

In 2009, Canada Post
earned a profit for the
15th consecutive year,
had its highest employee
engagement score ever,
was named a Top 100
employer for the fourth
straight year,
and did better than
ever before in delivery
performance and
customer service.

But...

...while we showed great progress in some areas in 2009, major challenges arose. Revenues were down sharply and we lost almost five years of volume growth.

The time is **now** to make some fundamental changes in our business, to ensure we can continue to provide excellent service to Canadians.

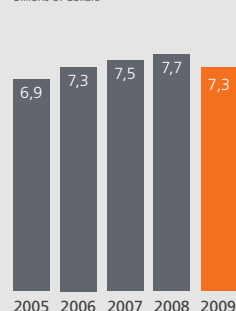
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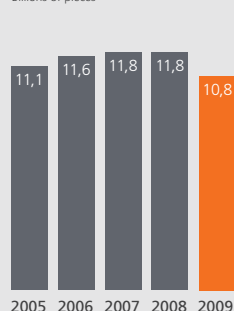
Financial and Operating Highlights – The Canada Post Group

Annual Report (in millions of dollars)		2009	2008	% CHANGE
Operations				
Revenue from operations	As reported	\$7,312	\$7,733	(5.1)%
Income from operations	Revenue from operations – cost of operations	357	139	155.0%
Operating profit margin (%)	Income from operations ÷ revenue from operations	4.9%	1.8%	–
Productivity (%)	Cost of operations as a % of revenue from operations	95.1%	98.2%	–
Income before income taxes	As reported	379	161	134.3%
Net income	As reported	281	90	210.4%
Return on equity (%)	Net income ÷ average equity	17.0%	6.1%	–
Dividend paid		0	22	(100)%
Dividend payout ratio (%)	Dividend paid as a % of prior year's net income	0%	40%	–
Cash from operations	As reported	134	598	(77.9)%
Capital expenditures	As reported	412	391	5.3%
Financial Position				
Cash		473	605	(21.9)%
Total assets		6,029	5,591	7.8%
Equity of Canada		1,787	1,507	18.6%

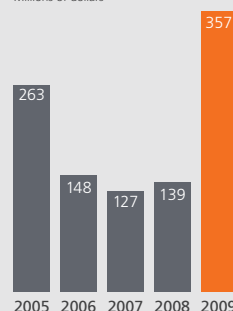
Revenue From Operations
Billions of dollars



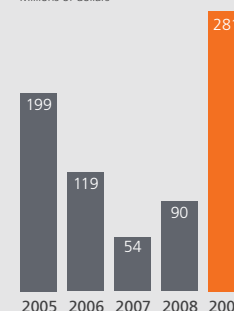
Volume
Billions of pieces



Income From Operations
Millions of dollars



Reported Net Income
Millions of dollars



The Canada Post Group processed 10.8 billion pieces during the 12-month period. Consolidated revenue from operations reached \$7.3 billion and consolidated net income totalled \$281 million.

President's Message

The past year was one of great achievements and of success—in spite of even greater challenges. That is a testament to the thousands of dedicated men and women who make this one of Canada's great companies.

The measure of any company is how its people respond in the face of adversity. Amid the toughest year in Canada Post's recent history, I was impressed by, and took great pride in, the outstanding contributions our people made to our success in 2009.

The Canada Post Group earned a profit for the 15th consecutive year in 2009, but it was a hard-won effort. Our consolidated profit increased to \$281 million from \$90 million in 2008, but this gain does not truly reflect the underlying weakness in our operating performance or our financial challenges ahead.

Revenues in all three of our core Canada Post segment lines of business, as well as our largest subsidiary, Purolator Courier, fell sharply. Consolidated revenue declined by \$421 million.

Our profit was primarily due to two factors: mainly a non-cash reduction in our employee future benefits expense that is explained elsewhere in this report, and incredible efforts in our core business to contain costs as our volumes plunged amid the economic downturn.

We had no choice but to react quickly. The result was impressive.

By year end, we had cut \$540 million from planned costs in our Canada Post segment, without which the Group would have lost money in 2009.

This necessary effort during the worst economic climate in decades did not, however, affect our other corporate priorities. In fact, we posted our highest-ever score in our annual employee engagement survey. Results improved in

key areas such as working conditions, safety, respect and fairness, ethics, collaboration, and teamwork. The majority of categories showed improvement.

We were recognized as one of Canada's Top 100 Employers for a fourth consecutive year and named Canada's Most Iconic Brand, based on an independent survey of Canadians. Our employees enthusiastically supported our cause of choice—mental health. In 2009, we raised \$1.6 million, surpassing our target of \$1.5 million. The Canada Post Foundation for Mental Health also disbursed all of the more than \$1 million raised in 2008 to 19 community organizations.

We reduced workplace accidents by 22 per cent. That is deeply gratifying given that employees, their families and the company all feel the effects when someone is injured.

Our delivery service performance met or exceeded targets for all products. We achieved record levels for on-time delivery in our Addressed Admail, Unaddressed Admail, Xpresspost and *Priority* Next A.M. products. Domestic Lettermail service met its goal of 96 per cent on-time delivery.

Serving Canadians is our mission, and there were important developments in 2009 to support our continued promise to them.

For example, by the end of 2009, Canada Post and project partners had automated or upgraded more than 5,900 point-of-sale systems. The vast majority of those are in rural and remote communities. This underscores our commitment to rural Canada.



Priority: Keeping the nation's mail secure

At Canada Post, our business is built on the trust Canadians place in us. In an era of growing concern about identity theft, we are doing everything in our power to keep the mail safe and secure. In 2009, among other things, we started replacing more than 800,000 master locks on street letter boxes, community mailboxes, apartment-style mailboxes and mailroom doors with Abloy™ high-security locks. We are also grateful that the Government of Canada established the fraudulent redirection of a person's mail and possession of a counterfeit Canada Post mail key as criminal offences early in 2010.



“Formidable challenges remain, but Canada Post proved in 2009 that its people are equal to the task. I am confident that, with co-operation and determination, this will continue to be the case in 2010 and beyond.”

Under the new *Canadian Postal Service Charter*, Canada Post will be even more accountable to Canadians. We will continue to live up to the service standards we are mandated—and proud—to provide.

To that end, I wish to extend profound thanks to the Government and particularly our Minister, Rob Merrifield, who has shown strong support for a sustainable Canada Post.

To face our mounting financial pressures and the long-term decline of our core transaction mail business, we must continue to contain costs as we did in 2009.

But trimming our operational costs in this way is not sustainable in the long run. We must consider more fundamental changes. We must modernize our business. Most importantly, we must focus on growth in our business. If at the end of the day we don't grow the business, our efforts will fall short of giving us a sustainable Canada Post that Canadians rely upon.

Sustaining our common future depends upon Postal Transformation, our ambitious modernization program. We appreciate that, in 2009, the Government of Canada approved a substantial increase in our borrowing limit from outside sources, which will allow us to fund Postal Transformation.

In 2010 the “star” of Postal Transformation will take centre stage, as we open our new flagship plant in Winnipeg. It will be Canada Post's first new mail-processing facility in 20 years. The advanced machinery and new delivery model coming first to Winnipeg and other locations represent a great leap forward—and change for our people.

Change is never easy. On the path forward—to a viable, cost-effective, highly productive Modern Post—the best approach is to walk together. We have made and continue to make careful preparations to manage it, working closely with our bargaining agents on Postal Transformation and consulting extensively with employees on the design of processes and equipment.

When we look at the many postal systems that modernized before us, we see ample reason to believe the new ways will be better. I encourage all employees to remain open-minded during the coming transition. Give change every chance.

Co-operation throughout our workforce is critical if we are to create a sustainable future, provide the service customers expect, and protect the salaries and pensions employees count on. These responsibilities are intertwined. So are we all.

Formidable challenges remain, but Canada Post proved in 2009 that its people are equal to the task. I am confident that, with co-operation and determination, this will continue to be the case in 2010 and beyond.

Moya Greene
President and Chief Executive Officer



Priority: Improving our safety

Reducing our lost-time workplace accidents by 22 per cent in 2009 was itself no accident. Management and employees continued to focus on improving safety after we did not meet our targets in 2008. Among other things, we used the results from 35 formal health and safety audits to correct identified shortfalls and we made sure that our team leaders focused on safety leadership throughout the year. Our lost-time accidents were down across the board in 2009, including slips, trips and falls and injuries from manual material handling. In 2010, safety will continue to be a key priority.

Financial Review

Despite posting a profit for the 15th straight year, our Canada Post segment faced major financial challenges in 2009 that will continue in 2010 and beyond.

Financial overview – Canada Post segment

Canada Post overcame severe financial challenges in 2009 by making tough, swift decisions in an extremely difficult operating environment. Each line of business experienced sharp volume decreases, and revenues fell sharply for the year—\$528 million below plan. By the end of 2009, Canada Post had lost the equivalent of almost five years of volume growth. Cash and equivalents declined by 28.9%, or \$162 million, from 2008.

In response, Canada Post cut \$540 million from planned costs. Cost-containment measures included: a reduction of management and other staff positions; cuts to discretionary spending such as information technology, travel and consulting; a productivity increase of 2.5% at mail-processing plants; and a reduction of more than 4.6 million paid hours in operations.

The segment's 2009 profit was largely due to a reduction in employee future benefit costs. The reduction was primarily non-cash and largely related to an increase in the discount rate used to value the future benefit obligation for accounting purposes. It is not a true reflection of our financial health.

We must manage the business guided by the assumption that our volumes in our higher-margin Transaction Mail line of business will continue to deteriorate, as has been the case at other Posts worldwide. However, the number of points of call continues to grow every year. Overall, this will lead to a deteriorating financial situation unless we make significant cost reductions.

In addition, recent global market turmoil has left us with an estimated \$2-billion solvency deficit in our Canada Post segment Registered Pension Plan. As a result, the Canada Post segment expects to make cash contributions of close to \$800 million to the Pension Plan in 2010, of which approximately \$450 million is a special payment to address the solvency shortfall.

Cost-containment measures will continue in 2010. In addition, we are modernizing our operations through our Postal Transformation program. Our plans evolved through 2009 and we now expect to invest \$2 billion in facilities, equipment and information technology, resulting in expected annualized savings of \$250 million.

Canada Post must invest to remain relevant and continue to provide the level of service that Canadians expect and deserve, and that we can afford.

Key figures at a glance for the Canada Post segment

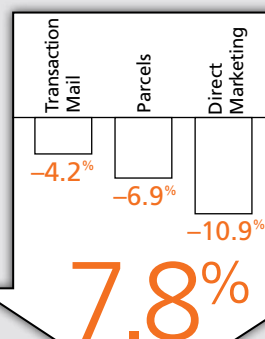
Revenue

In 2009, the Canada Post segment earned \$528 million less revenue than planned, and \$268 million less than in 2008.

\$528M

Volume

Our volumes dropped sharply across all three lines of business in the Canada Post segment, due to the impact of the economic downturn. The recession hastened what has been a steady decline in our transaction mail business over several years. In total, we lost almost five years of volume growth in 2009.



Cost control

Due to broad-based cost-control efforts, we reduced planned costs in our Canada Post segment by \$540 million, offsetting our revenue shortfall.

\$540M

Pension

We expect to contribute close to \$800 million to the Canada Post segment Pension Plan in 2010, most of which is necessary to begin addressing the Pension Plan's estimated \$2-billion solvency deficit.

\$800M

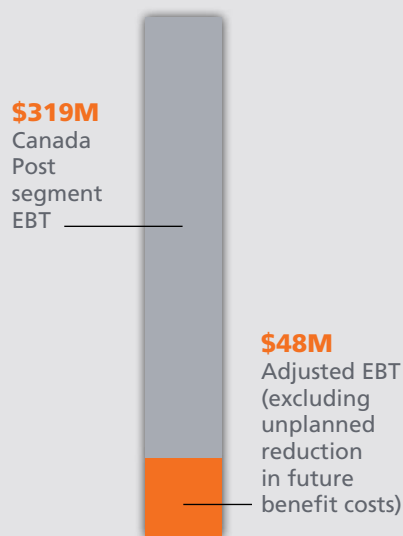
A note about our 2009 profit figure

The profit recorded by Canada Post in 2009 does not reflect the financial health of the company or our prospects.

When the global financial crisis hit in 2008, long-term interest rates rose sharply, a reflection of the increased risk in global markets. This sudden rise profoundly affected the accounting of Canada Post's financial commitments to future pensioners.

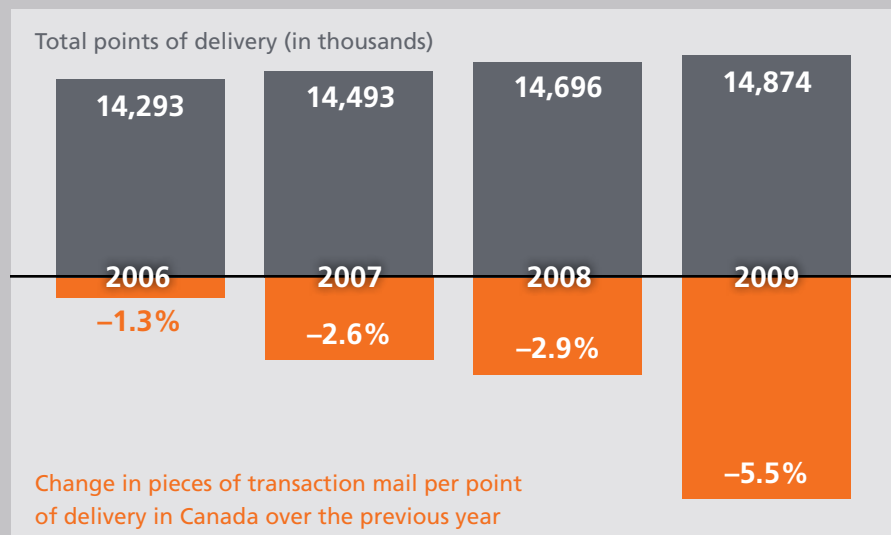
Like all pension sponsors in Canada, we use benchmark interest rates to determine the current value of our future pension and post-retirement health benefits obligation. The higher the interest rate, the lower the obligation (the reverse is also true). The Canada Post segment's future benefit expense was \$271 million lower in 2009 than planned, mainly due to the fact that interest rates were higher than planned.

Excluding this improvement in planned benefit expense, pre-tax profit from operations in our Canada Post segment would have been just \$48 million—a fraction of the \$319 million we reported.



2009 Canada Post segment EBT

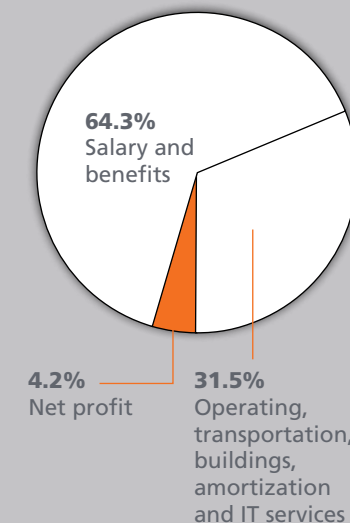
Managing declining volumes



The biggest challenge facing Canada Post is managing our declining mail volumes, particularly in our mature transaction mail business, which faces continued threat from the Internet and changing customer preferences. This business accounted for 54% of revenue in our Canada Post segment in 2009. Our challenge is compounded by the fact that we have served, on average, approximately 200,000 new points of delivery per year for the past several years.

Over the past four years, the number of pieces of transaction mail per point of delivery has declined at an increasingly rapid pace, falling to 334 pieces in 2009 from 377 in 2005. During that same period, the number of points of delivery we serve increased by approximately 800,000 at an added cost to the Corporation to serve them. It costs us more each year to deliver less transaction mail per point of call.

Canada Post segment revenue overwhelmed by costs



Wage and benefit costs amounted to close to two-thirds of the Canada Post segment's revenue in 2009. These labour costs are largely fixed and rising under collective agreements. Operating, transportation, building, amortization and other costs accounted for another 32 per cent—leaving a net profit of 4 per cent, unadjusted for the reduction in employee future benefit costs from 2008.

About Us

Canada Post operates the country's largest transportation and retail networks. It provides Canadians with outstanding delivery, logistics and communications services, and plays a key role in the Canadian economy.

To compete more effectively, we operate as The Canada Post Group, a group of related businesses—with approximately 71,000 employees—that include subsidiaries Purolator Courier Ltd. and SCI Group Inc. as well as joint venture Innovapost Inc. The Group remains one of the country's largest employers. It spends approximately \$3 billion annually on goods and services that support an additional 30,000 jobs in the national economy.*

In this report, "Canada Post" or "the Canada Post segment" refers to the core service of The Canada Post Group, consisting of our Transaction Mail, Direct Marketing and Parcels lines of business, and excludes our subsidiaries. The Canada Post segment represents approximately 80 per cent of the Corporation's consolidated operating revenue.

We have the exclusive privilege of collecting, transmitting and delivering letters up to 500 grams within Canada. In 2009, we delivered approximately 11 billion pieces of mail to 15 million residential and business addresses. Our delivery network continues to grow by approximately 200,000 addresses a year.

We believe in community involvement. In 2009, we raised more than \$1.6 million for mental health—our cause of choice. We also support literacy, the Canada Post Freestyle Team and United Way. Each Christmas, a team of employee volunteers helps Santa Claus answer more than one million letters in 28 languages. We are also proud to have been an official supplier of the Vancouver 2010 Olympic and Paralympic Winter Games.

Globally, most postal administrations are experiencing decreasing mail volumes, increasing points of call and demands from customers for more sophisticated services. Today, our

Canada Post at a glance

6,532

Post offices
across Canada

15 million

Addresses served
in Canada

96.4%

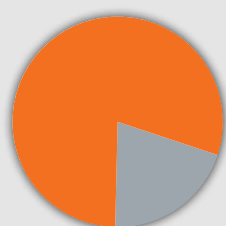
On-time delivery performance
As measured by IBM, a representative sample of fabricated short/long and oversized Lettermail test pieces is weighted according to origin-destination mail volumes.

competitors range from niche players to giant multinational corporations. Unlike our competitors, Canada Post is mandated to deliver mail to every address in Canada five days a week.

We are changing to meet our customers' evolving needs. We have undertaken a substantial \$2-billion Postal Transformation plan aimed at developing a more efficient mail delivery model. In the past two years, we have committed \$750 million to modernize equipment and enhance service. In 2010, Canada Post will open a new state-of-the-art mail-processing facility in Winnipeg, Manitoba, our first new mail-processing plant in more than 20 years.

* Conference Board of Canada study, 2007

Revenue
(Consolidated) Millions of dollars



■ Canada Post **\$5,840**
■ Subsidiaries/
Joint Venture* **\$1,472**

* including consolidation entries

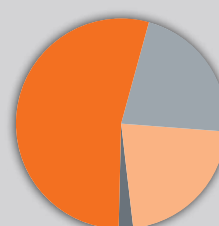
Income Before Taxes
(Consolidated) Millions of dollars



■ Canada Post **\$319**
■ Subsidiaries/
Joint Venture* **\$60**

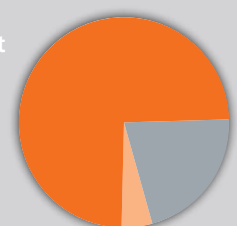
* including consolidation entries

Revenue by Market



■ Transaction Mail **54%**
■ Parcels **22%**
■ Direct Marketing **22%**
■ Other **2%**

Revenue Sources
Millions of dollars



■ Commercial **\$4,333**
■ Retail **\$1,244**
■ International Inbound
and Other **\$263**

Key Performance Indicators

Customer Value Index – Canada Post Segment

At Canada Post, we strive to gain market share and maintain profitability through customer loyalty. Knowing what drives customer loyalty is key to our performance. Our Customer Value Management program provides us with knowledge of the areas that we need to improve to keep our customers. The program identifies key drivers of customer loyalty. We study our customers' perceptions of the quality and value of our services, products, employees and website, and determine customer habits and practices through questionnaires and surveys. We measure customer loyalty across our three lines of business. In 2009, all three lines of business (Transaction Mail, Parcels and Direct Marketing) surpassed their Customer Value Index targets.



Delivery Service – Canada Post Segment

Our customers expect on-time delivery every time they send or receive a piece of mail. To support this, we set delivery targets and measure our performance against them. In 2009, we exceeded our corporate on-time performance target in all three lines of business: Transaction Mail, Parcels and Direct Marketing. Standards for our Lettermail™ service, Transaction Mail's main product, are based on delivery days that vary according to location. We achieved a score of 96.4 per cent, exceeding our target of 96 per cent. Parcel performance targets were based on a combination of delivery performance and delivery information about the location and status of the customer's item. This information provides our customers with the ability to confirm that the item was delivered and if it was on-time or not. Direct Marketing performance targets for our Admail™ products are set based on Canada Post's published service standards.



Financial Performance – The Canada Post Group

The fiscal year 2009 was difficult for The Canada Post Group. We faced many challenges brought on by the recession. We sustained a revenue decline of \$421 million from 2008. Cost-cutting measures and a mainly non-cash reduction in employee future benefits expense in the Canada Post segment allowed us to reduce our consolidated expenses by \$639 million. As a result, our profit increased to \$281 million from \$90 million in 2008. However, without the change in employee future benefits expense, which is not indicative of our operating performance, our net profit would have been lower. Our cash and cash equivalents decreased by \$132 million or 21.9 per cent. And while the number of points of delivery increased by approximately 200,000, the average number of pieces of transaction mail per address continued to decline, down to 334 pieces in 2009, compared to 377 in 2005.



Employee Engagement – Canada Post Segment

Respect, fairness, and the health and safety of our employees characterized our engagement efforts in 2009. We increased our Engagement Index to 58 from 56, improving or maintaining survey scores in most categories. We improved employee safety and reduced accidents in the workplace by 22 per cent, well in excess of our target for accident reduction for the year. We developed a Learning Index that measures employee training and brings visibility to the importance we place on employee development. We continued to encourage team leaders to recognize their employees for customer service and operational improvements. We involved front-line employees and their team leaders in discussions about our business through Regional Forums and front-line visits. We are encouraged by our progress as evidenced by customer service improvements, higher productivity and higher levels of employee engagement.



Connecting with our Customers

In 2009, Canada Post put the customer first in very specific ways. We created the position of Chief Customer Officer.

Making one person ultimately responsible for countless customer interactions with Canada Post, and making him one of only three chief corporate officers to report directly to our President and Chief Executive Officer, speaks to the importance we place on improving our customers' experiences with us.

Positive customer experiences are determined by their interactions with all facets of our business. Delivering on these expectations drives loyalty. We set standards and targets for several aspects of our service to customers, and then we measure our performance against those goals.

In 2009, our people were successful in delivering positive customer experiences and improving customer loyalty. We not only met our goals, we exceeded them.

Our customers noticed as well. We capture and analyze their feedback on our products and services, delivery, price, our reputation and the support we provide, asking them what they value and how their experience with us has been. This research generates what we call our Customer Value Index (CVI).

In 2009, our CVI for Transaction Mail and Parcels exceeded their targets by four percentage points each. Direct Marketing exceeded its target by three percentage points. These results tell us we're moving in the right direction.

Our front-line employees have played a large role in this success. Customers have told us that Canada Post drivers and delivery personnel perform extremely well, and are clearly dedicated to their work. With highly accessible locations, knowledgeable employees and

by focusing on the needs of our customers, our retail outlets have achieved their highest performance scores in our history. The overall quality of service, knowledge and sound advice of our sales and service personnel are also leaving a positive impression on customers. Our success is dependent on the dedication and hard work of our employees, and their achievements in 2009 demonstrate how valuable their contributions are to both the company and our customers.

Customers have told us that two things that affect their perceptions of Canada Post are on-time delivery and tracking. We can tell them the status of their package by scanning the item, but only when we scan items consistently and quickly enough. This is one of the most important areas we have targeted for improvement.

Our efforts to that end did yield considerably improved results in 2009. We increased our number of scans by 60 million, or 10.3 per cent, and we're getting the information from scans to customers faster than before, making significant progress toward having it available within minutes. We are continuing to focus our efforts on improved scanning in 2010.

Though we have put significant focus on getting the customer experience right, we also recognize that, from time to time, things can go wrong. If this happens, we have to fix the problem, learn from it and adopt measures to avoid similar issues in the future. We know that customers who don't experience problems with us are far more loyal than those who do.



Improving service to Canadians from sea to sea to sea

Looking to the future, in 2010 we plan to improve how we handle calls in our call centres. Customers want their calls answered quickly, consistently and accurately. We are building the system and processes to do so. At the same time, we're improving our reporting and analytic capabilities to identify the reasons behind the most common types of calls. With a better understanding of the problems, we can fix them.

In mid-2010, we will also open our new mail-processing plant in Winnipeg. This major investment will provide a far more automated and efficient way of moving the mail. Over time, this project and future modernization will help keep postal services affordable for all customers. The revitalization of our postal network will ensure that our customers receive the best possible service and a wider range of delivery choices through an integrated and efficient network.

As we move forward, understanding our customers' experiences with Canada Post, determining what we need to do to improve those interactions and making the necessary changes are critical to remaining relevant in a rapidly changing environment.

The next post office due east of Alice Tulk's would be... in Ireland.

Tulk, 63, is the postmaster in Aspen Cove, Newfoundland and Labrador, a fishing village (population 224) northeast of Gander. The post office is in her home perched on a hill above the Atlantic.

Until recently, Tulk used an old calculator, and filled out forms and counted inventory by hand. What's more, she could not offer customers the option of paying by debit or credit card.

Now life has changed—thanks to one of the most sweeping rollouts of networked retail technology in Canadian history.

In December 2009, Canada Post (and its project partners Innovapost and IBM) completed a two-year modernization of its retail point-of-sale ("RPS") system. The \$85-million initiative automated 3,000 post offices—nearly all of them in rural Canada. Another 2,846 already automated dealer and corporate outlets were upgraded to the new system.

The project demonstrates Canada Post's commitment to provide its customers with excellent service and the same access to its products, no matter where they live. David Roy, Canada Post's general manager of retail, says Canada Post now has one network from coast to coast to coast. Customers now benefit from quicker, consistently accurate transactions and, at the 3,000 previously manual outlets, they can now pay by debit or credit card and buy MoneyGrams™.

In her 39th year as postmaster, Tulk was taught new skills through the RPS project. She was among the many rural postmasters who had never used a computer. Now, she says she's really enjoying the new system.



Postal Transformation

Canada Post's \$2-billion modernization program will improve efficiency and productivity, allow us to respond better to changing markets, and help keep employees healthier and safer. 2009 brought us much closer to these goals.

With Postal Transformation, the company's technology leaps forward several generations. We are replacing mail-processing equipment from the 1970s and 1980s with leading-edge machinery capable of sorting mail faster, more accurately and more thoroughly. These machines can sort mail down to the individual letter carrier's route and place it in the order he or she travels the route.

Our industry calls this sequencing. After a 2009 full of planning, purchasing of equipment and preparation, sequencing will arrive in Winnipeg in 2010 and fan out in numerous other centres across the country before long. It will greatly reduce the amount of sorting carriers still do by hand. This time savings allows us to build efficiency into our new delivery model.

The way Canada Post delivers the mail has remained essentially unchanged for decades. Postal Transformation's updated technology and processes will modernize an outdated approach. Just as this modernization is unprecedented, so too is the degree of consultation the company has undertaken with its unions and employees.

Our new delivery model will also make its debut in Winnipeg in 2010. It will make use of the time letter carriers save by not having to manually sort so much mail. They will also be able to deliver parcels, collect mail from retail postal outlets and clear street letter boxes, all because most routes eventually will become motorized.

In 2009, letter carriers and health and safety experts were involved in testing the new light-duty vehicle our carriers will use.

This involvement helped with the company's decision in 2010 to purchase 1,175 fuel-efficient, ergonomic Ford Transit Connect™ mail trucks—the model those letter carriers preferred.

Using a “park-and-loop” system on their routes, letter carriers will park these vehicles at well-chosen spots to carry bundles of mail to the door on foot and loop back to the vehicle. They will also be able to make individual delivery stops for single, multiple or centralized points of delivery, reducing the weight they have to bear at any given time. The vehicle eliminates the need to use relay boxes on the routes and also offers letter carriers warmth and shelter when needed.

Early in 2009, Canada Post letter carriers learned when they visited their peers in North Dakota that sequencing and the park-and-loop method have proven safe and efficient for the United States Postal Service (“USPS”) for more than a decade. This is also true of carrying two light bundles of mail in one arm, which our letter carriers are adopting. We are encouraged that the USPS saw a decrease in injuries for letter carriers after introducing sequencing, and we look forward to seeing similar results.

During their shifts, letter carriers will also be able to update our database of addresses by using a new tool called Edit Book. Canada Post needs to continuously maintain an accurate, current inventory of addresses to improve and add to existing services.

Throughout 2009, we continued our consultations with our unions about the impact of Postal Transformation. We



In every aspect of Postal Transformation, we continued in 2009 to plan for employees' health and safety.

For example, we designed a “letterflattainer” with employees' input. This container is a basic tool of the trade used by thousands of our employees in our plants, depots and retail to help collect, sort and process the mail every day. During 2009, we took the best design elements from postal services around the world but we also had hundreds of Canada Post employees try out the design along with newly designed carts. These efforts helped us create a unique letterflattainer with, for example, smaller dimensions that make for lighter loads. This will reduce weight by 30 per cent.



With Postal Transformation, the company's technology leaps forward several generations.

met 30 times, for example, with the Canadian Union of Postal Workers at the national level, 13 times as a national joint health and safety committee, and on numerous other occasions to obtain agreement on the new work methods and standards for delivery.

Winnipeg benefits first from Postal Transformation. The opening in 2010 of this city's flagship mail-processing plant is a milestone. Located on 27 acres near James Armstrong Richardson International Airport, the plant replaces a 50-year-old plant downtown. Its innovative design demonstrates Canada Post's commitment to creating a safer, healthier workplace for employees and to protecting the environment.

While Winnipeg plans for state-of-the-art Lettermail sorting machines to sequence Lettermail items, it is also preparing for the new delivery model, having used Edit Book to achieve 99 per cent accuracy in addresses. The first of two new delivery depots in Winnipeg will also open in 2010. The Southwest depot, in an industrial park nine kilometres from City Hall, will consolidate three existing depots and portions of two other depots.

Winnipeg illustrates how much effort goes into preparing employees for change. For example, hundreds participated in a trade show to learn about the new work centres and equipment. A survey showed that 98 per cent of employees are proud that Winnipeg is leading the country into the Modern Post.

Winnipeg, after all, is just the start. In the coming months, Montréal, Toronto and Hamilton will also get new equipment. The Gateway facility in Mississauga, Ontario,

already saw major revamping in 2009, which included replacing its obsolete packet and bag sorters and construction of 24 new docks.

Postal Transformation has involved customers, too, through numerous consultations in 2009. They helped us plan many of our improvements. One example is the introduction of the Machineable Presort option for Addressed Admail™ items in January 2011. We continue to work with our customers to plan a smooth transition to the Modern Post.

In 2009, our Shareholder, the Government of Canada, helped us bring the benefits of Postal Transformation to customers and employees by increasing our borrowing limit to \$2.5 billion from \$300 million.

Our Postal Transformation plans will allow us to achieve the maximum possible benefits from an investment reduced from earlier forecasts of a \$3.1-billion spending program. We are focusing on the specific projects that are most crucial and those that will generate the highest return. Among other things, we will automate mail processing in all major cities across Canada. By 2017, when our plan is fully implemented, we forecast that modernization will generate annual savings of approximately \$250 million.

Postal Transformation—including the new delivery model—is crucial to sustaining our company because it offers greater efficiency, the opportunity to reduce our costs, improved service, and the flexibility to adopt new products, features and services.

By continuing to modernize, Canada Post is confident it can remain competitive.



We have assured our people and our unions that Postal Transformation will not result in layoffs. In future, Canada Post will need fewer people to operate, but the reduction will occur naturally as thousands of employees retire or choose to leave during the next several years. Efficient technology and processes mean the company will not have to replace all of the employees who leave. By taking advantage of this attrition, we will reduce our annual operating costs.

As the company and employees saw in a tough 2009, savings are vital to protecting secure jobs, and maintaining benefits and pension plans.

Lines of Business

The recession affected our three lines of business. However, with a recovery in business spending and a rise in consumer confidence now taking hold, we are cautiously optimistic.

Transaction Mail

In 2009, the Transaction Mail business posted decreases in volumes and revenues. The recession hastened a multi-year decline in the amount of traditional mail received by the average point of call in Canada, as businesses continue to encourage customers to move to electronic bill payments and to consolidate their bills into single statements.

Transaction Mail volume for the year was 5.1 billion pieces, down 4.2 per cent from 5.3 billion pieces of mail delivered in 2008. Revenue for Transaction Mail was \$3.1 billion in 2009, down 2.3 per cent from \$3.2 billion a year earlier.

To address the challenge of serving more addresses each year, manage declining Lettermail volumes and invest in infrastructure, we sought and received approval for an increase in the basic letter rate, to 57 cents from 54 cents, starting in January 2010. Domestic stamp rates will increase by a further two cents per year until 2014.

To counter the decline in our traditional business, we continue to pursue initiatives such as epost™, our online mail and bill presentation and payment service, and our SmartFlow™ document management services. While some emerging initiatives delivered strong growth in 2009, overall revenues remain small. Significant growth must be achieved before they become viable sources of replacement revenue for our declining core business.

We continue to focus on building these new channels, with plans to enhance the customer and consumer experience in 2010 through new technologies and equipment.

We do not expect our volumes to fully recover. Planned rate increases, however, will help compensate loss of revenue from declining volumes.

Parcels

The economic downturn made 2009 another challenging year for Canada Post's Parcels business. Overall, volumes were down 6.9 per cent compared to 2008 and revenue for the year was down 2.9 per cent at \$1.3 billion, as commercial customers sought to manage costs by switching from air shipments to ground delivery of parcels. A decline in the number of inbound parcels from the United States also weakened volumes.

We delivered 148 million parcels in 2009, compared to 159 million in 2008. The volume of deliveries of our Xpresspost™ service decreased by 11.7 per cent during the year.

To manage the challenges of 2009, Canada Post focused on rigid cost-containment measures and implemented initiatives aimed at improving levels of service. Last year, Canada Post added bar code scanners for smaller packet-sized products in major mail-sorting plants, and brought online enhanced tracking systems that allow for better management of delays due to weather and traffic. Through a strategic alliance with FedEx™, we supported the introduction of a northbound service launched by FedEx SmartPost for commercial shippers. The service speeds the delivery of parcels across the Canada-U.S. border.

Competition in the parcel market remains strong, with leading international players expanding their businesses in Canada. With the global recession easing, we are cautiously optimistic that the Parcels division will resume volume and revenue growth in 2010. We intend to further improve delivery service in 2010 through the application of new technologies and equipment.



Direct Marketing

The Direct Marketing business experienced a severe downturn in 2009, as volumes for our Admail services fell to levels not seen since the mid-2000s. With consumer confidence shaken and corporate budgets slashed, many direct-marketing customers decided not to advertise in 2009 or switched to less expensive online alternatives—leading to a sharp decline in volumes for the Addressed Admail and Unaddressed Admail™ services, which fell by 13.1 per cent and 10 per cent, respectively.

The biggest impact came from decisions by financial institutions and retailers to scale back their direct marketing to Canadian households. In 2009, we delivered 5.4 billion pieces of direct-marketing mail, down 10.9 per cent from a year earlier. Revenues generated from direct marketing totalled \$1.3 billion in 2009, down 8.2 per cent from 2008. While demand for direct marketing began to pick up in the last six months of 2009, Canada Post does not anticipate volumes to completely recover to 2008 levels until 2013.

To help fuel a rebound in direct marketing, we are developing tools that will allow customers to better target advertising to Canadian businesses and consumers. We have also begun to promote the value of integrating direct mail with online media. We are enhancing our external website, canadapost.ca, to provide more self-serve options to customers at a lower cost. We also continue to focus on the environmental obligations of direct marketing.

Subsidiaries

The Canada Post Group includes subsidiaries Purolator Courier Ltd. and SCI Group Inc., as well as Innovapost Inc., a joint venture.

Purolator is Canada's leading overnight courier company. In 2009, Purolator, which is 91 per cent owned by Canada Post, was affected by the economic downturn and resulting changes in customer behaviour as well as increased competition. Purolator segment revenue decreased by 8.2 per cent from 2008 levels and contributed \$53 million to consolidated income before taxes, a decrease of 42 per cent from 2008. In 2010, Purolator will focus on profitably growing its share of the express market.

The Logistics segment owns 98.7 per cent of SCI, one of the largest Canadian-owned logistics companies. In 2009, SCI earned \$10 million in income before taxes, a decrease of approximately 26 per cent from 2008. SCI's focus for 2010 is to maintain profitability through expansion into new markets and cost reductions.

Innovapost Inc., a joint venture between Canada Post (51 per cent ownership) and CGI Information Systems and Management Consultants Inc. (49 per cent), is responsible for the development, maintenance and operation of The Canada Post Group's computing and information systems. Innovapost revenue decreased by \$5 million in 2009, mainly due to lower infrastructure support and application development revenues. This was matched by \$5 million in cost reductions. In 2010, revenue is expected to decline, although Innovapost intends to expand its service offerings and capabilities.



Purolator
Where business is going

SCI

Innovapost

Corporate Social Responsibility

Our commitment to corporate social responsibility is anchored in the belief that our long-term financial sustainability is directly linked to the health and well-being of our employees, our communities and the environment.

From supporting communities and charities, to ensuring the health and safety of our employees and reducing our carbon footprint, the ultimate goal of our Corporate Social Responsibility (“CSR”) program is to create a financially sustainable company that provides value to all Canadians, benefits Canadian society and contributes to conservation of the environment. We remain committed to dedicating one per cent of the pre-tax profits of The Canada Post Group to non-profit and registered charitable organizations across the country.

At Canada Post, we have a unique privilege—and responsibility—among Canadian companies: we have a presence on the ground in every community across our country. It’s a privilege we take seriously because it enables us to ensure that our social responsibility efforts make a real difference to customers.

These include people like Douglas Blanchard and Roberta Robbins-Bell. Blanchard left his past, living on the streets, to rebuild his life and pursue a degree in social work at Vancouver Island University. After having three children, Robbins-Bell, a single mother, left her job and enrolled at Camosun College in Victoria, British Columbia, to follow her dream of becoming a community mental-health worker. In 2009, Canada Post awarded Robbins-Bell, Blanchard and 18 other students across the country a Canada Post Aboriginal Education Incentive Award. The \$1,000 awards are for First Nations, Métis and Inuit students who overcame adversity to return to university or community college. In 2010, Canada Post plans to grant 22 such awards.

These are also people like Alison Pepper and Richard Marr who were winners of Canada Post Community Literacy Awards in 2009. Pepper and Marr overcame their circumstances and fought against the odds to improve their literacy—and improve their lives. The Canada Post Community Literacy Awards celebrate the literacy efforts and achievements of adult learners, and those who have helped them learn to read and write. By acknowledging their efforts and achievements, the Awards encourage others to improve their reading and writing skills, and inspire them to reach their personal literacy goals. For many, that means obtaining their Secondary School Diploma or General Educational Development (GED). For others, it means reaching a level of reading and writing proficiency that allows them to participate more fully in the world around them.

Last year, for the fourth year in a row, Canada Post also made a real difference to Canadian troops deployed overseas by providing free delivery of letters and parcels.

In 2009, we devoted \$2.1 million to sponsorships with activities focused primarily on the Canada Post Freestyle Team and literacy programs such as the Canwest Canspell™ National Spelling Bee and La Dictée P.G.L. Our title sponsorship of the Canada Post Freestyle Team continued to provide value last year. We focused primarily on online advertising and also developed prepaid envelopes featuring the team, an Xpresspost envelope depicting freestyle skier Steve Omischl and a *Priority*™ Next A.M. envelope portraying moguls skier Jenn Heil.

We also donated nearly \$384,000 to 64 different registered charities and not-for-profit organizations last year, including a donation of \$165,000 to the Canada Post Foundation for Mental Health. This donation matched the amount of money raised by our employees through the Dime-a-Day campaign and other employee initiatives such as bake sales. As well, we raised \$2.3 million for United Way through employee and corporate donations. An additional 150 organizations received donations thanks to our employees’ volunteering time and our Coaching and Community Involvement Program.

