EVALUATING THE FINANCIAL VIABILITY OF CANADA POST CORPORATION: "DARK GLASSES OR ROSE-COLOURED ONES"

By Geoff Bickerton and Katherine Steinhoff

Canadian Union of Postal Workers

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Unions, not surprisingly, don't think that there is a financial crisis within the corporation, citing financial reports from Canada Post itself. However, the Task Force, appointed to examine the financial viability of Canada Post, tell a different story. Their analysis shows a looming financial crisis – ironically, citing the same financial reports as those used by the unions. Since they are both using the same data, obviously someone is either wearing dark glasses or rose-coloured ones.

Tom Lukiwski, Member of Parliament and Chair of the Standing Committee on Government Operations and Estimates, "Committee's study of Canada Post", November 7, 2016

INTRODUCTION

During the Canadian government's recent review of Canada Post Corporation (CPC), a Member of Parliament (MP) observed that it was possible for different stakeholders to look at the same financial information and come to different conclusions about the corporation's financial viability. He wryly noted that "someone is either wearing dark glasses or rose-coloured ones" (Lukiwski).

This paper aims to evaluate the financial viability of Canada Post through a clear lens, while recognizing that it is difficult to make predictions because post offices operate in a dynamic environment.

The use of the Internet and digital services is on the rise and mail volumes have fallen as a result of the shift to digital. However, e-commerce is growing and has boosted parcel volumes. In addition, posts around the world are diversifying. Non-mail revenues now account for an increasing share of industry revenues. But mail is still the main source of revenue for many posts (International Post Corporation 10-14). Futhermore, all industries are dealing with historically low interest rates and other challenges as a result of the 2008 financial crisis.

In short, changes and uncertainties abound and must be considered when evaluating Canada Post's financial viability. Section 1 of this paper outlines the uncertainties facing the corporation from a cost and revenue perspective. It also looks at factors such as productivity increases, work rules and discount rate changes. Section 2 reviews ongoing discussions within Canada about the future and viability of its public postal service. Section 3 considers recent reports or plans that have made wildly inaccurate predictions about the financial situation of Canada Post. And section 4 provides a framework for more accurately predicting the corporation's viability.

This paper aims at adding to the analysis of recent papers on volume decline, managing change and positioning posts for the future.

SECTION 1

THE MODERN POST OFFICE: CHANGING REALITIES AND UNCERTAIN FUTURE

To consider the difficulties and complexity of predicting the post office of the future, one must only look back at the tremendous changes that have occurred in the last ten years. In 2005, very few people could have imagined what the post office of 2015 would be like.

Few people would have thought that ten years later, in 2015, the majority of letter carriers would be driving vehicles and having their letters sorted to the line of delivery by machines. Although electronic communications were already a reality in 2005, mail volumes were still increasing. And virtually no one foresaw the sharp rise in Internet shopping, the threat it would pose to conventional retail operations and the demands it would place on delivery companies and postal services.

Consider some of the changes that occurred during the 2005-2015 decade compared with the previous 10 year period.

Table 1: CPC Segment: Changes in Revenue: 2005 to 2015

	2005	**2013**	**2015**
Total revenue ($ millions)	5,587	5,883	6,316
Total costs ($ millions)	5,374	6,152	6,224
Transaction mail revenue as % of total revenue	55.6%	50.4%	50.5%
Parcel revenue as % of total revenue	20.9%	23.6%	26.1%
Addressed admail as % of total revenue	9.5%	10.0%	8.9%
Unaddressed admail as % of total revenue	5.3%	6.8%	6.4%
Publications mail as % of total revenue	4.7%	3.9%	3.1%
Other Revenue as % of total revenue	4.0%	5.3%	5.0%
Casual/temporary labour as % of total paid hours	6.3%	7.4%	9.6%

As seen in Tables 1 and 2, Canada Post underwent very dramatic changes during the decade from 2005 to 2015 and the pace of change greatly accelerated in 2014 and 2015. Most significant has been the steep increase in parcel volumes, which occurred in the latter part of the period, and the steady decline in volumes of addressed letters which began in 2007. Also, the change in government policy to no longer hold changes in the price of transaction mail to equal or lower than the general rate of inflation permitted CPC to maintain and even increase addressed letter revenues at a time of declining volumes.

In the case of parcels CPC has been able to increase the average price per piece during a time of expanding volumes. For both types of direct mail (unaddressed and addressed admail), CPC was able to increase the average price per piece by more than twice the rate of inflation during the period 2005 to 2013.

Table 2: Canada Post Segment: Volume and Price Changes: 2005 to 2015

	2005-2013 (8 year period)	**2013-2015 (2 year period)**
Transaction Mail: volume changes:	-24.0%	-10.9%
Transaction Mail: change in average revenue per piece:	+25.4%	+20.0%
Parcels: volume changes:	+1.2%	+14.6%
Parcels: change in average revenue per piece:	+17.2%	+3.4%
Addressed Admail: volume changes:	-16.1%	-8.9%
Addressed Admail: change in average revenue per piece:	+31.9%	+5.8%
Unaddressed Admail: volume changes:	+1.0%	+2.2%
Unaddressed Admail: change in average revenue per piece:	+33.3%	+0.1%
Total Mail: volume changes:	-15.4%	-5.7%

As seen in Table 3, CPC has been extremely effective at reducing labour costs in order to maintain profitability during a time of shrinking letter volumes. One reason for this is the degree of flexibility contained in the labour agreement between CPC and the Canadian Union of Postal Workers (CUPW). Although the contract provides for job security for regular employees, it provides for a periodic re-evaluation of the staffing requirements that can generate either an increase or reduction of regular staff positions depending on changes in mail volumes. Also, almost 10% of the work is performed by temporary workers who are not entitled to job security, earn wages that are 25% less than regular employees and have benefit costs which are 60% less than regular employees. In recent years CPC has been increasing the number of temporary employees. Also the introduction of mechanized sequencing of letters by new high speed optical character readers and motorization of letter carriers has enabled Canada Post to increase productivity and reduce staff.

