

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 had segregated certain funds in anticipation of future cash flow requirements. These segregated funds have been used for significant projects to renew the operational capability of the Corporation and required regulatory solvency payments to the Corporation's Pension Plan.

8. Fair Value of Financial Instruments

(a) Financial instruments carried at fair value

The following table provides the estimated fair values of financial instruments carried at fair value in accordance with the Corporation's accounting policies. Fair values have been measured and disclosed based on a hierarchy described below that reflects the significance of inputs used in making these estimates.

As at December 31 **2010**
(in millions of dollars)

	Level 1*	Level 2**	Level 3***	Total
Cash and cash equivalents	$ 379	$ –	$ –	**$ 379**
Marketable securities	$ 1,082	$ –	$ –	**$ 1,082**
Other assets: illiquid securities	$ –	$ –	$ –	**$ –**
Segregated securities	$ 499	$ –	$ –	**$ 499**

As at December 31 2009
(in millions of dollars)

	Level 1*	Level 2**	Level 3***	Total
Cash and cash equivalents	$ 473	$ –	$ –	$ 473
Marketable securities	$ 270	$ –	$ –	$ 270
Other assets: illiquid securities	$ –	$ –	$ 4	$ 4
Segregated securities	$ 638	$ –	$ 16	$ 654

* Level 1 financial assets are defined as assets with quoted prices in active markets for identical assets.
** Level 2 financial assets are defined as assets measured at fair value with a valuation technique using observable inputs other than quoted prices included in Level 1.
*** Level 3 financial assets are defined as assets measured at fair value with a valuation technique using unobservable market inputs, which requires management's best estimate. Level 3 assets comprise investments in MAVII notes.

The Corporation does not have financial liabilities or derivatives measured at fair value.

Reconciliation of level 3 fair values:

	Illiquid securities included in: Other assets	Illiquid securities included in: Segregated securities
Opening balance	$ 4	$ 16
Proceeds from sales made during the year	(5)	(18)
Total gains in net income*	1	2
Ending balance	$ –	$ –
Cumulative unrealized gains from assets still held at year end	$ –	$ –

* Gains from illiquid assets classified in other assets are included with "Investment and other income" and gains from illiquid assets classified in segregated securities are included with "Benefits" on the consolidated income and comprehensive income statement.

(b) Fair values of other financial instruments carried at amortized cost

The fair value of the following items approximate their carrying values due to their expected short-term settlement: accounts receivable; accounts payable and accrued liabilities; salaries and benefits payable and outstanding money orders. Fair value of long-term debt disclosed in note 14 is estimated by reference to quoted market prices or in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using equivalent interest rates at the close of business on the balance sheet date.

9. Income Taxes

The Corporation is 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:

As at December 31 (in millions of dollars)	**2010**	2009
Net future income tax assets (liabilities)		
Capital assets	$ (24)	$ (11)
Salaries and benefits payable	25	24
Accrued pension, other retirement and post-employment benefits	176	135
Other	13	20
Net future income tax assets	**$ 190**	$ 168
Presented in the consolidated balance sheet as:		
Future income tax assets:		
Current	$ 26	$ 25
Long-term	204	179
Total future income tax assets	230	204
Future income tax liabilities:		
Long-term	(40)	(36)
Net future income tax assets	**$ 190**	$ 168

In 2009, the Corporation had deductible temporary differences in the amount of $768 million for which no future income tax assets had been recognized. Those differences related mainly to the accrued other retirement and post-employment benefit liability as they were not expected to reverse in the foreseeable future. In 2010, the Corporation recognized the entire balance of $768 million of previously unrecognized temporary differences as their realization was assessed to be more likely than not.

The major components of the income tax expense (benefit) are as follows:

Year ended December 31 (in millions of dollars)	**2010**	2009
Current income tax expense (benefit)	$ (111)	$ 5
Future income tax expense (benefit) relating to:		
Origination and reversal of temporary differences	166	88
Post-employment benefits	(192)	–
Reduction in tax rate	1	2
Income tax expense (benefit)	**$ (136)**	$ 95

A reconciliation of the income tax expense (benefit), related to income before income taxes, to the amount of income tax using the statutory federal tax rate follows:

9. Income Taxes (continued)

Year ended December 31 (in millions of dollars)	2010	2009
Income before income taxes	**$ 307**	$ 379
Federal income taxes at parent's statutory tax rate	$ 86	$ 110
Subsidiaries' and joint venture's provincial income taxes less federal tax abatement	3	2
Previously unrecognized difference in post-employment benefits	(192)	–
Effect of statutory tax rate changes on future income taxes	(32)	(20)
Other	(1)	3
Income tax expense (benefit)	**$ (136)**	$ 95

10. Capital Assets

As at December 31 (in millions of dollars)	2010			2009		
	Cost	**Accumulated amortization**	**Net carrying value**	Cost	Accumulated amortization	Net carrying value
Property, plant and equipment						
Land	$ 300	$ –	$ 300	$ 259	$ –	$ 259
Buildings	1,949	1,072	877	1,796	1,021	775
Leasehold improvements	224	158	66	214	149	65
Plant equipment	1,129	775	354	1,055	787	268
Vehicles	274	163	111	239	157	82
Sales counters, office furniture and equipment	409	275	134	408	277	131
Other equipment	822	491	331	788	460	328
Assets under development	37	–	37	139	–	139
Total property, plant and equipment	5,144	2,934	2,210	4,898	2,851	2,047
Intangible assets						
Software	540	409	131	489	360	129
Software under development	26	–	26	33	–	33
Customer contracts and relationships	27	23	4	27	20	7
Total intangible assets	593	432	161	549	380	169
Total capital assets	**$ 5,737**	**$ 3,366**	**$ 2,371**	$ 5,447	$ 3,231	$ 2,216

Amortization of property, plant and equipment amounted to $223 million in 2010 (2009 – $201 million) while amortization of intangible assets amounted to $53 million (2009 – $45 million).

During the year, The Canada Post Group invested $411 million (2009 – $412 million) in capital assets, comprising $367 million (2009 – $354 million) of property, plant and equipment and $44 million (2009 – $58 million) of intangible assets.

As at December 31, 2010, The Canada Post Group has acquired assets held under capital leases in three asset classes: sales counters, office furniture and equipment held under capital leases totalling $20 million (2009 – $18 million), net of accumulated depreciation of $15 million (2009 – $12 million); vehicles held under capital leases totalling $35 million (2009 – $20 million), net of accumulated depreciation of $4 million (2009 – nil); and plant equipment held under capital leases totalling $24 million (2009 – $25 million), net of accumulated depreciation of $3 million (2009 – $1 million).

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. The Corporation also provides pension benefits to eligible employees through defined contribution plans. 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 were 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 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.

11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

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 types 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 in which both employees and employer contribute. Plan members are not required nor permitted to contribute to the defined benefit pension plans.

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 compensation. 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 minimum 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. SCI and BCE have each made differing submissions to the regulator as to what the final transfer amount should be. 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 employee 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 (in millions of dollars)	**2010**		2009	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations				
Balance, beginning of year	$ 13,935	$ 2,698	$ 11,732	$ 2,489
Current service cost	313	88	243	73
Interest cost	934	184	880	189
Employee contributions	187	–	191	–
Benefits paid	(537)	(121)	(462)	(112)
Actuarial losses	2,067	377	1,351	86
Plan amendments	–	(19)	–	(27)
Curtailment	(2)	–	–	–
Balance, end of year	16,897	3,207	13,935	2,698
Plan assets				
Fair value, beginning of year	14,135	–	12,175	–
Actual return on plan assets	1,424	–	1,903	–
Employer regular contributions	356	–	304	–
Employer special contributions	441	–	24	–
Employee contributions	187	–	191	–
Benefits paid	(537)	–	(462)	–
Fair value, end of year	16,006	–	14,135	–
Funded status of defined benefit plans – surplus (deficit)	(891)	(3,207)	200	(2,698)
Unrecognized net actuarial losses	2,948	415	1,155	40
Unrecognized past service costs (credits)	21	(148)	23	(163)
Unrecognized funding excess	(25)	–	(57)	–
Total amount recognized	**$ 2,053**	**$ (2,940)**	$ 1,321	$ (2,821)

The recognized amounts are presented in the consolidated balance sheet as follows:

As at December 31 (in millions of dollars)	**2010**	2009
Accrued pension benefit asset	**$ 2,063**	$ 1,335
Accrued pension benefit liability	$ 10	$ 14
Accrued other retirement and post-employment benefit liability	2,940	2,821
Accrued pension, other retirement and post-employment benefit liability	**$ 2,950**	$ 2,835