We maintain complete openness and accountability in all of our charitable efforts, and all submissions for donations or sponsorships must meet strict eligibility criteria, as specified in our donations policies and practices.



Leading CSR Report

In 2009, CSR TRENDS, an independent survey published by Craib Design & Communications and PricewaterhouseCoopers, selected Canada Post's 2008 Corporate Social Responsibility Report from 1,115 company reports worldwide for having the best message to stakeholders in a CSR report.



In 2009, the Canada Post Foundation for Mental Health handed out more than \$1 million to fund projects that directly benefit people affected by mental illness.

(From left) Canada Post President and CEO Moya Greene, Grant Advisory Committee member Joan Parker, and Foundation Trustee Valerie Pringle present a \$64,962 cheque to Karen Engel, Executive Director, Yorktown Child and Family Centre in Toronto, in October 2009.

In June 2008, when the Canada Post Foundation for Mental Health was established, it pledged to do two things: to raise awareness about the plight of those struggling with mental illness; and to build the capacity of organizations, families and caregivers to support those affected.

In 2009, the Foundation lived up to its pledge by handing out more than \$1 million to 19 community-based groups across Canada. The grants, which provided new support to some of the seven million Canadians challenged by mental-health problems, came from money raised through the collective efforts of Canada Post, its employees and the Canadian public. An additional \$1.6 million will be distributed in 2010.

The grants distributed by the Foundation are making a real difference in the kinds of front-line services that agencies, such as the Labrador Friendship Centre, Revivre – Association de Soutien and the Schizophrenia Society of Alberta, can provide. A Foundation grant also made a real difference to the Yorktown Child and Family Centre in Toronto, which is using the money to help transform the way its workers treat children and youth who are experiencing distress or psychological difficulties as a result of a traumatic incident. Laing House in Nova Scotia, which provides young people living with a mental illness with the support they need to rebuild their lives, received a grant from the Foundation to fund its peer support network. The clock was ticking on the Elizabeth Fry Society's ability to continue to offer services when it learned it was among the first recipients of a grant from the Foundation. The money is being used to fund counselling

and support services for women and female youth coming through Adult and Youth Mental Health Courts. A Foundation grant is also helping the Canadian Mental Health Association Northwest Territories Division and Centre for Northern Families to fund a pilot program that supports the parents of children struggling with mental-health issues.

In total, more than 200 grant applications were received by the Foundation, which allocated funding to projects that build front-line capacity and provide community-based support to people affected by mental illness and their families and friends.

In 2009, Canada Post's employees and customers built on the success of the Foundation's first year by raising \$1.6 million for mental health, surpassing the target of \$1.5 million. Canadians reached into their pockets and gave generously when our retail clerks asked them to donate to the cause after every sale. More than \$700,000 was donated in this way. Canada Post also issued a new fundraising Mental Health stamp. One dollar from the sale of each booklet of 10 stamps went to the Foundation. Sales of the stamp raised a total of \$296,000. In addition, Canada Post's employees contributed \$165,000 to the Foundation through the Dime-a-Day campaign and other activities.

In 2010, we've set a higher goal: to raise \$2 million. It's a tall order, but that's what it takes to be a socially responsible corporation: set an ambitious target, hit the target, and then set a higher target. And, by doing this, we can help change the conversation about mental illness in this country, and benefit everyone.

Greening our buildings and our fleet

At Canada Post, we appreciate the enormous effect buildings can have on the environment—and the opportunities for savings that come with more sustainable design.

In 2009, we registered three new building projects for Leadership in Energy and Environmental Design (LEED™) certification, for a total of eleven registered projects across the country. LEED is an internationally accepted benchmark for the design, construction and operation of high-performance and environmentally friendly buildings. Building to LEED Canada criteria helps us reduce greenhouse-gas ("GHG") emissions, lower overall energy costs and help reduce our impact on the environment. It also benefits our employees and our customers

by providing safer and healthier workplaces. Buildings constructed to LEED standards, such as our new mail-processing plant in Winnipeg, opening in 2010, are designed to be more cost effective to operate. The new Winnipeg plant, which is built to cope efficiently with the demands of mail collection, sorting and delivery in the 21st century, will replace a crowded, inefficiently configured building in the heart of downtown—where mail trucks sometimes block traffic—with a modern, efficient, well-laid-out facility close to the airport, where access doesn't disrupt traffic.

In 2010, we remain committed to building for the future, investing in sustainability and ensuring that all major new Canada Post-owned building construction projects will be

Corporate Social Responsibility

Continued

registered for LEED certification. We want to make Canada Post stronger so we can remain financially viable and continue to deliver an affordable, confidential, secure and universal service to all Canadians for decades to come.

As for our fleet, in 2009, we continued our efforts to reduce our GHG emissions and lower our overall fuel consumption. By optimizing our delivery operations, we were able to remove 140 vehicles from our shuttle and courier network and transfer them into our letter carrier network. This transfer enabled us to avoid having to purchase this number of additional vehicles. We also initiated a pilot program with the purchase of two dual-fuel, gas and propane, cars, which offer a significant reduction in emissions. If the pilot is successful, we will look to expand the number of these vehicles in our fleet. At the end of 2009, we issued a Request for Proposal ("RFP") to replace part of our aging fleet with vehicles that are more fuel efficient, ergonomic and environmentally friendly. Based upon sustained funding approval, we plan to replace more than 3,000 vehicles over the next five years.

Ford Canada won the RFP and 1,175 Ford Transit Connects were ordered early in 2010 with annual purchases planned for the next few years. This vehicle is a fuel-efficient alternative to our larger commercial vehicles as well as being well suited to Canada's extreme weather conditions. We also introduced five new hybrid-electric vehicles from Azure Dynamics™, a Canadian-based company, early in 2010. The addition of these vehicles to our fleet is one more milestone in our drive to advance and adopt new technology that will enable us to achieve our GHG reduction target and improve fuel efficiency by 25 to 30 per cent.

Connecting with our people

During a challenging year, we continued to make employee engagement a priority. We worked to involve employees in our business, improve health and safety in our workplaces, and recognize employees for their contributions.

Our Best of Ops Awards recognized excellence in Operations, and encouraged a team approach to celebrating successes and resolving issues. The President's Awards for Customer Experience recognized 25 front-line employees in both Operations and Retail for their help in improving the customer experience.

We continued efforts to discuss our business with front-line employees and their team leaders. Our President and senior executives met with more than 3,100 front-line employees in 12 Regional Forums and with their 500 team leaders at Operations facilities throughout the country. Senior executives also met with more than 8,000 front-line employees.

We continue to make advances in employee engagement, as evidenced by our employee survey that showed increases in almost every engagement category and an improvement of two per cent over last year's survey results.

In 2009, employees supported many causes such as the Canada Post Foundation for Mental Health.

Employees submitted 119 creative homemade commercials to our internal video contest, viewed worldwide by more than 200,000 people on YouTube™.

Again this year, roughly 11,000 employees and retired employees volunteered their time to answer more than one million letters for Santa.



One of the Best Corporate Citizens in Canada

In 2009, Canada Post appeared on a list of Canada's Best 50 Corporate Citizens as ranked by Corporate Knights™, an independent company that publishes the world's largest circulation magazine with an explicit focus on corporate responsibility.



Four consecutive years on the Top 100

For the fourth year in a row, Canada Post was recognized as one of Canada's Top 100 Employers by Mediacorp. This award recognizes Canada's best places to work.

Chairman's Message



The global recession affected many businesses, and Canada Post was no exception. In 2009, our volumes and revenues decreased significantly. On behalf of the Board and the Shareholder, I am pleased to present The Canada Post Group's financial results for the year ending December 31, 2009.

In 2009, Canada Post recorded a consolidated net income of \$281 million. This marks the 15th consecutive profitable year. We achieved this profit for two reasons: the Canada Post segment benefited from a reduction in employee future benefits expense, the impact of which is not a true reflection of our performance. And also because our President, Moya Greene, and senior management recognized early in 2009 that it would be a very tough year, and took the very difficult and necessary steps to dramatically improve productivity and reduce planned costs.

In 2009, Canada Post did not pay a dividend to its Shareholder, the Government of Canada, in order to conserve cash for Postal Transformation. The Board believes that our low profitability and the need to invest in Postal Transformation preclude dividend payments for several years. We are grateful that our Shareholder agrees with this approach.

The Board continued to support management's Postal Transformation strategy, which is aimed at modernizing operations on an unprecedented scale. Our modernization plan has been modified to take into account the recession's negative financial consequences for Canada Post. The opening of a state-of-the-art, environmentally friendly mail-processing plant in Winnipeg later this year represents an important step in Postal Transformation.

In order to provide relevant and affordable services to Canadians, Canada Post must continue to improve productivity and embrace modern technology. Postal Transformation is a key component of this strategy. It will also provide a substantial portion of our employees with a better work environment.

Canada Post saw great progress in 2009 in important areas such as safety and employee engagement. I am proud to report that accidents decreased by 22 per cent, an incredible feat. Employee engagement continued to improve. The productivity improvement in 2009 would not have been as successful without this engagement.

In 2009, the Auditor General of Canada and KPMG performed their periodic special examination of Canada Post, as required by the *Financial Administration Act*. In the report, the auditors commended Canada Post for its many good systems and practices in several key areas, including corporate governance, customer relationships and human resources management. The auditors also pointed out the need for the company to secure funding for Postal Transformation. Significant progress was made on this matter in 2009 with the support of our Shareholder, whom I thank for acting on several fronts.

During 2009, the Government announced the *Canadian Postal Service Charter*, approved a five-year price increase and increased our borrowing limit from outside sources to \$2.5 billion. These actions by the Government put Canada Post in a much better position to continue to serve Canadians while remaining financially self-sufficient.

These measures also reflect our Shareholder's confidence in Canada Post's future and an understanding of the challenges that we face.

With regard to the governance of Canada Post, I am happy to report that the mandate of Moya Greene has been extended to May 2012. Daurene E. Lewis, a director since 2005, has stepped down. I thank Daurene for the valued and strategic advice she gave as a director and for her role as chair of the Corporate Social Responsibility, Environment and Health and Safety committee. The Hon. Stewart McInnes, Q.C., of Halifax has joined the Board.

On behalf of the Board, I would like to thank all of the people of Canada Post, whose hard work made for the success we achieved in 2009. This success gives me comfort that we are well positioned to face the future.

Finally, I would like to thank Canadians for continuing to make Canada Post a valued service provider.

A handwritten signature in black ink that reads "Marc Courtois". The signature is fluid and cursive.

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 2009, one new member was appointed and the terms of four existing members were renewed. 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 \$7.3-billion commercial and self-sufficient enterprise (on a consolidated basis), the Board must bring strong business judgment and valuable experience and insight in other fields to the stewardship of Canada Post. The Board meets on both pre-arranged meeting dates and at such other times as deemed necessary by the Chairman. In order to provide strong oversight for such a large, complex and important

company, the Board must devote approximately 35 days a year to its deliberations. In 2009, the Board met eight times. In addition, individual committees of the Board met a combined 30 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 \$14-billion Canada Post Pension Plan, Pension Plan matters and policies, including Pension Plan liabilities, Pension Plan strategies, Canada Post's responsibilities as Pension Plan sponsor, and Canada Post's fiduciary responsibilities as Pension Plan administrator.
- The Corporate Social Responsibility (CSR), Environment, Health and Safety Committee oversees Canada Post's policies, programs, practices, procedures and performance with respect to CSR, including the environment and occupational health and safety.

Board effectiveness

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

Fraud and error

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

Subsidiaries

A Governance Model for Canada Post's subsidiaries ensures consistent governance practices 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



Moya Greene

Ottawa, Ontario
President and CEO
Canada Post Corporation



Denyse Chicoyne ▶▲

CFA, MBA
Outremont, Quebec
Corporate Director



Thomas Cryer ■★

F.C.A.
Etobicoke, Ontario



A. Michel Lavigne ▲★

F.C.A.
Laval, Quebec



Siân M. Matthews ◆●

Calgary, Alberta



The Honourable Stewart McInnes ✱★

Halifax, Nova Scotia



Iris Petten ✱●

*Conception Bay South,
Newfoundland and Labrador*



Robert Pletch ▲✱

Q.C.
Regina, Saskatchewan
Chairman, MacPherson Leslie
and Tyerman LLP, law firm



William H. Sheffield ✱★

Vancouver, British Columbia
Corporate Director



Donald Woodley ◆●

Mono, Ontario

-
- 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
-

Annual Public Meeting:
June 4, 2010
Winnipeg, Manitoba

Officers of the Corporation



Moya Greene
President and CEO



Douglas Jones
Senior Vice-President
Operations



Douglas Greaves
Vice-President
Pension Fund and
Chief Investment Officer



Jacques Côté
Chief Operating Officer



Peter Melanson
Senior Vice-President
Sales



Susan Margles
Vice-President
Government Relations
and Policy



Wayne Cheeseman
Chief Financial Officer



Mary Traversy
Senior Vice-President
Transaction Mail



Clary Ottman
Vice-President
Finance and Comptroller



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



Phil Ventura
Senior Vice-President
Strategy



Serge Pitre
Vice-President
Sales



Laurene Cihosky
Senior Vice-President
Direct Marketing



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



Gerard Power
Vice-President
International



John Duncan
Senior Vice-President
Human Resources



Stephen Edmondson
Vice-President
Customer Service



Anthony Wilson-Smith
Vice-President
Communications



Cal Hart
Senior Vice-President
Postal Transformation

Ombudsman's Message

Measuring success through our customers' voice

With 3,708 in-depth investigations successfully completed in 2009—a six per cent increase over 2008—we issued more than 2,000 recommended resolutions to Canada Post, 64 per cent of which required the Corporation to take additional corrective action to satisfactorily resolve the customers' postal-service issues. A detailed view of the 2009 complaint-investigation trends is included in our annual report, which is available at www.ombudsman.postescanadapost.ca.

While we pride ourselves on meeting and, in many cases, exceeding our key performance indicators, we also recognize that the true value of our services can be measured only from the customer's perspective. To enable us to hear clearly what our customers are saying about our service—and what changes they feel are needed—in January 2009, we launched our own Customer Insight program. In asking customers about their experiences when dealing with our Office, the program puts the voice of our customers at the forefront of our operations in a factual and objective manner. This enables us to pinpoint and prioritize opportunities for improvement that actually matter to the customer without compromising the standards of practice espoused by the Ombudsman profession.

On a scale of one (poor) to 10 (excellent), our average customer experience rating was:

- 8.4 for the complaint-intake process;
- 9.0 for the case manager assigned to the investigation of the complaint; and
- 7.5 for the Office of the Ombudsman in general.

The *Canadian Postal Service Charter*, released in 2009, reinforces the role of the Ombudsman in ensuring that all Canadians have a fair and independent means of recourse if they feel that Canada Post has not lived up to its service commitments.

We believe that the ultimate measure of value is derived from our customers' likelihood to recommend our services to others. Our rating in this category was 7.5, a healthy vote of confidence given that the outcome of our investigations does not always support what the customers initially expect as a fair resolution to the problem they experienced with the postal service.

Despite the fact that we conducted 214 more investigations year over year, our ability to improve our final response time to customers by four per cent year over year is a tribute to the competence of our staff and its unwavering commitment to our ambitious business-excellence goals. It is also a tribute to the outstanding collaboration and timely support we enjoy in the course of our investigations from the Canada Post organization.

Thanks to the rich data that we have collected and analyzed through our Customer Insight program and our continued focus on process excellence, I am confident that we are well positioned to deliver the high level of quality service that Canadians deserve from our Office.



Nicole Goodfellow

I am confident that we are well positioned to deliver the high level of quality service that Canadians deserve from our Office.



Canadian Postal Service Charter

On September 12, 2009, the Government of Canada announced the creation of the *Canadian Postal Service Charter* that outlined the Government's expectations concerning the service provided by Canada Post.

The new *Canadian Postal Service Charter* (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* since its introduction up to December 31, 2009, is summarized below. This is Canada Post's first report on the *Service Charter*.

Universal service

Canada Post delivered more than 11 billion pieces of mail, parcels and messages in 2009 to some 15 million addresses in urban, rural and remote locations across Canada. In addition, Canada Post, through its Universal Postal Union alliance of 191 member countries around the world, provided inbound and outbound international postal services. Service to rural areas encompassed a substantial share of Canada Post's network and infrastructure, and included:

- Over 3,800 rural corporate or dealer post offices representing more than 58 per cent of all Canada Post retail outlets;
- More than 7,000 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 2009, the company applied uniform rates of postage to the following categories of letters:

Category	Postage rate	Effective date
Standard (envelopes, cards, self-mailers) 0 to 30 g	\$0.54	Jan. 12, 2009
30 to 50 g	\$0.98	Feb. 23, 2009
Medium (envelopes, cards, self-mailers) 0 to 50 g	\$1.08	May 15, 2009
Other Lettermail (non-standard and oversize) 0 to 100 g	\$1.18	Feb. 23, 2009
100 to 200 g	\$1.96	Feb. 23, 2009
200 to 500 g	\$2.75	Feb. 23, 2009

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, 2009; Canadian \$ equivalent; average exchange rate for 2009)

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 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 2009 Annual Cost Study are outlined on page 100.

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, 2009, Canada Post published in the *Canada Gazette* a regulatory proposal to increase the domestic basic letter rate and other regulated postage rates starting January 11, 2010. This was accompanied by a news release. It also generated significant media coverage. Following 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 three representations from customers (representing major mailers) 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 October 8, 2009.

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.

Reporting on the Service Charter

Continued

Frequent and reliable delivery

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 may be challenging because of distances or natural limitations to access.

Approximately 88 per cent of Canadian households received postal delivery services to their residence, apartment building, immediate neighbourhood or rural roadside postal box via an external delivery agent such as a Letter Carrier or Rural and Suburban Mail Carrier. More than 99.9 per cent of such households 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 a local post office 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 2009, Canada Post's on-time performance for Lettermail delivery was 96.4 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 2009, Canada Post had:

- 6,532 post offices;
- 17,000 retail locations throughout Canada, in addition to post offices, where postage stamps can be purchased;
- Approximately 200,000 collection points throughout Canada where postal items can be deposited (not including the approximately 800,000 rural mailboxes, which are also collection points).

Based on Canada Post's retail outlet network at December 31, 2009:

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

The moratorium on the closure of rural post offices was reaffirmed by the Government of Canada in 2009. 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 that affect service arise in rural communities, Canada Post ensures that mail delivery continues and meets with community leaders to explore options that address their postal needs.

From the introduction of the *Service Charter* on September 12 to December 31, 2009, there were 23 cases affecting Canada Post personnel or infrastructure that had an impact on post offices covered by the rural moratorium. Eighteen cases were resolved directly by Canada Post through staffing actions. In the remaining cases, after consultation with the affected communities and community leaders:

- Two cases were resolved through staffing of the postmaster position.
- Three 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 resolving all complaints related to privacy, confidentiality or our information-handling practices, if an individual feels his or her privacy rights have been breached, he or she may contact the Canada Post Privacy Coordinator by email at privacy@canadapost.ca or by mail at 2701 Riverside Dr., Suite N0165, Ottawa ON K1A 0B1.

Canada Post's Security and Investigation Services' employees are given special authority and responsibilities under the *Canada Post Corporation Act* with the duty to provide for the security of anything in the mail system. Recent amendments to the mail-theft provisions of the Criminal Code better equip Canada Post and law-enforcement agencies to prosecute identity theft and other crimes related to the mail.

Reporting on the Service Charter

Continued

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.

From the introduction of the *Service Charter* to December 31, 2009, of 15 million addresses served, fewer than 18,000 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)	532
Delivery equipment upgrade (e.g., conversion from a group mailbox to a community mailbox receptacle)	5,673
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)	11,271
Other reasons	132
TOTAL	17,608

In rural Canada, the moratorium on the closure of corporate post offices continued to be in force. However, as previously noted, the company responded to a small number of situations affecting Canada Post personnel or infrastructure.

There were no decisions by Canada Post to permanently close, move or amalgamate corporate post offices not subject to the moratorium from the time the *Service Charter* was introduced to December 31, 2009. Canada Post will comply with the requirements of the *Service Charter* for corporate post offices not subject to the moratorium.

Canada Post held its fourth Annual Public Meeting on June 17, 2009, in Regina, Saskatchewan. 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, stamp collectors, and others. Approximately 70 people attended the event while 29 companies and 1,180 employees participated through an audio webcast.

Responding to complaints

In 2009, Customer Service handled an estimated five million customer interactions. This included 3.8 million telephone calls handled by automated services and front-line agents, and 82,000 emails through the Canada Post website. Associated with these interactions are follow-up customer-service cases that included trace, claims and general case 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.

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.

Rural Service

Reporting on performance

The *Service Charter* was introduced more than nine months into the year. Therefore, some performance elements cannot be fully assessed or measured for 2009. Further refinements will be implemented for 2010 to improve reporting to the *Service Charter* expectations.

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	5,034,995 (34%)	\$253
Centralized point (e.g., apt. lobby lockbox)	3,656,801 (25%)	\$119
Group mailbox, community mailbox, kiosk	3,562,146 (24%)	\$100
Delivery facility (postal box, general delivery)	1,823,080 (12%)	\$63
Rural mailbox	797,336 (5%)	\$168
All methods	14,874,358	\$156

* as at Dec. 31, 2009

The 2009 total delivery costs include an estimated \$145 million year-over-year improvement in employee future benefits expense, primarily non-cash, largely related to an increase in the rate used to discount the Canada Post pension and other future benefits obligations for accounting purposes. We estimate that this has improved the year-over-year average delivery cost per address by \$10.

Canada Post has proudly served rural communities for more than 150 years. With more than 3,800 post offices in rural Canada, no other organization provides more consistent service to Canadians, regardless of where they live.

Canada Post commits to provide service to rural Canadians, strictly follows the Government's moratorium on the closure of rural post offices, and supports the *Canadian Postal Service Charter*.

Canada Post never seeks to close a rural post office. On occasion, events, such as retirements, illnesses, deaths, fires, bankruptcy or termination of a lease, can affect operations in rural communities. Most of the time, Canada Post hires a replacement postmaster or finds a new post office location.

In exceptional circumstances, Canada Post will engage with the community through an outreach process that involves local representatives. Often we are able to keep a post office open. Sometimes the community leaders advise us that other arrangements are preferred or needed.

In cases where a rural post office is closed, Canada Post ensures that retail services are available nearby—usually where residents shop. Canada Post informs the federal Minister responsible for Canada Post, the local member of Parliament and community leaders of events affecting the operation of a rural post office.

Committed to rural communities

When the Libau, Manitoba, postmaster announced her intention to retire after 30 years, Canada Post consulted with the community of 200, which made it clear that they wanted to keep the post office (shown here). The company took the message to heart and hired a new permanent, full-time postmaster.



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 is a federal Government program that subsidizes 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 an agreement with Indian and Northern Affairs Canada ("INAC"), Canada Post is 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 provides 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 2009, Canada Post shipped almost 20 million kilograms of goods under the Food Mail Program. Revenue attributed to this program was \$75 million (including \$56 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 revenue¹ amounted to approximately \$11 million.

Government Mail and materials for the blind

The *Canada Post Corporation Act* allows Canadians and the Governor General, members of Parliament, the Speakers of the Senate and House of Commons, the Parliamentary Librarian, and the Ethics Commissioner to send each other mail free of charge. Members of the House of Commons can also mail up to four flyers (through 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 2009, approximately 21 million letters were mailed as Government Mail (excluding mail from constituents to parliamentarians) and MPs mailed approximately 195 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 2009, it is estimated that more than two million shipments benefited from this program.

Notwithstanding a Government appropriation of \$23 million to help offset the financial impact of these programs on the company, Canada Post estimates that an additional \$17 million in foregone revenue¹ resulted from these programs in 2009.

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 2009, there were a total of 713,000 shipments of books under the Library Book Rate, generating \$772,000 in revenue for Canada Post. The foregone revenue¹ for Canada Post was estimated to be more than \$6 million for 2009. 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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MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") comments on the operations and financial condition of Canada Post Corporation (the "Corporation" or "Canada Post") for the year ended December 31, 2009. This discussion should be read together with the consolidated financial statements and accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles and are reported in Canadian dollars. The information in this MD&A is current to March 5, 2010, 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 63 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 2009 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 approximately 71,000 employees. Our employees deliver approximately 11 billion pieces of mail, parcels and messages each year to some 15 million addresses in urban, rural and remote locations across Canada. The Canada Post segment operates the largest retail network in Canada with 6,532 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.

Canada Post has public responsibilities of which we are proud. Pursuant to the *Canada Post Corporation Act*, the Corporation has a dual mandate to establish and operate a postal service for Canadians, and to conduct its operations on a financially self-sustaining basis. In addition to providing a universal postal service, the Corporation provides various services aimed at achieving other public-policy objectives. For example, pursuant to the *Canada Post Corporation Act*, Canada Post provides government mail for parliamentarians and certain senior government officials, and services free of charge for mailing of materials for the blind.

Canada Post is part of the international postal industry comprised of national postal operators or "Posts" throughout the developed world. All postal operators retain responsibility for some level of public service, referred to as a universal service obligation ("USO"). As in Canada, the USO has traditionally been financed through a legislated "exclusive privilege," where a portion of the national postal market is reserved for the Post. Our USO means that we are the only market participant to provide basic postal services to everyone and every business in Canada, regardless of location, every business day. For letters, we do this at the same price regardless of distance. Our postal service delivery standards require us to deliver letter mail consistently within two business days within the same metropolitan area or community; within three business days within the same province; and within four business days between provinces. In 2009, we continued to meet our domestic letter mail service delivery performance target of 96 per cent, ensuring that our service remains among the most consistently reliable services in Canada.

The environment in which we operate continues to change, and the recession of 2009 accelerated the pace. Market forces, influenced by the worst recession since the Second World War, have led to unprecedented declines in mail volumes over the past year. Unlike previous cyclical downturns, the consensus among Posts is that mail volumes will not return to their previous levels, and that physical mail markets are now fully mature and entering into a period of decline. Global postal industry trends include:

- electronic substitution of physical mail;
- consolidation of physical mail;
- liberalization of postal markets;
- modernization of postal operations and infrastructures.

Our strategies to meet both of our mandates have not changed in 2009. We continued to make strong progress on our strategic vision of building a modern Canada Post through advancement of the following multi-year strategic initiatives.

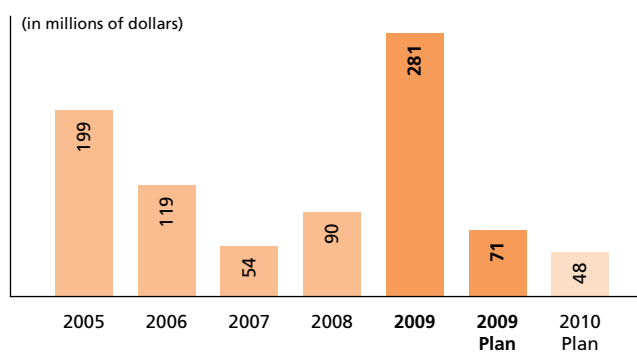
- **Engage our Employees** – Engage our employees by increasingly shifting to a customer-centric mindset, and improving the level of employee engagement, satisfaction and productivity. Despite a challenging year that included significant cost containment and restructuring, the 2009 employee engagement target was achieved with improvements in several key areas, including working conditions, safety, respect and fairness, ethics, collaboration, and teamwork. In 2009, we continued to invest in employee learning, development and communications with specific focus on corporate values, talent management, leadership effectiveness and organizational design.
- **Invest in our Infrastructure** – Our multi-year Postal Transformation infrastructure-renewal initiative was launched in 2008. Much of our current operating infrastructure was acquired in the 1970s and 1980s and limits operating flexibility, reliability and maintainability. Our aging infrastructure stands in the way of our priorities for modern and efficient operations. The transformation aims to enable annual cost savings made possible through increased automation and productivity improvement. Automation is expected to make possible total coverage of our postal network with fewer employees than we require today. Anticipated benefits will be achieved through leveraging the coming wave of attrition, as more than half of Canada Post employees become eligible for retirement within ten 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. In 2009, construction of the new Winnipeg facility continued with its completion proceeding on schedule to open in 2010. National critical infrastructure replacement continues on plan, including the design and production of new letter mail processing equipment and a centralized computer system.

- **Grow our Business** – Core postal services are protected from direct competition through our “exclusive privilege” to collect, transport and deliver letters. In recent years however, the value of this “exclusive privilege” has diminished. We have responded by expanding our direct marketing and parcel businesses through organic growth. Approximately 50 per cent of the Corporation’s 2009 consolidated revenues were derived from businesses that operate in competitive markets, and all revenues covered by the “exclusive privilege” face ever-increasing competition from electronic delivery alternatives. To further diversify our services, we continue to investigate and invest in electronic services. The investment in Postal Transformation intends to enable important efficiencies throughout our physical and electronic network, and also provide the platform to develop and deliver enhanced features and innovative services to customers without compromising the health and safety of our employees. While continuing to strive to meet our large enterprise customers’ needs and expectations, our strategy for expanding our customer base is to focus on the small to medium business (“SMB”) segment within all of our businesses, capitalizing on our core competency in retail access and reach.

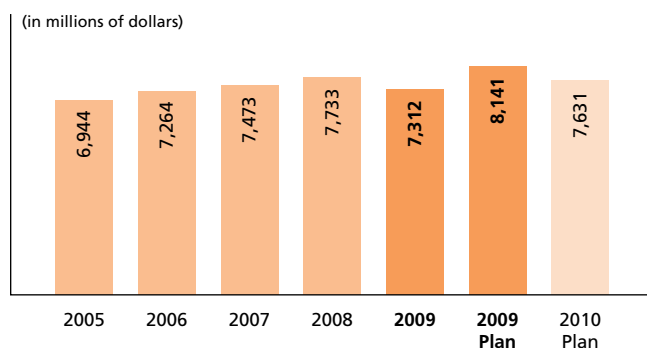
The Canada Post Group – 2009

The 2009 consolidated financial statements of Canada Post Corporation include the accounts of the Corporation, our subsidiaries Purolator Courier Ltd. (“Purolator”) and SCI Group Inc. (“SCI”), and our interest in Innovapost Inc. (“Innovapost”). The 2008 comparatives also include the accounts of a former subsidiary, Canada Post International Limited (“CPIL”). These companies are collectively referred to as “The Canada Post Group.”

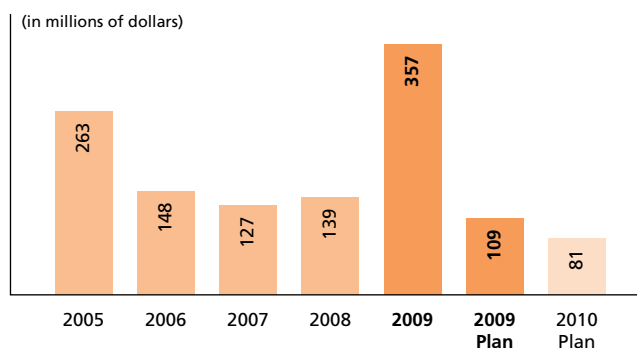
Consolidated net income



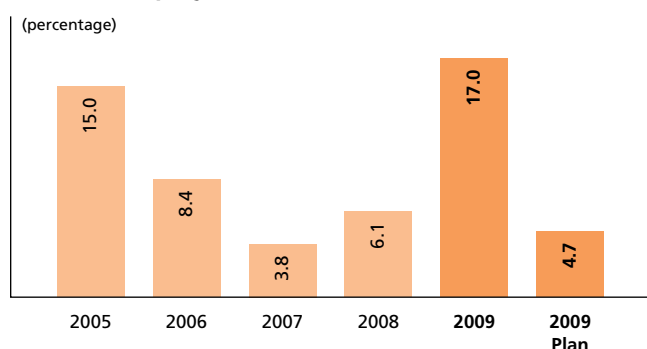
Consolidated revenue from operations



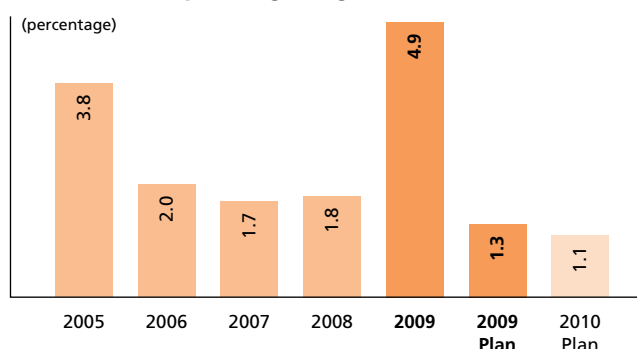
Consolidated income from operations



Return on equity of Canada



Consolidated operating margin



Without a doubt, 2009 has been one of our most difficult years. Despite the severe recession, the Corporation recorded its 15th consecutive profit with consolidated net income of \$281 million. This reflects our efforts to protect earnings against the economic downturn by increasing our 2009 cost-management program and significantly reducing planned operating costs in the Canada Post segment. In addition, the Canada Post segment benefited from a reduction in employee future benefits expense,

largely related to an unusually high increase in the rate used to discount the Canada Post pension and other future benefits obligations for accounting purposes, the impact of which is not a true reflection of our performance. Given the size of the Canada Post Pension Plan obligations of approximately \$14 billion, even a small change in the discount rate can cause a significant change in employee future benefits expense.

As demonstrated by our low and diminishing operating margin, The Canada Post Group continues to be marginally profitable, supporting the need to modernize our business model and cost structure to ensure our long-term financial self-sustainability. The following table presents the Corporation's consolidated performance for the 2009 fiscal year compared to the 2009 Corporate Plan.

(in millions of dollars)

Year ended December 31	2009 Results	2009 Plan		Explanation
Consolidated				<i>For further information, see Section 2 – Our Business, Vision and Strategy on page 39 and Section 8 – Results from Operations on page 77</i>
Revenue from operations	7,312	8,141	(829)	Fell short of expectations by \$829 million (Canada Post segment – \$528 million), primarily due to: <ul style="list-style-type: none"> • Global recession • Continued letter mail erosion and volume declines across all lines of business
Cost of operations	6,955	8,032	1,077	Exceeded expectations by \$1,077 million (Canada Post segment – \$811 million), primarily due to: <ul style="list-style-type: none"> • Tactical cost controls over labour, advertising, administration, project spending, operating efficiencies and lower volumes • In addition, in the Canada Post segment: <ul style="list-style-type: none"> – Reduction in employee future benefits expense (\$271 million), mainly due to changes in discount rates used to determine future obligations – Restructuring charges (\$41 million)
Non-operating income (expense)	22	8	14	Exceeded expectations by \$14 million (Canada Post segment – \$18 million) due to: <ul style="list-style-type: none"> • Gain on the sale of the Winnipeg plant • Lower-than-planned expense for the employee share ownership plan at Purolator This was partially offset by: <ul style="list-style-type: none"> • Lower-than-planned investment revenue
Income before income taxes	379	117	262	Excluding the \$271-million unplanned employee future benefits expense reduction, income before income taxes would have been \$108 million, or \$9 million lower than plan. The Canada Post segment income before income taxes would have been \$48 million, or \$30 million better than plan.

The following table presents the Corporation's consolidated performance for the 2009 fiscal year compared to 2008.

(in millions of dollars)

Year ended December 31	2009	2008	Change	%	Explanation of change
Consolidated income statement					<i>Highlights, as discussed in Section 8 – Results from Operations on page 77</i>
Revenue from operations	7,312	7,733	(421)	(5.1) %*	Primarily volume declines across all major businesses
Cost of operations	6,955	7,594	(639)	(8.4) %	Mainly due to: <ul style="list-style-type: none"> • 2009 cost containment such as organizational restructuring, cuts to discretionary spending, lower volumes and operational efficiencies • a \$320-million non-cash reduction in employee future benefits expense in the Canada Post segment, primarily due to change in discount rates
Income before income taxes	379	161	218	134.3 %	
Net income	281	90	191	210.4 %	
Return on equity	17.0%	6.1%	10.9%		Higher net income in 2009
Dividends paid	0	22	(22)	(100) %	No dividend paid to the Shareholder in recognition of the need for significant capital reinvestment to modernize the postal system
Consolidated cash flow statement					<i>Highlights, as discussed in Section 6 – Liquidity and Capital Resources on page 67</i>
Cash and cash equivalents	473	605	(132)	(21.9) %	Primarily due to the resumption of current service contributions to the Canada Post Pension Plan
Cash provided by operating activities	134	598	(464)	(77.9) %	Mainly due to an increase in payments for pension, other retirement and post retirement benefits, and a decrease in working capital
Cash used in investing activities	343	435	(92)	(21.3) %	Mainly due to a decrease in short-term investments and proceeds from sale of capital assets
Capital expenditures	412	391	21	5.3 %	Primarily Canada Post transformation and replenishment initiatives
Cash provided by financing activities	77	56	21	38.1 %	Mainly due to an increase in the long-term borrowings at a subsidiary and the decrease in dividends paid to our Shareholder

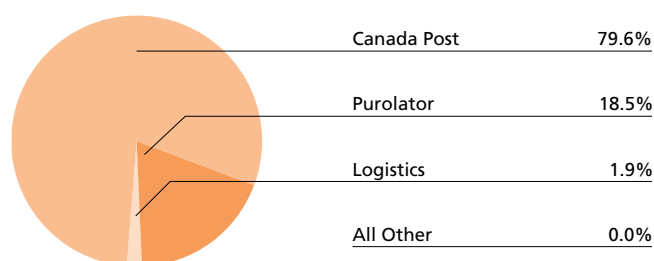
* Adjusted for trading days

The Canada Post Group segments – 2009

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 – 2009



Revenues by segment	2009	2008	2007
Canada Post	79.6%	78.7%	79.4%
Purolator	18.5%	19.4%	18.6%
Logistics	1.9%	1.9%	1.8%
All Other	0%	0%	0.2%

The Corporation’s unconsolidated results reflect the operations of the Canada Post segment. In 2009, the Canada Post segment generated \$5.8 billion in operating revenue and earned income before income taxes of \$319 million. This performance reflects our increased cost-management program with 2009 operating cost reductions of \$540 million as well as a \$271-million unplanned reduction in employee future benefits expense. Excluding the unplanned reduction, income before income taxes would have been \$48 million. The Canada Post segment operates three lines of business: Transaction Mail, Parcels and Direct Marketing. Each line of business earns a portion of its revenue as a result of the Corporation’s “exclusive privilege.” However, almost all of Parcels and a significant portion of Direct Marketing revenues are subject to competitive markets.

The majority of Transaction Mail revenue continues to be derived from traditional physical-mail delivery services. Transaction or traditional mail is letters, bills, statements, invoices and other forms of physical communications between businesses, governments and consumers, and is covered by the Corporation’s “exclusive privilege” to collect, transport and deliver letters. However, the “exclusive privilege” does not protect our revenues from competition from electronic delivery channels. The Parcels line of business provides a wide range of domestic and international parcel delivery services. It competes in the low-margin, extremely competitive Canadian shipping and delivery market with particular focus on the business-to-consumer (“B2C”) market segment. The vast majority of Direct Marketing’s revenue is also derived from physical mail delivery services, some of which is covered by the “exclusive privilege,” but its focus is on the delivery of direct-mail advertising from businesses and governments to consumers and citizens. In addition to competition from electronic delivery channels, Direct Marketing services compete with other advertising media that range from traditional television and newspaper channels to the Internet, email and text messaging.

The audited Annual Cost Study indicates that revenues subject to competition contribute towards the Canada Post segment’s fixed costs and, therefore, are not being subsidized by our exclusive privilege. Approximately 64 per cent of the Canada Post segment’s operating costs in 2009 can be assigned to services or groups of services. The remaining 36 per cent of costs are fixed costs common to the provision of all services, whether they are subject to competition or not.

Our subsidiaries have increased the diversity of the products and services we offer as well as our capability, reach and ability to access new sources of revenue. The day-to-day operations and supporting infrastructure of our subsidiaries and our interest in Innovapost are managed separately from the Canada Post segment. The leveraging of intersegment synergies and efficiencies is an ongoing priority of the Corporation. Established intersegment activities are supported by formal commercial contracts.