Table 3: Canada Post Segment: Labour

	2005-2013 (8 year period)	**2013-2015 (2 year period)**
Change in # of paid hours: urban operations	-14.5%	-3.9%
Change in # of paid hours: urban operations (regular employees)	-15.5%	-6.2%
Change in # of paid hours: urban operations(temporary employees)	+0.1%	+24.8%
Change in average hourly wage: operations employees	+18.3%	+2.0%
Change in total labour costs (salaries and benefits)	+19.8%	-1.1%

Purolator is Canada's largest courier company and is 91% owned by Canada Post Corporation. While this paper will focus on the future financial viability of the Canada Post segment, it is useful to compare the financial performance of the two companies. As seen in Table 4, parcel volumes at Purolator actually shrunk during the past decade. It should be noted that the CPC 2016 annual report may reveal that Purolator volumes increased in 2016 as a result of CPC management notifying all of its clients that Canada Post would not be delivering mail, including parcels, after June 30, 2016 because it planned on locking out its operational employees as of that date. Clients were encouraged to divert their shipments to Purolator, whose employees are represented by another union.

Despite the reduction in volumes Purolator has been able to maintain profitability as a result of pricing actions.

Table 4: Purolator Segment

	2005-2013 (8 year period)	**2013-2015 (2 year period)**
Parcel Volumes (Purolator)	-4.3%	-9.8%
Change in average revenue per piece: parcels (Purolator)	+35.2%	+4.9%

Other factors, unrelated to the postal courier industry, and outside of CPC's control, have also had a major impact on the financial performance of Canada Post. For example, the decline in the benefit discount rate during the past decade (See Table 5) has added hundreds of millions of dollars to the labour costs required to be reported by Canada Post.

Table 5: Economic Factors and CPC Consolidated Information

	2005-2013 (8 year period)	2013-2015 (2 year period)
Average benefit discount rate	5.5%	4.5%
Change in the Consumer Price Index	+14.8%	+3.1%
Change in total volumes (CPC Consolidated)	-15.2%	-5.7%
Change in total revenue (CPC Consolidated)	+6.4%	+5.9%
Change in total costs (CPC Consolidated)	+16.0%	+1.0%
Average profit from operations (CPC Consolidated)	$98.7 M	$234.0

If the numbers in the above tables tell us anything, it is that the job of predicting the future of a postal operator is a precarious occupation. Clearly, the past decade has seen a seismic shift in the product mix, away from letters and towards parcels. More automation, motorization, and new work methods have increased productivity and reduced costs. Depressed discounts rates have added mightily to costs without increasing the benefits to anyone.

SECTION 2

ONGOING PUBLIC DEBATE ABOUT CANADA POST

Section 2 reviews ongoing discussions within Canada about the future and viability of its public postal service.

Canadians have a lot to say about their postal service. No other public institution is as ubiquitous. Few have played as many roles.

The post office had a key role in the development of Canada as a nation. Early on, communities sought post offices as a way of building a social and economic relationship with the rest of the country (Campbell 11). Postal outlets linked communities and connected regions and territories. They ensured that inhabitants, regardless of their geographic location, had access to an affordable means of communications. That is, Canada's postal service helped build and unite the country.

Today, Canada Post continues to be one of the ties that binds our vast land, the second largest in the world. It is the sole face of the Canadian federal government in thousands of towns, villages and rural communities. Post offices are often community meeting places or hubs of local activity. In many ways, the postal service provides the infrastructure that communities and businesses in both rural and urban areas need to thrive and grow in an increasingly global world. It also provides government services and stable employment, especially for women in certain regions of the country.

For these and more local reasons, Canadians tend to be very vocal about Canada Post. Understandably, as lettermail volumes have declined, they have engaged in a debate about the financial viability and future of the corporation, including whether Canada Post should cut costs, raise rates or expand revenue-generating services.

There have been a number of key debates or reports since mail volumes started dropping in 2007:

2008/09 – Federal Government's Canada Post Corporation Strategic Review

2010 – CUPW's *The Future of Canada Post*

2013 –Conference Board of Canada's *The Future of Postal Service in Canada*

2013 – Canada Post's The Future of Canada Post

2015 – Canadian Federal Election

2008/09 – Federal Government's Canada Post Corporation Strategic Review

On April 21, 2008 Canada's federal government announced an inquiry called the Canada Post Corporation Strategic Review (CPCSR). The federal minister responsible for Canada Post at the time, said the government wanted to make sure that Canada Post had "the right tools and means to fulfill its mandate in the future… delivering essential, universal services every day to Canadians, while remaining financially self-sustaining" (Transport Canada 1).

The government appointed a three-person Advisory Panel, headed by chair Robert Campbell, to conduct its review. This panel held 71 consultations and site visits with individuals and organizations. In spite of the fact that the CPCSR was quick and not well publicized, the panel received 1,429 submissions - 596 from individuals and 833 from municipalities, organizations and businesses. In addition, 167 people participated in write-in campaigns and 23,360 people sent postcards to the panel (Bickerton et al. 21). Most submissions and input focused on service and postal deregulation rather than financial sustainability. Mail volumes had only just started to decline.