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 (in millions of dollars)	2010		2009	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations	$ 16,735	$ 3,207	$ 68	$ 2,698
Plan assets	15,732	–	49	–
Funded status of defined benefit plans – deficit	**$ (1,003)**	**$ (3,207)**	$ (19)	$ (2,698)

(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 of Directors 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	2010	2009
	Actual	Actual
Cash and money market instruments	2 %	1 %
Bonds	32 %	36 %
Canadian equities	27 %	26 %
U.S. equities	19 %	17 %
International equities	14 %	14 %
Real estate	4 %	4 %
Other assets less liabilities	2 %	2 %
Pension Plan assets of the Corporation	**100 %**	100 %

The pension plan assets of Purolator, SCI and Innovapost are governed by similar investment objectives and policies and account for 2% (2009 – 2%) of the total plan assets of $16,006 million (2009 – $14,135 million).

Total plan assets include $2,220 million (2009 – $2,271 million) in money market instruments and bonds issued by the Government of Canada, its agencies and other Crown corporations and $133 million (2009 – $128 million) in refundable taxes held by the Canada Revenue Agency.

11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

(e) Costs (recoveries)

The elements of employee future benefit costs (recoveries) recognized are as follows:

Year ended December 31 (in millions of dollars)	2010			2009		
	Incurred in year	**Adjustments***	**Recognized in year**	Incurred in year	Adjustments*	Recognized in year
Pension benefit plans						
Current service cost	$ 313	$ –	$ 313	$ 243	$ –	$ 243
Interest cost	934	–	934	880	–	880
Return on plan assets	(1,424)	273	(1,151)	(1,903)	803	(1,100)
Actuarial losses on accrued benefit obligations	2,067	(2,068)	(1)	1,351	(1,453)	(102)
Plan amendments	–	2	2	–	2	2
Amortization of funding excess	–	(32)	(32)	–	(32)	(32)
Defined benefit costs (recoveries)	1,890	(1,825)	65	571	(680)	(109)
Defined contribution costs	5	–	5	6	–	6
Total pension benefit costs (recoveries)	1,895	(1,825)	70	577	(680)	(103)
Transitional support from the Government of Canada	–	–	–	(23)	–	(23)
Net pension benefit costs (recoveries)	**$ 1,895**	**$ (1,825)**	**$ 70**	$ 554	$ (680)	$ (126)
Other benefit plans						
Current service cost	$ 88	$ –	$ 88	$ 73	$ –	$ 73
Interest cost	184	–	184	189	–	189
Actuarial losses on accrued benefit obligations	377	(375)	2	86	(93)	(7)
Plan amendments	(19)	(15)	(34)	(27)	(3)	(30)
Defined benefit costs	630	(390)	240	321	(96)	225
Return on segregated securities	(23)	–	(23)	(7)	–	(7)
Transitional support from the Government of Canada	(13)	–	(13)	(33)	–	(33)
Net other benefit costs	**$ 594**	**$ (390)**	**$ 204**	$ 281	$ (96)	$ 185

*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	2010		2009	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations:				
Discount rate	5.7%	5.8%	6.7%	6.9%
Long-term rate of compensation increase	3.0%	3.0%	3.0%	3.0%
Benefit costs:				
Discount rate	6.7%	6.9%	7.5%	7.6%
Expected long-term rate of return on plan assets	7.25%	N/A	7.25%	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	8.1%	N/A	8.4%
Cost trend rate declines to	N/A	4.9%	N/A	4.9%
Year that the rate reaches the rate it is assumed to remain at	N/A	year 19	N/A	year 20

(g) Sensitivity analysis

(g.1) Pension benefit plans

The discount rate used to estimate the present value of accrued benefit obligations has a significant effect on the accrued benefit obligations at the end of the year as well as on the pension benefit costs. The latter is also impacted by the expected long-term rate of return on plan assets. A fifty-basis-points change in discount rate and expected long-term rate of return on plan assets would have had the following effects for 2010:

Change in discount rate of 0.5%:

(in millions of dollars)	Increase	Decrease
Total of current service and interest costs	**$ (40)**	**$ 44**
Accrued benefit obligations	**$ (1,157)**	**$ 1,295**

Change of 0.5% in expected long-term rate of return on plan assets:

(in millions of dollars)	Increase	Decrease
Pension benefit costs	**$ (80)**	**$ 80**

11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

(g.2) Health-care plans

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 2010:

(in millions of dollars)	Increase	Decrease
Total of current service and interest costs	$ 37	$ (27)
Accrued benefit obligations	$ 446	$ (351)

The above sensitivities are hypothetical and must be used with caution. Changes in amounts based on the above variations 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.