In 2009, the Purolator segment generated \$1.4 billion in operating revenue, and earned income before income taxes of \$53 million. The Purolator segment derives its revenues from specialized courier services and competes within the same market as Parcels, but focuses on the business-to-business ("B2B") market segment. Purolator is a strategic asset of Canada Post and is an intrinsic part of our complete customer offering. Its focus on the B2B segment of the market complements Canada Post's focus on the B2C segment. In all cases, we look to provide value to our customers by pursuing synergies between the two companies, leveraging where possible common air transportation, surface transportation and information technology networks.

In 2009, the Logistics segment generated \$151 million in operating revenue, and earned income before income taxes of \$9 million. The Logistics segment is comprised of SCI and provides third-party logistics services in supply chain management and transportation services.

The All Other segment includes the financial results of Innovapost's information technology services, which are largely eliminated upon consolidation. Prior to 2009, this segment also included revenue from CPIL's postal and post-banking services in the Netherlands Antilles.

Factors that shaped our business in 2009

1. Global economic crisis

Responding to the global economic crisis has certainly been the dominant focus in 2009 for all postal operators, including the Canada Post segment. At no time in recent history have the challenges faced by the postal industry been so great. Market forces have led to unprecedented world declines in mail volumes over the past year. The United States Postal Service ("USPS"), Deutsche Post, Royal Mail and Australia Post have all reported substantial declines in their mail volumes in 2009. This has been a global phenomenon to which the Canada Post segment was not immune, experiencing a 4.2 per cent decline in volumes of transaction mail. As business customers cut their discretionary advertising budgets, direct-mail volumes experienced the most significant rate of decline, on average 10.9 per cent. The global economic crisis also dramatically affected demand in the Canadian shipping and delivery market, as demand is closely related to economic activity. Both the Parcels line of business and Purolator experienced reduced volumes. In addition, customers eager to cut costs were increasingly shopping around and moving from air to less-expensive deferred delivery or ground services.

2. Competition from electronic delivery channels

In 2009, Posts around the world conceded that physical-mail markets are now fully mature and entering a period of decline. We recognize that a more structural and lasting change is at hand and that the economic crisis has in fact accelerated the underlying market shift towards electronic delivery channels. Technology continues to have a major impact on the advertising world, providing marketers with numerous new media options to use, and with the potential to target and personalize their messages more effectively and thus improve their return on marketing expense. Measurement and accountability requirements will intensify the demand for lower-cost, more efficient and measurable delivery channels.

3. Competition in the Canadian shipping and delivery market

The Canadian market remains subject to intense global competition. It has five major players: Purolator, Canada Post Parcels, FedEx, United Parcel Service ("UPS") and Deutsche Post ("DHL"). We continue to lead the competition in domestic market share, with Canada Post Parcels within the B2C and Purolator within the B2B market segments. However, our larger multinational competitors are very strong in the international courier pickup and delivery business, and are generally concentrated in the large B2B segment where the recessionary impact has been felt the strongest. They responded by aggressively competing on price and by targeting customers in the B2C segment. With their global footprint, superior technology and excess network capacity, they can offer attractive prices and pose a real threat to Canada Post Parcels' retention of some of its key B2C accounts.

4. Expanding Canadian points of delivery

Over the last five years, the annual increase in the number of points of delivery has averaged more than 200,000. These increases translate into rising Canada Post segment delivery costs. In addition, because of significant declines in the volumes of transaction mail, we are also seeing the average number of transaction mail pieces per household trend downward, resulting in a rising gap between our costs and revenues.

5. Shareholder support

As a result of these challenges and in consideration of our need to remain financially self-sustaining, we continue to explore with our Shareholder alternatives to fund the increasing cost of our USO. In the past year, in conjunction with the completion of the 2008 Canada Post Strategic Review, this has included recognition that price increases in the basic letter rate were necessary, and a new pricing plan was approved for 2010 to 2014. Pricing alone, even with our new five-year pricing plan, will not be adequate to keep us financially self-sustainable.

In 2009, our Shareholder also approved an increase in the Corporation's external borrowing limit from \$300 million to \$2.5 billion, and updated our 2010 to 2014 Financial Framework targets. We are pleased that, during the year, our Shareholder recognized the Corporation's funding requirements in support of our modernization initiative and our need for a new Financial Framework.

Given the Corporation's current financing pressures, with our Shareholder's support, we did not pay a dividend in 2009 in respect of 2008 earnings. In addition, the new Financial Framework dividend payout ratio for 2010 to 2012 of 0 per cent to 20 per cent provides the flexibility of only proposing dividend payments if it is fiscally responsible to do so. In September 2009, the Government formally announced the *Canadian Postal Service Charter*. The *Service Charter* outlines the expectations concerning Canada Post's service and makes these expectations known to Canadians. Canada Post will report each year, beginning with this Annual Report, on its performance against the Government's expectations.

6. Canada Post segment cost-reduction initiatives

The severity and speed of the downturn in our business results has exposed our vulnerability to an extremely inflexible cost structure and the limitations of our current business model. The harsh realities of our financial situation are causing us to re-examine all aspects of our business. In 2009, we again set strict spending guidelines, increasing our cost-containment objectives. Organizational restructuring, cuts to discretionary spending, overtime reductions and major improvements in productivity in all our facilities yielded \$540 million in savings compared to the 2009 Corporate Plan.

7. Canada Post segment Postal Transformation investment

The objectives of Postal Transformation are to generate significant efficiencies throughout our physical and electronic network and to provide the platform to develop and deliver enhanced features and innovative services to customers by:

- replacing or improving current plants;
- automating manual sequencing with new equipment for mail and parcel processing;
- creating a motorized delivery force; and
- e-enabling the physical network to meet new customer expectations and generate alternate revenue streams to reduce our financial reliance on declining volumes of letter mail.

Our financial position and operations in 2009 have caused us to re-prioritize the next phase of Postal Transformation. We have revised our total project investment plan downward to \$2 billion. We anticipate that these investments will generate future annual cost savings estimated at \$250 million upon full implementation and stabilization in 2017 and will support our ability to fulfill the service commitments outlined in the recently launched *Canadian Postal Service Charter*. To achieve permanent cost reductions, we need to fully implement Postal Transformation over the coming years to benefit from the retirement of the baby boomers within our employee population.

8. Canada Post segment Pension Plan solvency deficit funding

Financial markets performed well for most of 2009, resulting in the Canada Post Pension Plan's return on assets being above the expected rate of return. However, this was offset by a decrease in the discount rates, resulting in an increase in the present value of the solvency pension obligation. Based on existing legislation and when using smoothed value of Plan assets, the overall solvency-funded status of the Canada Post Pension Plan deteriorated during 2009, leaving the Plan in an estimated \$2-billion¹ solvency deficit position. The going-concern surplus position is estimated at \$600 million at the end of the year. Our total current service contributions to the Canada Post Pension Plan in 2009 were \$269 million.

On October 27, 2009, the Minister of Finance released a proposed reform plan for the federal private pension legislative and regulatory framework under which the Canada Post Pension Plan is governed. The proposed reform plan includes measures to reduce funding volatility to enable plan sponsors to better manage their funding obligations, including a new standard for establishing minimum funding requirements on a solvency basis. The exact nature of these changes and their effective date is not known at this time.

¹ Solvency deficit when using fair value of Plan assets is approximately \$3.4 billion

Outlook 2010

The year 2010 promises to be challenging for us. The uncertainty created by the global economic crisis and the unprecedented 2009 decline in all volumes have made it more difficult to predict future revenues, earnings and cash position.

The Canada Post Group's planned revenue for 2010 is \$7.6 billion, which represents growth of 4.4 per cent, compared to 2009. We do not expect physical-mail volumes to return to the levels they were a year ago and, because of stiff competition on many fronts, some of our business volume may be gone for good. Therefore, revenues are projected to grow from this lower base with planned growth mostly attributed to price increases. The Canada Post Group's planned income before income taxes for 2010 is \$80 million. However, our current target for 2010 is now \$110 million. With very narrow operating margins, the Corporation must continue to be highly vigilant in controlling discretionary costs and finding new operational efficiencies if we are to reach our earnings target. Accordingly, we will continue to focus on significant cost-reduction and cost-containment measures to protect our earnings.

Going forward, we will need to make structural cost changes in addition to Postal Transformation in order to reduce costs permanently and improve our competitiveness. Sustainable change at Canada Post is only possible if we can modernize our collective agreements, and reconcile them with customer needs and comparable market-driven terms. Posts in foreign jurisdictions have also undertaken reforms to their collective agreements in recent years, including wage improvements that were directly linked to modernization and productivity targets. But implementing labour change is not easy. We want to honour our people's job security provisions, but the Corporation needs their commitment to help us improve productivity levels.

Pension reform proposed by the Minister of Finance in October 2009 could affect the amount of special payments required as a result of the Canada Post Pension Plan's solvency deficit. Therefore, special payment expectations may change. Based on the current rules, however, the Corporation expects to contribute approximately \$450 million in special payments above the approximately \$340 million of regular service contributions in 2010. The funding policy will continue to be re-evaluated based on the status of the Plan.

As the year progresses, management will consider factors, such as credit-market conditions, interest-rate movements and revisions to 2010 and 2011 cash-flow forecasts, in determining the amount of long-term debt it will issue during 2010. Canada Post will ensure that sufficient liquidity is maintained at all times by accessing capital markets, establishing operating lines of credit or other means, as appropriate.

Our ability to proceed with Postal Transformation is contingent on the financial health of the Corporation. That health will largely be driven by the state of the economy, the ability to make permanent changes to our cost structure and the funding of our pension obligations. While difficult decisions will need to be taken in the coming years, with our Shareholder's 2009 enabling policy changes and continued support, a modernized Canada Post will remain financially self-sustaining and provide continued value to Canadians for years to come.

2 Our Business, Vision and Strategy

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

The Canada Post Group is in the business of connecting Canadians "From anywhere... to anyone™." Our vision for Canada Post is to be a service provider of choice – one that is relevant to the needs of Canadians not only of today, but well into the future. Our 71,000 employees deliver approximately 11 billion pieces of mail, parcels and messages each year to some 15 million addresses in urban, rural and remote locations across Canada. Our objective is to provide Canadians with world-class postal service while remaining financially self-sustaining.

At no time in recent history have the challenges faced by the postal industry been so great. This has confirmed the necessity to invest and innovate in our services, our infrastructure and our culture in order to secure our future.

2.1 Trends, opportunities and threats

Global trends

Responding to the global economic downturn and unprecedented declines in mail volumes over the past year has certainly been the dominant focus for postal operators in 2009. The United States Postal Service ("USPS"), Deutsche Post, Royal Post and Australia Post have all reported substantial declines in their mail volumes in 2009. Declines in the volumes of addressed mail have varied from 4.1 per cent for Australia Post to 13 per cent for the USPS. Direct-mail volumes saw the most significant rate of decline. The consensus is that physical-mail markets are now fully mature and entering into a period of decline. In keeping with this view, these same Posts have forecasted further volume declines in the range of 2 per cent to 10 per cent for 2010.

Addressed Mail Volumes	2009 Actual	2010 Forecast
United States Postal Service	-13%	-6% to -9%
Deutsche Post	-6.5%	n/a
Royal Mail	-5.5%	-10%
Australia Post	-4.1%	-2.3%
Canada Post	-6.3%	-1.6%

Faced with a long-term decline in volumes of traditional mail, 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 that traditionally financed a Post’s USO is diminishing, Posts are increasingly taking action. Discussions are focused on finding a means to finance the rising costs of the USO and ensure long-term sustainability. Posts’ current strategies vary in accordance with the extent to which they have already undertaken substantial modernization initiatives and to the extent to which they operate in a modernized regulatory framework. The European Union (EU) leads the evolution of postal markets. Modernization efforts began initially as an offset to the anticipated impact of the liberalization of domestic postal markets in 2011. European Posts are now using the benefits of modernization to address the more immediate threat that the economic downturn and the consequent accelerated electronic substitution have set in motion.

Deutsche Post (Germany), 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 by undertaking initiatives similar to those proposed under Canada Post’s Postal Transformation plans and have generated new sources of revenue in areas such as logistics, technology and financial services. Taking these efforts even one step further, Posten (Sweden) and Post Danmark (Denmark) have recently merged in an effort to enhance their competitiveness and benefit from economies of scale. These Posts have seen their financial results deteriorate under the current economic crisis; however, all have been well positioned to respond to the decline in mail volumes while maintaining their USOs and have continued to report positive financial results.

These Posts stand in contrast to, for example, the United Kingdom’s Royal Mail. For a number of reasons, Royal Mail had failed to modernize in the face of liberalized markets, and is now struggling and in serious financial difficulty. Royal Mail has estimated that it is 40 per cent less efficient than its European counterparts, and asserts that this and rising pension obligations, rather than market liberalization, are the root causes of its projected annual cash shortfall of £400 million by 2010.

The USPS also finds itself in a financial crisis as it reported a US\$3.8 billion loss in 2009 and is projecting a net loss of more than US\$7 billion in 2010. It is not easy to compensate for the sharp decline in mail volumes given the high degree of fixed costs in its operations. The USPS continues to operate more than 400 mail-processing facilities and 37,000 retail and delivery facilities, and estimates that it is currently operating with 50 per cent excess processing capacity.

The experience of both Royal Mail and the USPS illustrate the need to adopt efficient business practices that allow for flexibility in order to adjust to any new market realities. This is especially true in a mature market such as the postal industry.

Canada

Canada Post continues to be a marginally profitable company, and it faces many challenges. Our business, including our reserved market, is under pressure on many fronts, including competitive pressures, the severe downturn in the economy, the cost of our universal service obligation and other public-policy obligations, putting our continued financial sustainability at risk.

Mailers aggressively looked to decrease their costs in response to the economic downturn, accelerating the trend to electronic substitution of transaction mail, our most profitable business. Internationally, low-cost re-mailers offer outbound mail services without the requirement of a universal postal service that we must provide. A variety of alternative media, from traditional to digital, can substitute for direct mail. The domestic parcel market, increasingly a technologically driven business, is highly competitive because of the presence of all the major global players – UPS, FedEx and DHL. These parcel competitors, who previously have focused on the B2B segment, are now looking to the high-growth B2C market where Canada Post holds a dominant position.

We face cost pressures that our competitors do not. These pressures are particularly difficult given the current economic climate. Canada Post delivers five days a week and meets specific service delivery standards at the same reasonable cost to everyone. While our delivery network grew by approximately 200,000 points of delivery, our traditional volumes of transaction mail declined significantly. Our ability to replace this revenue is limited by vigorous competition in the parcels and direct marketing parts of our business. Our fixed costs remain high, particularly labour and network costs resulting from the USO and collective agreements. As a result of these challenges and in consideration of our need to remain financially self-sustaining, we recognize that further actions are required to address the long-term deficiencies of the current business model.

2.2 Strategic Review of Canada Post

In April 2008, the Government announced a Strategic Review of Canada Post to examine the Corporation's public-policy objectives, our ability to remain financially self-sustaining, and the continued relevance of the Multi-Year Policy Framework set in 1998. The Strategic Review Advisory Panel submitted its findings and recommendations to the Minister responsible for Canada Post in December 2008.

In its report, the panel recognized the importance of Postal Transformation, made possible through increased access to financing, to sustain Canada Post and ensure that universal postal services can continue. The panel recognized the need for a new Financial Framework for Canada Post and endorsed changes to the pricing constraint imposed by the existing price-cap formula on the basic letter rate. The panel also made recommendations to address the need for better articulation and clarity regarding Canada Post's universal service obligation.

Subsequent to the Review, the Government undertook a number of important measures. In September 2009, the Government formally announced its *Canadian Postal Service Charter*. The *Service Charter* outlines the expectations concerning Canada Post's service and makes these expectations known to Canadians. It covers universal service, rates, delivery, access to postal services, security, outreach, and consultation and response to complaints. Canada Post will report each year on its performance against the Government's expectations commencing with this Annual Report. The Government will review the *Service Charter* every five years.

Under the terms of regulatory amendments approved by the Government in October 2009, the price-cap formula that had been in place since 2000, and limited increases to the domestic basic letter rate to two-thirds the rate of inflation as measured by the Consumer Price Index, was repealed in January 2010. In addition, the Corporation received regulatory approval for a new five-year pricing regime for the domestic basic letter rate with rate increases of three cents effective January 2010 and two cents per year thereafter through to 2014.

The Government also supported the need for an increased ceiling to Canada Post's borrowing authority. To that end, the Corporation's borrowing limit, other than from the Crown, increased from \$300 million to \$2.5 billion pursuant to *Appropriation Act No. 4, 2009-10*, which received royal assent on December 15, 2009. At any time, the value of these borrowings cannot exceed an aggregate amount of \$2.5 billion. The terms of any borrowings are subject to the provisions of the *Financial Administration Act*. The increase in borrowing limit will help the Corporation finance its cash-management needs.

A new Financial Framework with updated performance targets and metrics was also approved by the Government. The new framework supplants the former Multi-Year Policy Framework targets that had been in place for more than a decade. In 1998, our Shareholder had established a Multi-Year Policy Framework that included performance and financial objectives for Canada Post. The 1998 Multi-Year Policy Framework profitability objectives included income from operations² of \$175 million, a productivity ratio³ of 97 per cent (or an operating margin⁴ of 3 per cent), and return on equity⁵ of Canada of 11 per cent. Excluding the 2009 unplanned non-cash employee future benefit expense reduction, Canada Post has not met these profitability objectives since 2005.

The updated 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 at the end of the five-year period to reflect the impact of Postal Transformation, implementation of International Financial Reporting Standards ("IFRS"), the timing and amount of remaining investment, and new market, operational and policy realities at that time.

² 1998 Multi-Year Policy Framework profitability objective Earnings before interest and taxes (EBIT) of \$175 million. EBIT equates with income from operations as reported in the consolidated financial statements

³ 1998 Multi-Year Policy Framework profitability objective Productivity ratio = cost of operations ÷ revenue from operations

⁴ Operating margin = income from operations ÷ revenue from operations

⁵ 1998 Multi-Year Policy Framework profitability objective Return on equity of Canada = net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)

Financial Framework: Investment Phase (2010–2014)

Element	Definition	Target
Profitability		
EBITDA Margin	Earnings before interest, taxes, depreciation and amortization ÷ revenue	5.0% – 7.5%
Return on book equity	Net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)	0 – 5%
Leverage		
Total debt to EBITDAR	(Total debt + long-term financial obligations) ÷ (earnings before interest, taxes, depreciation and amortization with adjustment for operating leases)	2.5X – 4.0X
Total debt to book capital	(Total debt + long-term financial obligations) ÷ (total debt + long-term financial obligations + equity of Canada)	45% – 65%
Liquidity		
(EBITDAR – Capex) ÷ interest	(Earnings before interest, taxes, depreciation and amortization with adjustment for operating leases – Capex ⁶) / Interest	1.0X – 2.5X
Dividend payout		
Dividend payout ratio	Dividends paid ÷ prior year net income	0 – 20% for 2010–2012 15% – 20% for 2013–2014

2.3 Strategic vision – Building the Modern Post

Our vision is for Canada Post to be a service provider of choice – one that is relevant to the needs of Canadians not only of today, but well into the future. Additionally, we view being an employer of choice and a socially responsible company as fundamental requirements to achieving our vision. Successful achievement will involve continuous transformation and change in a rapidly evolving postal market where consumers and businesses have more choices than ever and where global integrators pose stiff competition.

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

Although the recent recession reduced our revenues and mail volumes, we must stay the course. A sound modernization plan, linking our physical network to a relevant electronic network, is critical to respond to Canadians' current and future needs. This will support the achievement of our vision by making our operations more efficient, more environmentally friendly, enhancing health and safety in our workplace, and making us better able to respond to changes in volume and customer demand.

We also recognize the need to diversify our revenue streams in light of the mature nature of the postal industry. We are exploring options that leverage our many assets, including our highly recognized and trusted brand.

⁶ Capex refers to maintenance capital

Laying the foundation

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

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

We have made strong progress in our journey and laid the foundation for the transformation of our company. We have increasingly shifted our mindset toward our customers, continuously improved our employees' level of engagement, commitment and job satisfaction, and improved productivity. We have intensified our efforts to engage our employees and improve health and safety. We have enhanced the security of the mail through installation of high-security locks on street letter boxes, community mailboxes and other company assets. Investments such as these in addition to other security initiatives are essential to preserving Canada Post's position as the country's trusted delivery agent.

Postal Transformation

In 2008, we set the groundwork for our Postal Transformation plans, including approval to proceed with our infrastructure modernization. Inadequate investment in our core infrastructure has left our network in great need of renewal. Much of our current operating infrastructure was acquired in the 1970s and 1980s, and limits operating flexibility, reliability and maintainability. As confirmed by the Advisory Panel in its Strategic Review of Canada Post, this puts us at risk of a breakdown in service, unable to meet the increasing e-capabilities that our customers require, and limits our ability to make further productivity improvements.

In 2009, we further clarified our long-term strategies and road map for building the Modern Post. We tested our assumptions in light of the changed economic conditions, and re-evaluated our investment strategy to prudently concentrate

on those areas that are most critical and that produce a maximum return on investment. Postal Transformation will first address critical infrastructure requirements needed to ensure essential business continuity, including meeting the service commitments outlined in the recently launched *Canadian Postal Service Charter*. A revised total investment of \$2.0 billion, including \$1.6 billion of capital expenditures, will be needed to support Postal Transformation. The initial deployment phase, totalling \$750 million, includes the replacement of obsolete letter-sorting equipment in major centres and the introduction of a new operations model in Winnipeg in 2010. Further investment of \$1.3 billion would extend the new model across the network where deemed either critical to operational needs or where significant density of mail volumes exists.

The transformation aims to generate annual cost savings made possible through increased automation and productivity improvement. Anticipated benefits will be achieved through leveraging attrition (not replacing people who leave) while respecting all provisions in our collective agreements, including commitments relating to job security. Modest cost savings are expected in 2011, which will increase yearly as investment progresses and permanent annual cost reductions of approximately \$250 million are anticipated to be generated upon full implementation and stabilization in 2017. The majority of anticipated savings will be derived from synchronizing upcoming accelerated attrition with machine sequencing of the mail to individual points of delivery in cities that generate the highest volumes of mail thus reducing reliance on manual work. Additional savings will result from increased productivity of new equipment, and processing efficiencies through the implementation of new technology and world-class ergonomic methods and processes of 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.

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

Diversify into new, profitable revenue streams

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

Postal Transformation intends not only to enable important efficiencies throughout our physical and electronic network by reducing labour-intensive work, but also to provide the platform to develop and deliver enhanced features and innovative services to customers. Our plans for Postal Transformation are to invest in equipment modernization and new technology that is intended to:

- enhance letter-automation equipment for standardized, high-performing operations and maintenance;
- automate manual sequencing to facilitate Canada Post's ability to respond to attrition forecasts and changes in market mix as well as improve productivity and efficiency of operations;
- create a motorized delivery force;
- replace and/or improve current plants; and
- e-enable the physical network to meet new customer expectations and generate alternate revenue streams to reduce our financial reliance on declining volumes of letter mail.

As part of our dedication to corporate social responsibility and employee engagement, we intend to make sure our investments and strategies meet sustainable environmental criteria, and protect our employees' health and safety. A significant milestone in our plan is the Winnipeg City Transformation. In 2010, a new LEED™ certified mail-processing plant – the first in Canada in 20 years – is scheduled to open in Winnipeg after more than a year of planning and 18 months of construction. Sustainable development principles will be incorporated into existing sites and green design principles will be incorporated within our new buildings. Postal Transformation also plans to bring increased motorization, with more letter carriers using fuel-efficient, low-emission vehicles for delivery.

The introduction of new ergonomically sound mail-processing equipment aims to reduce the amount of time employees spend manually handling and sorting mail thereby reducing the physical risks associated with the repetitive nature of manual sorting.

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

Customers are always seeking the best, predictable service from competitors. If we do not invest now, we anticipate that our ability to maintain or grow revenues will be negatively affected, as our competitors will continue to attract our customers if we are unable to offer similar basic features.

New infrastructure will provide capabilities to enhance our product and service offerings so we can defend and grow our core businesses. Modernization will also enhance health and safety in our workplace. We intend to continue to monitor our financial position in light of changing economic conditions and will adjust spending as needed. See *Section 6.6 – Liquidity and capital resources on page 70*.

Revenue diversification and growth

Canada Post prides itself as one of the most highly recognized and trusted brands in Canada. In 2009, Canada Post was recognized as the “most iconic brand” in Canada, topping an impressive list of other well-known and respected companies. We operate the largest delivery and retail networks in Canada. However, we must continue to adapt to new customer and consumer needs to ensure that this coveted status endures.

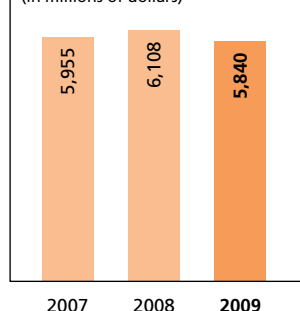
In 2009, we placed added emphasis on revenue diversification and growth. The role of Chief Customer Officer was created in November 2009 to integrate and leverage all major customer sales channels more efficiently. Additionally, a core team of executives was assigned oversight of our strategy for revenue diversification and growth. This effort is intended to build on and integrate the existing efforts that the lines of business, marketing, sales and retail groups have put forward. Canada Post has an opportunity to leverage its many assets and its new Modern Post capabilities to provide relevant, expanded and valued services to Canadians. This is essential to remaining relevant and sustainable in an increasingly changing environment.

2.4 Canada Post segment

The Canada Post segment generated revenue of \$5.8 billion and represents approximately 80 per cent of The Canada Post Group's 2009 consolidated revenue from operations of \$7.3 billion.

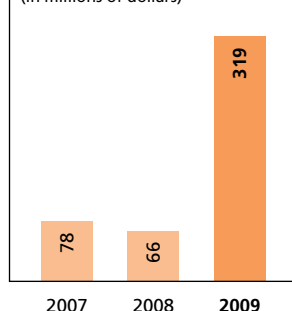
Revenue

(in millions of dollars)



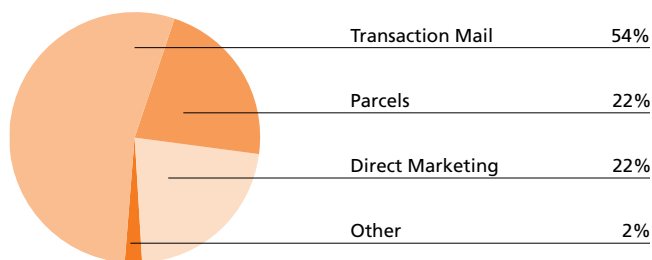
EBT

(in millions of dollars)



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 – 2009



Operating revenues by market	2009	2008	2007
Transaction Mail	54%	53%	54%
Parcels	22%	21%	21%
Direct Marketing	22%	24%	24%
Other	2%	2%	1%

2.5 Canada Post – Transaction Mail

Our business

Transaction Mail is our portfolio of services for the creation, delivery and response to letters, bills, statements, invoices and other forms of communications, in both paper and electronic formats. It is our most profitable line of business and is comprised of three distinct delivery services – domestic Lettermail™, international Letter-post and epost™, our online bill-presentment service. In addition to delivery services, through our SmartFlow™ Document Management Services, we also serve institutional customers' communication needs before and after delivery. This suite of services includes various aspects of document creation, management, storage and retrieval. SmartFlow Document Management Services allow businesses and governments to simplify and streamline production and management of document communications.

Transaction Mail accounts for \$3.1 billion or 54 per cent of the 2009 unconsolidated Canada Post segment operating revenue of \$5.8 billion. Today, the majority of Transaction Mail operating revenue is derived from the traditional physical-mail delivery services with domestic Lettermail accounting for more than 90 per cent.

Our customers include businesses, governments and consumers. On behalf of our customers, we deliver to consumers and businesses across Canada, and through international postal administrations, around the globe.

Vision

Our vision is to connect all physical and electronic document communications seamlessly and securely for Canadian businesses, governments and citizens.

Business environment

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

Both domestic Lettermail and international Letter-post mail volumes remained threatened by the continuing substitution by electronic alternatives and the current economic downturn. Canadians are increasingly shifting to email as a means of communication. More consumers are using electronic bill-presentment services and paying their bills online. Large mailers are consolidating the bills they send to their customers and encouraging the use of electronic payments. The use of electronic filing services for transactions, such as income taxes, is growing. The economic downturn has put increased pressure on businesses and consumers to review their costs and look for more economical ways to meet their communication needs.

At the same time as domestic Lettermail and international Letter-post mail volumes are declining, the number of Canadian points of delivery is increasing each year, thereby increasing our delivery costs. These trends continue to reduce the average number of pieces of letter mail per household, reducing profit contributions.

Transaction Mail	2009	2008	2007	2006	2005
Total volumes (in billions of pieces)	5.08	5.32	5.40	5.47	5.45
Less outbound mail (in billions of pieces)	(0.11)	(0.11)	(0.13)	(0.15)	(0.15)
Delivered volumes (in billions of pieces)	4.97	5.21	5.27	5.32	5.30
Delivery addresses (in millions)	14.87	14.70	14.49	14.29	14.05
Pieces of letter mail per household	334	355	364	372	377

Strategy

The experience of the past several years, and particularly of 2009, reflects our vulnerability to reductions and shifts in the volumes of physical mail. We are pursuing a mix of strategies to mitigate the impact of these trends. Due to the faster decline in mail use, driven by the economic downturn, to sustain the business we must accelerate the growth of emerging technology-enabled document-processing services and other non-traditional revenue streams. In 2010, we will refine the basic strategies to better focus on e-technology based solutions, document management services, and other assets and capabilities that immediately enable revenue diversification. Our 2010 strategic priorities are:

- defend the core letter mail business; and
- grow emerging businesses by expanding epost service and associated services.

2009 objectives and achievements

We continued to meet our domestic Lettermail service performance target of 96 per cent. Transaction Mail also surpassed its targeted improvement in the Customer Value Index.

In 2009, Transaction Mail operating revenue decreased \$86 million, compared with 2008, declining approximately 2.3 per cent, and was \$131 million less than the 2009 Corporate Plan of \$3,279 million. In 2009, this decline was especially evident in mail coming from the United States and the continuing softness of demand from consumer and small business stamp sales at retail postal outlets.

The following outlines the progress made against the strategic priorities set out for Transaction Mail in 2009:

- *Focus on Rapid Growth of SmartFlow* – The effects of the economic downturn hampered the development and growth of SmartFlow services in 2009 and, as a result, our expectations were not fully realized. However, SmartFlow Send did post operating revenue above target and 2008 operating revenue. We successfully expanded our customer base in the SmartFlow Send, SmartFlow Recover and SmartFlow Respond services.
- *Add Value to Increase Customers' Communication Effectiveness* – We addressed various ways to help customers raise the effectiveness of their communications with their own customers. The SmartFlow Console gave customers of the SmartFlow Send service the ability to view their communications through the development, production and delivery process, and the capacity to actively monitor and manage the mix of communication channels provided with their own customers. We also provided an information and resources program for customers called "Unlocking the Power of Lettermail."
- *Expand to Better Serve Small to Medium-Sized Commercial Customers* – We moved ahead with initiatives to create new capabilities that will better serve small and medium-sized customers. To alleviate the impact of the three-cent basic letter rate increase for 2010, all contract Canada Post customers and meter customers will receive a 5.3 per cent rebate applied to the first \$1,000 worth of our Lettermail product purchased in 2010. Approximately 36,800 small businesses will have the entire cost of the 2010 basic letter rate increase offset by the rebate.

2.6 Canada Post – Parcels

Our business

The Parcels line of business provides a wide range of domestic and international delivery services. Within Canada, Parcels serves domestic destinations through our Regular Parcel, Xpresspost™, Expedited Parcel and *Priority*™ products. Regular Parcel and Xpresspost services are economical express alternatives to other courier services. Expedited Parcel service provides ground service to high-volume customers, while *Priority*™ Next A.M. service guarantees next-day delivery by noon between major centres.

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

Parcels accounts for \$1.3 billion or 22 per cent of the 2009 unconsolidated Canada Post segment operating revenue of \$5.8 billion.

Parcels customers include businesses, governments, consumers, international postal administrations and other delivery companies. On behalf of its customers, Parcels delivers to consumers and businesses across Canada, and through postal and private service partners, around the globe.

Vision

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

Business environment

The Parcels line of business competes in the low-margin, extremely competitive Canadian shipping and delivery market. With an estimated value of \$6.2 billion in 2008, the Canadian shipping and delivery market consists of three primary segments – business-to-business (“B2B”), business-to-consumer (“B2C”) and consumer-sending. The B2C segment is sustaining higher growth than other segments in response to the growth of e-retailing.

The current recession has affected demand in the shipping and delivery market as demand is closely related to economic activity. Customers, eager to cut costs, were increasingly shopping around and moving from air to less expensive ground services.

The Canadian market remains subject to intense global competition. It has five major players: Purolator, Canada Post Parcels, FedEx, UPS and DHL. Our Purolator subsidiary leads the competition in domestic market share, while larger multi-national firms dominate international courier pickup and delivery. Canada Post Parcels competitors are generally concentrated in the large B2B segment, where the recessionary impact has been felt the strongest. They responded by aggressively competing on price and by targeting customers in the B2C segment.

Following the retrenchment of DHL – owned by Deutsche Post, the German postal administration – from the U.S. market in 2008, much of DHL’s U.S. business was absorbed by UPS and the USPS. As the DHL North American restructuring nears its completion, the withdrawal of its services has opened many opportunities for the remaining competitors and triggered aggressive plans by all remaining players.

We have increased our customers’ access to international and U.S. markets by a strategic alliance with FedEx™. Through our agreement with FedEx, Canada Post has increased the density of its deliveries to Canadians in rural and suburban areas.

More and more, this is a technology-driven business.

E-retailers increasingly recognize the critical importance of delivery as a component of their value chain and are demanding ever-increasing sophistication from their delivery suppliers, particularly related to visibility throughout the delivery process. It has become a physical delivery network governed by and supported through web service interfaces and applications.

As transportation is a significant cost component of the industry, costs are highly dependent on the price of fuel. As a result, the industry uses a fuel surcharge to correlate prices with fuel costs. Canada Post Parcels followed industry convention by introducing differentiated fuel surcharges for air and ground services in August 2008. Fuel costs stabilized in 2009. We continue to monitor the level of energy prices and regularly adjust the fuel surcharge relative to market prices.

Inbound parcel volumes from the U.S. are negatively affected by declines in the Canadian dollar. In 2009, the weaker Canadian dollar combined with the U.S. economy generated fewer inbound parcels.

Strategy

To grow and meet marketplace expectations, focus must be maintained on improving track-and-trace visibility, highly consistent service performance, valued customer service, and flexible shipping and delivery options.

- **Build on B2C Segment** – We intend to preserve and build on our share of the B2C segment through improved logistics with e-retailers, their shippers and their end consumers. For us, this means continued expansion of visibility through increasing the number of scans and improving their timeliness. We must also look for ways to integrate more easily with customers to give them ready access to shipping services and shipment data such as through web service interfaces. Improved online interfaces for consumers would let us further enhance the home-delivery experience through services such as delivery alerts, online payment and delivery or return options.
- **Increase Share of B2B Segment** – Further growth is tied to increasing our share of the B2B market, with a particular focus on small and medium-sized businesses (“SMB”). The Parcels line of business is looking to expand its current pickup options for SMB customers. Postal Transformation will build the infrastructure that will provide the line of business with the capability to offer a consistent on-demand pickup service across Canada.
- **International Partnerships** – Another focus will be to expand our international partnerships for inbound residential delivery. These arrangements will provide Canada Post Parcels with additional volume and revenue.

2009 objectives and achievements

For the fourth consecutive year, Parcels surpassed its targeted improvement in the Customer Value Index. Parcels also made major improvements in its Delivery Performance targets. On-time delivery performance in all products – *Priority Next A.M.*, *Xpresspost* and *Expedited Parcels* – improved dramatically, reflecting our commitment to drive excellence in service quality.

The recession negatively affected demand in the shipping and delivery industry. All players within the industry saw marked declines in their volumes in 2009. Although the Parcels line of business has been greatly affected by the recession, we fared better as the migration of customers from express air to more economical service offerings supported our volumes. As a result of the recession however, Parcels did not achieve its revenue plan.

Customer satisfaction, delivery performance and financial objectives were supported by a variety of Parcels initiatives in 2009.

- We continued to expand our visibility throughout our processing and delivery network by completing the deployment of an additional 4,800 Portable Data Terminals (PDTs) to all our remaining motorized routes, contractors and delivery-facility offices.
- We continued to install bar code scanners on our automated packet sorters in Montréal and deployed new wearable scanners in Vancouver and Ottawa for our manual sites.
- Responding to customers' needs, we enhanced our scan data to display intuitive information such as weather delays with updated delivery dates.
- We standardized our induction processes and scans to ensure consistent application of our commercial customers' parcels across the country.
- Understanding that on-demand pickup is crucial to the SMB market, we reduced our threshold for pickup and eliminated product limitations to make it easier for this market to access our services.
- In 2009, Canada Post licensed its Borderfree™ solution to a FedEx subsidiary called SmartPost. SmartPost, in turn, is adding the Borderfree solution as a service offering to its U.S. business clients shipping into Canada. Part of the Borderfree solution includes customs clearance and final delivery in Canada by Canada Post. This new agreement strengthened our e-commerce focus and international development strategies.

2.7 Canada Post – Direct Marketing, Advertising and Publishing

Our business

Our Addressed Admail™ and Unaddressed Admail™ products (collectively “Admail™ products”) are the primary products of the Direct Marketing, Advertising and Publishing (“Direct Marketing”) line of business. The Addressed Admail product targets promotional messages to specific businesses or individuals (for example, credit card applications). The Unaddressed Admail product enables our customers to reach specific neighbourhoods or regions across Canada (for example, store flyers). We also distribute periodicals, including newspapers, magazines and newsletters.

Direct Marketing accounts for \$1.3 billion or 22 per cent of the 2009 unconsolidated Canada Post segment operating revenue of \$5.8 billion.

Vision

Our vision is to be recognized as a 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

Admail products compete in the Canadian advertising and marketing services industry with other advertising media that range from traditional television and newspaper channels to email and text messaging. Our direct-mail products participate within the direct-marketing segment within the broader Canadian advertising and marketing services industry.

The Direct Marketing line of business remains one of the key players within the Canadian direct-marketing community. With its unprecedented reach and access to 15 million addresses, direct mail enables our customers to deliver customized messages and offerings to highly defined target groups.

The economic downturn is driving fundamental change in the size of marketing budgets, and how and where marketers are spending their limited advertising dollars. The proliferation of marketing channels has cluttered the marketing environment and is dulling consumer response. This, in turn, is driving the need for communications to be more targeted and relevant to the intended audiences. Marketers are looking to make both their online and offline communications more responsive while reducing overall communication costs. Measurement and accountability requirements will intensify the demand for lower-cost, more efficient and measurable media solutions.

Budgets are expected to shift from mass to measurable marketing programs with a focus on enhancing the value, efficiency and effectiveness of marketing activities. Consumers also are 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 and service providers to adopt “green” practices. As the market transforms, the need for a multi-channel offering with greater analytical capabilities and more personalization will emerge as an essential part of doing business.

Strategy

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

- *Diversification Into Data Offering and Marketing Analytical Services* – Enable the marketing community with improved data and analytics, through the use of marketing technologies that leverage Canada Post’s unique point-of-call delivery information. Direct Marketing will introduce affordable list and analytical services and a full-service data-hygiene offering, providing the small and medium-sized business segments with access to advanced solutions for targeting and analytics.
- *Multi-Channel Enablement* – Direct Marketing plans to introduce, within the planning period, a new highly targeted and consumer-focused online advertising channel to connect businesses and consumers. We will provide consumers with more control over what they receive by enabling them to select only relevant content in the format and timing of their choice.
- *Improving the Customer Experience* – We intend to improve customers’ overall experience by providing a consistent experience across all touch points. We plan to continue to review trends and engage with both consumers and customers to better understand future needs.
- *Ensuring the Sustainability of Direct Mail* – We intend to transform our products to meet the needs of the Modern Post, using these new capabilities to develop new product offerings, and continue to build a Direct Marketing Centre of Excellence and promote strategic thought leadership in the industry.

2009 objectives and achievements

Direct Marketing surpassed its Customer Value Index target. Direct Marketing also made major improvements in its Delivery Performance targets. The on-time delivery performance of Admail products improved dramatically, reflecting our commitment to promote excellence in service quality.