Nevertheless, the advisory panel's report noted that traditional mail volumes and revenues were expected to decline and have an impact on the financial health of posts world-wide. The report made a series of recommendations regarding the financial sustainability of Canada Post. Highlights follow:

- That the CPC Board of Directors draw up a long-term plan for financial sustainability that addresses the cost of its modernization plan and a new service charter (what became the Canadian Postal Service Charter);
- That the Board of Directors work with the government to get agreements:
    - i) allowing for increased capital and borrowing
    - ii) replacing the 2/3 price cap for basic lettermail with a new formula that better reflects factors influencing Canada Post's expenses, such as labour and transportation costs (at a minimum, the new formula should not be less than the full Consumer Price Index or CPI)
    - iii) allowing for a significant one-time stamp price increase for lettermail
    - iv) ensuring a pay-as-you-go approach to fully compensate Canada Post for carrying out the public policy objectives of the government
    - v) allowing Canada Post to forgo dividend payments while making capital investments during its modernization plan.
    - That Canada Post look at leveraging its networks to develop complementary activities and potential revenue streams, to the extent that these activities are related to its core business.
    - That Canada Post continue to function in competitive markets where it is currently active (Campbell et al. 159-161)

A new financial framework, with increased borrowing authority, was introduced following the CPCSR. The two-thirds price cap was repealed and a five-year pricing plan was introduced. The pricing plan included a three-cent rate increase for January 2010 and two-cent increases in each of the subsequent four years – the last of which was scrapped and replaced by a 22 cent increase for 2014, bringing the price of a basic stamp to 85 cents.

If postage pricing had been indexed against the CPI following the creation of Canada Post, the stamp price would have been 68 cents in 2014. Canada still has the second lowest domestic postage price among G7 nations (CUPW 2016 8).

2010 – CUPW's The Future of Canada Post

CUPW produced a 12-page paper called *The Future of Canada Post* in the run up to its 2011 negotiations. This paper aimed at raising the level of debate about the corporation's key challenges and opportunities and creating a more constructive dialogue with the public and other stakeholders during negotiations. It looked at volume declines, increases in points of call, profits and prices and concluded that "Faced with declining mail volumes and economic recession, it is very doubtful that Canada Post can continue to fulfill its mandate to provide universal service at acceptable postage rates and still remain financially self sufficient" (CUPW 2010 7).

CUPW's paper noted that management's response to its situation was to embark on a $2.5 billion modernization program that was expected to produce annual savings of $250 million. The union proposed an alternate route to sustainability through new revenue generating services such as postal banking, expansion of parcel delivery and new counter services. It also suggested that door-to-door delivery be extended to households receiving community mailbox (CMB) delivery as finances permit.

CUPW was not able to get Canada Post to consider its proposal to add financial and banking services, or other revenue-generating services during the 2011 or 2016 rounds of bargaining.

2013 – Conference Board of Canada's The Future of Postal Service in Canada

On April 23, 2013, the Conference Board of Canada released a 52-page report called *The Future of Postal Service in Canada.* This report, which was paid for by Canada Post, predicted significant volume declines and losses from operations, beginning in 2012 and growing to an annual loss of $1 billion by 2020. In light of volume and revenue projections, the report considered ways to financially sustain the corporation such as cutting postal services, increasing postage rates and freezing or decreasing the wages of postal workers.

The service reductions considered in the Conference Board's paper included:

- Going to alternate day delivery of mail;
- Replacing public post offices with private outlets or franchises;
- Converting door-to-door delivery in urban areas to community mailbox delivery;
- Reducing standards for speed of delivery.

The report said that each option could help Canada Post reduce operating losses and that eliminating home mail delivery would have the largest impact, with a savings of $576 million a year by 2020 (Vijay et al. 36).

As for rate increases, the report looked at increasing prices faster than the rate of inflation. It concluded that "Canada Post could significantly reduce its projected loss by raising prices, but cannot realistically return to self-sustainability through price increases alone" (Vijay et al. 36).

The Conference Board's report did not consider adding revenue-generating financial services as an option for sustaining Canada Post. It claimed that Canada's 'highly developed financial service sector' would prevent the post office from succeeding in this area. However, the report did acknowledge that financial services have been lucrative for many postal administrations. It specifically mentioned Swiss Post while failing to mention that Switzerland also has a highly developed financial services sector.

2013 – Canada Post's The Future of Canada Post

CPC held consultations under the banner of "The Future of Canada Post" in 2013. These consultations started the day after the Conference Board of Canada released its report, *The Future of Postal Service in Canada.*

Canada Post held invite-only meetings in 46 communities and conducted a largely online public consultation on its future, focusing on cuts.

Notably, the corporation did not hold any public meetings. In addition, it did not meet with stakeholders, such as seniors groups or organizations representing people with disabilities. It is fair to say that most Canadians did not even know that Canada Post was asking for input on its future.

Nevertheless, from April to October of 2013, Canada Post's website featured a "Future of Canada Post" page where members of the public were invited to answer the question: "What kind of postal service will you need in the future?" The corporation posted the Conference Board's report as background information. It also invited the public to mail in comments.

CUPW reviewed and analyzed all the comments on the "Future of Canada Post" webpage. The union did not have access to remarks sent through the mail.

- Less than 2 in 10 people called for cuts to services (19.26%).
- Over 45% of people who mentioned mail delivery said they wanted to keep delivery the same (45.22%) and almost 7% said they wanted delivery to increase (6.62%).
- Only 15% of people suggested that door-to-door delivery or rural box delivery be converted to community mailbox delivery (15.13%).
- Less than 1% suggested that Canada Post should close post offices or open more franchises (0.88%).
- Less than 1% said Canada Post should reduce the speed of delivery (0.22%).
- Almost 3% of people indicated that rate increases would be acceptable or help Canada Post (2.84%).

- Almost 14% of people said Canada Post should expand the services they offer (13.84%).