(h) Total cash payments

Cash payments for pension, other retirement and post-employment benefits are as follows:

Year ended December 31 (in millions of dollars)	**2010**	2009
Benefits paid directly to beneficiaries for unfunded other benefit plans	$ 121	$ 112
Employer regular contributions to funded pension benefit plans	356	304
Employer special contributions to funded pension benefit plans	441	24
Total cash payments for defined benefit plans	918	440
Contributions to defined contribution plans	5	6
Total cash payments	$ 923	$ 446

Under current legislation and regulations, the funding valuation of the Corporation's defined benefit pension plans is required to be filed annually unless the ratio of the solvency plan assets to solvency liabilities, at the valuation date, is 1.2 or greater, in which case it would be required at least every three years. In the event of a solvency or going-concern deficit, regulatory authorities require special contributions be made over specified future periods.

In May 2010, the Corporation's Pension Plan filed a valuation report as at December 31, 2009, at which time the plan was in a funding excess position on a going concern basis and in a deficit position on a solvency basis. Because the legislation and regulations were still under review at the time of filing, the December 31, 2009 valuation report was prepared pursuant to legislation and regulations in place at the end of 2009. Since then, new regulations have come into effect which will be taken into consideration in the next actuarial valuation for funding purposes. However, the legislation for federally regulated pension plans is still under review.

11. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Pursuant to current legislation and regulations, the expected solvency deficit will require special contributions for 2011 that are currently estimated at $652 million. However, as the legislation is currently under review, future funding rules may differ from those currently in effect which could affect the required deficit contributions. The Corporation is closely monitoring the situation.

The most recent actuarial valuations for funding purposes, and the next required actuarial valuations, are as of the following dates:

	Most recent actuarial valuation for funding purposes	Next required actuarial valuation for funding purposes
Canada Post Corporation	December 31, 2009	December 31, 2010
Purolator	December 31, 2009	December 31, 2010
SCI	December 31, 2009	December 31, 2010
Innovapost	December 31, 2007	December 31, 2010

12. Goodwill

The changes in the carrying amount of goodwill are as follows:

Year ended December 31 (in millions of dollars)				**2010**	2009
	Canada Post segment	**Purolator segment**	**Logistics segment**	**Total**	Total
Balance, beginning of year	$ –	$ 121	$ 4	$ 125	$ 124
Purchase price adjustment	–	–	–	–	1
Balance, end of year	**$ –**	**$ 121**	**$ 4**	**$ 125**	$ 125

In 2009, under the terms of a share purchase agreement, a further cash payment of $1 million became payable upon the achievement of certain specific conditions relating to contract renewals and related revenues under the contracts.

13. Other Long-Term Assets

As at December 31 (in millions of dollars)		**2010**		2009
Assets held for sale	$	1	$	6
Illiquid securities (note 7(a))		–		4
Other		11		13
Total other long-term assets	**$**	**12**	$	23

The Corporation classified several properties as held for sale at the end of 2010. It is anticipated that the carrying amount of the properties will be fully recovered through the sale proceeds. Four of the properties held for sale at the end of 2009 were sold in 2010. A gain of $4 million was recorded on the dispositions.

14. Long-Term Debt

As at December 31 (in millions of dollars)	**2010**		2009	
	Fair value	**Carrying value**	Fair value	Carrying value
Series 1 bonds maturing July 2040, interest at 4.36%, payable semi-annually on January 16 and July 16[1 & 3]	$ 527	$ 498	$ –	$ –
Series 2 bonds maturing July 2025, interest at 4.08%, payable semi-annually January 16 and July 16[1 & 3]	516	498	–	–
Non-redeemable bonds maturing March 2016, interest at 10.35%, payable semi-annually on March 15 and September 15[2 & 3]	75	55	78	55
Capital lease obligations, maturing on various dates from 2011 through 2013, net of implicit interest at rates varying from 5.7% to 7.5%[4]	6	6	6	6
Capital lease obligations, maturing in 2016, net of implicit interest at rates between 3.3% and 5.5%[5]	51	51	44	44
Revolving term credit facility, interest at Bank of Canada prime plus 1.0%, repayment term three years due in January 2012[6]	–	–	25	25
Total long-term debt	1,175	1,108	153	130
Less current portion	13	13	10	10
Long-term portion	**$ 1,162**	**$ 1,095**	$ 143	$ 120