The current recession has affected the level of advertising budgets and driven basic structural changes in how marketers are spending their advertising dollars. As a result, Direct Marketing did not achieve its revenue plan.

Customer satisfaction, delivery performance and financial objectives were supported by a variety of Direct Marketing initiatives in 2009.

- We heightened our presence within the industry and with our customers, providing leadership, marketing intelligence and creative solutions. In 2009, we developed reference material and tools to assist customers with planning and executing their marketing campaigns, including a white paper on “Direct Marketing in a Downturn Economy” and an update to our *Direct Marketing Insights Fact Book*. Direct Marketing also held more than 150 customer information sessions, reaching some 2,500 business customers across Canada and the U.S.
- We continue to take a lead role in reducing the impact of mail on the environment by educating marketers, mail-service providers and agencies through our “go green” section on Canada Post’s website and participation in Canadian Marketing Association initiatives.
- We have developed the platform required to enable the future delivery of advanced marketing and analytical services.
- In anticipation of the modernization of postal equipment, we have been consulting with the market to leverage the use of new technologies and to maximize value for our customers. We are also implementing new processes to enhance and improve access to the existing processes for machineable mail, including increasing the number of induction locations, lowering the testing sample size and improving the adjudication process.
- We have improved our website, making it easier to use by simplifying the language, and improving the navigation and content to provide customers with insights and knowledge. We simplified our processes in many areas and provided tools and guides.

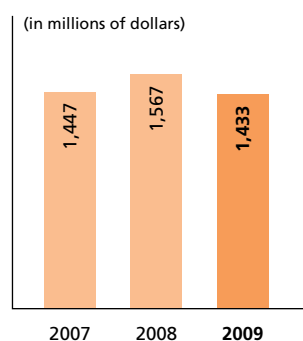
2.8 Purolator segment

The business

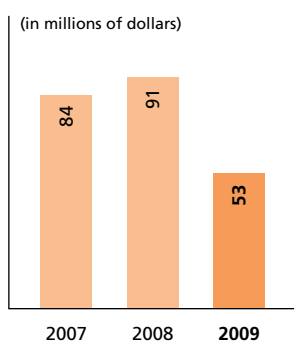
Purolator, owned 91.05 per cent by Canada Post, offers innovative products and dependable service. With 11,000 employees and a fleet of more than 4,000 vehicles, Purolator makes approximately 275 million deliveries and pickups each year. In 2009, Purolator was the leading overnight courier company in Canada. Purolator generated revenue of \$1.4 billion or approximately 18 per cent of The Canada Post Group's 2009 consolidated revenue of \$7.3 billion.

Purolator is a strategic asset of Canada Post. Its ability to focus on the B2B segment of the market and its ability to develop synergies, such as air line haul, allow The Canada Post Group to offer more value at lower cost.

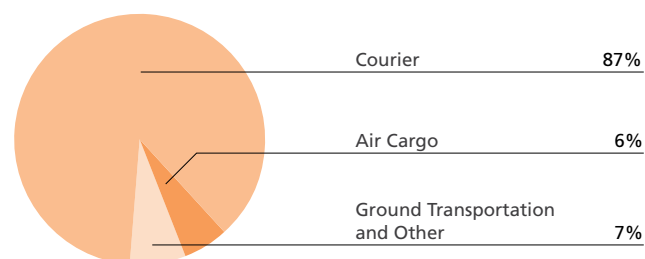
Revenue



EBT



Operating revenues by market – 2009



Operating revenues by market	2009	2008	2007
Courier	87%	89%	91%
Air Cargo	6%	5%	4%
Ground Transportation and Other	7%	6%	5%

Vision

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

Business environment

Purolator continues to be the leading provider of courier services in Canada with the largest market share by revenue but, like all companies in the Canadian shipping and delivery market, Purolator has been significantly affected by the global economic crisis.

In 2009, customers' focus was on cost control. As they experienced declines in their revenues, they looked to suppliers, such as Purolator, to help them meet their required cost reductions. Customers have changed their shipping patterns, moving from express to less-expensive extended delivery and from air to ground services. With the decline in volumes, competition has increased. 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.

Technology innovations continue to change customer expectations as well as the conduct of business and the management of transportation and distribution processes. It has led to the creation of new logistics service providers as competitors.

Strategy

As Purolator approaches the completion of its five-year transformation initiative, "Purolator 2010," it is refining its strategy with a focus on growth and enhancing the customer experience. Purolator management is committed to being an externally focused, market-driven organization. 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;
- broaden the portfolio by investing 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.

The “Purolator 2010” transformation has required significant investment in technology, infrastructure and internal coordination. Purolator intends to continue to invest in its future and will focus on areas that enhance its overall strategy.

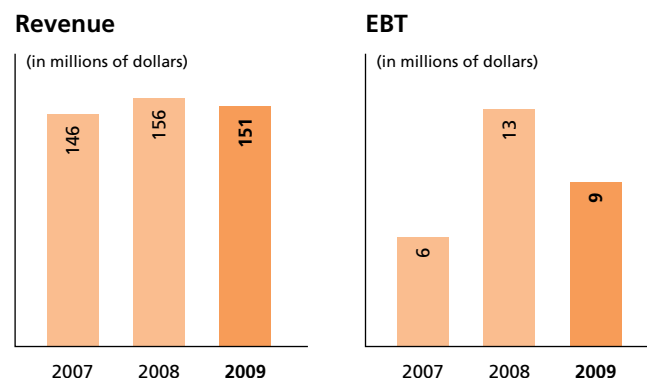
2009 objectives and achievements

For the third year in a row, Purolator is very proud to be named one of Canada’s 10 Most Admired Corporate Cultures in the 2009 Corporate Culture Study conducted by Waterstone Human Capital.

In 2009, Purolator’s revenues were significantly affected by the economic downturn, seeing a decline in volumes and a change in customer shipping behaviour. In response, Purolator increased its efforts to reduce its costs without affecting service levels. It continues to move customers over to its new customer-facing systems, to introduce new products and services, to expand coverage of premium products, and to invest in equipment automation. In 2009, Purolator also completed several key milestones against its core strategy and the “Purolator 2010” initiative.

- *Opened a New Hub in Richmond, B.C.* – This state-of-the-art sorting facility will triple processing capacity by: quadrupling the number of unload doors; doubling the number of outbound doors; doubling the air sort capacity; and adding an additional pickup and delivery sort line.
- *Invested in Customer Contact Transformation* – This project focuses on providing employees with tools that offer more detailed customer information as well as enhancing Purolator’s self-serve options for customers.
- *Create Awareness Through Advertising* – Awareness of Purolator’s premium service and brand leadership continued through its national advertising campaign. This year’s campaign focused on Purolator being the official courier of the Vancouver 2010 Olympic Winter Games and emphasized the company’s extensive network and capabilities.

2.9 Logistics segment



SCI Group Inc.

The business

The Logistics segment consists of SCI Group Inc. (“SCI”), which is 98.74 per cent owned by Canada Post. SCI Logistics Inc. changed its corporate name to SCI Group Inc. effective January 1, 2009. Through its subsidiaries, SCI offers order and inventory management services, including order processing, inventory control, order fulfillment, reverse logistics, delivery and transportation. Each subsidiary has a specific market focus, allowing the embedding of its logistics outsourcing services within its clients’ organizations, and thus enabling The Canada Post Group to offer Canadian businesses more comprehensive end-to-end supply chain services. SCI generated revenue of \$151 million or approximately 2 per cent of The Canada Post Group’s 2009 consolidated revenue of \$7.3 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 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 who are consolidating globally to gain market share and scale in technology, back office and transport buying power.

Strategy

SCI’s strategic mandate is to generate superior results through leadership in the design and operation of innovative supply chain solutions for select industry verticals that face particularly complex supply chains and where the value for SCI’s services is recognized.

The strategic direction for 2010 and beyond is to continue to expand SCI’s presence in the Canadian market. This will be done by continuing its client acquisition program, together with an expansion of service offerings into additional industry sectors such as oil and gas, utilities and health care.

To deliver on its commitments, improve profitability and increase value to all stakeholders, SCl intends to focus on the following strategic priorities:

- create tangible product/service differentiation;
- leverage its specialized supply chain competencies;
- reduce its cost base through quality and innovation; and
- accelerate the growth rate with more profitable accounts.

2009 objectives and achievements

In 2009, SCl's focus was on growth, specifically in the health care market segment. SCl also focused on improving operational and back-office cost structures by leveraging its culture of continuous improvement, and implementing an effective performance-management reporting and measurement system that allow both customers and SCl to monitor supply chain performance.

2.10 All Other segment

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). This segment previously included Canada Post International Limited ("CPIL"), which was a wholly-owned subsidiary. CPIL was wound up and dissolved in November 2008.

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, including CGI, to add value for its customers through the implementation of technology solutions.

During 2009, Innovapost was requested by Canada Post and Purolator Courier Ltd. to submit a proposal for the renewal of their service contracts that expire in 2012. Innovapost must submit proposals for renewal to Canada Post in May 2010 and to Purolator in July 2010.

Innovapost's strategy is to assist its clients in converting savings in base operating costs to investment in new technology. In addition, Innovapost will invest in and expand its service offerings to The Canada Post Group and its customers. It also will 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.

In 2009, Innovapost continued to reduce base operating costs for its clients, passing on price efficiencies gained in application management and infrastructure services. Innovapost achieved its key corporate metrics for customer satisfaction, employee satisfaction and service quality.

Canada Post International Limited ("CPIL")

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

3 Key Performance Drivers

A discussion of the key drivers of our performance, our progress against 2009 objectives and 2010 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 57.

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. Canada Post also measures delivery performance for its Admail and Parcels products.

Progress against 2009 objectives

Legend







-  Achieved
-  Partially achieved
-  Not achieved

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 2009 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 2009 objectives.

Customer Value	
2009 Objectives	2009 Results
Achieve customer value targets	 Customer value targets were exceeded in 2009. Our customers acknowledged excellent delivery performance across all product lines, enhanced visibility of parcel products in the delivery network, and significant reductions in Admail problem incidents.
Improve visibility of parcel tracking throughout the delivery network to enhance the customer experience and security of the mail	 Scanning terminals are now deployed to all motorized routes and most rural retail locations. New scan events continued to be expanded within the network to further enhance parcel tracking capabilities for our customers.
Complete deployment of new retail point-of-sale application and high-speed network to all high-volume post offices to enhance operational and financial controls and reduce customer wait times	 The deployment of the retail point-of-sale system was largely completed in 2009. The system has eliminated manual processes, improved the speed of customer transactions and increased parcel scanning, allowing better customer visibility. The new system also provides enhanced financial controls, and greatly simplifies deployment of new products and services.
Identify key drivers of customer problems and implement solutions to reduce the rate of problem incidence	 The rate of problem incidence for Admail products improved significantly, reflecting billing and payment improvements. However, problem incidence for both Lettermail service and parcels deteriorated slightly. Rates of problem resolution for parcels showed modest improvements, while results for Admail products and transaction mail declined.
Improve customer access to parcel tracking information	 New standardized tracking reports, along with improved web and integrated voice-response messaging, were implemented to enhance the customer experience when tracking parcels throughout Canada Post’s delivery network.
Enhance Canada Post's online strategy to support the growth of the online business channel	 Launched enhanced business desktop application with improved functionality and usability for our customers. The Canada Post website was updated to provide customers with simplified access, and enhanced product and service information.

Progress against 2009 objectives (continued)

Employee Engagement	
2009 Objectives	2009 Results
Achieve employee engagement target	<ul style="list-style-type: none"> ● The 2009 employee engagement target was achieved, with improvements in several key areas, including working conditions, safety, respect and fairness, ethics, collaboration, and teamwork.
Create a healthy and safe workplace by delivering programs focused on reducing the number of accidents	<ul style="list-style-type: none"> ● Training and awareness focused on safe workplace practices continued to be developed and deployed. Further, all leaders are now measured against safety leadership criteria, allowing us to keep safety top of mind throughout the organization. Accidents in 2009 have been reduced by 22 per cent.
Deliver development programs focused on leadership, productivity and customer service	<ul style="list-style-type: none"> ● Leadership development programs targeting key leadership capabilities and corporate values were delivered in 2009. Programs designed to enhance productivity were deployed to letter carriers and mail-processing employees. Customer service employees were provided with training to further enhance responsiveness to customer needs.
Delivery Performance	
2009 Objectives	2009 Results
Achieve delivery service targets	<ul style="list-style-type: none"> ● Service targets have been achieved for all products. Record performance levels achieved for Addressed Admail, Unaddressed Admail, Xpresspost and <i>Priority Next A.M.</i> products.
Achieve 2009 Postal Transformation milestones	<ul style="list-style-type: none"> ● Completion of the new Winnipeg facility is proceeding on schedule. It is on track to open in the second quarter of 2010. National critical infrastructure replacement continues on plan, including the design and production of new letter mail processing equipment and a centralized computer system. Phase 2 of the Postal Transformation project was approved, increasing total funding to \$2.0 billion, providing for expanded rollout of mail-sequencing capabilities.
Deliver corporate initiatives to support Postal Transformation	<ul style="list-style-type: none"> ● Development and implementation of product strategies and plant modifications in support of the Postal Transformation initiative are proceeding on schedule. Customers are being kept apprised of all changes in a timely manner.
Financial Performance	
2009 Objectives	2009 Results
Deliver The Canada Post Group earnings commitment of \$117 million	<ul style="list-style-type: none"> ● Consolidated income before income taxes was \$379 million. Excluding the unplanned reduction in employee future benefits expense in the Canada Post segment (due to discount rates), income before income taxes was \$108 million or short of the 2009 Corporate Plan by \$9 million.
Deliver Canada Post's revenue commitment	<ul style="list-style-type: none"> ● As a result of the global economic crisis, which was much more severe than anticipated, revenues for all lines of business fell significantly below target levels for the year.
Achieve Canada Post cost of operations objectives	<ul style="list-style-type: none"> ● Cost-reduction objectives were exceeded for 2009 as a result of strict cost-management actions implemented and significant operational efficiencies achieved during the year.
Deliver Canada Post earnings commitment of \$18 million	<ul style="list-style-type: none"> ● Canada Post segment income before income taxes of \$319 million exceeded plan by \$301 million. Excluding the unplanned reduction in employee future benefits expense in the Canada Post segment (due to discount rates), income before income taxes was \$48 million, exceeding the 2009 Corporate Plan by \$30 million.
Develop a Financial Framework in collaboration with our Shareholder to ensure the long-term financial sustainability of Canada Post	<ul style="list-style-type: none"> ● A new Financial Framework was established, including annual increases to the domestic basic letter rate for 2010 to 2014, an increase in Canada Post's external borrowing limit to \$2.5 billion, and updated five-year Financial Framework targets.

3.3 2010 Priorities

For 2010, we must stay the course to be able to provide the quality service that Canadians expect and to remain relevant in the future. Our priorities continue to be: implementing our Postal Transformation plan; focusing on the customer experience; engaging our employees; improving health and safety; and achieving our financial imperatives to ensure the financial sustainability of our business during what may prove to be a very challenging economic period.

Financial Imperatives

For 2010, we are facing some important challenges that could affect our long-term sustainability. The speed and extent of the recovery of our revenues after the severe economic downturn remains uncertain. Canada Post is responding with tough cost-management measures to achieve its financial objectives. We will ensure that spending commitments are within our current financial capacity. In addition, Canada Post is developing a growth strategy aimed at ensuring the financial sustainability of the Corporation even in the face of declining volumes in our core business. 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.

2010 Postal Transformation Plan

Our Postal Transformation plan is crucial to Canada Post's future ability to sustain service and address competitive pressures. The new Winnipeg mail-processing plant will open in 2010 and obsolete mail-processing equipment is being replaced in major centres. We are optimizing work processes to provide better service for Canadians and a safer work environment for our employees. Even with the implementation of our Postal Transformation plan, this alone will not be sufficient to ensure our sustainability over the longer term.

Make the Customer Experience Right

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. Our objective is to integrate a customer focus into our business by providing products and services that meet customer expectations, including enhancing customer tracking information for visibility of parcels throughout Canada Post's network. Our customer case-resolution system will be upgraded to improve the customer experience at first point of contact. These are just a few examples of actions that Canada Post plans to undertake in 2010 to make the customer experience right.

Employee Engagement and the Health and Safety of our Employees

In 2010, management will be stepping up 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.

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. A new accident reporting system will be introduced to target and focus on accident prevention strategies. We will continue to address the safety of rural mail delivery with the continuance of rural mailbox safety assessments.

4 Capability to Deliver Results

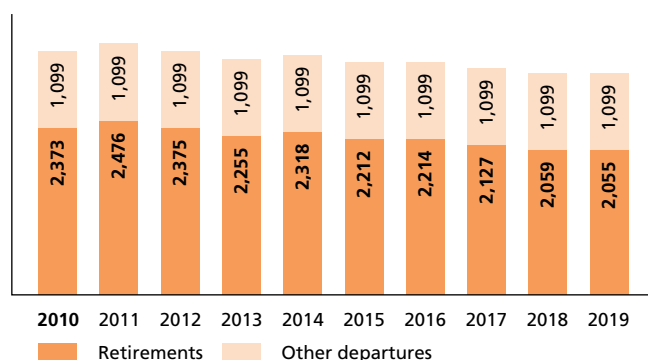
A discussion of the issues that affect our ability to execute strategies, manage key performance drivers and deliver results

4.1 Employees

The Canada Post Group operates as one of Canada's largest businesses with approximately 71,000⁷ employees. Canada Post, a Top 100 Employer for the fourth consecutive year, employs approximately 59,000 people and our subsidiaries employ another 12,000.

An estimated 33,454⁸ full-time employees will leave Canada Post between 2010 and 2019. Most employees will retire, but others will decide to leave to pursue opportunities in a highly competitive labour market. Recent analysis also shows that, in addition to retirements and voluntary departures, for every employee who leaves, another five employees, on average, will change jobs within the company. This churn will result in an estimated 167,000 employees changing jobs over the same ten-year period. High turnover places additional operating and cost pressures on the organization as we work to keep pace with the staffing, orientation, training and productivity impacts caused by this level of employee change.

Full-time attrition forecast retirements and other departures



Our company's transformation to the Modern Post depends on our ability to secure sufficient resources with the right skills, and to maintain an engaged and highly skilled workforce. One of the biggest challenges facing Canada Post is to create a high-performing workforce in the face of skill shortages described above and a tightening labour market.

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 new tools such as an e-recruitment system for external and internal hires, social media and modern leadership programs. These tools will help us recruit the right talent, enhance the work environment, increase skill levels, renew and retrain employees in preparation for Postal Transformation, and develop future leaders.

The difficult economy in 2009 created an enterprise-wide need to control costs. This included staffing reductions and hiring freezes. Despite the financial pressures, the organization continued to support activities that are essential to our future success. In 2009, we continued to focus on employee engagement, learning and development, corporate values, talent management, leadership effectiveness, and organizational design. In addition, we continued with several initiatives for talent segmentation, leadership development and succession planning. The enhanced capabilities of e-recruitment and partnerships with suppliers have improved recruitment outcomes for front-line, mid-management and executive-level employees.

Canada Post believes in the power and importance of learning, management development and leadership development as drivers of success. In 2009, in partnership with Queen's University, Canada Post senior executives delivered a comprehensive development program in seven critical business areas: finance, strategy, marketing, sales, operations, information technology and human resources. To emphasize and elevate our commitment to learning and development, we introduced a Learning Index. The index, which forms part of the Corporate Team Incentive, is used to plan, monitor and measure training efforts for a number of business-critical programs. This focus on learning was put in place to ensure that we are keeping pace with the skill demands placed on the organization by high levels of attrition and postal modernization. In addition, manager and superintendent mentoring and training programs, such as "Leading Edge," were delivered to emphasize coaching skills and promote employee engagement. 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 impact and effectiveness.

⁷ Employment figures include full-time and part-time paid employees, excludes temporary, casual and term employees

⁸ 33,454 full-time departures are expected by 2019 (22,464 retirements and 10,990 other departures)

Talent segmentation and succession planning tools were introduced in 2009 to 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 business-capability needs. The talent and succession tools strive to bring visibility to our current talent pools and build our capability to respond quickly in this area.

In 2010, we will leverage the new recruitment, learning and development, and talent and succession tools that were introduced in 2009 to allow us to better target our recruitment efforts and succession planning, and focus our leadership and other development initiatives on the right areas.

4.2 Employee engagement

Canada Post

We created an employee engagement strategy in 2006 with a goal to become the best place to work in Canada, with every employee contributing to and sharing in our success. Employee engagement continues to be a top priority for Canada Post.

In 2009, efforts to boost levels of employee engagement concentrated on improving respect and fairness in the workplace, employee health and safety, involving employees in decisions that affect their work, and developing leadership capabilities among our front-line team leaders. Carrying out the strategy involved extensive face-to-face communication with employees.

For the fourth year, the President and several senior executives held Regional Forums across the country. They held 12 meetings with 3,100 employees in attendance. To help strengthen leadership capabilities, we also held 12 Regional Forum meetings with 500 team leaders. At the Forums, we shared our business results, the financial challenges we faced in the economic downturn, discussed sustainability (Postal Transformation and the Canada Post Pension Plan), security of the mail, and health and safety.

As well, many vice-presidents and general managers met with small groups of employees in their workplaces. More than 400 of these executive visits took place with over 8,000 employees. The Forums and executive visits both aimed to connect front-line employees and supervisors to our business results by sharing our plans.

Because front-line leadership is critical to engaging employees and achieving business results, these executive visits were designed to help front-line team leaders with their leadership challenges, discuss solutions, and complement the training and mentoring programs developed for supervisors and middle management. The executives also leveraged these visits to recognize team leaders and acknowledge their contributions.

In 2009, Canada Post continued efforts to strengthen our health and safety leadership, accident reporting systems, and safety training. We also undertook extensive communication with team leaders and employees to ensure that health and safety is treated as a top priority, and to encourage vigilance. Thanks to these efforts, we exceeded our accident-reduction target, achieving an overall 22 per cent reduction in workplace accidents. To continue to improve engagement within work teams, we required team leaders and employees to create improvement plans based on issues identified in the Employee Survey feedback.

The results of the 2009 Employee Survey show improvements in most categories. We also achieved our goal of a two-percentage-point increase in the Employee Engagement Index. There has been a significant change in the drivers of engagement. Corporate social responsibility has replaced work unit functioning as a driver of employee engagement. Canada Post has been named one of Canada's Top 100 Employers for the fourth consecutive year by Mediacorp Canada Inc. While these results are encouraging, we still need to build higher levels of engagement and increase commitment to our customers.

Our employee engagement strategy for 2010 will seek to build on progress we have made to develop respect and fairness in the workplace, including protecting and promoting the health and safety of all employees. We will continue to engage front-line team leaders and develop their leadership skills. We will encourage all team leaders to involve employees in decisions that affect their work and workplaces, and to recognize employee contributions that support our corporate priorities such as excellence in customer service. We will also leverage our involvement in the community, such as our contributions to mental health – our cause of choice – and donations to the United Way/Centraide campaign, and we will promote environmental stewardship to build employee pride.

Purolator

Purolator continues to invest in its employees by ensuring that they have a safe place to work with the proper tools to do their job well. Sustained investment in employee training is an ongoing part of the foundation of the company's success. Purolator conducts Quarterly Pulse surveys that provide valuable information on employee morale. The information collected helps measure progress throughout the year. Employees are encouraged to share their thoughts and suggestions about how the company can improve in the areas of performance management, growth and development, and managing change. Employee feedback will help ensure that the right steps are taken in making Purolator an even better place to work. Employees also have a stake in the business since they own approximately two per cent of total issued share capital, through an employee share ownership plan.

4.3 Labour relations

Number of bargained employees – Canada Post

Bargaining unit	# of represented employees*	Collective agreement expiry date
CUPW (1)	40,372	January 31, 2011
CUPW-RSMC (2)	6,747	December 31, 2011
CPAA (3)	6,299	December 31, 2009
APOC (4)	3,747	March 31, 2014
PSAC/UPCE (5)	1,856	August 31, 2012
Total	59,021	

* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2009; 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 January 2010, the Canadian Union of Postal Workers ("CUPW") applied to the Canada Industrial Relations Board (the "Board") under section 18.1 "Review of Structure of Bargaining Units" under the Canada Labour Code. The CUPW has requested that the Board review the structure of the bargaining units at Canada Post, and establish a single bargaining unit for all operations employees, excluding supervisory personnel. The CUPW requests the merger of 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).

Canada Post has responded by disputing the CUPW's statements regarding the appropriateness of the current bargaining unit structures. Furthermore, Canada Post has requested that the Board dismiss the application by the CUPW outright as the application has not provided justifiable grounds for the Board to embark in a review of the Corporation's bargaining agents.

In terms of collective bargaining, it was another busy year as Canada Post engaged in contract negotiations with three of our five labour representatives throughout 2009. Our team aimed to negotiate agreements that recognize the need for immediate changes to ensure the Corporation's long-term sustainability. The decline in mail volumes and the need for new equipment have not altered our commitment to providing employees with compensation and benefits programs at a cost we can afford. After all, our employees are the foundation of our company.

The following discussion summarizes the progress of collective bargaining throughout the year, and our continued commitment to employees and their representatives.

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

We are now in the final year of a four-year collective agreement with the CUPW, which will expire on January 31, 2011. This union represents the largest group of employees: plant and retail employees as well as letter carriers and mail service couriers. Bargaining is expected to begin in the fall of 2010.

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

Canada Post and the CUPW-RSMC are currently in the sixth year of an eight-year collective agreement. This agreement contains three contractual re-openers prior to its expiry on December 31, 2011. The parties began negotiating the final contract re-opener in November 2009. In January 2010, the union exercised its right under the collective agreement to refer all unresolved matters to interest arbitration. Neither party has the recourse to strike or lockout.

Union of Postal Communications Employees ("UPCE")

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. The new collective agreement between Canada Post and the UPCE was signed in March 2009 and will expire on August 31, 2012.

Canadian Postmasters and Assistants Association ("CPAA")

The collective agreement between Canada Post and the CPAA, which represents rural post office postmasters and assistants, expired on December 31, 2009. The parties have been in the process of negotiating a new collective agreement since May 2009. In February 2010, the Association referred all outstanding matters to an arbitrator for final offer selection. Under this process, neither party has the recourse to strike or lockout.

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

Canada Post and APOC, which represents supervisory and sales employees, began negotiations towards a new collective agreement in November 2008 by way of interest-based negotiations. The parties referred all outstanding issues to an arbitrator in August and received a decision in October 2009. The new five-year collective agreement, which expires on March 31, 2014, includes wage increases in each year of the collective agreement, in addition to increases as a result of the new Job Evaluation Plans, the implementation of the Short-Term Disability Program, and updates to various benefits. The extended life of the collective agreement is intended to provide sound labour stability.

Number of bargained employees – Purolator

Bargaining unit	# of represented employees*	Collective agreement expiry date
Teamsters (1)	8,966	December 31, 2011
Other (2)	1,031	December 31, 2009 January 31, 2011 December 31, 2012
Total	9,997	

* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2009; excludes temporary, casual and term employees

(1) Teamsters = operations

(2) Other = clerical and administrative

In 2009, Purolator and a number of Teamster Local Unions, which represent clerical/administrative employees in Atlantic Canada, Ontario, Manitoba, Saskatchewan and Alberta, reached a series of mutually beneficial collective agreements. These agreements are effective from January 1, 2009, to December 31, 2012.

One clerical/administrative collective bargaining agreement expired on December 31, 2009, with the Communications, Energy and Paperworkers Union in the province of Quebec. It is expected that bargaining will begin in early 2010 to renew this agreement.

Purolator and The Public Service Alliance of Canada, which represents clerical/administrative employees in British Columbia, also reached a new collective agreement. This agreement is effective from January 1, 2009, to December 31, 2012.

Purolator's strong partnership with its employees helped facilitate these mutually acceptable agreements.

Number of bargained employees – Logistics – SCI Group

Bargaining unit	# of represented employees*	Collective agreement expiry date
CEP (1)	263	December 31, 2009 December 31, 2010 November 30, 2011

* Includes all full-time and part-time employees who are represented by a bargaining group as at December 31, 2009; excludes temporary, casual and term employees

(1) CEP = Communications, Energy and Paperworkers Union of Canada

The company has reached a tentative settlement for the collective agreement that expired on December 31, 2009, and is awaiting ratification by the membership.

4.4 Workplace health and safety

Canada Post has developed and is following a multi-year strategy with a focus on building safety leadership, identifying, preventing and controlling hazards, training, and continuous improvement to strengthen our health and safety program and measure our success. Our 2009 results show significant improvement with a 22 per cent decrease in the number of accidents compared to the previous year.

Safety leadership is key to building a safety culture. We have introduced to all levels of management clear expectations on actions and behaviours related to workplace safety. These criteria form part of the official performance scorecard and will continue to evolve over the years.

Our two most common types of injuries are slips, trips and falls, and musculoskeletal injuries such as strains and sprains. We continue with our program and our emphasis on the prevention of slips, trips and falls with the focus on route inspections to proactively identify hazards, guidance on footwear, provision of anti-slip devices, and an extensive external communication campaign to engage clients in doing their part by keeping walkways clear of snow and ice. We saw a 21 per cent reduction in slips, trips and falls compared to 2008. We continue to apply our ergonomic assessment tool to gain a better understanding of our current risks and to define our priorities for mitigation. We can therefore ensure that our solutions maximize ergonomic improvements. There is also emphasis within Postal Transformation to ensure that safety and ergonomic improvements are integrated into our future processes and equipment. In 2009, we continued to formally train our employees on safe lifting and proper manual material handling and the continuous reinforcement of what was taught will continue over the years to ensure that proper techniques are applied at all times. In 2009, we saw a 21 per cent reduction in musculoskeletal-related injuries compared to last year.

A third party (URS) was selected to perform health and safety compliance and health and safety management system audits in 35 locations across the country. Audits were completed and reports finalized in 2008. These audits include scores on various health and safety management system elements based on the British Standard Occupational Health and Safety Assessment Series 18001 (BS OHSAS) and serve as a baseline from which we can gauge our improvement over time. We will continue to address the issues identified by addressing higher-risk items first and tracking our improvement to the baseline scores. In 2009, we demonstrated a 14 per cent increase in score from our baseline.

For the next few years, we will continue to substantially improve our system and reporting capabilities related to workplace safety. The improvements will allow us to further analyze our Workers' Compensation claims, our costs, our accident types, opportunities for prevention, and various other trends that are required for us to ensure focused strategies and measured successful outcomes.

4.5 Infrastructure

Modern physical assets, including processing facilities and delivery and retail networks, are required to enable us to maintain our service commitments and meet customer requirements. Investment in basic infrastructure has lagged and significant capital expenditures are required to renew the asset base, leverage new technologies and improve productivity. *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 2009, Canada Post invested \$379 million in capital assets, primarily on buildings, systems and equipment.

In 2010, we plan to invest \$528 million in capital for land purchases, equipment and facility replenishment, IT infrastructure upgrades and other systems/technology to support business growth in key areas. Given the current economic climate, however, we intend to monitor our financial position closely and take action to mitigate any negative effects, including, if needed, a reduction in the pace of capital spending.

Our major infrastructure renewal project, which we call Postal Transformation, is crucial to Canada Post's future ability to sustain service and address competitive pressures. Our initial deployment plan addresses our most critical infrastructure-replacement requirements, including the construction of the new Winnipeg mail-processing plant, which will open in 2010. The new Winnipeg plant will reflect the Modern Post and be equipped with upgraded technology and ergonomically sound new-generation equipment. It will also be more environmentally friendly, incorporating green technologies and conforming to recognized green building standards (LEED™). New letter carrier depots also will be constructed and existing letter carrier depots will be retrofitted to support the process changes introduced by Postal Transformation.

The initial deployment plan also includes the replacement of obsolete letter-sorting equipment in major centres as well as the introduction of a new delivery model in Winnipeg. We are optimizing work processes to provide for better service for Canadians and a safer work environment for our employees.

The entire Postal Transformation plan will require a total investment of approximately \$2 billion and is estimated to generate approximately \$250 million in annual cost savings after full implementation.

The Corporation has completed a detailed cost and benefit analysis to estimate the benefits associated with Postal Transformation. As we proceed, we will continue to prioritize our activities based on those components that address our most critical operational needs and that have the highest return on investment. We will also maintain our practice of presenting detailed, up-to-date plans to the Board of Directors for its approval.

Over the next five years, our investment plans contemplate and require capital investment of up to \$2.3 billion, including \$1.4 billion on Postal Transformation. We will prioritize our investments based on the greatest need and spend only what we can afford. Postal Transformation has been designed with maximum flexibility in mind, and we will take on only those investments that are a prudent use of our financial resources and that will provide the most benefits.

Purolator

In 2009, Purolator moderated its investment in technology, infrastructure, processes and employees with the continued implementation of its business-transformation strategy, "Purolator 2010." In 2009, Purolator invested \$69 million in capital infrastructure to support key milestones in the transformation, including the expansion and automation of the Richmond, B.C., hub, the roll out of new hand-held scanners, and an investment in Customer Contact Transformation.

In 2010, Purolator will continue to monitor its investment activities, focusing on those areas with the most potential for revenue generation, customer-service improvement and employee development. A new long-term strategy will be rolled out that is expected to bring new strengths, increasing the reach and scope of its network, making it easier to find distribution solutions that fit customer requirements and ensuring that Purolator continues to provide the customer experience that has made it Canada's largest courier.

4.6 Delivery

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

In urban Canada, we continue to respond to volume changes by restructuring our letter carrier routes and our mail service courier routes, which has resulted in improved productivity. We also have focused on controlling staffing levels, and the use of supplementary hours such as overtime and using casual employees.

We have brought increased emphasis to the quality of our delivery operations through timely and improved reporting of quality issues, such as scanning-equipment defects, and through discussions and engagement with our employees.

We continue to work with our employees to improve safety on their routes and in letter carrier depots. A significant reduction in the number of accidents was achieved through this collaborative approach. We have continued awareness campaigns on hazards, such as avoiding slips and falls, as well as providing 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.

Improvement to the quality of delivery has also been achieved by continuing to increase and improve the address data in our Address Management System. Quality of delivery and on-time performance met or exceeded all targets in 2009, including Parcels, which was an area of focus.

In 2010, our focus will remain on improving quality, achieving productivity gains, enhancing employee safety as well as ensuring the security of the mail. In addition to continuing to equip our mailboxes with new high-security locks, Canada Post highlights security issues with our employees to protect our customers' mail. Canada Post also works closely 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, whose addresses comprise approximately five per cent of the 15 million Canadian addresses, receive their mail through rural mailboxes ("RMBs"). Continued urbanization throughout Canada has changed the volume and speed of traffic on previously quiet rural roads, resulting in 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 would impede vision.

To date, Canada Post has preserved delivery to 85 per cent of RMBs reviewed across Canada.

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

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

Approximately 40 per cent of the total 843,000 RMBs across the country have been assessed to date. Over the next five years, the costs for assessing and resolving health and safety risks for RMBs are estimated to be close to \$200 million in operating costs and approximately \$25 million in capital investment.

4.8 Retail

Canada Post has the largest retail network in Canada with 6,532 post offices serving both consumers and businesses. The network consists of corporate-provided and managed post offices, and post offices managed by private dealers. The dealer post offices are highly successful as they provide convenient access for Canadians through increased hours and parking, and are located where customers shop.

The Retail network includes more than 3,800 rural corporate and dealer post offices 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 without interruption. Our approach, called community outreach communication, includes open consultation with federal and local officials to ensure that all parties are informed and can provide input in these situations. Decisions are made on a case-by-case basis as we seek to find practical solutions that satisfy the community while providing sustainable service.

The Retail strategy continued in 2009. We continue to focus on improving core services, standardizing the look and feel of post offices, and ensuring consistent access for Canadians. For the third year, this strategy has meant Retail maintained consistently excellent results on customer surveys.

To further improve the customer experience, we have implemented retail automation. This program focused on the development of a new point-of-service application and new hardware, which has now been implemented in the majority of the network. The new system is already in operation in 5,924 sites or 90 per cent of our network. In 2010, the project will be completed and all but approximately 500 post offices will have been automated. The automation of post offices has allowed us to shorten and simplify processes, eliminate paper forms and improve the customer experience. The automation will help promote excellent and consistent service at the retail counter and provide the foundation for future sales opportunities. As well, the automation supports our compliance with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) requirements for reporting money order transactions.

Automation of our retail network of post offices has allowed us to branch out into new revenue opportunities, such as the VISA™ prepaid card launched in October, and to expand services such as MoneyGram™ electronic money transfers, and Virtual Prepaid products. It has also allowed us to streamline reporting and develop management-reporting tools for greater visibility for initiatives such as the mental health fundraising campaign launched in October 2009 that generated just over \$700,000 for Canada Post's cause of choice.

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 to 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, 2009.

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, 2009, in accordance with the 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, 2009. 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, 2009, 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 at all levels considers risks and opportunities in its business decisions. Under the oversight of Canada Post's executive team, the Audit Committee of the Board of Directors and the full Board of Directors, a more systematic, integrated and rigorous approach to Enterprise Risk Management ("ERM") is being pursued. Canada Post understands the most significant risks to our business. These risks are monitored and related risk-management plans refined, implemented and reassessed. The management team will continue to improve the ERM processes in 2010 to better align Canada Post with industry best practices and changes in the business environment.

5.1 Definition of risk

Canada Post defines risk as any event or condition that could have an adverse impact on the Corporation's ability to meet its key strategic, financial and organizational objectives. The following is a summary of the principal sources of both strategic and operational risk and uncertainty facing the Corporation and the associated risk-mitigation activities.

5.2 Strategic risks

Revenue declines

The global economic crisis has driven volume declines across all three lines of business. Competition is encroaching upon the company's core revenues. Transaction Mail and Direct Marketing face the continuing threat of permanent migration to alternative media. Participants in the Parcels market are competing aggressively for business. These issues present risk to Canada Post's revenue recovery as the Canadian economy exits the current recession.

Ongoing changes to privacy legislation and a rising awareness of "Do Not Contact" issues could have detrimental effects on Canada Post's Direct Marketing revenues.

Lettermail erosion poses a significant risk to our revenues. Significant and continuing reductions to Lettermail volumes have been experienced. The repercussions from the 2009 economic crisis are expected to contribute to further volume erosion in 2010. Approval of a proposed amendment to the *Canada Post Corporation Act* to remove the “exclusive privilege” on outbound international and U.S. letters will open this market to competition from re-mailers. The experiences of Posts around the world, along with increased competition from international outbound re-mailers, shifts to electronic bill presentment and consolidation of bills, reinforce the risk that this erosion will continue. The current economic crisis has advanced this trend and may permanently increase the rate of erosion in the future.

Risk mitigation

Canada Post will continue to respond to revenue risks through prudent cost management and investment in revenue-growth initiatives. In both 2008 and 2009, major cost reductions were implemented. The protection and growth of traditional revenue sources through service improvements, pricing optimization, customer acquisition and retention programs, and product innovations remains a central effort of the management team. Canada Post is also continuing to expand its service offerings beyond the areas of vulnerability as well as aggressively providing multi-channel offerings that link the physical mail stream with the electronic channel. Canada Post has also developed “stress-test” scenarios for our business plans, including recovery options over the short term.

Pension deficits require significant funding

The Canada Post Pension Plan’s two primary risk exposures are: (1) a decline in long-term real interest rates that increases the pension obligation on a solvency basis; and (2) below-expected returns on the Pension Plan’s assets, which reduces the assets available to meet that obligation. Both risks could require the Corporation to make larger funding contributions to the Pension Plan. These primary risk factors are inherently volatile, and are more material given the scale of the pension (based on existing legislation and when using smoothed value of Plan assets, the solvency deficit is approximately \$2,007 million⁹ at the end of 2009) relative to Canada Post revenues (unconsolidated revenues of \$5.8 billion in 2009) and profit margin. The scale and volatility of the Pension Plan pose an ongoing risk to the company’s ability to fund needed investments in modernization and growth.