In short, very few members of the public supported the kind of changes announced in Canada Post's Five-point Action Plan (CPC's 5PAP) on December 11, 2013. This plan called for:

1. Eliminating home mail delivery to about 5 million households in Canada and replacing it with delivery to CMBs.
2. Dramatically increasing postage rates.
3. Using more private postal outlets or franchises and fewer public post offices.
4. Streamlining operations.
5. Bringing labour costs down and eliminating 6,000 to 8,000 positions.

It should be noted that Canada Post cherry picked anecdotal statements made during its consultations on the future in order to create the illusion that there was support for CMBs and the other cuts considered in the Conference Board's report. The corporation did not provide any objective or quantitative information to back its finding of support for cuts, as outlined in its document, *The Future of Canada Post: Our Consultation with Canadians.*

2015 – Canadian Federal Election

CPC's 5PAP proved unpopular with Canadians, especially the concept of replacing home mail delivery with CMB delivery. This turned into a key election issue.

Following the announcement of CPC's 5PAP, almost 600 municipalities, including some of Canada's largest cities, passed resolutions opposing the end of home mail delivery or calling for a halt to the postal cuts until there was proper consultation.

As well, thousands of Canadians signed petitions drafted by CUPW and others, opposing the Canada Post cuts and calling for innovations such as postal banking. MPs regularly presented these petitions in the Canada's House of Commons. In fact, the petition campaign against the cuts was the largest seen in the House in 2014 (Korski 1). In addition, many MPs said that the loss of home mail delivery was generating more calls to their constituency offices than any other issue.

Once the election was called, home mail delivery was repeatedly mentioned in media coverage, as were related CUPW and community actions.

All federal political parties except the Conservatives promised to stop or put a moratorium on the home mail delivery cuts if elected, and the New Democratic Party and Green Party committed to restore home mail delivery to people who had lost it since December 2013.

Although the Liberal Party did not make restoration of home mail delivery part of its election platform, party leader Justin Trudeau did say “We will restore home delivery where it is necessary, where it fits, where there’s a clear desire to do it” while on the election trail in 2015. Other Liberal MPs made similar and stronger commitments to restore delivery.

In addition, most parties went on record as being concerned about the rate hikes and other cuts in CPC’s 5PAP.

In the end, the Liberal Party of Canada won the 2015 federal election with a majority of seats in the House of Commons. About a week later, Canada Post announced it would “temporarily” suspend the delivery cuts. It made this move because the Liberals had promised, in their election platform, to halt the delivery cuts and conduct a review of Canada Post.

The government’s review occurred from May to December in 2016 and involved a task force in stage one and parliamentary committee consultation in stage 2. The parliamentary committee recommended that home delivery be restored to people who had lost it as of the federal election call in 2015. However, the government has the final say. It is expected to make decisions about Canada Post this spring

As it stands now, public, union and political opposition to the postal cuts has resulted in the preservation of home mail delivery for more than 4 million households and saved thousands of full-time jobs.

SECTION 3

PROBLEMATIC PREDICTIONS

Section 3 looks at recent reports or plans that have made wildly inaccurate predictions about the financial situation of Canada Post.

The first report, called *The Future of Postal Service in Canada*, was published by the Conference Board of Canada in 2013 and used by Canada Post to set the stage for dramatic cuts. As noted above, this report predicted significant losses from operations, beginning in 2012, and an annual loss of $1 billion by 2020.

The second document, entitled *Canada Post Corporation: Summary of the 2014 to 2018 Corporate Plan/Summary of the 2014 Capital Budget,* was produced by Canada Post in 2013 and predicted losses in 2014.

The third paper, EY's *Financial assessment for the Canada Post Corporation (CPC) review* was commissioned by the task force reviewing Canada Post in 2016. It also forecast losses and claimed that Canada Post "is facing a financially unsustainable future" if it does not take advantage of "restructuring opportunities" (EY 1&3).

The Future of Postal Service in Canada – The $2 Billion Mistake

Canada Post used financial projections from the Conference Board of Canada report, *The Future of Postal Service in Canada,* to justify its decision to make major cuts, including ending home mail delivery in Canada

The corporation's media release announcing the cuts stated: "The Conference Board of Canada study projected a financial loss of close to $1 billion by 2020 unless Canada Post makes fundamental changes to its business" (Canada Post 1). This release resulted in headlines such as "Canada Post 'staring down' billion dollar loss by 2020, report says"(Ligaya 1) and "Cheque isn't in the mail: $1-billion loss for Canada Post by 2020?" (Marotte 1).

There were no headlines or corrections when the predictions that generated the $1 billion loss figure turned out to be wrong.

The Conference Board had arrived at its $1 billion annual loss figure by claiming that Canada Post would incur significant financial losses, starting in 2012.

For the year 2012, the Board predicted a loss from operations of $250 million. It also predicted a loss of $300 million in 2013, a loss of $400 million in 2014, a loss of $475 million in 2015 and a loss of $550 million in 2016

That is, the Conference Board projected a loss of almost $2 billion ($1,975,000) for the years 2012 to 2016. But the Board got it very wrong.

The fact is that the Canada Post Group reported a profit from operations of $131 million in 2012, a $193 million loss from operations in 2013, a $299 million profit from operations in 2014 and $169 million in 2015. The corporation has acknowledged that it made a profit in 2016. However, it has not yet released its annual report with official figures.

The Canada Post segment reported a profit from operations of $77 million in 2012, a $269 million loss from operations in 2013, a $204 million profit from operations in 2014, $92 million in 2015, and a profit in 2016.

In other words, the reality is that Canada Post reported an overall profit, not a loss of $2 billion for the years 2012 to 2016, as the Conference Board predicted.

