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.

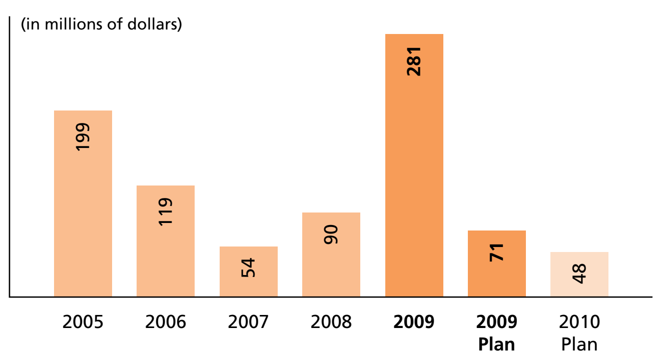
Our strategies to meet both of our mandates have not changed in 2009. We continued to make strong progress on our strategic vision of building a modern Canada Post through advancement of the following multi-year strategic initiatives.

- *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.

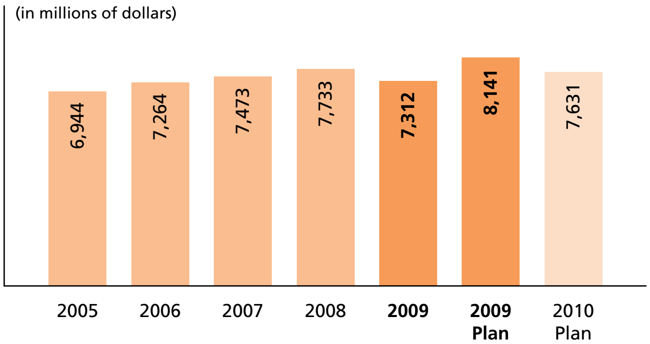
The Canada Post Group – 2009

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."