Financial markets performed well in 2009, resulting in the Pension Plan’s return on assets being above the expected rate of return. This was more than offset, however, by a decrease in long-term benchmark interest rates during the year that increased the present value of the pension obligation at the end of 2009. Overall, the funded status of the Canada Post Pension Plan deteriorated during 2009, continuing to leave the Plan in a solvency-deficit position at the end of the year. However on a going-concern basis, the Plan is in a surplus position. *Further information is provided in Section 6.5 – Canada Post Pension Plan on page 68.*

Risk mitigation

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. Risk monitoring and mitigating practices are in place. 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 Pension Plan’s investments and administration. An asset-liability study will be conducted in 2010 and the Pension Plan’s risk exposures will be reviewed and updated as part of this study.

Postal Transformation implementation

Canada Post is investing in Postal Transformation to remain financially self-sufficient and relevant to customers. The current Postal Transformation plan is large and complex. There are risks to implementing the project on time and within budgets while still achieving the targeted cost savings and other benefits. There are also risks that arise as a result of making significant changes to our plants, equipment and processes.

Risk mitigation

These risks are managed with thorough oversight, including detailed execution plans, extensive project management and a benefits-management process. Progress reports are prepared monthly for senior management, the senior management committees and the Board of Directors. Internal review mechanisms within Postal Transformation’s project management structure include the Postal Transformation Committee (chaired by the Chief Operating Officer), a risk management process and Internal Audit. Benefit-management processes are being put in place to track progress and ensure that maximum benefits are achieved. Impacts on employees will be managed through extensive employee engagement efforts, training, and significant

⁹ Solvency deficit when using fair value of Plan assets is approximately \$3,370 million

safety and ergonomic enhancements. Implementation of the first phase has commenced and is on track to become operational in 2010. Within the current Postal Transformation plan, we have identified the next group of priority projects – those that are the most critical and have the highest return on investment.

Inflexible cost structure

The current collective agreement with our largest union, the Canadian Union of Postal Workers (“CUPW”), does not permit the necessary flexibility to react to changes in the marketplace. The complex web of work rules contained in the collective agreement limit Canada Post’s ability to implement change. The job security and negotiated work rules contained in the collective agreement result in significant costs to the Corporation. The current agreement expires in early 2011.

Risk mitigation

Preparations for the next round of negotiations with the CUPW have commenced. As with any round of negotiations, terms of settlement will be sought that align to Canada Post’s financial and operational needs. We will also continue to find ways to achieve more flexibility in our work processes while leveraging our employee engagement strategies.

Culture and processes encumber modernization

Employee engagement and greater operational flexibility are critical to better serving our customers. Financial pressures, accentuated by impacts from the recession on mail volumes and the Pension Plan, necessitate that Canada Post carefully manage and reduce costs. These cost reductions pose a risk to enterprise-wide employee engagement.

Risk mitigation

Cultural risks continue to be addressed with increased communications with employees. This includes greater executive visibility through front-line visits and Regional Forums with operational staff to promote an understanding of our challenges and the need for transformation.

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 continuously addressing these risks and improving safety through Postal Transformation, the review of safety for rural delivery, and a variety of health and safety initiatives. To remain focused and promote continuous improvement on reducing the number of accidents suffered by employees, we invest in health and safety programs as part of a multi-year strategy that focuses on building safety leadership, and identifying, preventing and controlling hazards while offering training to employees. *For further information, see Section 4.4 – Workplace health and safety on page 59.*

Security and privacy

Breaches of the physical security of mail, customer information, contractors/partners information and employee information are of utmost concern to Canada Post. Canadians trust Canada Post to securely deliver approximately 11 billion pieces of mail each year. This trust is a very strong pillar in Canada Post’s brand reputation. An event that compromises Canada Post’s security could result in hardship for customers and serious damage to the company’s reputation.

Risk mitigation

The Corporation issues extensive security-related bulletins, and has clear policies and guidelines for employees. Numerous physical security measures are in place to protect the mail and postal facilities, including monitoring, access controls and physical layers of security. Canada Post continues to monitor activities and analyze data to ensure that appropriate resources are invested into physical and technical security. These investments continue to improve our processes to mitigate security risks and protect privacy. Privacy impact assessments are conducted to ensure that new technologies, information systems and initiatives adequately protect privacy. Recent investments to enhance security include fortified mailboxes, high-security locks and a new secure parcel delivery offering. We adhere to the Government of Canada Security Policy for the Management of Information Technology Security (MITS). Audits related to the information security of our multi-channel products are conducted frequently to mitigate risks.

Business continuity

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

Risk mitigation

Postal Transformation is a key response to business continuity risks and will provide major improvements to critical infrastructure to ensure the continuity of postal services. The company is also prepared for events such as pandemics, critical equipment failures, risks to our electronic infrastructure and other major events.

Environmental sustainability

Environmental concerns from customers could pose a threat to mail revenues and Canada Post's reputation. These issues are related to the way that Canada Post sorts, transports and delivers the mail, and also apply to the entire mail value chain. These concerns could affect our business in several ways, including decreased volumes in Direct Marketing products and requirements to use different transportation solutions. Furthermore, legislative policies on carbon emissions may emerge and could eventually affect Canada Post or our suppliers.

Risk mitigation – Canada Post

As part of our overall corporate social responsibility strategy, Canada Post is addressing environmental concerns through investments in Postal Transformation, other investments and changes to existing products. New buildings will be LEED certified and Canada Post will gradually replace its existing fleet with smaller, more fuel-efficient vehicles between 2010 and 2015. We are committed to continuously improving the way we conduct our business by following leading environmental and ethical business practices, and by monitoring North American and international developments regarding climate change legislation. Our continuous collaboration with the International Post Corporation on an Environmental Measurement and Monitoring System will help us monitor our own carbon emissions as well as emissions from our supply chain with a common set of internationally recognized indicators within the industry. This collaboration will also help us better understand the environmental impact of the mail. We are also promoting green best practices in the industry by working with mailers to minimize the environmental impact of their mailings.

Risk mitigation – Purolator

Purolator continues to be an industry leader with respect to investment in hybrid electric vehicles (HEVs) in its curbside delivery fleet. Currently, there are 205 pickup and delivery vans, and one five-ton vehicle on the road. The company continues to investigate new ways to reduce emissions through new technologies.

Attrition

Canada Post, like many Canadian companies, is currently facing attrition-related risks in the form of high rates of retirement and increased voluntary turnover caused by a tight labour market for specialized skills. This is a long-term problem for Canada Post as we anticipate that more than half of our current full-time employee population will leave over the next ten years. 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 strives to be an employer of choice through a global best practice framework for strategic workforce planning, improved working conditions and strong employee communications. The company is actively managing attrition risks and opportunities, and is focused on employee engagement, employment brand and recruitment, skills training and employee development, leadership development, knowledge transfer, and talent management.

Legal risk

Canada Post has assessed 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 against Canada Post that office clerks did not receive equal pay for work of equal value compared to postal clerks and letter carriers. The Human Rights Tribunal found Canada Post liable and ordered payment for lost wages, discounted by 50 per cent. Canada Post and PSAC appealed to the Federal Court Trial Division and, in February 2008, the Federal Court Trial Division allowed Canada Post’s appeal, referring the complaint back to the Tribunal with the direction that the complaint be dismissed as not substantiated according to the legal standard of proof. The Canadian Human Rights Commission and PSAC appealed this decision to the Federal Court of Appeal, where it was heard on November 3 and 4, 2009. By its decision of February 22, 2010, the Federal Court of Appeal dismissed the appeals of PSAC and the Canadian Human Rights Commission. PSAC and the Commission have 60 days from the date of the Court of Appeal’s decision to seek leave to appeal to the Supreme Court of Canada.

b) Volumetric process – Lee Valley Tools

A class-action suit was commenced in October 2006 in the Superior Court of Ontario, alleging that Canada Post violated the *Weights and Measures Act* based on Canada Post’s volumetric process. Examinations for discovery are continuing and the trial date is anticipated in 2011.

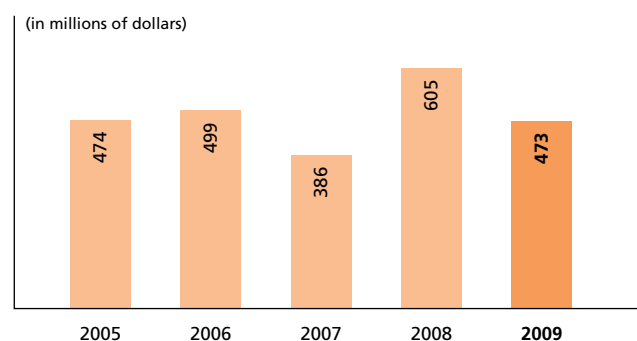
c) Air transportation procurement – Canadian North

On December 18, 2007, Canadian North filed a Statement of Claim, claiming that Canada Post conducted an unfair procurement of air transportation services to remote northern communities in relation to the Food Mail Program. Canadian North is seeking damages in the amount of \$75 million plus \$1 million in punitive damages. Examinations for discovery are expected to be held in early 2010.

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 \$473 million at the end of 2009 – a decrease of \$132 million, when compared with 2008, mainly due to the resumption of current service contributions to the Canada Post Pension Plan. From a segment perspective, the \$132-million decrease mostly arose from the Canada Post segment (\$162 million), partially offset by a \$33-million increase from the Purolator segment.

6.2 Operating activities

(in millions of dollars)	2009	2008	Change
Cash provided by operating activities	134	598	(464)

Canada Post generated \$134 million in cash from operating activities in 2009 – a decrease of \$464 million, when compared with 2008. Cash was provided primarily by the Canada Post segment (\$85 million) and the Purolator segment (\$52 million). The 2009 decrease in cash provided by operating activities was primarily due to a \$222-million reduction in working capital and a \$225-million increase in payments for pension, other retirement and post-employment benefits. The increase in payments for pension, other retirement and post-employment benefits is mainly due to the fact that employer pension contributions were only made for two months in 2008 compared to a full year in 2009 (in July 2007, employer contributions ceased due to the Canada Post Pension Plan’s surplus position at that time, but employer contributions recommenced in November 2008 due to the decreasing return on Plan assets).

6.3 Investing activities

(in millions of dollars)	2009	2008	Change
Cash used in investing activities	343	435	(92)

Cash used in investing activities decreased by \$92 million in 2009, when compared with 2008, primarily due to the following changes in investing activities:

- The Corporation's consolidated net position in short-term investments from normal cash management transactions decreased by \$48 million in 2009, compared to a \$36-million increase in 2008, resulting in a year-over-year decrease of \$84 million;
- Proceeds from the sale of capital assets increased by \$25 million;
- Cash used in business acquisitions and dispositions decreased by \$12 million.

The above decreases in investing activities were partially offset by the following:

- Investment in capital assets increased by \$21 million, as described below;
- Other investing activities increased by \$8 million.

Capital expenditures

(in millions of dollars)	2009	2008	Change
Canada Post	372	271	101
Purolator	41	117	(76)
Logistics	4	6	(2)
All Other and intersegment	(5)	(3)	(2)
The Canada Post Group	412	391	21

Capital acquisitions for The Canada Post Group increased by \$21 million in 2009, when compared with 2008.

- Canada Post segment capital expenditures increased by \$101 million in 2009, when compared with 2008, mainly due to the continued focus on Postal Transformation, which increased capital spending by \$115 million.

- Purolator segment capital expenditures totalled \$41 million in 2009 – \$76 million lower than in 2008. 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 2009, Purolator's investments focused on the completion of its latest automated hub in Richmond, B.C., the rollout of its new ergonomically friendly hand-held scanners that have the capacity to support future technology enhancements, and the completion of its Customer Contact Transformation project that provides employees with tools to better assist customers and enhanced self-serve options.

6.4 Financing activities

(in millions of dollars)	2009	2008	Change
Cash provided by financing activities	77	56	21

Cash flows provided by financing activities increased by \$21 million in 2009 (mainly from Purolator), when compared to 2008. The increase was primarily due to:

- A \$45-million increase in long-term borrowings in 2009, compared to 2008, mainly due to a subsidiary drawing \$44 million from a leasing facility at December 31, 2009;
- A \$22 million decrease in dividends paid to our Shareholder.

The above increases were partially offset by the following factors:

- Transitional support, received from the Government of Canada to assist with incremental costs incurred as a result of establishing the Canada Post Pension Plan, decreased by \$25 million in 2009. The declining transitional funding will end in 2010;
- Repayment of long-term debt increased by \$20 million.

6.5 Canada Post Pension Plan

The Canada Post Pension Plan is required to file periodic actuarial valuations with the Office of the Superintendent of Financial Institutions ("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 Pension Plan to eliminate this shortfall over five years.

On January 9, 2009, the Minister of Finance released a discussion paper on improving the framework for federally regulated private pension plans. The purpose of this paper was to solicit the views of Canadians on issues related to the legislative framework for federally regulated pension plans, including solvency measurement, funding and contribution holidays, with the objective of making permanent changes in 2009. On October 27, 2009, the Minister of Finance released a proposed reform plan for the federal private pension legislative and regulatory framework. The pension reform proposals have five principal objectives:

- reduce funding volatility for defined benefit plan sponsors;
- enhance protections for plan members;
- make it easier for participants to negotiate changes to their pension arrangements;
- improve the framework for defined contribution plans and negotiated pension plans; and
- modernize the rules for investments made by pension plans.

Measures to reduce funding volatility to allow pension plan sponsors to better manage their funding obligations within their overall business operations include introducing a new standard for establishing minimum funding requirements on a solvency basis. It will use average solvency ratios over three years, rather than only the current year, to determine minimum funding requirements. The measures will also permit the plan sponsor to use letters of credit to satisfy solvency payments up to a limit of 15 per cent of plan assets, and increase the pension surplus threshold under the *Income Tax Act*, to 25 per cent from 10 per cent. Actuarial valuations will be required annually regardless of the funded status of a pension plan. Some of the proposed changes can be introduced by changes to regulations while others will be implemented by legislation introduced in Parliament. The effective date of these changes is not known at this time.

The actuarial valuation for the Canada Post Pension Plan as at December 31, 2008, disclosed a going-concern deficit of \$1,211 million and a solvency deficit of \$1,161 million, as compared to a going-concern surplus of \$1,257 million and a solvency surplus of \$449 million as at December 31, 2007. In March 2009, OSFI issued a specification on asset values used in pension plan solvency valuations. The specification provides that smoothing of assets up to 110 per cent of the market value of net assets available for benefits is permitted in actuarial reports. Previously, OSFI did not limit actuarial asset value adjustments. In 2009, the Canada Post Pension Plan implemented the OSFI specification, resulting in a retrospective restatement of the previously reported December 31, 2008, actuarial estimate on a going-concern basis from a surplus of \$675 million to a deficit of \$1,211 million.

The Corporation will file an actuarial valuation for the Canada Post Pension Plan as at December 31, 2009, 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, 2009, when using smoothed value of Plan assets is a going-concern surplus of \$567 million and a solvency deficit of approximately \$2,007 million¹⁰. Despite earning 16.2 per cent on Plan assets in 2009, 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.

Based on the current solvency deficit estimate, the reintroduction of asset smoothing and legislation currently in place, the Corporation expects to make special payments to the Canada Post Pension Plan of approximately \$450 million in 2010. If the proposed pension measures become effective for the December 31, 2009, actuarial valuation, the Corporation may use a letter of credit to partially satisfy special payments up to the proposed limit of 15 per cent of Plan assets. Using a letter of credit would result in no special payments being required to the Canada Post Pension Plan in 2010. Management will consider the final form of the legislation, its liquidity position, and the financial costs and benefits in determining whether to pursue this option should it, in fact, become available.

¹⁰ Solvency deficit when using fair value of Plan assets is approximately \$3,370 million

Due to the then-surplus position of the Pension Plan, in June 2007, the Board of Directors of Canada Post authorized the recovery of special payments previously made to the Canada Post Pension Plan through a current service contribution holiday. In November 2008, we resumed current service contributions to the Canada Post Pension Plan totalling \$61 million in 2008. Our total current service contributions to the Canada Post Pension Plan in 2009 were \$269 million. The estimated amount of the 2010 current service contributions is approximately \$340 million.

As small changes in discount rates can significantly affect the results of actuarial valuations prepared on a solvency basis, 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

Canada Post manages \$1,933 million of capital, which includes equity of Canada, long-term debt and other long-term financial obligation.

As at December 31 (in millions of dollars)	2009	2008
Equity of Canada	1,787	1,507
Long-term debt	130	74
Other long-term financial obligation	16	19
Total capital	1,933	1,600

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, which replaces the 1998 Multi-Year Policy Framework, has been put into place with the objective of maintaining financial self-sustainability.

Given the significant and critical level of investment to be undertaken by Canada Post with Postal Transformation, a financial framework should reflect the changes in financial position as the Corporation manages through various stages of investment. These stages include: an investment phase, when the investment is at its highest level; a transitional phase, when the level of investment begins to diminish and the company begins to realize the benefits from Postal Transformation; and a steady-state phase, when investment is more maintenance in nature and the benefits are fully realized. The new Financial Framework establishes target ratio ranges for profitability, leverage, liquidity and dividend policy for each of the three upcoming investment stages. For the five-year plan period, the new Financial Framework is consistent with the investment-phase target ratios.

In addition to the key elements of financial sustainability noted above, 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

Canada Post requires sufficient liquidity to support our day-to-day operations. Management considers it prudent to maintain ongoing minimum, immediately available liquidity of \$200 million for these purposes.

In 2009, as in recent years, the liquidity required to support our financial obligations and fund capital and strategic requirements was provided by operations and accumulated funds. The Corporation began 2009 with \$1,059 million of cash equivalents and marketable securities (including segregated funds), which declined to \$886 million by year-end. As discussed in *Section 6.5 – Canada Post Pension Plan on page 68*, the special payments recovered through a current service contribution holiday totalled \$161 million in 2007 and \$212 million in 2008. Funds not contributed were segregated to make future special contributions to the Pension Plan or to assist with specific future cash flow requirements related to significant projects to renew the future operating capability of the Corporation. These segregated funds amounted to \$351 million at the start of 2009, which was reduced to \$143 million at year-end as funds were applied to significant projects during the year. The outlook is for cash equivalents and marketable securities (including segregated funds) to decline further in 2010 as funds are drawn upon to fund significant capital expenditures associated with Postal Transformation and special payments to the Pension Plan.

As discussed in Section 4.5 – Infrastructure – Canada Post on page 60, our investment plans over the next five years require capital investment of approximately \$2.3 billion, including \$1.4 billion of Postal Transformation and \$900 million of ongoing capital investment. These investments, combined with Pension Plan funding requirements and expected medium-term weakness in operating cash flows, mean it will be necessary for the Corporation to access capital markets in the coming years. As the year progresses, management will consider factors, such as credit market conditions, interest rate movements and revisions to 2010 and 2011 cash flow forecasts, in determining the amount of long-term debt it will issue during 2010. Canada Post will ensure that sufficient liquidity is maintained at all times by accessing capital markets, establishing operating lines of credit or other means, as appropriate.

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. 3) 1996-97*, borrowing from other than the Government of Canada's Consolidated Revenue Fund was limited to \$300 million. However *Appropriation Act No. 4, 2009-10*, which received royal assent on December 15, 2009, increased this limit to \$2.5 billion.

The Canada Post Group's borrowings amounted to \$130 million as at December 31, 2009. While the Corporation had only \$19 million of unused bank lines of credit available at December 31, 2009, management believes it can obtain all of our funding needs on a timely basis, up to the \$2.5-billion external financing limit, by arranging new bank lines of credit, accessing the commercial paper or long-term debt capital markets, or using specialized financing such as leasing.

The Corporation's subsidiaries and joint venture also have access to financing facilities totalling \$200 million as at December 31, 2009. Of this amount, \$69 million was drawn (\$25 million for operating purposes and \$44 million for the purchase of equipment), which was converted into capital leases in 2009. The subsidiaries' existing financing facilities terms have the potential to restrict upstream distributions or loans to the Corporation.

This move to fund major capital, Pension Plan and other business requirements through substantial borrowings is a new approach for the Corporation, to respond to the need for cash to carry out a major infrastructure investment at a time when revenues generated from operations are experiencing medium-term weakness. We will establish a detailed financing plan, compliant with the Minister of Finance Financial Risk Management Guidelines for Crown Corporations, which specifies the forms, timing, amounts, terms and costs of planned borrowings. The Corporation is confident that the appropriate oversight mechanisms are in place to ensure that borrowing activities are appropriate and affordable. 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.

Dividends

In accordance with the 1998 Multi-Year Policy Framework, the Corporation has historically paid an annual dividend to the Shareholder equal to 40 per cent of the prior year's consolidated net income. However, the Corporation did not pay a dividend in 2009 in respect of 2008 earnings. The Government of Canada has approved the Corporation's proposal not to pay a dividend in 2010 in respect of 2009 earnings. Dividends paid over the past five years total \$208 million.

(in millions of dollars)	2009	2008	2007	2006	2005
Consolidated net income	281	90	54	119	199
Dividend paid	0	22	47	80	59

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	2009				
	Available for sale	Held for trading	Loans and receivables	Other liabilities	Total
Financial assets					
Cash and cash equivalents (note 7)	–	473	–	–	473
Marketable securities (note 7)	–	270	–	–	270
Accounts receivable (note 6)	–	–	586	–	586
Segregated securities (note 7)	638	16	–	–	654
Other assets (note 7)	–	4	–	–	4
	638	763	586		1,987
Financial liabilities					
Non-interest-bearing* (note 6)	–	–	–	720	720
Long-term debt (note 13)	–	–	–	130	130
				850	850

* 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 2009 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 other prices, including commodities.

a) Interest rate risk

The Corporation's investment policy for cash and segregated financial assets carries a low probability of default. Therefore, the value and timing of cash flows (interest- and principal-related) can be 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 other than illiquid securities, extending terms to maturity to better match certain long-term post-retirement obligations to which they are externally restricted. The maximum duration in the portfolio was 10 years

as at December 31, 2009 (2008 – 92 days). The increase in term to maturity is attributable to the Corporation's increased use, as a risk management strategy, of longer terms to maturity for segregated securities.

Based on a sensitivity analysis of interest rate risk, it is expected that an increase or decrease of one per cent in market interest rates, with all other variables held constant, would increase or decrease the value of the segregated securities (excluding Master Asset Vehicle II notes) by \$35 million, which would represent a significant impact on the fair value of the Corporation's investments at December 31, 2009. 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 \$130 million (2008 – \$74 million) includes fixed rate debt without prepayment options, a credit facility with a variable rate at prime plus 1.5 per cent and capital lease obligations.

b) Foreign currency risk

The Corporation's exposure to foreign currency risk arises primarily from international settlements with foreign postal administrations and from the redemption of money orders denominated in foreign currencies. The obligation to settle with foreign postal administrations is denominated in Special Drawing Rights (SDRs) – a basket of currencies comprising the U.S. Dollar ("US\$"), Japanese Yen, Sterling and Euro, whereas payment is usually denominated in US\$ or, in some circumstances, the Euro. The principal exposure is to the US\$. The effect of a

10 per cent increase or decrease in the US\$ exchange rate on the net overall exposure after matching associated US\$ payables and receivables at the balance sheet date, and with all other variables held constant, would have increased or decreased net income for the year by \$6 million. There is no significant impact on net income arising from exposures to other currencies. Net exchange losses included in revenue amounted to \$5 million in 2009 (2008 – \$13 million of net exchange gains).

c) Price risk

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

Credit risk

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

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

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

Credit risk arising from investments is mitigated by investing with issuers who meet specific criteria and by imposing dollar limits by financial product type and debt issuer. Investments in financial institutions and corporations must have minimum ratings from two external rating agencies that are equivalent to DBRS ratings of R-1(middle) for short-term investments and A for long-term investments. The Corporation regularly reviews the credit ratings of issuers with whom the Corporation holds investments and, where an active market exists, disposes of investments within a specified time period when the issuer's credit rating declines below acceptable levels. Impairment losses on investments recognized during the year were \$2 million (2008 – \$9 million) as described in *note 7 to the consolidated financial statements on page 121*.

Credit risk associated with accounts receivable from wholesale and commercial customers is mitigated by the Corporation's large customer base, which covers substantially all business sectors in Canada. The Corporation follows a program of individual customer credit evaluation based upon financial strength and payment history, and limits the amount of credit extended when deemed necessary. The Corporation monitors customer accounts against these credit limits and the aging of past-due invoices. The Corporation establishes an

allowance for doubtful accounts that reflects the estimated impairment of accounts receivable. A general provision is estimated based on prior experience with, and the past-due status of, doubtful debtors while large accounts are assessed individually based on factors that include ability to pay and payment history.

Credit risk attributable to receivables from foreign postal administrations, other than the United States Postal Service ("USPS"), is generally mitigated by offsetting accounts payable to foreign postal administrations on an individual country basis, under the provisions of the Universal Postal Union. Amounts receivable from and payable to the USPS are settled independently under the bilateral agreement between Canada Post Corporation and the USPS. Estimates of receivables and payables, including monthly provisional payments, are based on statistics in 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 impairment of receivables from specific foreign postal administrations based on the period past due after billing of the final settlement.

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

On January 21, 2009, under the oversight of the Ontario Superior Court and as proposed by the Pan American Investors Committee, the non-bank-sponsored asset-backed commercial paper (ABCP) programs were restructured under the Montreal Accord. Upon restructuring, the Corporation elected to receive various classes of MAV II notes with an equivalent face value of \$38 million and an estimated fair value of \$22 million. At December 31, 2009, the carrying value of the MAV II notes was further adjusted to an estimated fair value of \$20 million (2008 – \$22 million). Further details on MAV II notes are provided in *note 7 to the consolidated financial statements on page 121*.

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 13 and 16 to the consolidated financial statements on pages 136 and 139, respectively*.

(in millions of dollars)	Total	< 1 year	1–3 years	3–5 years	> 5 years
Long-term debt*	55	–	–	–	55
Interest on long-term debt @ 10.35%	38	6	11	11	10
Capital lease obligations	55	12	19	19	5
Other long-term borrowings**	25	–	25	–	–
Operating leases***	1,109	143	230	143	593
Postal Transformation contractual obligations****	306	114	163	29	–
Total	1,588	275	448	202	663

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

** Other long-term borrowings include a three-year revolving term credit facility. The principal is not due until maturity

*** 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 19 to the consolidated financial statements on page 143*, 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.

Upon expiration or termination of certain agreements with Innovapost, 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, 2009, and December 31, 2008

(in millions of dollars)

ASSETS	2009	2008	Change	%	Explanation of change
Cash and cash equivalents (note 7)	473	605	(132)	(21.9) %	Refer to section 6 – Liquidity and Capital Resources on page 67
Marketable securities (note 7)	270	103	167	162.8 %	Primarily maturing cash equivalents reinvested in marketable securities to enhance returns
Accounts receivable	586	575	11	1.8 %	Primarily increased international settlements receivable for Canada Post and increased trade receivables for SCI Group Inc.
Income tax recoverable	69	7	62	838.5 %	Primarily due to an expected refund of Canada Post's and Purolator's 2009 tax installments as well as an expected refund generated by a loss carry-back for Canada Post
Prepaid expenses	74	71	3	3.6 %	Primarily increased prepaids for Canada Post and Innovapost
Current portion of future income tax assets (note 8)	25	23	2	12.7 %	Primarily due to a net increase in temporary differences of Canada Post's short-term liabilities and provisions
Total current assets	1,497	1,384	113	8.1 %	
Segregated securities (note 7)	654	862	(208)	(24.1) %	Primarily due to a reduction of internally restricted funds to fund transformation activities
Property, plant and equipment (note 9)	2,047	1,881	166	8.8 %	Primarily Canada Post and Purolator capital acquisitions for transformation and replenishment in excess of amortization
Intangible assets (note 9)	169	153	16	10.8 %	Primarily software assets
Accrued pension benefit asset (note 10)	1,335	898	437	48.8 %	Primarily attributable to employer contributions made during the year as well as the 2009 negative pension expense, primarily due to change in discount rates at the end of last year, which affected current year costs
Future income tax assets (note 8)	179	270	(91)	(33.8) %	Primarily due to a net decrease in temporary differences related to Canada Post's Registered Pension Plan asset, employee future benefits liability and capital assets
Goodwill (note 11)	125	124	1	1.0 %	Due to a 2009 contingent payment related to SCI Group Inc.'s acquisition of The AMG Group in 2007
Other assets (note 12)	23	19	4	22.9 %	Mainly due to an increase in assets held for sale
Total assets	6,029	5,591	438	7.8 %	

Financial Condition (continued)

(in millions of dollars)

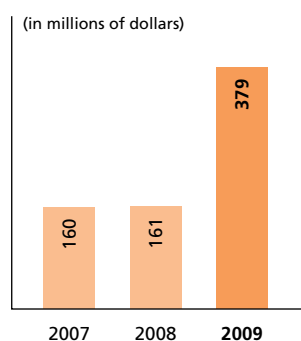
LIABILITIES AND EQUITY	2009	2008	Change	%	Explanation of change
Accounts payable and accrued liabilities	413	469	(56)	(11.9) %	Primarily decreased trade payables due to lower spending
Salaries and benefits payable	575	509	66	12.9 %	Mainly increased restructuring costs and accrued salaries for days outstanding
Income tax payable	2	16	(14)	(88.2) %	Primarily due to a net decrease in taxes payable by Canada Post, Purolator and Innovapost
Deferred revenue	142	145	(3)	(2.1) %	Decreased customer prepayments of services and decreased deferral for meter sales, partially offset by increased deferral for stamp and parcel sales
Outstanding money orders	37	42	(5)	(11.9) %	Primarily reduction in exchange provision for U.S. dollar money orders and increased provision for unredeemed money orders
Current portion of long-term debt (note 13)	10	0	10	2,547.1 %	\$7-million increase from a subsidiary's principal repayment of its capital lease obligation and \$3-million increase from Canada Post's principal repayment for leased computers
Total current liabilities	1,179	1,181	(2)	(0.2) %	
Long-term debt (note 13)	120	74	46	63.5 %	Primarily due to a subsidiary drawing \$44 million from a leasing facility at December 31, 2009
Accrued pension, other retirement and post-employment benefit liability (note 10)	2,835	2,722	113	4.2 %	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 8)	36	30	6	17.5 %	Primarily due to an increase in temporary differences in Purolator's employee future benefit liability and capital assets
Other long-term liabilities	43	51	(8)	(15.6) %	Primarily due to a reduction in SCI Group's deferred revenue and a reduction in Purolator's other long-term liabilities
Total liabilities	4,213	4,058	155	3.8 %	
Non-controlling interest	29	26	3	11.6 %	Minority interest on net income of Purolator
Equity of Canada	1,787	1,507	280	18.6 %	Consolidated net income of \$281 million, primarily from Canada Post and Purolator
Total liabilities and equity of Canada	6,029	5,591	438	7.8 %	

8 Results from Operations

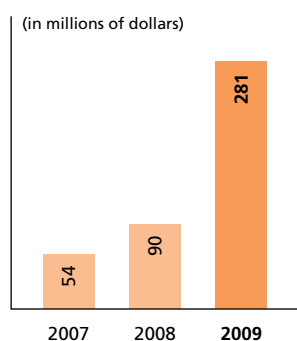
A detailed discussion of our financial performance in 2009

8.1 Consolidated trends

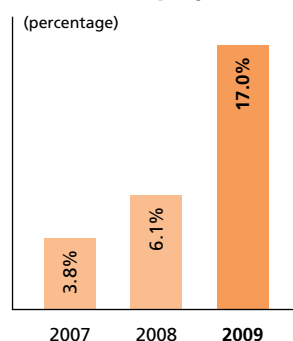
Consolidated income before income taxes



Consolidated net income



Return on equity



8.2 Consolidated results from operations

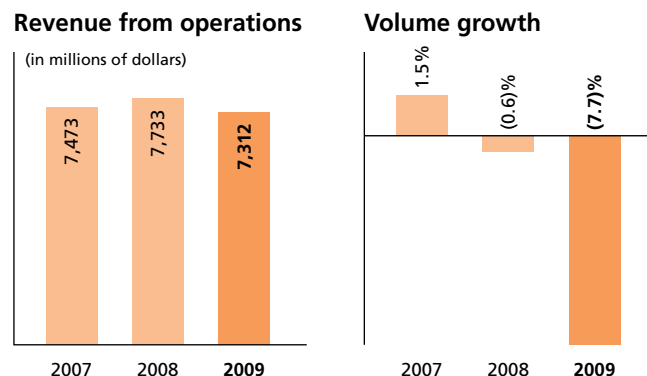
Consolidated income statement

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	7,312	7,733	(421)	(5.1) %
Cost of operations	6,955	7,594	(639)	(8.4) %
Income from operations	357	139	218	155.0 %
Non-operating income (expense)	22	22	0	1.1 %
Income before income taxes	379	161	218	134.3 %
Income tax expense	95	67	28	41.8 %
Non-controlling interest	3	4	(1)	(30.0) %
Net income	281	90	191	210.4 %
Return on equity	17.0%	6.1%	10.9%	

The Canada Post Group reported consolidated net income of \$281 million in 2009 – an increase of \$191 million, when compared with 2008. Despite a significant drop in revenues caused by the 2009 recession, income from operations increased by \$218 million, mainly due to the Corporation's ability to offset the revenue shortfall with cost containment and due to a decrease in employee future benefits costs (primarily due to increases in discount rates used in the actuarial computation).

Consolidated revenue from operations



Revenue from operations declined by \$421 million or 5.1 per cent in 2009, when compared with 2008, driven primarily by volume declines across all major product lines within the Canada Post segment, and decreased fuel surcharge revenue and lower shipping and handling revenue within the Purolator segment. A detailed discussion of revenue by segment follows.

Consolidated cost of operations

Cost of operations decreased by \$639 million or 8.4 per cent, when compared with 2008, mainly due to cost-containment activities, organizational restructuring, cuts to discretionary spending, lower volumes and operational efficiencies, and a reduction in employee future benefits expense in the Canada Post segment largely related to an increase in the discount rate for accounting purposes. A detailed discussion of cost of operations by segment follows.

Consolidated non-operating income (expense)

Non-operating income was flat in 2009, when compared to 2008, mainly due to lower investment revenue being partially offset by higher gains on the sale of capital assets and lower expense at Purolator due to periodic valuations of their employee share ownership plan.

Consolidated income tax expense

Consolidated income tax expense increased by \$28 million or 41.8 per cent, due in large part to a significant increase of Canada Post's income before income taxes. Furthermore, a disparity between short-term and long-term tax rates combined with the use of previously unrecognized losses in 2008 also contributed to the increase.

8.3 Operating results by segment

The year 2009 has been one of our most difficult years with declines in most segments, when compared to 2008, except for the Canada Post segment where income before income taxes increased by \$253 million.

Segmented results – Income before income taxes

(in millions of dollars)	2009	2008	2007	2006	2005
Canada Post	319	66	78	99	250
Purolator	53	91	84	69	57
Logistics	9	13	6	(1)	(7)
All Other	15	15	8	2	(5)
Intersegment and unallocated	(17)	(24)	(16)	(3)	(13)
The Canada Post Group	379	161	160	166	282

8.4 Canada Post segment

The Canada Post segment contributed \$319 million of income before taxes to the 2009 consolidated results – an increase of \$253 million, when compared with 2008.

Negative pressure on revenue growth caused by the recession was somewhat mitigated through aggressive cost containment and operational efficiencies, which reduced planned expenditures by \$540 million. A reduction in employee future benefits expense in the Canada Post segment also affected results, primarily non-cash and largely related to an increase in the discount rate for accounting purposes (\$271 million unplanned). As discount rates are determined by reference to market conditions and could significantly change in future years, the majority of the 2009 year-over-year reduction in employee future benefits expense is not an indicator of the expected level of this expense in the future.

The decrease in non-operating income was due mainly to lower investment revenue and lower dividend income from our subsidiaries, partially offset by higher gains on the sale of capital assets.

Canada Post summary

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	5,840	6,108	(268)	(4.0) %
Cost of operations	5,560	6,088	(528)	(8.7) %
Income from operations	280	20	260	1,334.8 %
Non-operating income (expense)	39	46	(7)	(17.0) %
Income before income taxes	319	66	253	384.1 %

Revenue from operations

Canada Post generated revenue from operations of \$5,840 million in 2009 – a decrease of \$268 million or 4.0 per cent, when compared to 2008. Volumes were down across all major product lines. The \$268-million revenue decrease was comprised of a \$86-million decrease in revenue from Transaction Mail, a \$43-million decrease in revenue from Parcels, a \$123-million decrease in revenue from Direct Marketing, and a \$16-million decrease 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)			
	2009	2008	Change	%	2009	2008	Change	%
Transaction Mail								
Domestic/Outbound	3,024	3,108	(84)	(2.3) %	4,829	5,045	(216)	(3.9) %
Inbound	124	126	(2)	(1.2) %	246	274	(28)	(9.8) %
Total Transaction Mail	3,148	3,234	(86)	(2.3) %	5,075	5,319	(244)	(4.2) %
Parcels								
Domestic/Outbound	1,128	1,164	(36)	(2.7) %	115	122	(7)	(5.8) %
Inbound	140	147	(7)	(4.4) %	33	37	(4)	(10.6) %
Total Parcels	1,268	1,311	(43)	(2.9) %	148	159	(11)	(6.9) %
Direct Marketing								
Addressed Admail	569	635	(66)	(10.1) %	1,301	1,503	(202)	(13.1) %
Unaddressed Admail	380	399	(19)	(4.3) %	3,640	4,061	(421)	(10.0) %
Publications Mail™	259	289	(30)	(9.9) %	471	522	(51)	(9.4) %
Other	100	108	(8)	(6.9) %	37	56	(19)	(34.1) %
Total Direct Marketing	1,308	1,431	(123)	(8.2) %	5,449	6,142	(693)	(10.9) %
Other revenue	116	132	(16)	(11.4) %	–	–	–	–
Total	5,840	6,108	(268)	(4.0) %	10,672	11,620	(948)	(7.8) %

Transaction Mail

Total 2009 Transaction Mail revenue of \$3,148 million is comprised of the following four product categories: domestic Lettermail (\$2,836 million); international outbound letter mail (\$146 million); international inbound letter mail (\$124 million); and other (\$42 million).

Total 2009 Transaction Mail revenue declined by \$86 million, compared to 2008. This revenue erosion represents a year-over-year decrease of 2.3 per cent. The revenue decline was driven by a recession-influenced volume reduction of 4.2 per cent over last year, partially offset by an increase in the average revenue per piece of 2.7 per cent. Year-over-year changes are broken down by product category as follows:

- Domestic Lettermail revenue declined by \$78 million or 2.3 per cent, compared with 2008. The revenue decline was due to volume declines of 4.0 per cent, partially offset by price increases as the average revenue per piece increased by 2.4 per cent.
- International outbound mail revenue improved by \$1 million or 1.2 per cent, compared to the previous year, as a result of a 2.5 per cent improvement in outbound volumes.
- International inbound mail 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 \$2 million or 1.2 per cent, due to a 9.8 per cent recession-driven volume decline mostly from the U.S., partially offset by price increases as the average revenue per piece increased by 6.0 per cent.
- Other Transaction Mail service revenue declined by \$7 million or 14.5 per cent, compared to 2008.

Parcels

Total 2009 Parcels revenue of \$1,268 million is comprised of four product categories: domestic parcels (\$887 million); international outbound parcels (\$193 million); international inbound parcels (\$140 million); and other (\$48 million).

Total 2009 Parcels revenue declined by \$43 million, representing a decrease of 2.9 per cent, compared to 2008. The revenue decline was driven by a volume reduction of 6.9 per cent, partially offset by an increase in the average revenue per piece of 4.2 per cent. Year-over-year changes are explained below by product category:

- Domestic parcels revenue declined by \$26 million or 2.5 per cent, compared with 2008. The revenue decline was accompanied by a volume decline of 5.8 per cent. These decreases were primarily driven by the recession, a steep volume decline in premium products, such as Xpresspost, insufficient growth in the competitively priced commercial Expedited Parcel product as well as decreased fuel surcharge revenue.
- International outbound parcel revenue decreased by \$7 million or 3.2 per cent, compared to the previous year. A 6.2 per cent corresponding reduction in outbound parcel volumes was driven by weak U.S. economic conditions.
- International inbound parcel revenue declined by \$7 million or 4.4 per cent. The 2009 revenue decline was caused by a 10.6 per cent reduction in volumes, partially offset by a 6.5 per cent increase in the average revenue per piece.
- Other Parcels revenue declined by \$3 million or 4.6 per cent, compared to 2008.