It should be noted that the 2013 results were greatly affected by Canada Post applying new and revised International Accounting Standards (IAS). Without the amendments to IAS 19, Canada Post would have reported significant profits.

Table 6: Profit (Loss) From Operations ($millions)

	2012	**2013**	**2014**	**2015**	**2016**
Conference Board Projection	(250)	(300)	(400)	(475)	(550)
Reported Profit from Operations (Canada Post Group)	131	(193)	299	169	Profit*
Reported Profit from Operations (Canada Post Segment)	77	(269)	204	92	Profit*

*Canada Post managers acknowledge the corporation will report a profit for 2016.

Source: Conference Board of Canada, The Future of Postal Service in Canada. April 2013; Canada Post Annual Report, 2012, 2013, 2014, 2015

The Conference Board report also underestimated parcel volume increases, productivity gains, and the impact of the 2014 rate increase while underestimating the ability of CPC to reduce staffing in line with transaction mail volume declines.

Canada Post Corporation: Summary of the 2014 to 2018 Corporate Plan/Summary of the 2014 Capital Budget – The $1/2 Billion Mistake in 2014

Canada Post also used financial projections from its 2014 to 2018 corporate plan to legitimize its plan to make major changes such as converting door-to-door delivery to CMB delivery.

The corporation's corporate plan for 2014 to 2018 was approved by the government in December 2013. It stated that the move to CMBs was "crucial to the financial viability of Canada Post"(Canada Post 10).

The plan predicted a $256 million loss from operations in 2014. But the actual result was an operating profit of $299 million. In other words, Canada Post's forecast was off by $555 million, amounting to a $1/2 billion dollar mistake.

There was no reason for Canada Post to predict an operating loss in 2014, other than as part of a public relations strategy. Before the 2014 to 2018 corporate plan was released, CPC knew that the discount rate would rise from 4.4% to 5.0%, significantly decreasing benefit costs. The "beneficial results" of a higher discount rate for 2014 was also predicted in the corporation's 2013 annual report. In addition, Canada Post knew about very significant rate increases, which were announced in December 2013 and took effect on March 31, 2014. All signs pointed to a successful 2014, yet the CPC plan deliberately called for a large financial loss.

The projected loss for 2014 was designed to help Canada Post justify its plan for cuts in the media and with other stakeholders. It certainly fed into the corporation's narrative that its financial sustainability was at risk, as indicated in its December 2013 media release announcing its plan for CMBs and other major cuts:

"Canada Post has begun to post significant financial losses. If left unchecked, continued losses would soon jeopardize its financial self-sufficiency and become a significant burden on taxpayers and customers…The implementation of this plan means Canada Post can return to financial sustainability by 2019" (Canada Post 1).

In spite of what Canada Post stated in its media release, it had not posted significant losses up to this point (See Appendix A). In fact, the corporation had earned profits every year since 1996, with the exception of 2011. In 2011, the corporation reported a net loss of $188 as a result of a lockout of CUPW members and two one-time events (a special pay equity payment and a special pension adjustment because of changes in the Pension Benefits Standard Act). But in 2012, the year prior to announcing its plan of cuts, Canada Post reported a net profit of $94 million, thereby resuming its money-making status. It did not therefore make sense for Canada Post to claim that its plan would return it to financial sustainability, except perhaps as a public relations exercise.

It should be noted that Canada Post did not claim the profits it ultimately made in 2014 were the result of its cuts to door-to-door delivery. Canada Post acknowledged that they were mainly due to rate increases, lower labour costs and increased parcel volumes (Canada Post 1).

The EY Report - Getting It Wrong Again

EY's *Financial assessment for the Canada Post Corporation (CPC) review* is the most recent document suggesting that CPC will not be financially sustainable without making major changes such as "reinstating the door to door to CMB conversion program, reducing the corporate retail network and expanding the use of franchises, changing employee benefits and reducing labour costs"(EY 3).

In May 2016, as part of an overall review of Canada Post Corporation, the Canadian government established a four-person task force to deliver a discussion paper outlining viable options for the future of the post office. The task force retained the services of EY (Ernst & Young) to conduct an independent review of Canada Post's financial position and projections. In its discussion paper, the task force relied heavily on the analysis and observations contained in EY's report entitled *Financial assessment for the Canada Post Corporation (CPC) review.*

Like the Conference Board report, EY concluded that Canada Post faces an uncertain financial future and that the current operational model is no longer sustainable over the medium and long term. Whereas, in 2013, the Conference Board had estimated financial losses of $1 billion by 2020 ($700 million with significant rate increases), in its 2016 report, EY estimated losses surpassing $700 million by 2026.

Both reports shared the dubious distinction of estimating CPC's losses to begin in the year of the publication of their reports only to have Canada Post Corporation surprise them by reporting profits. In the case of EY, it accepted CPC management's projection of a $43 million loss for 2016. Although the final result is not available at the time of writing, CPC has confirmed it will report a profit for 2016. It has also stated that the profit would have been $100 million greater had management not informed large volume mailers that it planned to lock out its employees and cease all delivery in July 2016.

So how did EY come to an estimate of losses of $700 million by 2026 and how did it get its 2016 prediction so wrong?

EY Accepted CPC's Financial Analysis and Projections

EY appears to have conducted virtually no independent analysis of the corporation's current projections of its financial future. Indeed, in the introduction of its report, EY states that in preparing the report EY *"relied upon audited and unaudited financial information, financial projections prepared by CPC, and discussions with management of CPC"* (EY ii). It went on to say *"EY has not audited, reviewed or otherwise attempted to verify the accuracy and completeness of such information, and accordingly, EY expresses no opinion or other form of assurance in respect to such information in this report*"(EY ii). Hardly a vote of confidence in its own work.