1) In July 2010, the Corporation issued Series 1 & 2 bonds with a combined principal of $1 billion. The net proceeds after deducting transaction costs were $996 million. These proceeds will be used to fund the Corporation's Postal Transformation Program. The Corporation has a right of redemption prior to maturity at a premium to fair value.
2) Fair value of the non-redeemable bonds is estimated by reference to quoted market prices of similar bonds. The effective interest rate as at December 31, 2010 was 10.6% (2009 – 10.6%). The scheduled repayment date of these bonds is March 2016. There are no prepayment terms associated with this debt.
3) Bonds constitute direct, unconditional and unsecured obligations of the Corporation and direct, unconditional obligations of the Government of Canada.
4) Capital lease obligations relate to the Corporation's computer refresh program and are repayable in monthly installments. The effective interest rate as at December 31, 2010 was 6.6% (2009 – 6.7%).
5) As at December 31, 2010, $51 million (2009 – $44 million) has been drawn by a subsidiary from a leasing facility to acquire capital assets. The leasing facility, which allows for borrowings of up to $125 million, requires on a quarterly basis the funded debt to earnings before interest, tax and amortization covenant ratio be equal to or less than 2.5:1. The subsidiary is in compliance with this covenant.
6) The facility allows a subsidiary to borrow to a maximum of $75 million on an unsecured three-year term revolving line of credit. There were no amounts drawn under this facility at December 31, 2010 (2009 – $25 million). 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 plus 1.0%. This credit facility contains two covenant requirements applied to the subsidiary. On a quarterly basis the funded debt to earnings before interest, tax and amortization covenant ratio must be equal to or less than 2.5:1 and the interest coverage ratio must be equal to or greater than 4:1. The subsidiary is in compliance with both covenants.

Interest expense on long-term debt amounted to $28 million (2009 – $8 million).

14. Long-Term Debt (continued)

Principal repayments on long-term debt excluding capital lease obligations are as follows:

(in millions of dollars)

2016	$ 55
2025	500
2040	500
	$ 1,055

Minimum capital lease payments are as follows:

(in millions of dollars)

	Principal	Interest	Payment
2011	$ 13	$ 3	$ 16
2012	11	1	12
2013	10	1	11
2014	11	1	12
2015	6	–	6
Thereafter	6	–	6
	$ 57	**$ 6**	**$ 63**

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. Certain of the Corporation's buildings also have other site restoration costs.

The Corporation has recognized conditional asset retirement obligations associated with asbestos removal and other site restoration costs 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 and other site restoration obligations, the Corporation does not have sufficient information as of December 31, 2010 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 $9 million (2009 – $7 million). The sales of the properties are expected to occur within the next five years, and the estimated cash flows have been discounted at a credit-adjusted risk-free rate of between 1.9% and 2.9%. The present values of the Corporation's conditional asset retirement obligations at December 31, 2010, totalling $8 million (2009 – $6 million), are included in other long-term liabilities.

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.

A new five-year Financial Framework, supplanting the former Multi-Year Policy Framework targets that had been in place since 1998, was approved by the Government of Canada in late 2009. The new Financial Framework establishes financial performance targets and metrics for 2010 to 2014, and reflects Canada Post's projected financial position during a period of intensive investment in Postal Transformation. These targets and metrics will be revisited in 2011 to consider the impacts of the Corporation's transition to IFRS.

The Corporation defines and computes its capital as follows:

As at December 31 (in millions of dollars)	**2010**	2009
Equity of Canada	$ 2,236	$ 1,787
Long-term debt	1,108	130
Other long-term financial obligation	14	16
Total capital	**$ 3,358**	$ 1,933

The Corporation's objectives in managing capital are to:

- Provide sufficient liquidity to support and repay its financial obligations and support its operating and strategic plans;
- Meet the financial targets as laid out in the Financial Framework for Canada Post approved by the Government of Canada in December 2009;
- Generate a reasonable return to the Government of Canada in support of the objectives of the Financial Framework; and
- Maintain financial capacity and access to credit facilities to support future development of the business.

These objectives and their related strategies are reviewed and approved each year by the Board of Directors through the annual Corporate Plan submission, which is then forwarded for Governor in Council approval. The Corporation's 2011 to 2015 Corporate Plan was approved by the Governor in Council on December 9, 2010.