Direct Marketing

Total 2009 Direct Marketing revenue of \$1,308 million is comprised of the following four product categories: Addressed Admail (\$569 million); Unaddressed Admail (\$380 million); Publications Mail (\$259 million); and other (\$100 million).

Total 2009 Direct Marketing revenue decreased by \$123 million or 8.2 per cent, over the prior year. The revenue decline was partly offset by a 2.7 per cent increase in the average revenue per piece. Overall volumes decreased by 10.9 per cent, which was experienced by all core products. The recession had a severe impact on advertising budgets and continued to cause declines across all key industry sectors in 2009. The financial services and the retail and manufacturing sectors were most affected by these market conditions

and significantly reduced their level of spending on direct marketing compared to previous years. Year-over-year changes by product category are summarized as follows:

- Addressed Admail revenue eroded by \$66 million or 10.1 per cent, compared to 2008. The revenue decline was due to year-over-year volume erosion of 13.1 per cent offset by a 3.5 per cent increase in average revenue per piece.
- Unaddressed Admail revenue decreased by \$19 million or 4.3 per cent, compared to the previous year. The revenue decline was mainly due to volume erosion of 10.0 per cent, which was offset by a 6.3 per cent increase in the average revenue per piece.
- Publications Mail revenue eroded by \$30 million or 9.9 per cent over the prior year. The revenue decline was caused by volume erosion of 9.4 per cent, combined with a 0.6 per cent reduction in the average revenue per piece due to a reduction in average weight per piece.
- Other Direct Marketing revenue declined by \$8 million or 6.9 per cent, compared to 2008.

Other revenue

Other revenue decreased by \$16 million or 11.4 per cent in 2009, when compared to 2008. The strengthening of the Canadian dollar resulted in foreign exchange losses of \$5 million from settlements with other postal administrations (compared with foreign exchange gains of \$9 million in 2008).

Cost of operations

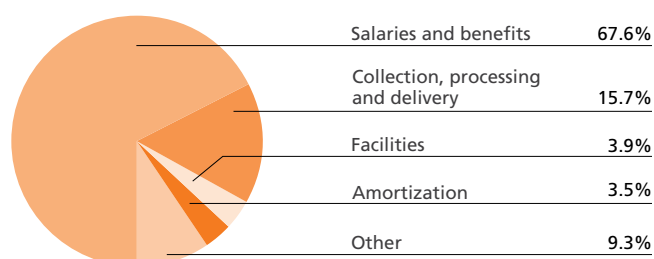
In 2009, the Canada Post segment's cost of operations totalled \$5,560 million – a decrease of \$528 million or 8.7 per cent, over the prior year.

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Salaries	3,294	3,318	(24)	(0.7) %
Benefits	462	785	(323)	(41.1) %
Total salaries and benefits	3,756	4,103	(347)	(8.4) %
Collection, processing and delivery	872	936	(64)	(6.8) %
Facilities	219	217	2	0.7 %
Amortization	196	191	5	2.7 %
Other	517	641	(124)	(19.4) %
Total	5,560	6,088	(528)	(8.7) %

The chart below shows the breakdown of costs as a percentage of total cost of operations. Salaries and benefit costs comprise 67.6 per cent of the total cost, demonstrating the labour-intensive nature of the business.

Cost of operations – 2009



Cost of operations	2009	2008	2007
Salaries and benefits	67.6%	67.4%	68.6%
Collection, processing and delivery	15.7%	15.4%	11.3%
Facilities	3.9%	3.6%	3.6%
Amortization	3.5%	3.1%	3.0%
Other	9.3%	10.5%	13.5%

Salaries

The cost of salaries decreased by \$24 million or 0.7 per cent, when compared with 2008, despite \$41 million of restructuring charges and regular salary increases. By focusing on quality and process improvements as mail volumes declined in 2009, the Corporation was able to reduce labour costs by decreasing the size of the work force via organizational restructuring and attrition and through less use of temporary labour and overtime, where paid hours were reduced by 4.6 million in our collection, processing and delivery operations.

Benefits

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Pension expense	(126)	131	(257)	(196.2)%
Retirement health benefits	138	219	(81)	(37.1)%
Other employee future benefits	86	96	(10)	(11.0)%
Interest on segregated assets	(7)	(10)	3	33.4%
Transitional funding	(56)	(81)	25	30.8%
Total employee future benefits	35	355	(320)	(90.3)%
Active employee benefits	425	430	(5)	(1.0)%
Other	2	0	2	269.5%
Net benefit costs	462	785	(323)	(41.1)%

Net benefit costs for employees decreased by \$323 million or 41.1 per cent, when compared with 2008, as detailed below.

- Non-cash pension expense was \$257 million or 196.2 per cent lower than 2008, mainly due to an increase in the discount rate from 5.6 per cent to 7.5 per cent.
- Non-cash post-retirement health benefits expense declined by \$81 million or 37.1 per cent, primarily due to an increase in the discount rate from 5.5 per cent to 7.6 per cent.
- Other employee future benefits expense decreased by \$10 million or 11.0 per cent, mainly attributable to higher discount rates in 2009, when compared to 2008.
- Employee future benefits expense was partially offset by interest on segregated assets, which declined by \$3 million or 33.4 per cent, compared to the prior year. The 2009 decline was due to a significantly lower rate of return for money market and fixed income instruments.
- Employee future benefits expense was also reduced by transitional funding from the Government of Canada, which decreased by \$25 million or 30.8 per cent in 2009. As described further in *note 2 to the consolidated financial statements on page 108*, 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 will end in 2010.
- Benefits expense for active employees decreased by \$5 million or 1.0 per cent in 2009, when compared to the prior year, due to a reduction in the number of active employees and the elimination of the Alberta Health Premium.

Collection, processing and delivery

Contracted collection, processing and delivery costs decreased by \$64 million or 6.8 per cent, when compared with 2008.

- Transportation costs decreased by \$34 million, due to continuous improvement initiatives and reduced fuel costs.
- Rural mail delivery costs decreased by \$12 million, mainly due to the reduced use of contractors to cover rural routes as a result of increased staffing levels.
- Automotive services decreased by \$6 million, primarily due to reduced fuel costs.
- International settlements decreased by \$6 million, due to lower outbound volumes.
- Urban delivery costs decreased by \$4 million, mainly due to lower volumes and cost control.

Facilities

The cost of facilities increased by \$2 million to \$219 million or 0.7 per cent, primarily due to increases in maintenance and repairs.

Amortization and impairment

Amortization expense increased by \$5 million to \$196 million or 2.7 per cent, when compared with 2008, mainly due to increased capital acquisitions, offset by a change in useful life estimate for vehicles that reduced 2009 amortization expense by \$11 million.

Other expense

Total other expense, which includes information technology, administration, program expense, selling and other costs, decreased by \$124 million or 19.4 per cent, due to cost reduction and containment initiatives implemented in 2009.

8.5 Purolator segment

The Purolator segment contributed \$53 million to 2009 consolidated income before income taxes, a decrease of \$38 million, when compared with 2008.

Purolator summary

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	1,433	1,567	(134)	(8.2) %
Cost of operations	1,380	1,472	(92)	(6.2) %
Income from operations	53	95	(42)	(43.9) %
Non-operating income (expense)	(0)	(4)	4	83.4 %
Income before income taxes	53	91	(38)	(41.7) %

Revenue from operations

Purolator revenue from operations decreased by \$134 million or 8.2 per cent in 2009, when compared with 2008. This decline was primarily attributed to the challenging economic environment and severe competition that led to a decrease in volumes across various lines of business and to reduced fuel surcharge revenue. Revenues were also affected by changes in customer behaviour (shift from express to extended delivery and from air to ground transportation).

Revenue from Purolator Freight™ was flat, when compared to the prior year. However, the Purolator USA division was affected by a more severe economic downturn in the U.S. and witnessed a significant decline in its volumes. Collaboration between Purolator and Canada Post has continued to contribute to synergies in air cargo volumes.

In this challenging economic environment, maintaining service levels continues to be a key focus. Purolator's brand value is based on its premium service and will provide a foundation for future growth as the economy recovers.

Cost of operations

In 2009, the cost of operations decreased by \$92 million or 6.2 per cent, when compared to 2008. As a result of the decline in revenues, Purolator focused on cost containment in 2009. Areas of focus included wages, ground line haul costs and air transport costs, as explained below.

- Purolator streamlined the management team and refocused its efforts. Ground line haul costs were reduced through lower fuel prices, load consolidation, route reductions and the use of long combination vehicles.
- Air transport costs were reduced, partially due to a decline in volumes, lower fuel prices and efficiencies introduced into the air network. Both Purolator Freight and Purolator USA reduced their costs in response to the decline in volumes.

8.6 Logistics segment

The Logistics segment includes the consolidated financial results of SCI Group. The Logistics segment contributed \$9 million to 2009 consolidated income before income taxes, a decrease of \$4 million compared to the prior year.

Logistics summary

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	151	156	(5)	(3.2) %
Cost of operations	141	143	(2)	(1.8) %
Income from operations	10	13	(3)	(24.5) %
Non-operating income (expense)	(1)	0	(1)	(154.3) %
Income before income taxes	9	13	(4)	(27.8) %

Income before income taxes by entity

Increase (decrease)

(in millions of dollars)	2009	2008	Change
SCI Group	10	14	(4)
Other	(1)	(1)	0
Total segment	9	13	(4)

SCI Group (SCI)

SCI's financial performance declined in 2009 with income before income taxes of \$10 million, a decrease of \$4 million, when compared with 2008.

Revenue from operations decreased by \$5 million, primarily due to client volume reductions and account attrition. It should be noted that there was a change in revenue recognition for a transportation client in 2009. In prior years, this clients' revenue was recognized at net, but due to contract changes, the revenue is now recognized at gross. This change added \$6.5 million to 2009 revenue and had no impact on earnings. In 2009, 37 per cent of SCI's revenue was derived from its largest customer (2008 – 40 per cent).

Cost of operations decreased by \$2 million in 2009, when compared with 2008. This decrease was attributable to a reduction in operational expenses for warehouse supplies as well as a reduction in professional services. This decrease was offset by a restructuring program for corporate overhead that cost \$0.5 million and increased transportation expenses due to a change in revenue recognition as noted above.

8.7 All Other segment

The All Other segment includes the financial results of Innovapost and Canada Post International Limited (CPIL). Virtually all of Innovapost's services are provided to The Canada Post Group. Accordingly, the Corporation's proportionate share of Innovapost's 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 \$153 million (2008 – \$158 million).

All Other summary

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	168	176	(8)	(4.4) %
Cost of operations	153	162	(9)	(5.3) %
Income from operations	15	14	1	1.6 %
Non-operating income	0	1	(1)	(79.9) %
Income before income taxes	15	15*	(0)	(1.7) %

* 2008 income before income taxes includes a loss of \$1 million from CPIL

Innovapost

Increase (decrease)

(in millions of dollars)	2009	2008	Change	%
Revenue from operations	168	173	(5)	(2.3) %
Cost of operations	153	158	(5)	(3.1) %
Income from operations	15	15	0	1.9 %
Non-operating income	0	1	(1)	(80.8) %
Income before income taxes	15	16	(1)	(3.6) %

Innovapost's financial performance in 2009 was stable, compared to the prior year, with income before income taxes of \$15 million.

Revenue from operations decreased by \$5 million, mainly due to lower infrastructure support and application development revenues from Canada Post. Cost of operations decreased by \$5 million in 2009, when compared to 2008. This decrease was due to reductions in administration expenses and head count.

9 Critical Accounting Estimates and Accounting Policy Developments

A review of critical accounting estimates and changes in accounting policies in 2009 and future years

9.1 Critical accounting estimates

Our significant accounting policies are described in *note 2 to the consolidated financial statements on page 108*. 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 108*. 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 2009, management undertook an assessment of the estimated remaining useful life of its major asset classes to be more closely aligned with the requirements of International Financial Reporting Standard IAS 16 "Property, Plant and Equipment." As a result of this review, estimated useful lives for several classes of vehicles were extended on a prospective basis in 2009. The extensions were made 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 16 to the consolidated financial statements on page 139*.

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 that the accounting estimates related to its employee benefit plan costs are critical accounting estimates because: (1) the amounts are based on complex actuarial calculations using several assumptions; and (2) given the magnitude of the estimated costs, differences in actual results or changes in assumptions could materially affect the consolidated financial statements.

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

- **Discount rates** – The Group's discount rate assumptions, which are set annually at the measurement date, are used to determine the present value of the projected benefit obligation at the end of the year and the net periodic benefit cost for the following year. The discount rate is used to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments with a rating of AA or better, would provide the necessary cash flows to pay for the benefit plans as they become due. The actuary determines the discount rate using a yield curve approach, which is based on pricing and yield information for high-quality AA-rated corporate bonds. The selected discount rate will have a cash flow pattern that resembles that of the plan being valued. The actuary determines the future benefit payments based on assumptions, which include the respective plans' demographics, retirees' profile and medical trend.
- **Expected long-term rate of return on plan assets** – The expected rate of return on plan assets assumption is based on the statement of investment policies and procedures. It is a long-term assumption for which the accuracy can only be measured over a long period based on past experience. The investment strategy for the assets in the pension plans is to maintain a diversified portfolio of assets, invested in a prudent manner to maintain the security of funds while maximizing returns within the guidelines provided in the investment policy.
- **Projected salary increases** – The rate of compensation increase is another significant assumption in the measurement of the accrued benefit obligation for pension benefit plans and some of the other non-pension benefit plans. The short-term assumptions for projected salary increases are as reflected in the current active collective agreements; otherwise an 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 10 to the consolidated financial statements on page 127*, 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:

(in millions of dollars)	Change in assumption	
	Increase	Decrease
Change in discount rate of 50 basis points		
Increase (decrease) in annual pension expense	(97)	107
Increase (decrease) accrued pension obligation	(865)	964
Change in expected return on plan assets of 50 basis points		
Increase (decrease) in annual pension expense	(75)	75

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

(in millions of dollars)	Change in assumption	
	Increase	Decrease
Change in discount rate of 50 basis points		
Increase (decrease) in annual health care expense	(6)	9
Increase (decrease) accrued health care obligation	(139)	156
Change in health care cost trend rates of 100 basis points		
Increase (decrease) in annual health care expense	60	(38)
Increase (decrease) accrued health care obligation	330	(263)

For further details on our annual expense and obligation, see *note 10 to the consolidated financial statements on page 127*.

Income taxes

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

Future income tax assets and liabilities are comprised of temporary differences between the carrying amount and tax basis of assets and liabilities as well as tax losses carried forward. The timing of the reversal of the temporary differences is estimated, and the tax rate substantively enacted for the period of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are based upon the amounts recorded in the consolidated financial statements and are therefore subject to accounting estimates that are inherent in those balances. The Corporation has significant deductible temporary differences. However, future tax assets have only been recorded to the extent that they are more likely than not to be realized. The deductible temporary differences that are not expected to reverse relate mainly to the accrued other retirement and post-employment benefit liability. See *note 8 to the consolidated financial statements on page 125*.

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

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

9.2 Accounting policy developments

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

Adoption of new accounting standards

The Canada Post Group has prospectively adopted the following CICA accounting standards effective January 1, 2009.

Goodwill and intangible assets

Commencing with the 2009 fiscal year, the Corporation adopted the recommendations of CICA Section 3064 "Goodwill and Intangible Assets," which replaced CICA Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs." The Accounting Standards Board (AcSB) also amended CICA Section 1000 "Financial Statement Concepts" and Accounting Guideline AcG 11 "Enterprises in the Development Stage." The new and amended guidance clarifies that costs incurred on the acquisition or development of intangible resources may only be deferred when they relate to an item that meets the definition of an intangible asset. The practice of matching revenues and expenses remains appropriate only for allocating the cost of an intangible asset that is consumed in generating revenue over multiple reporting periods. Section 3064 provides extensive guidance on the types of expenditures that qualify for recognition as intangible assets.

These adopted recommendations did not have any effect on financial results.

Credit risk and the fair value of financial assets and financial liabilities

In January 2009, the CICA's Emerging Issues Committee ("EIC") issued Abstract No. 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" (EIC-173). EIC-173 requires an entity to take into account its own credit risk and that of the relevant counterparty(ies) when determining the fair value of financial assets and financial liabilities, including derivative instruments. This EIC had no impact on our financial position or results of operations.

Fair value and liquidity risk disclosure – amendments to financial instruments – disclosures

In June 2009, the CICA amended Section 3862 "Financial Instruments – Disclosures" to improve fair value and liquidity risk disclosures. Section 3862 now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels, described below, for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair value of assets and liabilities:

- Level 1 – inputs are unadjusted quoted prices of identical instruments in active markets;
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly;
- Level 3 – one or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments.

Determination of fair value and the resulting hierarchy requires the use of observable market data, whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The amendments only affect the Corporation's disclosure. Refer to *note 7(b) to the consolidated financial statements on page 122*.

Impairment of financial assets – amendments to financial instruments – recognition and measurement

In August 2009, the CICA issued various amendments to Section 3855 "Financial Instruments – Recognition and Measurement" and Section 3025 "Impaired Loans" to change the categories into which certain debt investments are required or permitted to be classified and to require the reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances. These amendments had no significant effect on the Corporation's current operating results or financial position.

Future year accounting changes

Business combinations, consolidated financial statements and non-controlling interest

In January 2009, the AcSB issued CICA Section 1582 "Business Combinations," Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests," which replace Section 1581 "Business Combinations" and Section 1600 "Consolidated Financial Statements." Section 1582 applies to prospective business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted, but Sections 1601 and 1602 must be applied concurrently.

Section 1582 provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 “Business Combinations.” The new recommendations require measuring business acquisitions at the fair value of the acquired assets and assumed liabilities, including any non-controlling interest and contingent liabilities. Acquisition-related costs are expensed as incurred.

Section 1601, combined with Section 1602, replaces Section 1600. Section 1601 establishes standards for the preparation of consolidated financial statements and is aligned with the corresponding provisions of Section 1600. Section 1602 is aligned with the corresponding provisions of International Financial Reporting Standard IAS 27, “Consolidated and Separate Financial Statements” and establishes standards for accounting for a non-controlling interest in a subsidiary subsequent to a business combination. Section 1602 introduces a number of changes, including:

- The presentation of non-controlling interests as a separate component of equity rather than in between liabilities and equity on the balance sheet;
- Non-controlling interests are no longer recorded as a deduction of net income and total comprehensive income, but are shown as a separate component of the income statement, which discloses the allocation of net income between the owners of the parent and the non-controlling interests based on their relative economic interests. This allocation is also disclosed on the Statement of Comprehensive Income.

Canada Post will consider the early adoption of these sections, effective January 1, 2010, in the event of any business acquisitions undertaken in 2010, to be more closely aligned with International Financial Reporting Standards (“IFRS”) and to mitigate the impact of adopting IFRS at the January 1, 2011 changeover date. In accordance with the transitional provisions, these sections will be applied prospectively, except for the presentation requirements for non-controlling interests, which must be applied retrospectively. The adoption of these sections is not expected to have a significant impact on the Corporation’s consolidated financial statements, but will give rise to the above-mentioned reclassifications of non-controlling interests.

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 statement of financial position at January 1, 2010, and full comparative information for 2010.

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 implementation 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 is ongoing, and we are finalizing the detailed evaluation phase and focusing on implementation activities throughout 2010.

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

The table on page 89 summarizes the key elements and current status of our plan.

Convergence with IFRS – Key plan elements

Key activities	Status at December 31, 2009
Financial statement preparation: <ul style="list-style-type: none"> Identifying differences in Canadian GAAP/ IFRS accounting policies Selecting ongoing IFRS policies Selecting first-time adoption elections Developing financial statement presentation and disclosure format Preparing opening IFRS statement of financial position 	<ul style="list-style-type: none"> Analysis of key differences completed in 2008 Detailed evaluation completed for most reporting areas, covering policy and first-time adoption elections and implementation choices First-time adoption elective exemption decisions analyzed and costs and benefits of each exemption considered, with a number of conclusions reached and decisions to be finalized in the first half of 2010 Financial statement presentation meeting IAS 1 and IFRS 1 requirements and preparation of opening IFRS statement of financial position in process
Financial reporting expertise: Appropriate level of IFRS expertise to be defined and introduced for each of the following: <ul style="list-style-type: none"> Core finance team Senior executives and Board of Directors, including Audit Committee Operational personnel 	<ul style="list-style-type: none"> Several technical training sessions delivered to our core finance team Periodic status updates delivered to our senior executives, the Board of Directors and the Audit Committee Several information sessions on implementation issues conducted with key operational personnel and other functional areas Training needs are continuously reviewed and will continue to be provided in 2010, as required
Information technology: Information technology to be IFRS compliant for all: <ul style="list-style-type: none"> Systematic processing changes Program upgrades/changes Date of transition entries (IFRS 1) Gathering data for disclosures Scope of consolidation package Budget/plan/forecast monitoring process 	<ul style="list-style-type: none"> Impact of the conversion on our accounting systems evaluated Detailed plans developed to address any required systems upgrades and necessary changes Specifications of additional systems requirements and related deadlines confirmed with Innovapost, our IT/IS provider All significant system changes underway at the balance sheet date (and completed prior to the issuance of the 2009 Annual Report) Remaining minor system changes will be finalized prior to our conversion to IFRS Internal planning and budgeting impacts under consideration
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 ICFR and to report satisfactorily following the transition to IFRS	<ul style="list-style-type: none"> Changes to design and operation of ICFR due to IFRS transition in process No significant modifications expected at this time
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 DC&P and to report satisfactorily following the transition to IFRS	<ul style="list-style-type: none"> Changes to DC&P are being identified as each standard is reviewed and will be implemented in 2010
Business activities: Impact of IFRS on key business activities to be evaluated, including: <ul style="list-style-type: none"> Compensation plans Financing arrangements and requirements Other contractual and legal arrangements Capital expenditures Key ratios 	<ul style="list-style-type: none"> We assessed the impacts of adopting IFRS on our covenants and other contractual arrangements No material compliance matters have been identified at this time Assessment of impacts on compensation plans currently underway

Impact of adoption of IFRS

Overview

First-time adoption of IFRS requires that the Corporation re-assess its current accounting policies, and make any required changes and decisions to ensure the policy for each area meets 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. Changes to the opening statement of financial position may also require that a corresponding future 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.

Major differences

IFRS represents a principle-based framework similar to Canadian GAAP; however, significant differences exist in some areas where there are different recognition, measurement and disclosure requirements. Accordingly, the transition to IFRS will result in changes to some of the current accounting policies used by the Corporation, relative to those that will be required under IFRS. Major differences identified at this time relate to:

- property, plant and equipment;
- employee benefits (including pensions);
- impairment of assets; and
- provisions, contingent liabilities and contingent assets.

The accounting treatment of our joint venture, Innovapost, may also change pending the outcome of the current IASB project on joint ventures.

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 retrospective application, this is subject to certain elective exemptions that

provide an alternative implementation basis. The Corporation has not yet finalized all such first-time adoption decisions, but currently expects to exercise the elective exemption in the following areas:

- business combinations;
- property, plant and equipment (fair value on transition for selected assets);
- leases (IFRIC 4 "Determining whether an arrangement contains a lease");
- effects of changes in foreign exchange rates;
- financial instruments: recognition and measurement; and
- borrowing costs.

As noted in the prior year, the above areas represent our assessment based on the information available at this time. As we complete our IFRS changeover procedures, additional areas may be identified and further details of the differences identified to date will become available to management and subsequently disclosed.

Impact of elective exemptions and accounting policies

The following disclosure highlights significant elective exemption adjustments required to be made upon adoption of IFRS in order to provide an opening statement of financial position as well as significant accounting policies required or expected to be applied by the Corporation that will be significantly different from current accounting policies.

Property, plant and equipment

Adoption of IFRS requires compliance with IAS 16 "Property, Plant and Equipment" ("IAS 16"). Although this standard permits a choice between the revaluation model and the cost model, the Corporation will continue to apply the cost model, consistent with its current accounting policy.

The Corporation plans to apply the IFRS 1 elective exemption to fair value selected buildings at January 1, 2010. Based upon information available to date, this will result in a net decrease to the carrying amount of these assets and therefore a decrease in the opening IFRS equity position. As a result, the amount of depreciation required under IFRS related to such assets will be lower than what would be charged to income under Canadian GAAP.

Impairment of property, plant and equipment will follow the requirements of IAS 36 "Impairment of Assets" ("IAS 36"). While some of the concepts in IAS 36 are consistent with Canadian GAAP, IAS 36 requires that prior impairments are reversed in future periods in certain circumstances, with the exception of goodwill. The impact of this requirement will be contingent on future events.

Business combinations

IFRS 3 "Business Combinations" ("IFRS 3") is substantially harmonized with the revised Canadian guidance on the same subject, which may be adopted on or before January 1, 2011. IFRS 3 may be applied retrospectively or prospectively from January 1, 2010. 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, which permits prospective application, a goodwill impairment test will be completed at January 1, 2010.

Employee benefits

Post-employment benefits (referred to as post-retirement benefits under Canadian GAAP)

Recognition of actuarial gains and losses

Actuarial gains and losses arise as a result of changes in the value of the accrued benefit obligation and plan assets due to experience being different from that assumed and changes in actuarial assumptions. IAS 19 "Employee Benefits" ("IAS 19") allows an entity to immediately recognize actuarial gains and losses in full as they arise in income or in other comprehensive income or to recognize them over a longer period through a systematic amortization through income. The latter approach is consistent with the Corporation's current policy.

Under IFRS, we expect to implement a policy recognizing actuarial gains and losses as they occur in other comprehensive income. The impact of this proposed policy change is twofold:

- Recognition, as part of opening equity, of all unrecognized actuarial gains and losses as at January 1, 2010. It is expected that this change will significantly reduce the accrued pension benefit asset, but will have a much lesser impact on the accrued benefit liability accrued for other benefits offered upon retirement. The decrease in the accrued pension benefit asset as well as the change in the accrued benefit liability would result in a reduction in the equity of Canada.
- Thereafter, actuarial gains and losses will be recognized as they occur in other comprehensive income.

The Corporation believes that this policy choice will result in greater transparency with the recognition of actuarial gains and losses in the opening statement of financial position as it relates to the financial position of the defined benefit plans. This choice is also aligned with the proposed direction of the IASB with respect to immediate recognition of actuarial gains and losses.

Past service cost for post-employment benefits

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 that the vested portion of the benefits be immediately accounted for through the profit and loss. As for the remaining portion, it should be recognized over the average period until the employees become fully eligible for the benefit. This is in contrast with the current accounting policy, whereby the total impact of such changes is recognized over a future remaining service period up to full eligibility. Under IFRS, this change in policy will result in a reduction of the accrued benefit liability for the other benefits offered upon retirement.

Funding excess

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. IAS 19 requires this excess to be accounted for as a reduction of expense immediately whereas, under Canadian GAAP, it was being recognized on a straight-line basis over the expected average remaining service period of active employees covered by the Plan at the time of the transfer. It is expected that the recognition of the unamortized excess will result in an increase of the accrued pension benefit asset as at January 1, 2010.

Other benefits

IAS 19 provides specific guidance on short-term and other long-term employee benefits. Under IAS 19, actuarial gains and losses as well as past service cost arising in relation to the other long-term benefits shall be recognized immediately through profit and loss. Under current principles, the actuarial gains and losses for such benefits are amortized over the expected average remaining service life of active employees. As for the past service cost, the current treatment is similar to the one used for the benefits offered upon retirement. This policy change should result in an increase in the accrued benefit liability and a reduction of the equity of Canada.

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 will require some change in 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. The impact of IAS 37 on the Corporation has not yet been determined, but we do not expect to see a material adjustment based upon our analysis to date. We may need to modify our analysis depending on the outcome of the current IASB project on IAS 37 (see below).

Future changes to IFRS

IFRS 1 requires that the accounting policies used by the Corporation in the opening IFRS statement of financial position 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.

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.

If the recommendations of the exposure draft are adopted with an effective date of December 31, 2011, or earlier, then we may be required to account for our joint venture using the equity method rather than proportionate consolidation in our financial statements for the year ending December 31, 2011.

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." 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, if the effective date is December 31, 2011, or earlier, the Corporation will have to measure such obligations in accordance with the new amendments, as described earlier.

10 Outlook for 2010

Our prospects for 2010

10.1 Economic outlook

The Canadian economy contracted by an estimated 2.5 per cent in 2009. The recession lasted 10 months before the Canadian economy returned to growth at the end of the second quarter of 2009. The injection of liquidity into the global financial system has stabilized financial markets, consumer and business confidence is on the rise, and, as of December 31, the Toronto Stock Exchange had risen by nearly 55 per cent from its March lows. Though the worst appears to be over, considerable risk remains and could delay or reverse the economic recovery. The consensus among forecasters is that the economic growth will gradually pick up momentum in 2010 and grow by 2.6 per cent. Not until 2011 do forecasters expect robust economic growth of 3.4 per cent.

Inflation as measured by the consumer price index (CPI) was 0.3 per cent in 2009 and is projected to be 1.6 per cent in 2010. This low inflation in 2009 was primarily due to significant declines in energy prices. Inflation is expected to average 2.0 per cent a year over the period 2010 to 2014. As a user of fuel for our transportation network, The Canada Post Group is sensitive to the changes associated with the prices of gasoline, diesel and aviation fuel. Forecasters expect to see fuel prices continue to increase quickly in the coming years as the global economy strengthens.

Housing completions in Canada are expected to continue to grow by 175,000, thereby increasing our points of delivery. This will add significant costs to delivery operations.

Economic outlook

	2010	2011	2012	2013	2014
Economic (% change)					
Real Gross Domestic Product	2.6%	3.4%	3.6%	3.0%	2.6%
Inflation (Consumer Price Index)	1.6%	2.1%	2.1%	2.0%	2.0%
Demographic (% change)					
Total population growth	1.1%	1.0%	0.9%	1.1%	1.0%
Households growth	1.1%	1.1%	1.2%	1.2%	1.2%

Sources:

The economic outlook is based on the most recent Statistics Canada data, the December 2009 Canadian Outlook of The Conference Board of Canada and the January 2010 Global Insight Macro Economic forecast. Forecasts of GDP and CPI also consider projections from the five major Canadian banks and The Bank of Canada. The demographic indicators are based on actual data from Statistics Canada and projections from Global Insight and The Conference Board of Canada.

10.2 The Canada Post Group outlook

The year 2010 promises to be challenging for us. The uncertainty created by the global economic crisis and the unprecedented 2009 decline in all volumes have made it more difficult to predict future revenues, earnings and cash position.

We do not expect physical-mail volumes to return to the levels they were a year ago and, because of stiff competition on many fronts, some of our business volumes may be gone for good. Therefore, revenues are projected to grow from this lower base. Planned revenue for 2010 is \$7.6 billion, which represents growth of 4.4 per cent compared to the previous year, mostly due to price increases. The Canada Post Group's 2010 planned income before income taxes is \$80 million. However, our current target for 2010 is now \$110 million. With very narrow operating margins, the Corporation must continue to be highly vigilant in controlling discretionary costs and finding new operational efficiencies if we are to reach our earnings target. Accordingly, we will continue to focus on significant cost-reduction and cost-containment measures to protect our earnings.

Going forward, we will need to make structural cost changes in addition to Postal Transformation to permanently reduce costs and improve our competitiveness. Sustainable change at Canada Post is only possible if we can modernize our collective agreements in line with terms and conditions of employment that are customer and market driven. Post offices in foreign jurisdictions have also undertaken reforms to their collective agreements in recent years, including wage improvements that were directly linked to modernization and productivity targets. We continue to be committed to providing employees with compensation and benefits programs at a cost we can afford. To improve our competitiveness, in the next round of negotiations with the Canadian Union of Postal

Workers (CUPW), we will seek changes that will improve Canada Post's cost structure and long-term sustainability. But implementing labour change is not easy. We want to honour our people's job security provisions, but the Corporation needs their commitment to help us improve productivity levels.

Pension reform proposed by the Minister of Finance in October 2009 could affect the amount of special payments required as a result of our Pension Plan's solvency deficit. Therefore, special payment expectations may change. Based on the current rules, however, the Corporation expects to contribute approximately \$450 million in special payments above the almost \$340 million of regular contributions in 2010. The funding policy will continue to be re-evaluated based on the status of the Plan.

As the year progresses, management will consider factors, such as credit market conditions, interest rate movements and revisions to 2010 and 2011 cash flow forecasts, in determining the amount of long-term debt it will issue during 2010. Canada Post will ensure that sufficient liquidity is maintained at all times by accessing capital markets, establishing operating lines of credit or other means, as appropriate.

Our ability to proceed with Postal Transformation is contingent on the financial health of the Corporation. That health will largely be driven by the state of the economy, the ability to make permanent changes to our cost structure and the funding of our pension obligations. While difficult decisions will need to be taken in the coming years, with our Shareholder's 2009 enabling policy changes and continued support, a modernized Canada Post will remain financially self-sustaining and provide continued value to Canadians for years to come.

The Canada Post Group segments – 2010

Canada Post:

- *Transaction Mail* – Our Lettermail product is still a vital part of the set of options available to businesses and governments for communication with customers and citizens. It is a key part of the integrated set of communication alternatives that Canada Post provides along with epost service and our other electronic delivery services as well as the SmartFlow Document Management Services suite. We see increasing movement to multi-channel communications in 2010 and for the foreseeable future. This will further fragment the communications media environment.
- *Parcels* – Given the uncertain economic conditions, coupled with intense industry competition, growth in 2010 will be challenging. Parcels will continue to develop greater visibility and work to enhance our online capabilities for customers, improving consumer interfaces and making returns easier. We will also remain focused on the SMB customers with our continued drive to improve our on-demand pickup options and capabilities.
- *Direct Marketing* – Advertising and marketing budgets, with the exception of online, are predicted to remain flat throughout 2010 as economic growth remains slow and uncertain. We anticipate a modest recovery of the Direct Marketing line of business in 2010. The use of data for better targeting, combined with the availability of digital channels, is anticipated to drive more integration across channels. We believe that our new data products, coupled with our core Admail products, will be positioned to offer measurability, high return on investment and more personalized communications. These fundamental characteristics are critical in a time when every dollar spent must be accounted for and measured. We will also continue to provide leadership by demonstrating to our customers the impact and effectiveness of direct mail through cultivating strategic relationships with our key existing and new customers.

Purolator – In 2010, Purolator will be externally driven and market focused, ensuring it meets customer needs. The company will refocus its efforts toward its core business, continue to investigate areas of efficiencies and maintain cost controls as effort is made to regain market volume.

Logistics – SCI's focus for 2010 will be to maintain profitability. The key drivers for achieving this will be through growth via entering new market verticals, expanding service offerings, and reducing 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 concentrate on expanding its service offerings and capabilities. Innovapost revenues depend on the level of information technology activity at Canada Post and Purolator. In 2010, revenue is expected to decline as Canada Post and Purolator reduce the pace of technology investment compared to 2009 while continuing to require savings in their base operating costs.

HISTORICAL FINANCIAL INFORMATION

(unaudited, in millions of dollars)	2009	2008	2007	2006	2005
OPERATIONS					
Revenue from operations*	7,312	7,733	7,473	7,264	6,944
Cost of operations	6,955	7,594	7,346	7,116	6,681
Income from operations*	357	139	127	148	263
Per cent of revenue from operations	4.9 %	1.8 %	1.7 %	2.0 %	3.8 %
Non-operating income*	22	22	33	18	19
Income before income taxes	379	161	160	166	282
Income tax expense	95	67	102	44	80
Net income before non-controlling interest	284	94	58	122	202
Non-controlling interest in net income of subsidiaries	3	4	4	3	3
Net income	281	90	54	119	199
Other comprehensive income (loss), net of tax	(1)	–	–	–	–
Comprehensive income	280	90	54	119	199
Return on equity of Canada	17.0 %	6.1 %	3.8 %	8.4 %	15.0 %
BALANCE SHEET					
Assets					
Current	1,497	1,384	1,388	1,470	1,468
Segregated securities	654	862	632	469	446
Capital assets	2,216	2,034	1,855	1,731	1,693
Accrued pension benefit asset	1,335	898	944	1,010	784
Other	327	413	348	319	228
Total assets	6,029	5,591	5,167	4,999	4,619
Liabilities and equity of Canada					
Current	1,179	1,181	1,073	1,185	1,117
Accrued pension, other retirement and post-employment benefit liability	2,835	2,722	2,513	2,247	1,973
Other liabilities	199	155	120	115	119
Non-controlling interest	29	26	22	19	16
Equity of Canada	1,787	1,507	1,439	1,433	1,394
Total liabilities and equity of Canada	6,029	5,591	5,167	4,999	4,619
ACQUISITION OF CAPITAL ASSETS					
Land and buildings	65	145	110	65	42
Other capital assets	347	246	221	241	126
	412	391	331	306	168

* Comparative figures have been reclassified in order to conform to the presentation adopted in 2009.