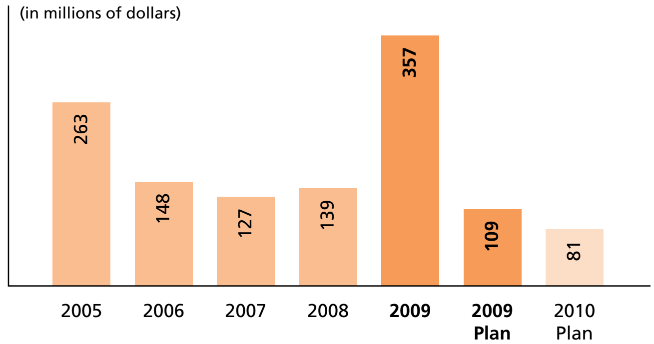
Consolidated net income



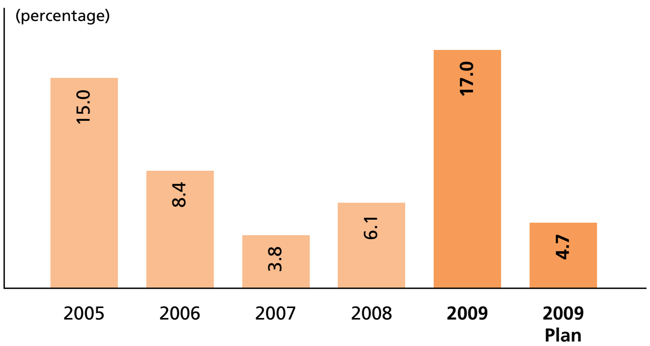
Consolidated revenue from operations



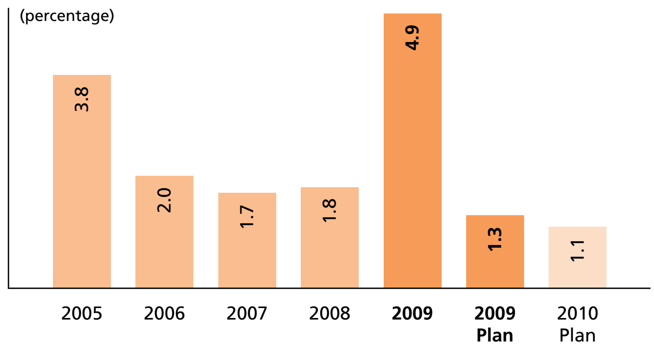
Consolidated income from operations



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				*For further information, see Section 2 – Our Business, Vision and Strategy on page 39 and Section 8 – Results from Operations on page 77*
Revenue from operations	7,312	8,141	(829)	Fell short of expectations by $829 million (Canada Post segment – $528 million), primarily due to: • 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: • Tactical cost controls over labour, advertising, administration, project spending, operating efficiencies and lower volumes • In addition, in the Canada Post segment: – 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: • 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: • 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					*Highlights, as discussed in Section 8 – Results from Operations on page 77*
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: • 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					*Highlights, as discussed in Section 6 – Liquidity and Capital Resources on page 67*
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

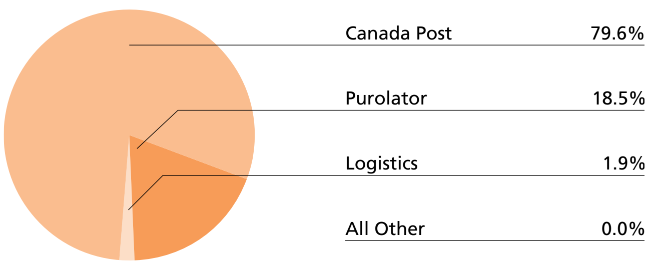
* Adjusted for trading days

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-billion[1] 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 operations[2] of $175 million, a productivity ratio[3] of 97 per cent (or an operating margin[4] of 3 per cent), and return on equity[5] 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

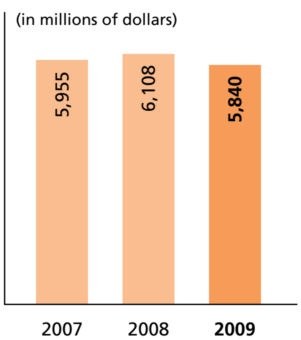
Canada Post prides itself as one of the most highly recognized and trusted brands in Canada. In 2009, Canada Post was recognized as the "most iconic brand" in Canada, topping an impressive list of other well-known and respected companies. We operate the largest delivery and retail networks in Canada. 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.

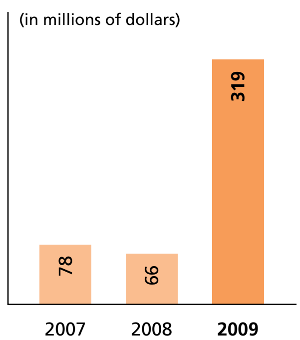
2.4 Canada Post segment

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

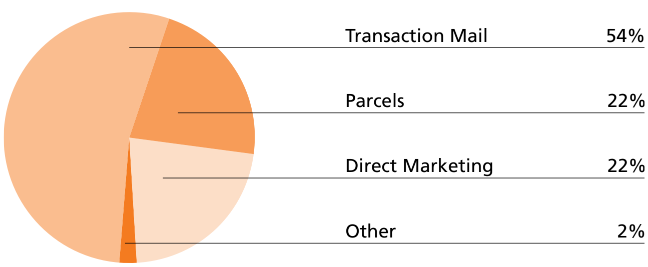


EBT



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

Operating revenues by market – 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.

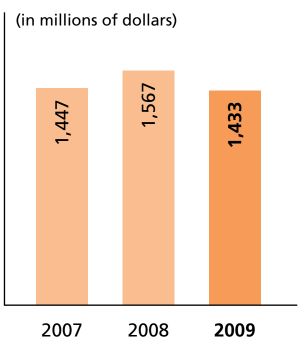
2.8 Purolator segment

The business

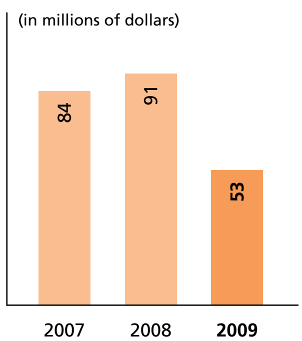
Purolator, owned 91.05 per cent by Canada Post, offers innovative products and dependable service. With 11,000 employees and a fleet of more than 4,000 vehicles, Purolator makes approximately 275 million deliveries and pickups each year. In 2009, Purolator was the leading overnight courier company in 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.