The declaration, amount and payment of a dividend to the Government of Canada are subject to the Acts. Consistent with the 1998 Policy Framework, the Corporation has been making dividend payments equivalent to 40 per cent of the prior year's consolidated net income since 2004, when the return on equity target was first reached. It has paid $271 million in dividends to the Government of Canada since that time. The new Financial Framework includes a dividend payout target of 0% to 20% for 2010 through 2012 and 15% to 20% for 2013 and 2014.

No dividend was paid to the Shareholder in 2009 or 2010. The Shareholder has temporarily waived dividends while the Corporation is in a high asset investment mode. This waiver is reviewed annually. The Government of Canada has approved the Corporation's proposal to not pay a dividend in 2011.

16. Capital Management (continued)

The borrowing capacity of the Corporation and its access to credit facilities are outlined in the discussion of liquidity risk in Note 6 (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 to the Plan, 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 borrowing transaction must be approved by the Minister of Finance.

The Government has endorsed the Corporation's need for an increased authority for its external borrowing by increasing the Corporation's borrowing limit, other than from the Crown, from $300 million to $2.5 billion. This increase was authorized pursuant to *Appropriation Act No. 4, 2009-10*, which received Royal Assent on December 15, 2009. The *Appropriation Act No.4, 2009-10* stipulated that at no time can the value of these borrowings exceed an aggregate amount of $2.5 billion and that the borrowings must be in accordance with the terms and conditions approved by the Minister of Finance. Included in the total authorized borrowing limit is a maximum of $250 million available for cash management purposes in the form of short-term borrowings.

In July 2010, the Corporation issued bonds with a face value of $1 billion. Terms of the bonds are described in note 14. Funds from the bond issue are being used for the Corporation's Postal Transformation Program.

The Corporation's ability to obtain additional capital is subject to market conditions and pursuant to the provisions of the Acts. 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 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.

The complaint filed by the Public Service Alliance of Canada ("PSAC") in 1983, was referred by the Commission to the Canadian Human Rights Tribunal ("the Tribunal") which rendered a decision in October 2005, concluding that the Corporation had participated in "systemic discrimination" in the setting of wages for a group of PSAC members and ordered payment of lost wages at a discount of 50%.

Both PSAC and the Corporation appealed the decision of the Tribunal to the Federal Court Trial Division. In February 2008, this Court released its decision allowing the Corporation's application for judicial review and referred the complaint back to the Tribunal with the direction that the complaint be dismissed. In March 2008, PSAC and the Commission appealed this decision to the Federal Court of Appeal.

On February 22, 2010, a majority of the Court of Appeal upheld the Trial Division's decision, finding in favour of the Corporation and dismissing both appeals. PSAC and the Commission sought leave to appeal to the Supreme Court of Canada, which was granted on December 16, 2010. The appeals will be heard by the Court on November 17, 2011. The estimated potential cost to Canada Post should PSAC's claim be successful is $175 million. However, as Canada Post does not consider it likely that the claim will succeed, this amount has not been accrued.

The complaint filed by the Canadian Postmasters and Assistants Association initially in December 1982 was, in February 2006, recommended by a conciliator to be declined by the Commission on the basis that the complaint is one that could more appropriately be dealt with under the *Canada Labour Code*. There have been no new developments in respect of this complaint.

The outcome of these complaints is currently not 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.

17. Commitments and Contingencies (continued)

(b) The Corporation and Purolator individually have entered into agreements with Innovapost for the provision of IT-related services. These agreements were signed for a 10-year period that commenced in 2002, with an optional renewal period of five years. Canada Post and Purolator have declared their intention to not automatically renew their agreements with Innovapost under the current terms and conditions. Review and discussion of a possible renewal of these agreements with Innovapost are underway. Under their respective agreements, Canada Post and Purolator have made certain commitments that apply upon the expiration or termination of their respective agreements with Innovapost. These commitments include the purchase of assets used on a dedicated basis in the provision of services to the Corporation and Purolator, as the case may be, at the time of expiration or termination of the agreements, for an amount equal to the then net book value and the assumption of certain obligations and contracts related to such assets or applicable to the services provided by Innovapost to the Corporation or Purolator, as the case may be. In addition, upon the occurrence of specific events described in its agreement with Innovapost, Purolator has the option rather than the obligation, to assume these commitments. 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 maximum potential future liability under the above commitments is dependent on the value of the subject assets, obligations and contracts at the time of expiration or termination of the agreements. The Corporation and Purolator do not currently possess sufficient information to estimate such future liability.