HISTORICAL FINANCIAL INFORMATION

	2009	% Change	2008	% Change	2007	% Change	2006	% Change	2005 ¹
LINE OF BUSINESS DIMENSIONS									
REVENUE FROM OPERATIONS									
(unaudited, in millions of dollars / trading day adjusted per cent)									
Transaction mail									
Domestic mail/mail to foreign postal administrations ²	3,024	(2.3) %	3,108	(0.1) %	3,100	(0.2) %	3,093	3.5 %	2,988
Mail from foreign postal administrations ³	124	(1.2) %	126	9.7 %	114	0.1 %	114	(4.1) %	119
Canada Post segment	3,148	(2.3) %	3,234	0.2 %	3,214	(0.2) %	3,207	3.2 %	3,107
All other segments	–	–	–	–	–	(100.0) %	4	(1.9) %	4
Elimination of intersegment	(4)		(5)		(5)		(6)		(5)
The Canada Post Group	3,144	(2.3) %	3,229	0.2 %	3,209	(0.3) %	3,205	3.2 %	3,106
Parcels									
Domestic mail/mail to foreign postal administrations ²	1,128	(2.7) %	1,164	4.9 %	1,105	3.8 %	1,061	(0.9) %	1,069
Mail from foreign postal administrations ³	140	(4.4) %	147	9.5 %	134	(0.6) %	134	33.0 %	101
Canada Post segment	1,268	(2.9) %	1,311	5.4 %	1,239	3.3 %	1,195	2.1 %	1,170
Purolator segment	1,433	(7.9) %	1,563	7.4 %	1,448	7.1 %	1,347	7.4 %	1,254
Logistics segment	151	(3.2) %	156	6.4 %	146	8.3 %	134	(6.1) %	143
All other segments ²	–	–	–	–	–	–	–	(100.0) %	2
Elimination of intersegment	(108)		(97)		(84)		(61)		(56)
The Canada Post Group	2,744	(6.1) %	2,933	6.3 %	2,749	4.7 %	2,615	4.0 %	2,513
Direct marketing									
Addressed Admail™	569	(10.1) %	635	1.9 %	621	6.1 %	583	9.9 %	530
Unaddressed Admail™	380	(4.3) %	399	5.6 %	376	10.3 %	339	14.4 %	297
Publications Mail™	259	(9.9) %	289	0.9 %	285	3.2 %	275	4.3 %	263
Other ²	100	(6.9) %	108	(1.3) %	109	7.5 %	101	10.1 %	92
Canada Post segment	1,308	(8.2) %	1,431	2.5 %	1,391	6.7 %	1,298	9.8 %	1,182
All other segments ²	–	–	–	–	–	–	–	–	–
The Canada Post Group	1,308	(8.2) %	1,431	2.5 %	1,391	6.7 %	1,298	9.8 %	1,182
Other revenue									
Canada Post segment	116	(11.4) %	132	18.7 %	111	(16.1) %	131	2.8 %	128
Purolator segment ⁴	(0)	(109.2) %	4	617.5 %	(1)	(8,356.2) %	(0)	98.4 %	(0)
All other segments	168	(4.4) %	176	0.3 %	175	1.2 %	173	(1.4) %	175
Elimination of intersegment	(168)		(172)		(161)		(158)		(160)
The Canada Post Group	116	(16.8) %	140	11.9 %	124	(15.2) %	146	2.9 %	143
Revenue from operations									
Canada Post segment	5,840	(4.0) %	6,108	2.2 %	5,955	1.7 %	5,831	4.4 %	5,587
Purolator segment	1,433	(8.2) %	1,567	7.8 %	1,447	7.1 %	1,347	7.4 %	1,254
Logistics segment	151	(3.2) %	156	6.4 %	146	8.3 %	134	(6.1) %	143
All other segments	168	(4.4) %	176	0.3 %	175	(1.4) %	177	(2.3) %	181
Elimination of intersegment	(280)		(274)		(250)		(225)		(221)
The Canada Post Group	7,312	(5.1) %	7,733	3.1 %	7,473	2.5 %	7,264	4.6 %	6,944

HISTORICAL FINANCIAL INFORMATION

	2009	% Change	2008	% Change	2007	% Change	2006	% Change	2005 ¹
LINE OF BUSINESS DIMENSIONS									
VOLUME (unaudited, in millions of pieces / trading day adjusted per cent)									
Transaction mail									
Domestic mail/mail to foreign postal administrations	4,829	(3.9) %	5,045	(1.8) %	5,116	(1.3) %	5,161	0.8 %	5,122
Mail from foreign postal administrations ³	246	(9.8) %	274	(6.1) %	290	(6.8) %	310	(6.2) %	331
Canada Post segment	5,075	(4.2) %	5,319	(2.0) %	5,406	(1.6) %	5,471	0.3 %	5,453
Elimination of intersegment	(5)		(6)		(7)		(7)		(7)
The Canada Post Group	5,070	(4.2) %	5,313	(2.0) %	5,399	(1.6) %	5,464	0.3 %	5,446
Parcels									
Domestic mail/mail to foreign postal administrations	115	(5.8) %	122	(0.7) %	123	(0.2) %	123	(8.1) %	134
Mail from foreign postal administrations ³	33	(10.6) %	37	(26.7) %	51	(2.2) %	51	135.4 %	22
Canada Post segment	148	(6.9) %	159	(8.3) %	174	(0.7) %	174	12.0 %	156
Purolator segment	138	(3.0) %	143	0.2 %	142	1.5 %	140	0.3 %	139
Elimination of intersegment	(2)		(3)		(2)		(2)		(2)
The Canada Post Group	284	(4.9) %	299	(4.6) %	314	0.1 %	312	6.4 %	293
Direct marketing									
Addressed Admail™	1,301	(13.1) %	1,503	(1.8) %	1,525	3.3 %	1,470	5.0 %	1,400
Unaddressed Admail™	3,640	(10.0) %	4,061	2.7 %	3,940	5.4 %	3,722	9.1 %	3,411
Publications Mail™	471	(9.4) %	522	(2.9) %	535	(0.4) %	536	0.8 %	531
Other	37	(34.1) %	56	(16.0) %	66	9.5 %	60	(7.4) %	65
The Canada Post Group	5,449	(10.9) %	6,142	0.9 %	6,066	4.4 %	5,788	7.0 %	5,407
Total Volume									
Canada Post segment	10,672	(7.8) %	11,620	(0.6) %	11,646	1.5 %	11,433	3.8 %	11,016
Purolator segment	138	(3.0) %	143	0.2 %	142	1.5 %	140	0.3 %	139
Elimination of intersegment	(7)		(9)		(9)		(9)		(9)
The Canada Post Group	10,803	(7.7) %	11,754	(0.6) %	11,779	1.5 %	11,564	3.7 %	11,146
EMPLOYMENT⁵									
Full-time employees	60,126	(2.0) %	61,368	(0.3) %	61,557	0.8 %	61,064	1.1 %	60,405
Part-time employees	10,622	(0.1) %	10,632	(2.8) %	10,937	1.2 %	10,805	(2.0) %	11,028
Total employees	70,748	(1.7) %	72,000	(0.7) %	72,494	0.9 %	71,869	0.6 %	71,433
MAIL NETWORK									
Post offices	6,532	(1.3) %	6,618	0.1 %	6,614	0.2 %	6,602	(1.8) %	6,724
Points of delivery (in thousands)	14,874	1.2 %	14,696	1.4 %	14,493	1.4 %	14,293	1.7 %	14,053
Pick-up points (in thousands) ⁶	994	(1.3) %	1,008	(0.7) %	1,015	(0.3) %	1,019	0.0 %	1,018

¹The 2005 Canada Post segment revenues and volumes have been restated to reflect the 2006 change in methodology that now allocates the sales of commemorative stamps to transaction mail and parcels.

²The 2005 to 2007 revenues were restated to reflect minor realignments made in 2008 between lines of business.

³In 2005, Canada Post redesigned and increased sampling activity to achieve statistical validity and improved receipt verification reports and processes for international mail settlements. The scope of this initiative was subsequently expanded to include a joint effort with the United States Postal Service (USPS) to modify and improve the processes and procedures governing mail settlement between the two organizations. As a result of this, the inbound mail 2006 values are not comparable to the prior years.

⁴The 2005 to 2008 revenues for the Purolator segment were restated to include foreign exchange gains and losses.

⁵Includes paid full-time and part-time employees and excludes temporary, casual and term employees.

⁶Includes rural mailboxes (RMBs), which are collection points for customers with this mode of delivery.

ADDITIONAL INFORMATION

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

Consolidated Ratios (unaudited)	Policy Framework	2009	2008	2007	2006	2005
Profitability						
(1) Return on equity of Canada	11.0 %	17.0 %	6.1 %	3.8 %	8.4 %	15.0 %
(2) Operating profit margin		4.9 %	1.8 %	1.7 %	2.0 %	3.8 %
(3) Productivity	97.0 %	95.1 %	98.2 %	98.3 %	98.0 %	96.2 %
Leverage						
(4) Total debt to total capital	40.0 %	7.6 %	5.8 %	4.9 %	4.9 %	5.8 %
(5) Cash flow to debt		90.3 %	644.6 %	459.6 %	366.0 %	246.8 %
Liquidity						
(6) Current ratio		1.27	1.17	1.29	1.24	1.31
(7) Gross interest coverage		55.65	14.12	12.47	14.58	25.62
Investment						
(8) Cash flow to capital expenditures		32.1 %	153.0 %	104.0 %	87.9 %	126.7 %
(9) Capital asset investment rate		7.2 %	8.1 %	5.7 %	6.7 %	3.5 %
Dividend payout						
(10) Dividend payout ratio	25.0 %	0.0 %	40.0 %	40.0 %	40.0 %	40.0 %
Dividend payout ratio once return on equity of Canada \geq 11%	40.0 %					

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

AUDITORS' REPORT ON ANNUAL COST STUDY CONTRIBUTION ANALYSIS

To the Board of Directors

Canada Post Corporation

We have audited the Annual Cost Study Contribution Analysis of Canada Post Corporation for the year ended December 31, 2009, prepared in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis. This financial information is the responsibility of the Corporation's management and has been prepared using Canada Post Corporation segment revenues and expenses contained in note 21 to the audited consolidated financial statements for the year ended December 31, 2009, and other unaudited operational data extracted from Canada Post Corporation's systems. Our responsibility is limited to expressing an opinion, based on our audit, on the financial information resulting from the application of the Cost Methodology.

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

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

In our opinion:

- (a) the Annual Cost Study Contribution Analysis presents fairly, in all material respects, the contribution of services by lines of business and the contribution by exclusive privilege, competitive and concessionary services for the year ended December 31, 2009, in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis, and using Canada Post Corporation segment revenues and expenses contained in note 21 to the audited consolidated financial statements for the year ended December 31, 2009, and other unaudited operational data extracted from Canada Post Corporation's systems; and
- (b) using the Cost Methodology described in the notes, Canada Post Corporation did not cross-subsidize its competitive services group by using revenues protected by exclusive privilege for the year ended December 31, 2009.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants
Ottawa, Canada
March 24, 2010

ANNUAL COST STUDY CONTRIBUTION ANALYSIS

Canada Post Corporation

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

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

The methodology, which is summarized in the notes to the Annual Cost Study Contribution Analysis on page 101, 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, 2009, 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, 2009

(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 64% 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	\$ 3,619	\$ 1,901	\$ 124	\$ 196	\$ 5,840
Long-run incremental costs	\$ (1,970)	\$ (1,381)	\$ (125)	\$ (96)	\$ (3,572)
Long-run incremental contribution to the fixed costs	\$ 1,649 46%	\$ 520 27%	\$ (1) (1)%	\$ 100 51%	\$ 2,268 39%
Unallocated fixed costs					\$ (1,988)
Contribution before the under-noted items					\$ 280
Investment and other income					\$ 45
Interest and other expense					\$ (6)
Income from the Canada Post segment before income taxes					\$ 319

II - Long-Run Incremental Contribution by line of business

The following analysis is based on the assignment of 62% 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	\$ 3,148	\$ 1,268	\$ 1,308	\$ 116	\$ 5,840
Long-run incremental costs	\$ (1,604)	\$ (1,001)	\$ (777)	\$ (81)	\$ (3,463)
Long-run incremental contribution to the fixed costs	\$ 1,544 49%	\$ 267 21%	\$ 531 41%	\$ 35 30%	\$ 2,377 41%
Unallocated fixed costs					\$ (2,097)
Contribution before the under-noted items					\$ 280
Investment and other income					\$ 45
Interest and other expense					\$ (6)
Income from the Canada Post segment before income taxes					\$ 319

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, 2009

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 that are incurred because of the provision of a service are attributed to that service. Activity costs that cannot be attributed to the provision of a service but that are common to a specific group of services are attributed at that higher level of aggregation. The remaining business-sustaining or common fixed costs are “unallocated fixed costs.”
- d) **Source data** • The source of the financial data used to produce the Annual Cost Study results is the Canada Post Corporation general ledger revenues and costs. Operational time, volume and weight/cubage data are used to attribute general ledger costs to activities and activity costs to services. Operational volume data is used to determine revenue by services. Where operational data is not available, an appropriate proxy is used to make the attribution.
- e) **Reconciliation to financial records** • Total revenues and costs considered in the Annual Cost Study are agreed to the total revenues and expenses forming the Canada Post Corporation segment of the audited consolidated financial statements, which have been reported on by another firm of chartered accountants.
- f) **Cross-subsidization test** • Under the Cost Methodology in the Annual Cost Study, a positive long-run incremental contribution (revenue exceeds long-run incremental cost) for a line of business, and competitive grouping of services establishes that the grouping of services has not been cross-subsidized using revenues from other services or groups of services.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Management is responsible for the consolidated financial statements and all other information presented in this Annual Report. The *Financial Administration Act* and regulations require the consolidated financial statements to be prepared in accordance with Canadian generally accepted accounting principles. Where appropriate, the consolidated financial statements include amounts based on management's best estimates and judgments. Financial information presented elsewhere in this Annual Report is consistent with the consolidated financial statements.

In support of its responsibilities, management established a system of internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable financial information in accordance with the *Financial Administration Act* and regulations, as well as the *Canada Post Corporation Act* and regulations and by-laws of the Corporation. Internal audits examine and evaluate the application of the Corporation's policies and procedures and the adequacy of the system of internal controls.

The Board of Directors has delegated responsibility for oversight of the financial reporting process to the Audit Committee. The Committee acts on behalf of the Board of Directors in fulfilling the Board's responsibilities, which are prescribed by Section 148 of the *Financial Administration Act*. The Audit Committee is entirely constituted of non-executive directors and currently composed of five members who are therefore independent in accordance with the Corporation's standards of independence. The Audit Committee is responsible for reviewing the consolidated financial statements and the Annual Report and for meeting with management, internal auditors and external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee meets not less than four times a year, focusing in particular on the areas of financial reporting, risk management and internal control.

The Board of Directors, on the recommendation of the Audit Committee, approves the consolidated financial statements.

Canada Post Corporation is a Crown corporation included since 1989 in Part II of Schedule III of the *Financial Administration Act*. The Auditor General of Canada and KPMG LLP were appointed as joint auditors of the Corporation for the year ended December 31, 2009, in accordance with the *Financial Administration Act*. The Auditor General and KPMG LLP audit the consolidated financial statements and report to the Audit Committee of the Board of Directors, as well as the Minister of Transport, Infrastructure and Communities.



President and Chief Executive Officer

March 5, 2010



Chief Financial Officer

AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

To the Minister of Transport, Infrastructure and Communities,

We have audited the consolidated balance sheet of Canada Post Corporation as at December 31, 2009 and the consolidated equity of Canada statement, the consolidated income and comprehensive income statement and the consolidated cash flow statement for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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



Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
March 5, 2010

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Corporation and its wholly-owned subsidiaries that have come to our notice during our audit of the consolidated financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canada Post Corporation Act* and regulations, the by-laws of the Corporation and its wholly-owned subsidiaries and the directives issued pursuant to section 89 of the *Financial Administration Act*.



Chartered Accountants, Licensed Public Accountants

CONSOLIDATED BALANCE SHEET

As at December 31 (in millions of dollars)	2009	2008
Assets		
Current assets		
Cash and cash equivalents (note 7)	\$ 473	\$ 605
Marketable securities (note 7)	270	103
Accounts receivable (note 6)	586	575
Income tax recoverable	69	7
Prepaid expenses	74	71
Current portion of future income tax assets (note 8)	25	23
Total current assets	1,497	1,384
Capital assets (note 9)		
Property, plant and equipment	2,047	1,881
Intangible assets	169	153
	2,216	2,034
Other assets		
Segregated securities (note 7)	654	862
Accrued pension benefit asset (note 10)	1,335	898
Future income tax assets (note 8)	179	270
Goodwill (note 11)	125	124
Other long-term assets (note 12)	23	19
Total assets	\$ 6,029	\$ 5,591
Liabilities and equity of Canada		
Current liabilities		
Accounts payable and accrued liabilities	\$ 413	\$ 469
Salaries and benefits payable	575	509
Income tax payable	2	16
Deferred revenue	142	145
Outstanding money orders	37	42
Current portion of long-term debt (note 13)	10	–
Total current liabilities	1,179	1,181
Long-term debt (note 13)	120	74
Accrued pension, other retirement and post-employment benefit liability (note 10)	2,835	2,722
Future income tax liabilities (note 8)	36	30
Other long-term liabilities	43	51
Total liabilities	4,213	4,058
Non-controlling interest	29	26
Equity of Canada	1,787	1,507
Total liabilities and equity of Canada	\$ 6,029	\$ 5,591


Commitments and contingencies (notes 1 and 16)
Conditional asset retirement obligations (note 14)

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

Approved on behalf of the Board:



Chairman of the Board of Directors



Chairperson of the Audit Committee

CONSOLIDATED EQUITY OF CANADA STATEMENT

Year ended December 31 (in millions of dollars)	2009	2008
Contributed capital	\$ 1,155	\$ 1,155
Retained earnings		
Balance, beginning of year	352	284
Net income	281	90
Dividend (note 15)	–	(22)
Balance, end of year	633	352
Accumulated other comprehensive loss		
Balance, beginning of year	–	–
Other comprehensive loss	(1)	–
Balance, end of year	(1)	–
Total retained earnings and accumulated other comprehensive loss	632	352
Equity of Canada	\$ 1,787	\$ 1,507

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)	2009	2008
Revenue from operations	\$ 7,312	\$ 7,733
Cost of operations		
Salaries	3,893	3,932
Benefits, net of transitional support of \$56 million (2008 – \$81 million) (note 10e)	579	907
Non-labour collection, processing and delivery	1,319	1,465
Facilities	306	303
Amortization	246	237
Other	612	750
Total cost of operations	6,955	7,594
Income from operations	357	139
Non-operating income (expense)		
Investment and other income	29	34
Interest and other expense	(7)	(12)
Non-operating income, net	22	22
Income before income taxes	379	161
Income tax expense (note 8)	95	67
Net income before non-controlling interest	284	94
Non-controlling interest in net income of subsidiaries	3	4
Net income	\$ 281	\$ 90
Other comprehensive income (loss), net of tax		
Unrealized losses on available-for-sale financial assets arising during the year	(1)	–
Change in unrealized losses on available-for-sale financial assets	(1)	–
Other comprehensive loss	(1)	–
Comprehensive income	\$ 280	\$ 90

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

CONSOLIDATED CASH FLOW STATEMENT

Year ended December 31 (in millions of dollars)	2009	2008
Operating activities		
Net income	\$ 281	\$ 90
Adjustments to reconcile net income to cash provided by operating activities:		
Accrued pension, other retirement and post-employment benefits	122	476
Pension, other retirement and post-employment benefit payments	(446)	(221)
Transitional support offsetting pension reform incremental costs	(56)	(81)
Amortization	246	237
Future income tax benefit	90	(64)
Gain on sale of capital assets	(19)	(2)
Proceeds from long-term inducements	3	8
Other income not affecting cash, net	(8)	12
Change in non-cash operating working capital (note 17)	(79)	143
Cash provided by operating activities	134	598
Investing activities		
Business acquisitions or dispositions	(1)	(13)
Acquisition of securities	(3,173)	(3,392)
Proceeds from sale of securities	3,221	3,356
Acquisition of capital assets	(412)	(391)
Proceeds from sale of capital assets	32	7
Other investing activities, net	(10)	(2)
Cash used in investing activities	(343)	(435)
Financing activities		
Transitional support received from the Government of Canada	56	81
Repayment of long-term debt	(23)	(3)
Proceeds from long-term borrowing	45	–
Dividend paid	–	(22)
Other financing activities, net	(1)	–
Cash provided by financing activities	77	56
Net increase (decrease) in cash and cash equivalents	(132)	219
Cash and cash equivalents, beginning of year	605	386
Cash and cash equivalents, end of year	\$ 473	\$ 605

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(December 31, 2009)

1. Incorporation, Business Activities and Directives

Established by the *Canada Post Corporation Act* ("the Act") in 1981, Canada Post Corporation ("the Corporation") is a Crown corporation included in Part II of Schedule III to the *Financial Administration Act* and is an agent of Her Majesty. The Corporation's head office is located in Ottawa, Ontario, Canada.

The Corporation operates a postal service for the collection, transmission and delivery of messages, information, funds and goods both within Canada and between Canada and places outside Canada. While maintaining basic customary postal services, the Act requires the Corporation to carry out its statutory objects, with regard to the need to conduct its operations on a self-sustaining financial basis while providing a standard of service that will meet the needs of the people of Canada and that is similar with respect to communities of the same size.

Under the Act, the Corporation has the sole and exclusive privilege (with some exceptions) of collecting, transmitting and delivering letters to the addressee thereof within Canada. Other lines of business, not covered by the exclusive privilege, include parcels and direct marketing products and services. The Corporation's subsidiaries offer courier, transportation and logistics services. Innovapost, a joint venture, provides information technology services to The Canada Post Group.

In December 2006, the Corporation was issued two directives pursuant to section 89 of the *Financial Administration Act*.

The Corporation was directed to continue its financial contribution to the Publications Assistance Program until March 31, 2009. This financial contribution was capped at \$15 million per year (note 20). 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, or will be, made to the Program.

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 2008 and 2009, 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. In light of the variability in the extent and rate of recovery of the global and Canadian economies, and the general inability to forecast the effect on the Corporation's operations, it is reasonably possible that management's reassessments of these and other estimates and assumptions in the near term, as well as actual results, could require a material change in reported amounts and disclosures in the consolidated financial statements of future periods.

Certain comparative figures have been reclassified in order to conform to the presentation adopted in 2009.

2. Significant Accounting Policies (continued)

A summary of the significant accounting policies used in these consolidated financial statements follows:

- (a) **Consolidation** • These consolidated financial statements include the accounts of the Corporation and its subsidiaries, as well as its proportionate share of the accounts of its joint ventures (collectively referred to as “The Canada Post Group”). The results of any subsidiary or joint venture acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Effective January 1, 2009 the name of SCI Logistics Inc. was changed to SCI Group Inc. As at and subsequent to December 31, 2008, Purolator Courier Ltd (“Purolator”) and SCI Group Inc. (“SCI”) are the principal subsidiaries of the Corporation, and Innovapost Inc. (“Innovapost”) is the only joint venture. On April 3, 2008, a subsidiary of the Corporation, Canada Post International Limited (“CPIL”), transferred all of the shares of its subsidiary Nieuwe Post Nederlandse Antillen N.V. (“NPNA”) to the Government of the Netherlands Antilles, thereby terminating early the concession agreement to provide postal and postbanking services in the Netherlands Antilles. Subsequently, on November 19, 2008 the Corporation wound up CPIL. The operations of CPIL and NPNA were not significant to the Corporation.
- (b) **Financial instruments** • 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) All **investments** are financial assets designated as held for trading or available-for-sale and, therefore, are measured at fair value. With the exception of illiquid securities (note 7), fair value is determined directly by reference to quoted market prices, and may not be realized on sale. Investment transactions are recognized at the settlement date and changes in fair value are recognized as they occur.

Interest income, changes in fair value and realized gains and losses on sale of investments classified as held for trading are recorded in investment and other income.

Investments designated as available-for-sale consist of investments segregated to manage certain defined benefit plans (Note 7(f)). 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.

Investments are divided into four categories for separate presentation on the consolidated balance sheet. Each category is defined as follows:

- **Cash equivalents** are highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value. Therefore, cash equivalents consist of investments with maturities of three months or less from the date of acquisition.
- **Marketable securities** are investments with initial maturities greater than three months. Marketable securities are classified as current assets since reasonably prompt liquidation is possible.
- **Illiquid securities** are investments that are not traded actively and would be difficult to sell.
- **Segregated securities** are segregated funds invested by the Corporation. Although the liquidity of segregated securities varies, only the portion offsetting related current liabilities is presented as a current asset.

2. Significant Accounting Policies (continued)

- (b.2) **Accounts receivable** are financial assets classified as loans and receivables. These financial assets are subsequently measured at amortized cost using the effective interest method, less any impairment. Where the time value of money is not significant due to their short-term settlement, accounts receivable are 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 other cost of operations.

- (b.3) **Accounts payable and accrued liabilities, salaries and benefits payable and outstanding money orders** include other financial liabilities as well as obligations created by statutory requirements imposed by governments and other non-financial liabilities. After initial recognition at fair value, other financial liabilities are measured at amortized cost using the effective interest method. Where the time value of money is not significant due to their short-term settlement, the other financial liabilities are carried at payment or settlement amounts.

- (b.4) **Long-term debt** instruments are classified as other financial liabilities and initially recognized at fair value, net of any transaction costs. After initial recognition, long-term debt instruments are measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any transaction costs, and any discount or premium on settlement. Interest expense on long-term debt is recognized in interest and other expense.

- (c) **Capital assets** • Property, plant and equipment and intangible assets other than goodwill are referred to collectively as capital assets. The carrying value of capital assets is calculated as follows:

- (c.1) **Cost** • Capital assets acquired or developed internally are initially recorded at cost, with the exception of property, plant and equipment transferred from the Government of Canada on incorporation in 1981 that were recorded at their estimated fair value at that date. Assets acquired under capital leases are initially recorded at the present value of the minimum lease payments at the inception of the lease.

2. Significant Accounting Policies (continued)

- (c.2) **Amortization** • Amortization commences when the assets are placed into service and is recognized over the estimated useful lives of the assets, using the following methods:

Type of asset	Amortization method	Amortization period or rate
Buildings	Straight-line	15, 30 and 40 years
Leasehold improvements	Straight-line	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 5 years
Customer contracts	Straight-line	Term of contract plus period of renewal options, maximum of 5 years in 2009
Customer relationships	Straight-line	Estimated period of future benefit, based on historical experience and future projections of customer business, maximum of 20 years in 2009

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

Estimated useful lives for several classes of vehicles have been extended on a prospective basis in 2009. The extensions were made in order 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.

- (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.

2. Significant Accounting Policies (continued)

- (d) **Goodwill** • Goodwill, arising on the acquisition of a business, represents the excess of the cost of acquisition over The Canada Post Group's interest in the net fair value of the identifiable assets and liabilities of the business recognized at the date of acquisition. Goodwill is initially recognized at cost and is subsequently measured at cost less any accumulated amortization and impairment losses. Goodwill is not amortized but is instead tested for impairment annually, or more frequently if events and circumstances indicate that there may be impairment.

For the purpose of impairment testing, goodwill is allocated to reporting units. Reporting units comprise business operations with similar economic characteristics and may represent either an operating segment or a business unit within an operating segment. Potential impairment is identified when the carrying value of a reporting unit, including the allocated goodwill, exceeds its fair value. Fair value of the reporting unit is determined using the expected present value of future cash flows. Goodwill impairment is measured as the excess of the net carrying value of the reporting unit's allocated goodwill over the implied fair value of the goodwill, based on the fair value of the assets and liabilities of the reporting unit. An impairment loss is recognized in the year in which it is determined.

- (e) **Revenue recognition** • The Canada Post Group's revenue is mostly derived from providing the products and services that comprise the three lines of business: Transaction Mail, Parcels and Direct Marketing. Transaction Mail includes the physical and electronic delivery of bills, invoices, notices and statements. Parcels include regular parcels, all expedited delivery and courier services, as well as transportation and third-party logistics services. Direct Marketing includes Addressed Admail™, Unaddressed Admail™ and Publications Mail™, such as newspapers and periodicals. Other mail products and services include money orders and postal box rentals, as well as retail and philatelic products.

Revenue is recognized when the service has been rendered, goods have been delivered or work has been completed. Revenue from meter customers, for which services have not been rendered prior to year end, is deferred based on a sampling methodology that closely reflects the meter resetting practices of customers. Similarly, payments received in advance are deferred until services are rendered or products are delivered. Deferred revenue is also recorded when resellers are billed for postal products shipments prior to the Corporation rendering the related services to customers.

The Canada Post Group may enter into arrangements with subcontractors to provide services to customers. If The Canada Post Group acts as the principal in such an arrangement, the amount billed to the customer is recognized as revenue. Otherwise, the net amount retained (i.e. the amount billed to the customer less the amount paid to the subcontractor) is recognized as revenue.

When no identifiable and separable benefit is received by The Canada Post Group in return for consideration given to a customer, such as a benefit that might arise in a customer loyalty program, the consideration is recorded as a reduction of revenue.

- (f) **Incentive and lease inducement** • The incentive received upon signing of a 10 year outsourcing contract in 2002 was deferred, and is being amortized on a straight-line basis over the term of the contract. Lease inducements are also deferred, and are amortized on a straight-line basis over the initial fixed lease term. Amortization of the incentive is presented as reduction of other cost of operations while amortization of the lease inducements is presented as reduction of facilities expense. The current portion of the deferred incentive and lease inducement is presented in deferred revenue, and any remaining unamortized balance is presented in other long-term liabilities.

2. Significant Accounting Policies (continued)

(g) **Defined pension, other retirement and post-employment benefit plans** • The obligation for providing defined pension, other retirement and employee termination benefit plans is recognized over the period of employee service. However, the obligation for providing workers' compensation benefits and the continuation of certain benefits for employees on long-term disability is recognized when the event triggering the obligation occurs. Therefore, defined benefit plans can be divided into two types as follows:

(g.1) **Service-related defined benefit plans** • The estimated costs and accrued benefit obligations are determined annually, on an actuarial basis, using the projected benefit method prorated on service. For accounting purposes, accrued benefit obligations and fair value of plan assets are measured annually as at December 31.

The actuarial calculations include management's best estimate of the rates of return on plan assets, inflation, rates of compensation increase, retirement age, rates of employee disability, mortality, growth rates of health care costs and dental costs, as applicable. The expected long-term rates of return on plan assets are based on historical long-term returns provided by various asset categories weighted according to each pension plan's targeted asset allocations. The discount rates used to value the accrued benefit obligations are determined by reference to market conditions at year end, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the respective accrued benefit obligations.

Defined benefit costs include, as applicable, the estimated cost of employee benefits for current year's service, interest on accrued benefit obligations, expected return on plan assets, gain or loss on curtailment or settlement, expense recognized for special termination benefits and adjustments to allocate actuarial gains (losses), plan amendments, transitional obligation and funding excess to different years consistent with the long-term nature of employee future benefits.

To calculate the expected return on plan assets, these assets are valued at market-related values, whereby actuarial gains (losses) on plan assets for a year are recognized on a straight-line basis over five years.

Actuarial gains (losses) on plan assets for a year arise from the difference between the actual return on plan assets and the expected return. Actuarial gains (losses) on the accrued benefit obligations arise from the differences between actual and expected experience and changes in the assumptions used to determine the accrued benefit obligations. For each plan, the unrecognized net actuarial gain or loss exceeding 10% of the greater of the accrued benefit obligation or the market-related value of plan assets at the beginning of the year is recognized over the average remaining service period of active employees. Actuarial estimates indicate that the average remaining service periods of active employees covered by service-related defined benefit plans are as follows:

As at December 31	2009		2008	
	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	12 to 14 years	N/A	12 to 14 years	N/A
SCI	5 to 11 years	14 years	5 to 11 years	14 years
Innovapost	9 years	N/A	9 years	N/A

Past service costs arising from plan amendments are recognized on a straight-line basis over the expected average remaining service period of employees active on the date of amendment, up to the date of full eligibility.

On October 1, 2000, the Corporation assumed responsibility for a defined benefit provincial health insurance premium retirement plan and applied the accounting standards on employee future benefits to this obligation on a prospective basis. The transitional obligation, representing the unrecognized deficit in the plan at that date, was recognized on a straight-line basis over 8 years, being the expected average remaining service period, up to the date of full eligibility, of employees expected to receive benefits as of that date. The transitional obligation was fully recognized as at December 31, 2008.

2. Significant Accounting Policies (continued)

The funding excess, resulting from the *Federal Public Sector Pension Reform* effective October 1, 2000, represents the excess amount of the assets, transferred from the Government of Canada to the Corporation's pension plan, over the obligations assumed for the defined benefit pension plan. The funding excess is recognized on a straight-line basis over 11 years, being the expected average remaining service period of active employees covered by the pension plan as of that date.

The asset and liability recorded in the consolidated balance sheet represent the cumulative difference between the defined benefit costs and the total cash payments for the defined benefit plans.

(g.2) Event-driven defined benefit plans • The same methodology and assumptions as service-related defined benefit plans apply, except for the following:

- The projected benefit method is not prorated on service since the obligations are recognized when the event triggering the obligation occurs;
- Management's best estimate also takes into account the experience and assumptions of provincial workers' compensation boards;
- Actuarial gains (losses) are recognized over the average duration of the accrued benefit obligation; and
- Actuarial estimates indicate that the average duration of the accrued benefit obligations ranges from 3 to 8 years (2008 – from 3 to 9 years).

(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.

The Corporation is scheduled to receive the remaining \$13 million of transitional support in 2010.

(j) Income taxes • Future income tax assets and future income tax liabilities are recognized for the tax effect of the difference between the carrying values and tax basis of assets and liabilities. Future income tax assets are recognized for deductible temporary differences, for unused tax losses and income tax reductions to the extent that it is more likely than not that future income tax assets will be realized. Income tax assets and income tax liabilities are measured using substantively enacted income tax rates and income tax laws. These amounts are reassessed each year in the event of changes in income tax rates. Each change resulting from a revaluation is recognized in the financial results of the year of change.

Scientific research and experimental development ("SR&ED") tax credits are recorded using the cost reduction method, whereby the credits are recorded as a reduction of current cost of operations or property, plant and equipment, when there is reasonable assurance that the SR&ED tax credit will be realized.

(k) Foreign currency translation • Transactions in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect the rates of exchange in effect at the balance sheet date. All exchange gains and losses are included in revenue for the current year.

3. Adoption of New Accounting Standards

The Canada Post Group has prospectively adopted the following Canadian Institute of Chartered Accountants ("CICA") accounting standards effective January 1, 2009.

- (a) **Goodwill and Intangible Assets** • In February 2008, the CICA issued Section 3064 "Goodwill and Intangible Assets" which replaced CICA Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". The Accounting Standards Board ("AcSB") also amended CICA Section 1000 "Financial Statement Concepts" and Accounting Guideline AcG 11 "Enterprises in the Development Stage". The new and amended guidance clarifies that costs incurred on the acquisition or development of intangible resources may only be deferred when they relate to an item that meets the definition of an intangible asset. The practice of matching revenues and expenses remains appropriate only for allocating the cost of an intangible asset that is consumed in generating revenue over multiple reporting periods. Section 3064 provides extensive guidance on when expenditures qualify for recognition as intangible assets. These recommendations were adopted by The Canada Post Group on January 1, 2009 and did not have any effect on financial results.
- (b) **Credit Risk and the Fair Value of Financial Assets and Financial Liabilities** • In January 2009, the CICA's Emerging Issues Committee ("EIC") issued Abstract No. 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" (EIC-173). EIC-173 requires an entity to take into account its own credit risk and that of the relevant counterparty(ies) when determining the fair value of financial assets and financial liabilities, including derivative instruments. This EIC had no impact on the financial position or results of operations.
- (c) **Fair Value and Liquidity Risk Disclosure – Amendments to Financial Instruments – Disclosures** • In June 2009, the CICA amended Section 3862 "Financial Instruments – Disclosures" to improve fair value and liquidity risk disclosures. Section 3862 now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels, described below, for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair value of assets and liabilities:
- Level 1 – inputs are unadjusted quoted prices of identical instruments in active markets;
 - Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly;
 - Level 3 – one or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments.
- Determination of fair value and the resulting hierarchy requires the use of observable market data whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The amendments only impact the Corporation's disclosure. Refer to note 7(b).
- (d) **Impairment of Financial Assets – Amendments to Financial Instruments – Recognition and Measurement** • In August 2009, the CICA issued various amendments to Section 3855 "Financial Instruments – Recognition and Measurement" and Section 3025 "Impaired Loans" to change the categories into which certain debt investments are required or permitted to be classified and to require the reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances. These amendments had no significant effect on the Corporation's current operating results or financial position.

4. Recent Accounting Pronouncements Requiring Implementation in Future Years

- (a) **Business Combinations, Consolidated Financial Statements and Non-controlling Interest** • In January 2009, the AcSB issued CICA Section 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests", which replace Section 1581 "Business Combinations" and Section 1600 "Consolidated Financial Statements". Section 1582 applies to prospective business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted, but sections 1601 and 1602 must be applied concurrently.

Section 1582 provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 "Business Combinations". The new recommendations require measuring business acquisitions at the fair value of the acquired assets and assumed liabilities, including any non-controlling interest and contingent liabilities. Acquisition-related costs are expensed as incurred.

Section 1601, combined with Section 1602, replaces Section 1600. Section 1601 establishes standards for the preparation of consolidated financial statements and is aligned with the corresponding provisions of Section 1600. Section 1602 is aligned with the corresponding provisions of International Financial Reporting Standard IAS 27, "Consolidated and Separate Financial Statements" and establishes standards for accounting for a non-controlling interest in a subsidiary subsequent to a business combination. Section 1602 introduces a number of changes, including:

- The presentation of non-controlling interests as a separate component of equity rather than in between liabilities and equity on the balance sheet.
- Non-controlling interests are no longer recorded as a deduction of net income and total comprehensive income, but are shown as a separate component of the income statement, which discloses the allocation of net income between the owners of the parent and the non-controlling interests based on their relative economic interests. This allocation is also disclosed on the statement of comprehensive income.

Canada Post will consider the early adoption of these sections, effective January 1, 2010, in the event of any business acquisitions undertaken in 2010, in order to be more closely aligned with International Financial Reporting Standards ("IFRS") and to mitigate the impact of adopting IFRS at the January 1, 2011 changeover date. In accordance with the transitional provisions, these sections will be applied prospectively, except for the presentation requirements for non-controlling interests, which must be applied retrospectively. The adoption of these sections is not expected to have a significant impact on the Corporation's consolidated financial statements, but will give rise to the above-mentioned reclassifications of non-controlling interests.

- (b) **International Financial Reporting Standards ("IFRS")** • In February 2008, the AcSB confirmed that publicly accountable entities will be required to adopt IFRS in place of Canadian 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 will be required to follow IFRS for periods beginning January 1, 2011. The Corporation, which meets the current definition of a publicly accountable entity, will report under IFRS in its financial statements for the year ending December 31, 2011. These financial statements will include comparative results for the periods commencing January 1, 2010.

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

The implementation plan consists of three phases. The first phase, focusing on planning and early issue identification, was completed in 2008. The Corporation is currently focused on finalizing the second and third phases consisting of detailed evaluations and implementation. 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 through regulations under the *Canada Post Corporation Act* ("the Act") for domestic Lettermail™ and international Letter-post items, as well as fees for certain other services such as Registered Mail. These regulations are subject to approval by the Government of Canada, the sole shareholder and, therefore, a related party of the Corporation. The Act permits the Corporation to offer rates that differ from regulated rates under certain circumstances, such as when the customer agrees to mail in bulk. The Act states that regulated postage rates must be fair and reasonable, and consistent so far as possible with providing revenue, together with any revenue from other sources, sufficient to defray the costs incurred by the Corporation in the conduct of its operations under the Act.

The regulated pricing approval process requires that proposed rate changes 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. Subsequently, the final form of the proposed rate changes is approved by the Board of Directors and submitted to the Minister responsible for Canada Post for approval by the Government of Canada, specifically the Governor in Council. The rate changes are deemed approved 60 days after submission to the Governor in Council, unless the Governor in Council previously approved or refused to approve the changes.

Since 2001, the basic domestic letter rate ("BLR") has been determined by a price-cap formula set out in the *Letter Mail Regulations*, which limits increases to 66.67% of increases in the Consumer Price Index, implemented no more than once a year. However, Government approval was received to increase the BLR by one cent over that provided by the price-cap formula, and the BLR increased by 2 cents from \$0.52 to \$0.54 effective January 12, 2009. In October 2009, Government approval was received to replace the price-cap formula with five years of set prices for the BLR, effective January 2010. Under the new pricing plan, the BLR increased by 3 cents to \$0.57 in January 2010, then will increase by 2 cents each year after that through 2014. Government approval was also received in October 2009 to increase rates for other regulated products effective January 2010.

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 19).

The fact that postage rates for certain products and services are subject to regulation does not affect the application of Canadian generally accepted accounting principles to these consolidated financial statements.

Revenue from products and services charged to customers at regulated rates comprises 31% (2008 – 31%) of the Canada Post segment revenue (note 21).

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 and foreign exchange 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 other prices such as commodities.

(i) Interest rate risk

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 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 other than illiquid securities, extending terms to maturity to better match certain long-term post-retirement obligations to which they are externally restricted. The maximum duration in the portfolio was 10 years as at December 31, 2009 (2008 – 92 days). The increase in term to maturity is attributable to the Corporation's increased use, as a risk management strategy, of longer terms to maturity for segregated securities.

The Corporation has performed a sensitivity analysis on interest rate risk using a 1 percent 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 percent in market interest rates, with all other variables held constant, would increase or decrease the value of the segregated securities by \$35 million, excluding Master Asset Vehicle II ("MAVII") notes, at December 31, 2009. Such change in value would be partially offset by the change in value of certain long-term post-retirement obligations. Please refer to note 7(c) for a sensitivity analysis on MAVII notes. The Corporation's fixed-rate long-term debt will mature in 2016. There are no prepayment terms associated with the debt.

(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 US Dollar ("US\$"), Japanese Yen, Sterling and Euro, whereas payment is usually denominated in US\$ or, in some circumstances, the Euro. The Corporation's principal exposure is to the US\$. The effect of a 10% increase or decrease in the US\$ exchange rate on the balance sheet date, all other variables held constant, would have increased or decreased net income for the year by \$6 million. There is no significant impact on revenue arising from exposures to other currencies. Net exchange losses included in revenue amounted to \$5 million (2008 – \$13 million of net exchange gains).

(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.

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 where an active market exists, disposes of investments within a specified time period when the issuer's credit rating declines below acceptable levels. Impairment losses on investments recognized during the year were \$2 million (2008 – \$9 million) as described in note 7.

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

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	2009	2008
(in millions of dollars)		
Trade accounts receivable:		
Current	\$ 360	\$ 338
1-15 days past due	58	71
16-30 days past due	18	26
Over 30 days past due	24	22
Allowance for doubtful accounts	(12)	(11)
Trade accounts receivable – net	\$ 448	\$ 446
Receivables from foreign postal administrations	86	76
Other receivables	52	53
Accounts receivable	\$ 586	\$ 575

Impairment losses on accounts receivable recognized during the year were \$6 million (2008 – \$7 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. The Corporation's objective is to maintain immediately available liquidity of \$200 million to support current operating activities. Surplus cash is invested into a range of short-term money market securities. The Corporation invests in high credit quality Government or corporate securities in accordance with policies approved by the Board of Directors.