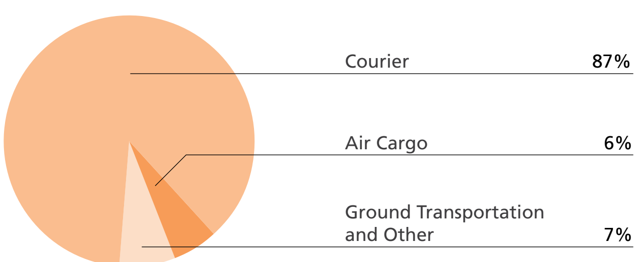
Revenue



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.

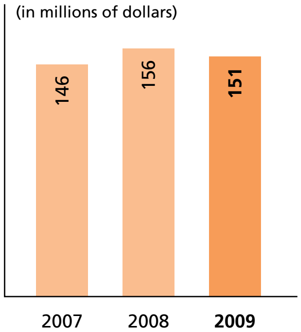
In 2009, Purolator's revenues were significantly affected by the economic downturn, seeing a decline in volumes and a change in customer shipping behaviour. In response, Purolator increased its efforts to reduce its costs without affecting service levels. It continues to move customers over to its new 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

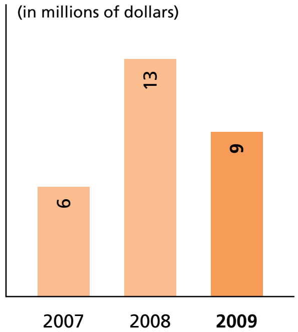
Revenue

(in millions of dollars)



EBT

(in millions of dollars)



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, SCI 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, SCI's focus was on growth, specifically in the health care market segment. SCI 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 SCI 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.

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.

Progress against 2009 objectives

Legend

●●● Achieved

●● Partially achieved

● Not achieved

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	●●●	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	●●●	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	●●	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	●●●	Service targets have been achieved for all products. Record performance levels achieved for Addressed Admail, Unaddressed Admail, Xpresspost and *Priority* Next A.M. products.
Achieve 2009 Postal Transformation milestones	●●●	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	●●●	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	●●	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	●	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	●●●	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	●●●	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	●●●	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

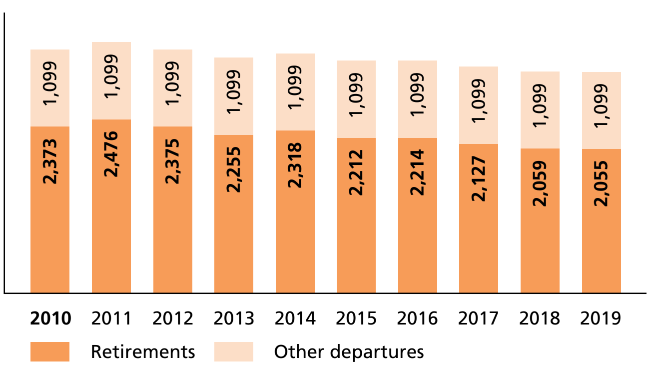
A discussion of the issues that affect our ability to execute strategies, manage key performance drivers and deliver results

4.1 Employees

The Canada Post Group operates as one of Canada's largest businesses with approximately 71,000[7] 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 33,454[8] 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 million[9] 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.

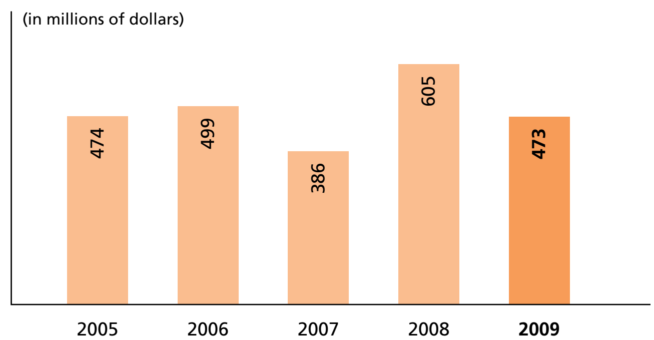
c) Air transportation procurement – Canadian North

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 million[10]. 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)