The failure of EY to even attempt to verify the financial projections of Canada Post management is curious given the deplorable record of Canada Post with respect to past financial projections. See Table: 7

Table 7: Consolidated Results: Actual Reported Profit from Operations Compared to CPC Plan

Year	Actual Profit from Operations	CPC Planned Profit from Operations
	($ millions)	*($ millions)*
2010	315	81
2011	(226)	151
2012	131	73
2013	(193)	(475)
2014	299	(256)
2015	169	61
2016	NA	(43)

Source: CPC Annual Reports and EY Report

Misinterpreting the Past

The EY report relied heavily of the experience of 2011 to 2015, which it refers to as "the historic period", as a basis for its future financial projections. The report not only misrepresents the 2012 financial results but it also neglects to examine, and in some cases even mention several one-time, non-recurring events that had a major impact on the financial results of the other four years.

Consider the following:

2011: As a result of a Supreme Court of Canada decision CPC was required to make special pay equity payments of $291 million for the period 1982-2002. The lock-out of CUPW employees in June 2011 resulted in financial losses of $67 million. Also a special one-time pension adjustment due to changes in federal pension regulations added an additional $63 million in costs.

2012: EY does not use the actual results for 2012. It uses numbers that were restated only for comparative purposes due to the IAS 19 accounting change which was introduced in 2013. Instead of a net loss of $83 million cited in the EY report, Canada Post actually reported a net profit of $94 million in 2012.

2013: The introduction of the IAS 19 accounting change had a one-time impact of reducing net profits in 2013 by $350 million, turning what would have been a $321 million net profit into a net loss of $29 million. Both the 2011 and 2012 CPC annual reports had cautioned that the introduction of IAS 19 in 2013 would have a very significant impact on the 2013 CPC financial results. Yet EY neglects to even mention the significant one-time impact of this accounting change (2013 Canada Post Corporation Annual Report 94-95).

2014: A significant price increase was introduced on March 31, 2014 and an increase in the benefit expense discount rate from $4.4% to 5.0% increased net profits.

2015: A sharp decrease in the benefit expense discount rate, from 5.0% to 4.0%, increased benefit costs by $189 million. There were also significant increased costs due to the introduction of the community mailbox program.

Misjudging the Future

The EY report makes several dubious assumptions with respect to major cost and revenue drivers. When these assumptions are then extrapolated over a ten year period, their impact is enormous.

Labour Costs: Although labour costs have declined by a compound annual growth rate (CAGR) of 0.2% during the past five years, EY assumes an average growth rate of 2.4% per year for the next ten years. There is no explanation of this dramatic change projected by EY. However, if one assumes a static workforce and adopts the actual average wage increases of the past five years of 1.3%, the result in 2026 would be to reduce annual labour costs by $520 million less than EY's projections.

Discount Rates**:** The EY report acknowledges that the $307 million increase in benefit expenses during the period 2011 to 2015 was primarily due to the decline of the discount rates applied to the calculation of future benefits. EY's projections of increased future benefit costs assume continuation of today's low interest rates for the next 10 years. Should the defined benefit expense discount rate increase to the average experienced during the historic period (4.8% instead of remaining at 4.1% as it is in 2016), there would be an actual reduction in benefit costs of more than $75 million by 2016.

Direct Mail Volumes: The EY report assumes an annual 2% reduction in revenues from direct mail during the next 10 years. It does not factor in the 2016 collective agreement changes which significantly increased the size of admail that CPC will be able to deliver in the future. The increased size will enable CPC to enter into a large part of the unaddressed admail market. If direct mail revenues increase by just 1.5% per year due to the changes in maximum sizes, the revenue from direct mail in 2026 will be $402 million greater than that projected by EY.

Parcel Volumes and Revenues*:* The EY report also does not recognize the significant changes in work rules and compensation negotiated with CUPW in 2016 which will allow CPC to increase early morning, evening and weekend deliveries.

Transaction Mail Revenue: EY predicts a loss of $618 million in transaction mail revenue during the 2016-2026 period (EY 52). It is unclear what assumptions are used to project this figure and if rate increases are included. It should be noted that even without a rate increase, revenues for transaction mail increased slightly in

2016 Q2 and the reduction for the first six months of 2016 amounted to $35 million. In 2015, revenues decreased by only $13 million.

Solvency Payments: The EY report assumes CPC will make pension solvency payments of $1,300 million during the next ten years. There is no explanation for this assumption, however, it appears that EY assumes a continuation of the current abnormally low long term discount rates. In 2013, the federal government exempted Canada Post from having to make pension solvency payments for four years. It is widely accepted that the government will extend this exemption to 2018 and beyond. Also, there is a growing consensus that long term discount rates will continue to increase in the future. A one percent increase would have the effect of virtually eliminating the solvency deficit. On a going concern basis, the CPC pension has a surplus of over $1.3 billion and the actual pension surplus for 2015 was $2.7 billion. There is no need to assume a requirement to make such large solvency payments during the next ten years.

Incorrect Labour Cost Information: The EY report claims that CPC's productive labour rate is 41% higher than its competitors. This is not correct. Based on information provided by Canada Post Corporation, the productive labour rate for the corporation's delivery agents (letter carriers, mail service couriers and rural and suburban mail carriers) is 13% greater than the average of the competitors (Purolator, DHL and UPS). The competitors pay higher hourly wages but CPC's productive labour rate is currently artificially inflated due to the impact of low interest rates on the pensions and retiree benefits. Higher interest rates will reduce the productive labour cost differential between CPC and its competitors.

Incorrect Cost of Delivery Modes: The EY report includes a table which identifies a 163% ($185.00) difference between door-to-door and community mailbox delivery. Information provided by Canada Post indicates that the difference between door-to-door and community mailbox delivery by letter carrier is 74% ($115.00) (Canada Post 1).