(c) 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.

(d) 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.

(e) Until December 2009, all of the Corporation's employees except Rural and Suburban Mail Carriers were permitted to accumulate unused sick leave. During 2010, the sick leave plan was replaced by a new short-term disability program for all employees except those represented by the Canadian Union of Postal Workers. Under the new plan, employees cease to accumulate sick leave and any unused entitlement was converted to top-up credits to be used as part of a short-term disability program. Under both plans, leave entitlements do not vest and can only be used in the event of illness. Payments of sick leave benefits and top-up credits are included in the cost of operations. Under IFRS, the commitment as at the transition date of January 1, 2010 has been actuarially determined to be $236 million.

17. Commitments and Contingencies (continued)

(f) 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)		
2011	$	139
2012		121
2013		98
2014		80
2015		49
2016 and thereafter		243
Total	**$**	**730**

Included in the above are lease payments made in the normal course of business in the amount of $17 million with a related party, the Government of Canada, for premises used in postal operations (2009 – $20 million).

(g) The Corporation has contractual arrangements with third-party suppliers totalling approximately $284 million related to its Postal Transformation Program (2009 – $306 million). These contractual arrangements are subject, in most instances, to the Corporation's contractual right of termination and extend to 2013 as follows:

(in millions of dollars)		
2011	$	184
2012		65
2013		35
Total	**$**	**284**

(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 (in millions of dollars)	**2010**	2009
Change in non-cash operating working capital		
Increase in accounts receivable	$ (43)	$ (5)
Increase in net income tax recoverable	(69)	(69)
Increase (decrease) in accounts payable and accrued liabilities	46	(56)
Increase in salaries and benefits payable	1	66
Decrease in deferred revenue	(20)	(6)
Net increase (decrease) in other non-cash operating working capital items	7	(9)
Total	**$ (78)**	$ (79)
Supplementary information		
Interest paid	**$ 9**	$ 8
Income tax paid (received)	**$ (40)**	$ 81

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. All revenue is intersegment and has been eliminated, and all cash flows are operating. Cost of operations included in the consolidated financial statements of the Corporation includes the Corporation's proportionate share of expenses related to these services of approximately $120 million (2009 – $153 million). The Corporation's proportionate share of the assets and liabilities of Innovapost at year end is $27 million (2009 – $35 million) and $22 million (2009 – $34 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 5). In addition, pursuant to an agreement with the Department of Indian Affairs and Northern Development (now Indian and Northern Affairs Canada), 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 $82 million (2009 – $79 million) are included in revenue from operations. In May 2010, the Government of Canada announced a new northern food subsidy program to replace the Food Mail Program. The new program, Nutrition North Canada, will come into effect April 1, 2011. The agreement between Canada Post and the Department of Indian Affairs and Northern Development will terminate effective March 31, 2011; Canada Post will have no role in the shipment of goods under this new program.

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, 2010, the amounts of accounts receivable and deferred revenue from these related parties are $33 million (2009 – $28 million) and $3 million (2009 – $3 million), respectively.

20. Related Party Transactions (continued)

(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 and Québecor Média. In 2010, the Corporation provided services to Telus Corporation of $56 million (2009 – $53 million). Services received from Telus Corporation in 2010 amounted to $3 million (2009 – $4 million). Similarly, during 2010, the Corporation provided services to Québecor Média of $10 million (2009 – $15 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 (2009 – $111 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 of Canada and the Corporation 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 varied over the Government's fiscal year, the Government's contribution to the Program was capped at $60 million in its fiscal year 2009/2010 ($45 million in 2008/2009). The Corporation did not contribute to the Program in 2009/2010 ($15 million in 2008/2009) in accordance with a directive by the Government of Canada in December 2006 for Canada Post to continue its financial contribution to the Program only until March 31, 2009. No further financial contribution will be made to this Program, however, the Corporation agreed to continue to provide certain administrative services under the Program until March 31, 2010 in order to assist the Government's transition to a new, restructured program.

22. Segmented Information

(a) Operatings segments • 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 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 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. The revenues are attributable to information technology services.

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.