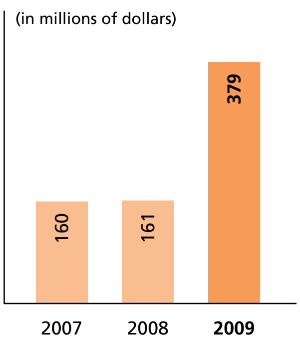
LIABILITIES AND EQUITY	2009	2008	Change	%	Explanation of change
Accounts payable and accrued liabilities	413	469	(56)	(11.9) %	Primarily decreased trade payables due to lower spending
Salaries and benefits payable	575	509	66	12.9 %	Mainly increased restructuring costs and accrued salaries for days outstanding
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

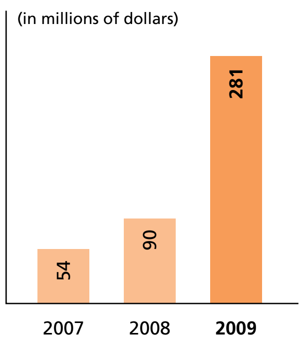
A detailed discussion of our financial performance in 2009

8.1 Consolidated trends

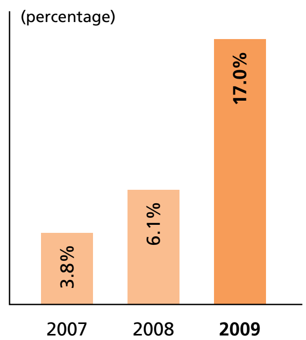
Consolidated income before income taxes



Consolidated net income



Return on equity



8.2 Consolidated results from operations

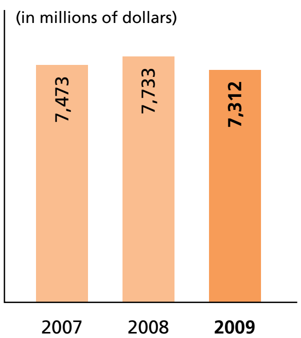
Consolidated income statement

(in millions of dollars)	2009	2008	Change	%
			Increase (decrease)	
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%	

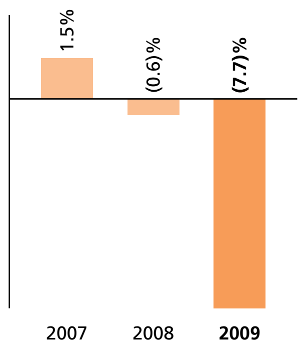
The Canada Post Group reported consolidated net income of $281 million in 2009 – an increase of $191 million, when compared with 2008. Despite a significant drop in revenues caused by the 2009 recession, income from operations increased by $218 million, mainly due to the Corporation's ability to offset 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



Volume growth



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

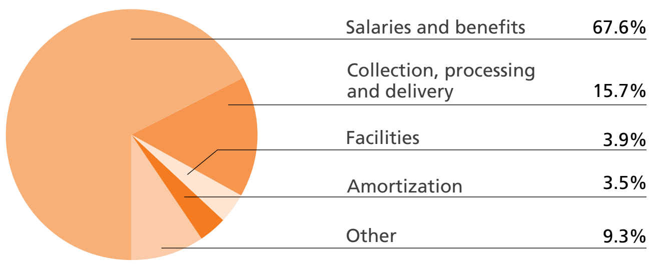
In 2009, the Canada Post segment's cost of operations totalled $5,560 million – a decrease of $528 million or 8.7 per cent, over the prior year.

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:

	Change in assumption	
(in millions of dollars)	**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:

	Change in assumption	
(in millions of dollars)	**Increase**	**Decrease**
Change in discount rate of 50 basis points		
Increase (decrease) in annual health care expense	(6)	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: • 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	• 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: • Core finance team • Senior executives and Board of Directors, including Audit Committee • Operational personnel	• Several technical training sessions delivered to our core finance team • Periodic status updates delivered to our senior executives, the Board of Directors and 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: • 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	• 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	• 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	• 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: • Compensation plans • Financing arrangements and requirements • Other contractual and legal arrangements • Capital expenditures • Key ratios	• We assessed the impacts of adopting IFRS on our covenants and other contractual arrangements • No material compliance matters have been identified at this time • 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.