The Corporation's borrowing plan is reviewed and approved annually by the Board of Directors and 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 Minister of Finance may require that his recommendation also be obtained before the Corporate Plan is submitted to the Governor in Council for approval. In addition, the detailed terms and conditions for each borrowing must also be approved by the Minister of Finance. Pursuant to the *Canada Post Corporation Act*, the Corporation may borrow a maximum of \$500 million from the Government of Canada's Consolidated Revenue Fund. Pursuant to *Appropriation Act No. 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.

Although the Corporation's indebtedness has been maintained at a low level, the Corporation is considering increasing its indebtedness to address ongoing cash management needs. The Canada Post Group's borrowings amounted to \$130 million as at December 31, 2009 (2008 – \$74 million), of which \$120 million (2008 – \$74 million) was long-term. Within the above limits, the Corporation has a line of credit of \$19 million with a Canadian chartered bank and a commercial paper program that were not used during the year.

The Corporation's subsidiaries and joint venture also have access to financing facilities totalling \$200 million and of this amount, \$69 million (2008 – \$18 million) was drawn as at December 31, 2009.

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		2009			2008	
(in millions of dollars)						
	Weighted average effective interest rate	Less than 1 year	1–5 years	More than 5 years	Total	Total
Non-interest bearing*		\$ 719	\$ 1	\$ –	\$ 720	\$ 732
Non-redeemable bonds	10.6%	6	23	64	93	98
Other borrowings	Prime + 1.5%	–	25	–	25	18
Capital lease obligations	4%	12	38	5	55	1
		\$ 737	\$ 87	\$ 69	\$ 893	\$ 849

*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 15.

7. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities

(a) Nature and extent of investments

The nature and extent of the investments for each category are as follows:

As at December 31 (in millions of dollars)	Remaining term to maturity*			2009	2008
	Within 3 months	3 to 12 months	One to 10 years	Total	Total
Cash and cash equivalents					
Cash	\$ 126	\$ –	\$ –	\$ 126	\$ 90
Money market instruments issued by:					
Government of Canada	50	–	–	50	400
Provincial governments	35	–	–	35	40
Financial institutions	187	–	–	187	60
Corporations	75	–	–	75	15
Total cash and cash equivalents	\$ 473	\$ –	\$ –	\$ 473	\$ 605
Marketable securities					
Money market instruments issued by:					
Government of Canada	\$ 49	\$ 119	\$ –	\$ 168	\$ 103
Provincial governments	–	102	–	102	–
Total marketable securities	\$ 49	\$ 221	\$ –	\$ 270	\$ 103
Illiquid securities					
Master Asset Vehicle II (note 12)	\$ –	\$ –	\$ 4	\$ 4	\$ 5
Segregated securities					
Cash	\$ 14	\$ –	\$ –	\$ 14	\$ 1
Money market instruments issued by:					
Government of Canada	92	–	–	92	691
Provincial governments	31	20	–	51	88
Financial institutions	–	–	–	–	50
Corporations	–	–	–	–	15
Bonds issued by:					
Government of Canada	–	–	98	98	–
Provincial governments	–	–	167	167	–
Corporations	–	–	216	216	–
Master Asset Vehicle II	–	–	16	16	17
Total segregated securities	\$ 137	\$ 20	\$ 497	\$ 654	\$ 862

*Remaining term to maturity classifications are based on the contractual maturity of the investments or expected maturities for Master Asset Vehicle II notes.

All money market instruments and bonds held as at December 31, 2009 were issued by Canadian entities at fixed interest rates or discounted values. The weighted average effective interest rate as at December 31, 2009 was 0.3% for money market instruments (2008 – 1.3%) and 3.7% for bonds.

7. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities (continued)

(b) Fair value of financial instruments

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. The fair value of long-term debt is provided in note 13. The fair value of other financial assets and liabilities approximate their carrying values due to their expected settlement in the short-term.

As at December 31 (in millions of dollars)				2009	2008
	Level 1*	Level 2**	Level 3***	Total	Total
Cash and cash equivalents	\$ 473	\$ –	\$ –	\$ 473	\$ 605
Marketable securities	\$ 270	\$ –	\$ –	\$ 270	\$ 103
Other assets: illiquid securities	\$ –	\$ –	\$ 4	\$ 4	\$ 5
Segregated securities	\$ 638	\$ –	\$ 16	\$ 654	\$ 862

* 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 and requires management's best estimate. Level 3 assets comprise investments in MAVII notes.

The Corporation does not have financial liabilities measured at fair value or derivatives.

Reconciliation of level 3 fair values:

	Illiquid securities included in:	
	Other assets	Segregated securities
Opening balance	\$ 5	\$ 17
Total losses in net income*	(1)	(1)
Ending balance	\$ 4	\$ 16
Cumulative unrealized losses from assets still held at year end	\$ 4	\$ 14

* Losses from illiquid assets classified in other assets are included with "Investment and other income" and losses from illiquid assets classified in segregated securities are included with "Benefits" on the consolidated income and comprehensive income statement.

7. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities (continued)

(c) Fair value of Master Asset Vehicle II notes ("MAVII")

On January 21, 2009, under the oversight of the Ontario Superior Court and as proposed by the Pan American Investors Committee, the non-bank sponsored asset backed commercial paper ("ABCP") programs were restructured under the Montreal Accord. Upon restructuring, the Corporation elected to receive various classes of MAVII notes with an equivalent face value of \$38 million.

The Corporation received the following MAVII notes (in millions of dollars):

MAVII notes	Face value received January 21, 2009	Cumulative fair value adjustment as at December 31, 2009	Fair Value at December 31, 2009
Class A-1	\$ 24	\$ (9)	\$ 15
Class A-2	8	(4)	4
Class B	2	(1)	1
Class C	1	(1)	—
Class 13	3	(3)	—
Total	\$ 38	\$ (18)	\$ 20

The MAVII notes include a pooling of leveraged investments as well as traditional assets and cash, which are expected to increase the stability of the notes when compared with the previously held ABCP. The Corporation elected to receive notes issued by MAVII in which investors are not required to advance funds to meet future margin calls, should they occur. The Class A-1 and A-2 have been rated "A" and "BBB(low)" respectively by the Dominion Bond Rating Service ("DBRS") while the Class B, C and 13 are unrated.

The Class A-1, Class A-2, and Class B notes have interest rates of Bankers' Acceptance (BA) rate less 50 basis points and have legal maturity dates of July 15, 2056. The Class C notes have interest rates of BA rate plus 20% per annum and mature on July 15, 2056. However, the expected repayment date of the Class A-1, A-2, B and C notes is January 22, 2017. The Class 13 notes have interest based on the net rate of return generated by certain asset tracking notes and mature on March 20, 2014.

The Corporation is monitoring the publicly announced market activity of these notes and is aware of certain transactions which occurred prior to December 31, 2009. However, these transactions have not been used as a basis to determine the fair value of its notes since in the Corporation's view, an active market remains to be established. If an active market were to develop in the future, the Corporation will change its valuation technique to determine fair value of its notes using quoted market prices.

The Corporation's estimate of the fair value of MAVII notes was determined using a discounted cash flow technique, based on the best available information as at December 31, 2009. The significant assumptions used in the valuation model at December 31, 2009 are based on expected maturities.

Weighted average interest rate	0.50%
Weighted average discount rate	8.75%
Credit losses	Up to 50%

7. Cash and Cash Equivalents, Marketable Securities, Illiquid Securities and Segregated Securities (continued)

Based on this analysis, an additional impairment of the total fair value of the MAVII notes of \$2 million was recorded in 2009. The most significant assumptions in determining the fair value are the discount rate and coupon interest rates assigned to the new notes. A 1% increase (decrease) in the weighted average discount rate or a 0.5% decrease (increase) in the weighted average interest rate would result in a decrease (increase) in the estimated fair value of MAVII notes held by the Corporation of approximately \$1 million.

Continuing uncertainties regarding the development of an active market for MAVII notes, the amount and timing of interest and principal payments, the value of the assets that underlie the notes, and the credit and liquidity risks associated with them could give rise to further changes in the fair value of the Corporation's investment in MAVII notes, although this is not expected to result in a significant impact on the Corporation's future earnings.

(e) Income from investments

Interest income and gains and losses on cash and cash equivalents, marketable and illiquid securities amounted to \$3 million (2008 – \$18 million). Interest income and gains and losses on segregated securities amounted to \$8 million (2008 – \$18 million). The portion of income relating to the defined benefit plans was \$7 million (2008 – \$10 million) and was used to offset benefit costs. The remaining \$1 million (2008 – \$8 million) relates to internally restricted funds and was recognized in investment and other income.

(f) Segregated securities

Funds have been segregated as follows:

As at December 31 (in millions of dollars)	2009	2008
Other retirement dental and life insurance benefits	\$ 511	\$ 511
Internally restricted funds	143	351
Total segregated securities	\$ 654	\$ 862

Funds were segregated either to conform with externally imposed restrictions or in anticipation of future cash flow requirements as explained below:

- External restrictions were imposed on other retirement dental and life insurance benefit plans repatriated through the *Federal Public Sector Pension Reform*. These defined benefit plans are partially funded by the transitional support and, therefore, the Corporation is obligated to use these funds exclusively for related benefit payments.
- The Corporation has segregated certain funds in anticipation of future cash flow requirements. These segregated funds will be used either for significant projects to renew the operational capability of the Corporation or required regulatory contributions to the Corporation's pension plan in the event of either a solvency or going-concern shortfall.

8. 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)	2009	2008
Net future income tax assets (liabilities)		
Capital assets	\$ (11)	\$ 6
Salaries and benefits payable	24	20
Accrued pension, other retirement and post-employment benefits	135	213
Other	20	24
Net future income tax assets	\$ 168	\$ 263
Presented in the consolidated balance sheet as:		
Future income tax assets:		
Current	\$ 25	\$ 23
Long-term	179	270
Total future income tax assets	204	293
Future income tax liabilities:		
Long-term	(36)	(30)
Net future income tax assets	\$ 168	\$ 263

Deductible temporary differences for which no future income tax assets have been recognized amount to \$768 million (2008 – \$768 million) and relate mainly to the accrued other retirement and post-employment benefit liability. These differences are not expected to reverse in the foreseeable future.

The major components of the income tax expense are as follows:

Year ended December 31 (in millions of dollars)	2009	2008
Current income tax expense	\$ 5	\$ 131
Future income tax expense (benefit) relating to:		
Origination and reversal of temporary differences	88	(64)
Reduction in tax rate	2	–
Income tax expense	\$ 95	\$ 67

A reconciliation of the income tax expense, related to income before income taxes, to the amount of income tax using the statutory federal tax rate follows:

Year ended December 31 (in millions of dollars)	2009	2008
Income before income taxes	\$ 379	\$ 161
Federal income taxes at parent's statutory tax rate	\$ 110	\$ 48
Subsidiaries and joint venture's provincial income taxes less federal tax abatement	2	4
Effect of statutory tax rate changes on future income taxes	(20)	9
Other	3	6
Income tax expense	\$ 95	\$ 67

9. Capital Assets

As at December 31

2009

2008

(in millions of dollars)

	Cost	Accumulated amortization	Net carrying value	Cost	Accumulated amortization	Net carrying value
Property, plant and equipment						
Land	\$ 259	\$ –	\$ 259	\$ 259	\$ –	\$ 259
Buildings	1,796	1,021	775	1,801	1,024	777
Leasehold improvements	214	149	65	201	133	68
Plant equipment	1,055	787	268	975	738	237
Vehicles	239	157	82	219	152	67
Sales counters, office furniture and equipment	408	277	131	339	257	82
Other equipment	788	460	328	799	478	321
Assets under development	139	–	139	70	–	70
Total property, plant and equipment	4,898	2,851	2,047	4,663	2,782	1,881
Intangible assets						
Software	489	360	129	418	326	92
Software under development	33	–	33	52	–	52
Customer contracts and relationships	27	20	7	27	18	9
Total intangible assets	549	380	169	497	344	153
Total capital assets	\$ 5,447	\$ 3,231	\$ 2,216	\$ 5,160	\$ 3,126	\$ 2,034

Amortization of property, plant and equipment amounted to \$201 million in 2009 (2008 – \$196 million) while amortization of intangible assets amounted to \$45 million (2008 – \$41 million).

During the year, The Canada Post Group invested \$412 million (2008 – \$391 million) in capital assets, comprising \$354 million (2008 – \$342 million) of property, plant and equipment and \$58 million (2008 – \$49 million) of intangible assets.

As at December 31, 2009, 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 \$18 million (2008 – \$1million), net of accumulated depreciation of \$12 million (2008 – nil); vehicles held under capital leases totalling \$20 million (2008 – nil), net of accumulated depreciation \$0 (2008 – nil); and plant equipment held under capital leases totalling \$25 million (2008 – nil), net of accumulated depreciation of \$1 million (2008 – nil).

10. Pension, Other Retirement and Post-Employment Benefit Plans

(a) Description of benefit plans

The Corporation has a number of funded and unfunded defined benefit plans that provide pension, other retirement and post-employment benefits for most of its employees. Unfunded plans are plans where benefits are paid directly by the Corporation. With funded plans, funds are transferred to external trusts and the benefits are paid directly from these trusts. The Corporation's defined benefit pension plan is a funded plan based on length of pensionable service, the average of the best five consecutive years of pensionable salary and retirement age. The plan provides for retirement pension, survivor's pension or a refund after termination of employment or death. Pension benefits are covered by the registered pension plan and the retirement compensation arrangement, for benefits in excess of statutory limits as defined under the *Income Tax Act*. Pension benefits in pay are indexed annually. Both the Corporation's contributions and the employees' contributions to the external trusts are made in accordance with the provisions of the plan. In addition, the Corporation's contributions are determined by actuarial valuations, in compliance with the requirements of regulatory authorities, to ensure that the external trusts have sufficient assets to pay pension benefits when employees retire.

Other retirement defined benefit plans include unfunded health care, dental and life insurance plans. The post-employment defined benefit plans include unfunded employee termination benefits and health and dental coverage for employees receiving long-term disability benefits. The benefit costs covered by the Corporation and the costs assumed by employees and retirees are determined in accordance with the rules of each plan and the provisions of labour contracts.

By the end of 2006, the Corporation's employee termination benefit plan was fully curtailed. The curtailment of the plan froze the employees' entitlement based on the accumulation of years of service as of the curtailment date, and further benefit entitlements based on years of service was discontinued. On curtailment, employees were given the option of settlement by receiving the cash value of their accrued termination benefit or the option of deferring receipt of their benefit until departure, at which time the benefit would reflect their base salary at retirement or their base salary at the curtailment date if they resign or are terminated. Most employees chose the option of settlement.

The Corporation is subject to the *Government Employees Compensation Act* and, therefore, is not mandatorily covered under any provincial workers' compensation act. The Corporation is a self-insured employer, responsible for workers' compensation benefits incurred since incorporation. The Corporation's unfunded obligation for workers' compensation benefits is based on known awarded disability and survivor pensions and other potential future awards for accidents that occurred up to the measurement date. Workers' compensation benefits are provided according to the respective provincial workers' compensation legislation. Benefit entitlements in the three Territories are based on the Alberta legislation.

Purolator has a number of funded defined benefit pension plans. The defined benefit plans are based either on length of pensionable service and salary paid each year or on negotiated benefit rates, depending on the type of employees. Since these defined benefit plans are subject to the maximum pension payable under the *Income Tax Act*, a supplementary pension plan, based on length of pensionable service and final average salary, is offered to designated employees. Purolator also provides pension benefits to eligible employees through a defined contribution plan. Plan members are not required nor permitted to contribute to the defined benefit pension plans.

10. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Certain employees of SCI presently belong to a pension plan sponsored by SCI's former owner, Bell Canada. The BCE Inc. Pension Plan is a non-contributory, defined benefit pension plan that provides for benefits based on length of pensionable service and final average salary. Pension benefits in pay are indexed annually. The assets of the pension plan are invested in units of the BCE Master Trust Fund with Royal Trust acting as trustee. However, in 2001 the Corporation entered into a Share Purchase Agreement with Bell Canada whereby the employees of SCI started participating in a new pension plan, disengaged from Bell Canada. The pension plan assets and liabilities for pensions and related benefits accrued at the date of change of ownership will be transferred to the new pension plan on completion of the related actuarial valuations, pending regulatory approval. The amounts of assets and liabilities included in these consolidated financial statements represent current estimates of the amounts to be transferred to the new Pension Plan, adjusted for all activity subsequent to the change of ownership. The estimate of the transfer amount relating to plan assets includes management's best estimate of the effect of certain events related to the BCE Inc. Pension Plan that occurred prior to the purchase of SCI by the Corporation. The estimate was revised in 2007 based on a report provided by BCE Corporate Services. The amounts to be transferred into the new, separate Pension Plan will be finalized and transferred over only when regulatory approval has been obtained. In 2005, a supplementary pension plan was created for designated employees to replace the current plan, whereby employees who reach the maximum pension payable from the registered plan would receive the excess pension payable by SCI. The results for this plan are included with those of the regular plan. After the acquisition, a defined contribution provision was added to SCI's pension plan.

The other retirement benefit plans pertaining to SCI's employees consist of medical and dental benefits, and life insurance after retirement. SCI pays the full cost of these benefits, except for the dental plan which is paid 100% by the retirees who choose this coverage.

Innovapost has a funded defined benefit pension plan. Like the Corporation, pension benefits that are not permissible in the registered pension plan are provided by a retirement compensation arrangement. Pension benefits, based on length of pensionable service and average pensionable salary, are indexed according to the annual increase in the consumer price index. Employer and employees' contributions are made in accordance with the plan. After October 31, 2002, no new members are eligible to join Innovapost's pension plan.

10. 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)	2009		2008	
	Pension benefit plans	Other benefit plans	Pension benefit plans	Other benefit plans
Accrued benefit obligations				
Balance, beginning of year	\$ 11,732	\$ 2,489	\$ 14,208	\$ 3,215
Current service cost	243	73	447	107
Interest cost	880	189	803	180
Employee contributions	191	–	188	–
Benefits paid	(462)	(112)	(391)	(105)
Actuarial (gains) losses	1,351	86	(3,531)	(900)
Plan amendments	–	(27)	12	(6)
Curtailment	–	–	–	(2)
Settlement	–	–	(4)	–
Balance, end of year	13,935	2,698	11,732	2,489
Plan assets				
Fair value, beginning of year	12,175	–	15,180	–
Actual return on plan assets	1,903	–	(2,909)	–
Employer regular contributions	304	–	98	–
Employer special contributions	24	–	13	–
Employee contributions	191	–	188	–
Benefits paid	(462)	–	(391)	–
Settlement	–	–	(4)	–
Fair value, end of year	14,135	–	12,175	–
Funded status of defined benefit plans – surplus (deficit)	200	(2,698)	443	(2,489)
Unrecognized net actuarial (gains) losses	1,155	40	506	(53)
Unrecognized past service costs (credits)	23	(163)	25	(166)
Unrecognized funding excess	(57)	–	(89)	–
Net amount recognized for:				
Defined benefit plans	1,321	(2,821)	885	(2,708)
Defined contribution plans	–	–	(1)	–
Total amount recognized	\$ 1,321	\$ (2,821)	\$ 884	\$ (2,708)

10. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

The recognized amounts are presented in the consolidated balance sheet as follows:

As at December 31 (in millions of dollars)	2009	2008
Accrued pension benefit asset	\$ 1,335	\$ 898
Accrued pension benefit liability	\$ 14	\$ 14
Accrued other retirement and post-employment benefit liability	2,821	2,708
Accrued pension, other retirement and post-employment benefit liability	\$ 2,835	\$ 2,722

(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)	2009		2008	
	Pension benefit plans	Other benefit plans	Pension benefit plans	Other benefit plans
Accrued benefit obligations	\$ 68	\$ 2,698	\$ 57	\$ 2,489
Plan assets	49	–	44	–
Funded status of defined benefit plans – deficit	\$ (19)	\$ (2,698)	\$ (13)	\$ (2,489)

(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.

10. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

The Corporation's investment objective for its pension plan assets is to achieve a long-term rate of return, net of administrative expenses, which exceeds inflation by at least 4.75%. Investments are made according to criteria and limitations set by the Board of Directors and applicable legislation. Allowable types of investment, individual investment limits, portfolio investment limits, maturity limits and minimum credit quality ratings are set by the Board to reduce the level of risk and provide diversification between industry sectors, geographic/economic areas and management styles. The asset allocations, by asset category, of the Corporation's pension plan are as follows:

As at December 31	2009		2008
	Target	Actual	Actual
Cash and money market instruments	1 %	1 %	3 %
Bonds	36 %	36 %	38 %
Canadian equities	22 %	26 %	22 %
U.S. equities	20 %	17 %	17 %
International equities	15 %	14 %	14 %
Real estate	5 %	4 %	5 %
Other assets less liabilities	1 %	2 %	1 %
Pension plan assets of the Corporation	100 %	100 %	100 %

The pension plan assets of Purolator, SCI and Innovapost are governed by similar investment objectives and policies and account for 2% (2008 – 2%) of the total plan assets of \$14,135 million (2008 – \$12,175 million).

Total plan assets include \$2,271 million (2008 – \$2,338 million) in money market instruments and bonds issued by the Government of Canada, its agencies and other Crown corporations and \$128 million (2008 – \$122 million) in refundable taxes held by the Canada Revenue Agency.

10. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

(e) Costs (recoveries)

The elements of employee future benefit costs (recoveries) recognized in the year are as follows:

Year ended December 31 (in millions of dollars)	2009			2008		
	Incurred in year	Adjustments*	Recognized in year	Incurred in year	Adjustments*	Recognized in year
Pension benefit plans						
Current service cost	\$ 243	\$ –	\$ 243	\$ 447	\$ –	\$ 447
Interest cost	880	–	880	803	–	803
Return on plan assets	(1,903)	803	(1,100)	2,909	(3,976)	(1,067)
Actuarial (gains) losses on accrued benefit obligations	1,351	(1,453)	(102)	(3,531)	3,532	1
Plan amendments	–	2	2	12	(9)	3
Settlement loss	–	–	–	1	–	1
Amortization of funding excess	–	(32)	(32)	–	(32)	(32)
Defined benefit costs (recoveries)	571	(680)	(109)	641	(485)	156
Defined contribution costs	6	–	6	5	–	5
Total pension benefit costs (recoveries)	577	(680)	(103)	646	(485)	161
Transitional support from the Government of Canada	(23)	–	(23)	(35)	–	(35)
Net pension benefit costs (recoveries)	\$ 554	\$ (680)	\$ (126)	\$ 611	\$ (485)	\$ 126
Other benefit plans						
Current service cost	\$ 73	\$ –	\$ 73	\$ 107	\$ –	\$ 107
Interest cost	189	–	189	180	–	180
Actuarial (gains) losses on accrued benefit obligations	86	(93)	(7)	(900)	957	57
Plan amendments	(27)	(3)	(30)	(6)	(24)	(30)
Curtailement gain	–	–	–	(2)	–	(2)
Amortization of transitional obligation	–	–	–	–	3	3
Defined benefit costs	321	(96)	225	(621)	936	315
Return on segregated securities	(7)	–	(7)	(10)	–	(10)
Transitional support from the Government of Canada	(33)	–	(33)	(46)	–	(46)
Net other benefit costs	\$ 281	\$ (96)	\$ 185	\$ (677)	\$ 936	\$ 259

* Adjustments to allocate costs to different years so as to recognize the long-term nature of employee future benefits.

10. 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	2009		2008	
	Pension benefit plans	Other benefit plans	Pension benefit plans	Other benefit plans
Accrued benefit obligations:				
Discount rate	6.7%	6.9%	7.5%	7.6%
Long-term rate of compensation increase	3.0%	3.0%	3.0%	3.0%
Benefit costs:				
Discount rate	7.5%	7.6%	5.6%	5.5%
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	8.4%	N/A	8.9%
Cost trend rate declines to	N/A	4.9%	N/A	5.3%
Year that the rate reaches the rate it is assumed to remain at	N/A	year 20	N/A	year 10

(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 2009:

Change in discount rate of 0.5%:

(in millions of dollars)	Increase	Decrease
Total of current service and interest costs	\$ (35)	\$ 39
Accrued benefit obligations	\$ (887)	\$ 989

Change of 0.5% in expected long-term rate of return on plan assets:

(in millions of dollars)	Increase	Decrease
Pension benefit costs	\$ (76)	\$ 76

10. 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 2009:

(in millions of dollars)	Increase	Decrease
Total of current service and interest costs	\$ 40	\$ (30)
Accrued benefit obligations	\$ 330	\$ (264)

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)	2009	2008
Benefits paid directly to beneficiaries for unfunded other benefit plans	\$ 112	\$ 105
Employer regular contributions to funded pension benefit plans	304	98
Employer special solvency contributions to funded pension benefit plans	24	13
Total cash payments for defined benefit plans	440	216
Contributions to defined contribution plans	6	5
Total cash payments	\$ 446	\$ 221

Under current legislation, the funding valuation of the Corporation's defined benefit pension plans is required to be filed at least every three years and annually if the solvency ratio of a plan assets to solvency liabilities is less than 1.0 at the time of filing. In the event of a solvency or going-concern deficit, regulatory authorities require special contributions be made over specified future periods.

The Corporation's pension plan last filed a valuation report as at December 31, 2007 at which time the plan was in a funding excess position, both on a going concern and solvency basis. This allowed the Corporation to take contribution holidays for part of 2008. Given the current position of the Corporation's pension plan, the Corporation resumed its contributions as at November 1, 2008 and continued to do so in 2009. Furthermore, a funding valuation as at December 31, 2009 will be filed with regulatory authorities during the course of 2010 which is one year earlier than initially planned.

10. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Pursuant to current legislation, the expected solvency deficit will require special contributions for 2010 that are currently estimated at \$455 million. However, as the legislation and regulations for federally regulated pension plans are currently under review, future funding rules may differ from those currently in effect which could affect the required deficit contributions.

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, 2007	December 31, 2009
Purolator	December 31, 2008	December 31, 2009
SCI	December 31, 2006	December 31, 2009
Innovapost	December 31, 2007	December 31, 2010

11. Goodwill

The changes in the carrying amount of goodwill are as follows:

Year ended December 31 (in millions of dollars)	2009			2008	
	Canada Post segment	Purolator segment	Logistics segment	Total	Total
Balance, beginning of year	\$ –	\$ 121	\$ 3	\$ 124	\$ 124
Purchase price adjustment	–	–	1	1	–
Balance, end of year	\$ –	\$ 121	\$ 4	\$ 125	\$ 124

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.

12. Other Long-Term Assets

As at December 31

(in millions of dollars)

	2009	2008
Assets held for sale	\$ 6	\$ 1
Illiquid securities (note 7)	4	5
Other	13	13
Total other long-term assets	\$ 23	\$ 19

The Corporation has classified several properties as held for sale at the end of 2009. It is anticipated that the carrying amount of the properties will be fully recovered through the sale proceeds. All but two of the properties held for sale at the end of 2008 were sold in 2009 as anticipated. A gain of less than \$1 million was recorded on the disposition.

13. Long-Term Debt

As at December 31

(in millions of dollars)

	2009		2008	
	Fair value	Carrying value	Fair value	Carrying value
Non-redeemable bonds maturing March 2016, interest at 10.35% payable semi-annually on March 15 and September 15 ¹	\$ 78	\$ 55	\$ 79	\$ 55
Capital lease obligations, maturing on various dates in 2011 and 2012, net of implicit interest at rates varying from 5.7% to 7.5% ²	6	6	1	1
Capital lease obligations, maturing in 2016, net of implicit interest at rates between 3.1% and 5.5% ³	44	44	—	—
Revolving term credit facility, interest at Bank of Canada prime plus 1.5%, repayment term three years due in January 2012 ⁴	25	25	—	—
Other long-term borrowing, interest at Bank of Canada prime rate, repayment term five years ⁵	—	—	18	18
Total long-term debt	153	130	98	74
Less current portion	10	10	—	—
Long-term portion	\$ 143	\$ 120	\$ 98	\$ 74

¹ Fair value of long-term bonds is estimated by reference to quoted market prices of similar bonds. The effective interest rate as at December 31, 2009 was 10.6% (2008 – 10.5%) for the non-redeemable bonds. The scheduled repayment date of these bonds is March 2016. There are no prepayment terms associated with this debt.

² 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, 2009 was 6.7% (2008 – 6.8%).

³ A subsidiary has drawn \$44 million from a leasing facility to acquire capital assets. The leasing facility, which allows for borrowings of up to \$50 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.

⁴ A subsidiary entered into a revolving term credit facility with a Canadian bank in January 2009. The facility allows the subsidiary to borrow to a maximum of \$150 million on an unsecured three year term revolving line of credit. The amount drawn under this facility is \$25 million at December 31, 2009 and is not due until the end of the term of the facility. 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 1.5%. 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.

⁵ The other long-term borrowing of one of the Corporation's subsidiaries represented an amount drawn on a credit facility as at December 31, 2008, which was converted to capital leases in 2009.

Interest expense on long-term debt amounted to \$8 million (2008 – \$6 million).

13. Long-Term Debt (continued)

Principal repayments on long-term debt excluding capital lease obligations are as follows:

(in millions of dollars)

2012	\$	25
2016		55
	\$	80

Minimum capital lease payments are as follows:

(in millions of dollars)

	Principal	Interest	Payment
2010	\$ 10	\$ 2	\$ 12
2011	9	1	10
2012	9	1	10
2013	8	1	9
2014	9	–	9
Thereafter	5	–	5
	\$ 50	\$ 5	\$ 55

14. 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, 2009 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 \$7 million (2008 – \$11 million). The sales of the properties are expected to occur within the next four years, and the estimated cash flows have been discounted at a credit-adjusted risk-free rate of between 3% and 4.2 %. The present values of the Corporation's conditional asset retirement obligations at December 31, 2009, totalling \$6 million (2008 – \$10 million), are included in other long-term liabilities.

15. Capital Management

The Corporation is subject to the *Canada Post Corporation Act* and the *Financial Administration Act* ("the Acts") and any directives issued pursuant to the Acts. These Acts affect how the Corporation manages its capital by, among other things, setting broad objectives for the Corporation. Specifically, while maintaining basic postal service and in carrying out its objectives, the Corporation must have regard for the need to conduct its operations on a self-sustaining financial basis while providing a standard of service that meets the needs of the people of Canada.

In April 2008, the Government launched a Strategic Review of the Corporation to examine the Corporation's public policy objectives, its ability to remain financially self-sustaining, and the continued relevance of the 1998 Policy Financial Framework. The Strategic Review Advisory Panel submitted its findings and recommendations to the Minister responsible for the Corporation in December 2008. Among various recommendations, the Advisory Panel endorsed the importance of investment renewal, enabled through increased access to financing, needed to sustain the Corporation and assure that universal postal services can continue. The panel also recommended the need for a new financial framework for the Corporation.

The Government has endorsed the Corporation's need for an increased authority for its external borrowing. To that end, the Corporation's borrowing limit, other than from the Crown, increased from \$300 million to \$2.5 billion pursuant to *Appropriation Act No. 4, 2009-10*, which received Royal Assent on December 15, 2009. At any time, the value of these borrowings cannot exceed an aggregate amount of \$2.5 billion, in accordance with the terms and conditions approved by the Minister of Finance. The increase will help the Corporation to address ongoing cash management needs.

The Corporation defines and computes its capital as follows:

As at December 31 (in millions of dollars)	2009	2008
Equity of Canada	\$ 1,787	\$ 1,507
Long-term debt	130	74
Other long-term financial obligation	16	19
Total capital	\$ 1,933	\$ 1,600

The Corporation's objectives in managing capital are to:

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

In 2009 and 2008, the Corporation relied on cash flow provided by operations and accumulated funds to support its financial obligations and fund its capital and strategic requirements. Indebtedness has been maintained at a low level. Since 2007, the Corporation has segregated funds for specific future cash flow requirements. These segregated funds would be drawn only for significant projects related to the renewal of the Corporation's operational capabilities or to make regulatory contributions to the Corporation's pension plan in the event of a solvency or going-concern deficit.

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.

15. 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 thereto, which are subject to the approval of the Board of Directors and the Governor in Council. In addition, the detailed terms and conditions of any specific borrowing transaction must be approved by the Minister of Finance.

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 since that time.

Given the Corporation's current financing pressures, no dividend was paid in 2009. The Government of Canada has approved the Corporation's proposal not to pay a dividend in 2010.

The Corporation's financial objectives and 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. Approval was received on December 10, 2009 for the first year of the Corporation's 2009 to 2013 Corporate Plan and for the Corporation's 2010 to 2014 Corporate Plan.

The Corporation and its subsidiaries and joint venture are not subject to any externally imposed capital requirements.

16. 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 have 60 days from the date of the Court of Appeal's decision to seek leave to appeal to the Supreme Court of Canada.

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.

16. Commitments and Contingencies (continued)

- (b) The Corporation and Purolator have made certain commitments that apply upon the expiration or termination of their respective agreements with Innovapost. These agreements were signed for a 10 year period that commenced in 2002, with an optional renewal period of five years. 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) CPIL and its subsidiary entered into an agreement with the Government of the Netherlands Antilles to provide postal and postbanking services, to the residents of the five islands that comprise the Netherlands Antilles, for a 20 year period that commenced in May 2003. Compliance with certain terms of the agreement for the concession was in dispute, with each party alleging defaults by the other. A number of meetings were held in 2007 with the Government of the Netherlands Antilles, with the objective of negotiating an amicable settlement. As a result of these meetings, the parties signed a Memorandum of Understanding in December 2007 and a Settlement Agreement in January 2008. The appropriate authorization under the *Financial Administration Act* was obtained in February 2008.

As per the terms and conditions set out in the Settlement Agreement, in April 2008, CPIL transferred 100% of the shares in its subsidiary, Nieuwe Post Nederlandse Antillen N.V., to the Government of the Netherlands Antilles and paid \$7 million as full and final settlement. Subsequently, in November 2008, the Corporation wound up and dissolved CPIL.

- (d) In the normal course of business, the Corporation has entered into agreements that include indemnities in favour of third parties. In addition, the Corporation has entered into indemnity agreements with each of its directors, officers and certain employees to indemnify them, subject to the terms of these agreements, against claims and expenses incurred by them as a result of serving as a director or officer of the Corporation or as a director, officer or in a similar capacity of another entity at the request of the Corporation.

These agreements generally do not contain specified limits on the Corporation's liability and, therefore, it is not possible to estimate the potential future liability under these indemnities. No amounts have been accrued in the consolidated financial statements with respect to these indemnities.

- (e) The Corporation is involved in various claims and litigation in the normal course of business. Provisions are recorded when and if losses are likely and amounts can be reasonably estimated.
- (f) The Corporation's employees are permitted to accumulate unused sick leave. However, such leave entitlements do not vest and can be used only in the event of illness. The amount of accumulated sick leave entitlements which will become payable in future years cannot reasonably be determined. Payments of sick leave benefits are included in the cost of operations.

16. Commitments and Contingencies (continued)

- (g) The future minimum lease payments with respect to facilities, transportation equipment and other operating leases with terms in excess of one year, are as follows:

(in millions of dollars)

2010	\$	143
2011		127
2012		103
2013		80
2014		63
2015 and thereafter		593
Total	\$	1,109

Included in the above are lease payments made in the normal course of business in the amount of \$20 million with a related party, the Government of Canada, for premises used in postal operations (2008 – \$27 million).

- (h) The Corporation has contractual arrangements with third-party suppliers totalling approximately \$306 million related to its Postal Transformation investment project. 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)

2010	\$	114
2011		98
2012		65
2013		29
Total	\$	306

- (i) 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.

17. Cash Flow Information

Year ended December 31

(in millions of dollars)

2009

2008

Change in non-cash operating working capital

Decrease (increase) in accounts receivable	\$ (7)	\$ 6
Decrease in net income tax payable	(69)	(13)
Increase (decrease) in accounts payable and accrued liabilities	(56)	38
Increase in salaries and benefits payable	66	119
Decrease in deferred revenue	(6)	(9)
Net increase (decrease) in other non-cash operating working capital items	(7)	2

Total	\$ (79)	\$ 143
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Supplementary information

Interest paid	\$ 8	\$ 8
Income tax paid	\$ 64	\$ 142

18. Joint Venture

The Corporation has a 51% ownership interest in Innovapost, The Canada Post Group's primary information technology service provider. Virtually all of Innovapost's services are provided to The Canada Post Group based on consideration contractually established and agreed to by the related party. Cost of operations included in the consolidated financial statements of the Corporation includes the Corporation's proportionate share of expenses related to these services of approximately \$153 million (2008 – \$158 million). The Corporation's proportionate share of the assets and liabilities of Innovapost at year end is \$35 million (2008 – \$36 million) and \$34 million (2008 – \$51 million), respectively.

19. 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, 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 \$79 million (2008 – \$78 million) are included in revenue from operations.

In addition, the Corporation has other transactions with the Government of Canada, its agencies and other Crown corporations in the normal course of business at commercial prices and terms.

For the year ended December 31, 2009, the amounts of accounts receivable and deferred revenue from these related parties are \$28 million (2008 – \$41 million) and \$3 million (2008 – \$4 million), respectively.

- (b) **Directors** • In the normal course of business, the Corporation may interact with companies whose directors or officers are directors of the Corporation. The affected directors always recuse themselves from all discussions and decisions related to transactions between the companies. Such cases of company interaction occurred during the year with Telus Corporation and Québecor Média. In 2009, the Corporation provided services to Telus Corporation of \$53 million (2008 – \$51 million). Services received from Telus Corporation in 2009 amounted to \$4 million (2008 – \$3 million). Similarly, during 2009, the Corporation provided services to Québecor Média of \$15 million (2008 – \$16 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 \$111 million (2008 – \$109 million). These transactions were made at prices and terms comparable to those given to other suppliers of the subsidiary.

20. Publications Assistance Program

Under the Government of Canada's Publications Assistance Program, the Government and the Corporation have subsidized a portion of the distribution costs incurred by eligible publishers of eligible publications using the Corporation's Publications Mail™ service. Although subsidy payments payable to eligible publishers vary over the Government's fiscal year, the Government's contribution to the Program was capped at \$45 million in its fiscal year 2008/2009 (\$45 million in 2007/2008). The Corporation's contribution to the Program was capped at \$15 million in 2008/2009 (\$15 million in 2007/2008) and is included in cost of operations. As directed by the Government of Canada in December 2006, Canada Post continued its financial contribution to the Program until March 31, 2009. No further financial contribution was, or 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 or restructured program.

21. Segmented Information

The Corporation manages its operations and, accordingly, determines its operating segments on the basis of the legal entities. Three reportable operating segments have been identified: Canada Post, Purolator and Logistics. The Logistics segment is comprised of SCI.

The Canada Post segment provides transaction mail, parcels and direct marketing services, as well as other mail products and services. The Purolator segment derives its revenues from specialized courier services. The Logistics segment provides third-party logistics services in supply chain management and, from March 30, 2007, transportation services in the small to medium enterprise market.

Operating segments below the quantitative thresholds, for determining reportable operating segments, are combined and disclosed in the "all other" category. Their revenues are attributable to information technology services.

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.

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

21. Segmented Information (continued)

Year ended, and as at, December 31, 2008

(in millions of dollars)

	Canada Post	Purolator	Logistics	All other	Elimination of intersegment	The Canada Post Group
Revenue from external customers	\$ 6,084	\$ 1,499	\$ 147	\$ 3	\$ –	\$ 7,733
Intersegment revenue	24	68	9	173	(274)	–
Revenue from operations	\$ 6,108	\$ 1,567	\$ 156	\$ 176	\$ (274)	\$ 7,733
Income (loss) before the undernoted items	\$ 211	\$ 135	\$ 20	\$ 16	\$ (6)	\$ 376
Amortization	(191)	(40)	(7)	(2)	3	(237)
Investment and other income	54	–	–	1	(21)	34
Interest and other expense	(8)	(4)	–	–	–	(12)
Income (loss) by segment	\$ 66	\$ 91	\$ 13	\$ 15	\$ (24)	161
Unallocated amounts						(4)
Income tax expense						(67)
Net income						\$ 90
Assets by segment	\$ 5,096	\$ 689	\$ 88	\$ 240	\$ (523)	\$ 5,590
Unallocated amounts						1
Total assets						\$ 5,591
Acquisition of capital assets	\$ 271	\$ 117	\$ 6	\$ 1	\$ (4)	\$ 391

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