22. Segmented Information (continued)

Year ended, and as at, December 31, 2010
(in millions of dollars)

	Canada Post	Purolator	Logistics	All Other	Elimination of intersegment	The Canada Post Group
Revenue from external customers	$ 5,910	$ 1,403	$ 140	$ –	$ –	$ 7,453
Intersegment revenue	19	89	9	148	(265)	–
Revenue from operations	$ 5,929	$ 1,492	$ 149	$ 148	$ (265)	$ 7,453
Income (loss) before the undernoted items	$ 429	$ 128	$ 18	$ 20	$ (4)	$ 591
Amortization	(219)	(52)	(7)	(2)	4	(276)
Investment and other income	49	–	–	–	(27)	22
Interest and other expense	(26)	(4)	–	–	–	(30)
Income (loss) by segment	$ 233	$ 72	$ 11	$ 18	$ (27)	$ 307
Unallocated amounts						(4)
Income tax benefit						136
Net income						$ 439
Assets by segment	$ 7,016	$ 797	$ 82	$ 213	$ (507)	$ 7,601
Unallocated amounts						(1)
Total assets						$ 7,600
Acquisition of capital assets	$ 394	$ 17	$ 3	$ –	$ (3)	$ 411
Liabilities by segment	$ 5,071	$ 231	$ 44	$ 25	$ (40)	$ 5,331
Unallocated amounts						–
Total liabilities						$ 5,331

22. Segmented Information (continued)

Year ended, and as at, December 31, 2009
(in millions of dollars)

	Canada Post	Purolator	Logistics	All Other	Elimination of intersegment	The Canada Post Group
Revenue from external customers	$ 5,818	$ 1,351	$ 143	$ –	$ –	$ 7,312
Intersegment revenue	22	82	8	168	(280)	–
Revenue from operations	$ 5,840	$ 1,433	$ 151	$ 168	$ (280)	$ 7,312
Income (loss) before the undernoted items	$ 477	$ 98	$ 16	$ 16	$ (4)	$ 603
Amortization	(197)	(44)	(7)	(1)	3	(246)
Investment and other income	45	–	–	–	(16)	29
Interest and other expense	(6)	(1)	–	–	–	(7)
Income (loss) by segment	$ 319	$ 53	$ 9	$ 15	$ (17)	$ 379
Unallocated amounts						(3)
Income tax expense						(95)
Net income						$ 281
Assets by segment	$ 5,445	$ 787	$ 86	$ 219	$ (507)	$ 6,030
Unallocated amounts						(1)
Total assets						$ 6,029
Acquisition of capital assets	$ 372	$ 41	$ 4	$ 1	$ (6)	$ 412
Liabilities by segment	$ 3,911	$ 258	$ 55	$ 29	$ (40)	$ 4,213
Unallocated amounts						–
Total liabilities						$ 4,213

(b) Geographic area information • Revenue recognition is based on the location of the customer hiring the service. Individual foreign countries with material revenue are reported separately. The Corporation has no assets located outside of Canada. Because all intersegment revenue is domestic, revenue for geographic areas is reported net of elimination of intersegment revenue.

Year ended December 31 (in millions of dollars)	**2010**	2009
Canada	$ 7,110	$ 6,964
United States	262	263
Rest of world	81	85
Total revenue	**$ 7,453**	$ 7,312

22. Segmented Information (continued)

(c) Products and services information • Revenue reported for core products and services is based on information available at the time of sale, such that stamps and meter revenue are reported separately rather than being attributed to either of the Corporation's lines of business of Transaction Mail or Parcels.

Year ended December 31, 2010
(in millions of dollars)

	Total revenue	Elimination of intersegment	Revenue from external customers
Revenue attributed on sale			
Transaction Mail	$ 1,875	$ (4)	$ 1,871
Parcels	2,925	(113)	2,812
Direct Marketing	1,355	–	1,355
Other	241	(148)	93
	$ 6,396	$ (265)	$ 6,131
Unattributed revenue			
Stamp postage	$ 565	$ –	$ 565
Meter postage	757	–	757
	$ 1,322	$ –	$ 1,322
Total	$ 7,718	$ (265)	$ 7,453

Year ended December 31, 2009
(in millions of dollars)

	Total revenue	Elimination of intersegment	Revenue from external customers
Revenue attributed on sale			
Transaction Mail	$ 1,794	$ (4)	$ 1,790
Parcels	2,860	(108)	2,752
Direct Marketing	1,307	–	1,307
Other	256	(168)	88
	$ 6,217	$ (280)	$ 5,937
Unattributed revenue			
Stamp postage	$ 598	$ –	$ 598
Meter postage	777	–	777
	$ 1,375	$ –	$ 1,375
Total	$ 7,592	$ (280)	$ 7,312