SECTION 4

THE FUTURE FINANCIAL VIABILITY OF CANADA POST CORPORATION

Section 4 provides a framework for more accurately predicting Canada Post's financial viability.

Canada Post, EY and the Conference Board Are Wrong: What Is Right?

"Predictions," goes an old Danish proverb, "are hazardous, especially about the future." For national postal services, the hazards are especially great.

In recent years, efforts to prophesize the financial viability of Canada Post, conducted by reputable organizations such as Canada Post Corporation, the Conference Board of Canada and EY have met with dismal failure. But if the Canada Post, Conference Board and EY could be so wrong, what then is right?

Several lessons can be learned from the failure of recent attempts to predict the financial viability of Canada Post.

1. Limit the time frame under consideration.
2. Assume the stakeholders (management, labour, politicians, and regulators) will make adjustments to avoid catastrophe.
3. Do not include the impact of one-time events into the baseline used to extrapolate the future.
4. State all underlying assumptions concerning future costs and revenues in a clear and transparent manner.

The Timeframe: Section 1 of this paper (Tables 1-6) details the enormous changes that CPC experienced during the years 2014 and 2015. These changes were heavily influenced by the government's decision to authorize a steep rate increase in 2014, a dramatic increase in parcel deliveries generated by Internet purchases and major swings, both up and down, in the benefit expense discount rate. These events were not predictable even three or four years in advance. At the current time, it is impossible to know what discount rates will look like in 2022, what new competitors, if any will have entered into the delivery business, and what the regulatory framework or even what public service mandate will govern CPC's operations.

For these reason we will project only for the 2.5 year period between mid-2016 and the end of 2018.

Stakeholder Adjustments: At the time of writing, the federal government is studying a Canada Post Review Task Force report and the recommendations of the report of the Standing Committee on Government Operations and Estimates which examined Canada Post's operations and made many recommendations with respect to services, revenues, governance, and labour relations. The decision of the government is expected sometime in late May or early June 2017. It is possible the government will institute some significant changes which might have a major impact on CPC's revenues or expenditures. The only action by a stakeholder that we are prepared to predict and build into our projections is that CPC will once again be exempted from making pension solvency payments during the next four years. As previously stated, in 2013, the federal government exempted Canada Post from having to make pension solvency payments for four years. Without such an exemption, CPC would have been required to make special payments of $1 billion per year into the pension, money it does not have. It should be noted that a one percent increase in long term discount rates would have the effect of virtually eliminating the entire solvency deficit. On a going concern basis, the CPC pension has a surplus of over $1.3 billion and the actual pension surplus for 2015 was $2.7 billion.

Our projections do include an assessment of the impact of the changes in work rules with respect to parcel and unaddressed admail delivery that were negotiated in 2016 and come into effect in 2017 and 2018.

One Time Events: We use the financial and operational experience from 2014 to mid-2016 as a baseline for our projections. These years were chosen primarily because they reflect the significant changes in the letter and parcel markets as well as operational changes with CPC. The choice of these dates, as opposed to a five year period, avoids having to extract the impact of one-time events such as the 2011 pay equity payment and the 2013 impact of introducing the IAS 19 accounting changes. Both of these events had a one-time effect in excess of $290 million but had very limited impact going forward.

Transparency: The assumptions which form the basis of the financial projections will be clearly explained. Where possible, the potential impact of alternative scenarios will be reviewed. For the most part, the years 2014, 2015, and the first six months of 2016 have been used to identify baseline trends. The major exception to this is the issue of transaction mail revenue which was magnified by the March 31, 2014 rate increase. The experience of the third quarter of 2016 has not been included as CPC recognized that it lost net income of $100 million due to the corporation notifying all customers of its decision to lock out its operations employees effective July 1, 2016. This projection assumes no major changes in operations such as the opening or closure of large numbers of facilities, major collective agreement changes, or new service offerings such as postal banking or special services to vulnerable members of the community. It does not include any financial impact that may arise as a result of the pay equity process scheduled to conclude in 2018. It assumes no significant changes in the economic performance of CPC's subsidiaries.

Projection: 2018 Canada Post Revenues Will Be $103 Million Greater Than 2015.

This revenue projection is driven by the following projections.

Transaction Mail: Transaction mail volume will continue its steady decline, falling 6% per year. Annual revenue from transaction mail will follow the pattern of 2015 Q3 and decline by 2.7% in each of 2016 and 2017. There will be a rate increase in 2018 justified by the need to compensate for the lack of rate increases since March 31, 2014. This will increase annual transaction mail revenues by 3.0% in 2018. The result will be an annual decline of transaction mail revenue of $258 million between 2015 and 2018.

Parcels: Parcel volumes will continue to increase. Despite increased competition, the projection is for volumes to increase 7.7% per year continuing the trend from 2014-2016 Q2. This increase will be made possible by the contractual changes agreed to in the 2016 collective bargaining, which will enable CPC to expand parcel delivery in the evenings, mornings and on weekends. Revenue per piece will remain constant as of 2018. The result will be an increase of parcel revenue of $410.3 million for 2018 over 2015.

Addressed Admail: Despite new marketing initiatives, addressed admail annual volumes will decrease 2.9%. This is in keeping with the longer term trend and results for the first two quarters of 2016. Revenues will decrease by 2.2% per year resulting in a decline of addressed admail revenue of $ 36.5 million between 2015 and 2018.

Unaddressed Admail: Volumes and revenues will remain flat until 2018. As a result of contractual changes permitting letter carriers to deliver larger sizes of unaddressed admail, effective January 15 of that year, volumes will increase 5% and revenues will increase 7%. The result will be an increase of unaddressed admail revenue of $28.5 million for 2018 over 2015.

Publications Mail: Volumes will continue the downward trend with revenues declining 7.5% annually. The result will be a decrease of publications mail revenue of $41 million for 2018 compared to 2015.

Other Canada Post Segment Revenues: The assumption is that they will remain constant.

Projection: 2018 Canada Post Costs Will Be $30 Million Greater Than 2015.

The major driver of Canada Post costs is labour. Labour costs are influenced by changes in the number of paid hours, changes in benefits and wages which are influenced by collective bargaining, changes in the benefit discount rate, and employer staffing practices. In recent years, the corporation's cost increases have been totally accounted for by labour costs. Other operating costs increased by 1.6% in 2015 and decreased by 2.4% in the first six months of 2016.

Benefit and Pension Costs: Benefit and pension costs are influenced heavily by changes in the discount rate, changes in the consumer price index, investment returns, and changes in health care costs. In recent years, the increase in discount rates has resulted in a considerable increase in benefit costs despite the reduction of paid hours. Assuming a modest increase in the discount rate for 2017 and 2018, we can project that total benefit and pension costs will remain stable for the period 2015 to 2018.

Other Operating Costs: It is assumed that other operating costs will continue to be flat with no substantial change between 2015 and 2018.

Paid Hours: As seen in Table 3, the number of paid hours for urban operations employees has declined by about 2% per year. This has been a response to declining letter volumes, introduction of new technology and work methods, motorization of letter carriers, slightly offset by increased points of delivery and increased parcel volumes. Considering the continued increase in parcel volumes, contractual changes introduced in 2016 and increased hours for rural and suburban mail carriers, it is assumed paid hours will decline annually by 1.25 %. With no increases in wages or benefits this would have the effect of reducing labour costs by $160.7 million between 2015 and 2018.

Wage Increases: The wage increase for urban operational employees for 2016 was 1% and 1.5% for 2017. Assuming a 2% wage increase in 2018, wages will have increased 4.56% between 2015 and 2018. Combining the impact of reduced paid hours with increased wages, and no change in benefit, pension and other operating costs, the net result is an increase in costs of $30 million between 2015 and 2018.

Continuation of Profitability: The above calculations lead us to the conclusion that, in 2018, Canada Post will achieve an operating profit of $73 million greater than the $92 million reported for 2015. Should all of these assumptions be correct, or should the errors in projected costs and revenues cancel out each other, Canada Post has a very good chance of maintaining, and even increasing its rate of profitability.

CONCLUSION

The above projections are based on an underlying assumption that no unpredicted and drastic event is likely to occur in the next few years. We have limited ourselves to a very narrow timeline in order to avoid the errors we have witnessed in other forecasts which have examined periods of eight and ten years. Canada Post management used these long term projections of massive financial losses as a means of justifying major cutbacks in service, which they knew would be unpopular. This was a mistake. However it would be an equal mistake to use our projection of continued profitability to justify maintaining the status quo at Canada Post.

Canada Post is not currently in a financial crisis. If current patterns hold, there is every reason it will remain profitable for the next few years. However, there are several developments which could jeopardize its future profitability, such as a sharp downturn in the overall economy, an escalation of transaction mail decline, or a reduction in parcel volume growth.

Though not facing an imminent financial crisis, Canada Post urgently needs to expand its service offerings in order to increase revenues and reduce its dependence on a very limited number of product lines.

Other postal administrations have proven to be very innovative in introducing or expanding revenue generating services such as postal banking, checking-in on vulnerable persons and greater leveraging of retail facilities.

Hopefully, Canada Post can use the current period of profitability to diversify and invest in new revenue-generating services and thereby increase its likelihood of maintaining financial self-sustainability in the future.

APPENDIX A

CANADA POST PROFIT/LOSS – 1988/89 TO 2015

YEAR	NET PROFITS
Apr 1988-Mar 1989	96
Apr 1989-Mar 1990	149
Apr 1990-Mar 1991	14
Apr 1991-Mar 1992	(128)
Apr 1992-Mar 1993	26
Apr 1993-Mar 1994	(270)
Apr 1994-Mar 1995	(69)
Apr 1995-Mar 1996	28
Apr 1996-Mar 1997	112[1]
Apr 1997-Mar 1998	36[2]
Apr 1998-Mar 1999	50[3]
Apr 1999-Mar 2000	75[4]
Apr 2000-Mar 2001	84[5]
Apr 2001-Dec 2001	67[6]
Jan 2002-Dec 2002	71[7]
2003	253[8]
2004	147
2005	199
2006	119
2007	54
2008	90
2009	281
2010	439
2011	(188)[9]
2012	(83)[10] 94
2013	(29)
2014	198
2015	99

Source: Canada Post annual reports and corporate plans

1. 95 million from Canada Post, 17 million from Purolator
2. 24 million from Canada Post, 12 million from Purolator
3. 43 million from Canada Post, 7 million from Purolator
4. 84 million from Canada Post, 9 million loss from Purolator
5. $106 million from Canada Post: $22 million loss from Purolator
6. $57 million from Canada Post: $10 million from Purolator
7. Canada Post stopped providing net profit figures for its various operations.

8. Includes one time payment of $118 million, a settlement with a foreign postal administration over terminal dues.
9. Canada Post would not have lost money if it were not for the one-time benefit increase of $63 million as a result of a pension adjustment in the second quarter, and a one-time pay equity payment of $291 million for the period 1982-2002 in the third quarter. Also, the lock-out of CUPW resulted in a $67 million loss.
10. Canada Post reported a $94 million profit in 2012 but restated it in 2013 for comparative purposes when the corporation introduced new accounting standards.

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