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Review of the Boston Consulting Group's report to the Minister for Communications

Briefing for the CWU on Australia Post's
operations

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The Australia Institute

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Introduction

Australia post made a profit before tax of \$402.8 million in 2012-13. In the last 4 years its combined profits were more than \$1.25 billion.

Australia Post is experiencing a trend decline in the volume of letters it delivers and a trend increase in the volume of small parcels it delivers. As described above, its overall profitability is growing. The trend decline in the volume of letters is a worldwide phenomenon which is explained by a growing reliance on electronic communication, however, while there is little doubt about the decline in the volume of mail, estimates of the rate of decline vary significantly and assertions that the trend decline will continue for a decade or more are based on no empirical evidence.

While the costs of maintaining a delivery network for letters is large it is important to note that the costs of this network underpins not just the delivery of letters but of small parcels as well. While Australia Post and the Boston Consulting Group have recently argued that the delivery of letters is placing an 'unsustainable' financial burden on Australia Post, in fact the delivery network used for letters is actually the foundation on which the rapidly growing, and highly profitable, small parcel delivery business is based.

The way that Australia Post is presenting its financial accounts conceals the relationship between the 'losses' made delivering letters and the 'profits' made delivering small parcels. In turn, any proposal to reform the letter delivery business of Australia Post needs to be based on a detailed analysis of the inter-relationship between different Australia Post business units rather than a simple analysis of the costs and revenues of a particular administrative 'silo'.

That said, based on the publicly available information provided in the Australia Post annual report, the largest financial losses relate to the delivery of international mail. If Australia Post or other analysts are interested in reforming the organisation it would seem that international mail delivery, rather than the domestic mail delivery service, would appear to be the most important place to start.

This brief provides an overview of the current financial position of Australia Post and provides a critique of a recent report into Australia Post by Boston Consulting which was commissioned by the Abbott Government. Our critique finds that the Boston Consulting report largely ignores the strong financial position of Australia Post and that its narrow focus on the costs and revenues allocated to the letter delivery services of Australia Post paints an unduly negative picture as it largely ignores the rapid growth in the highly profitable small parcel business which relies on many of the network services provided by the letter delivery network.

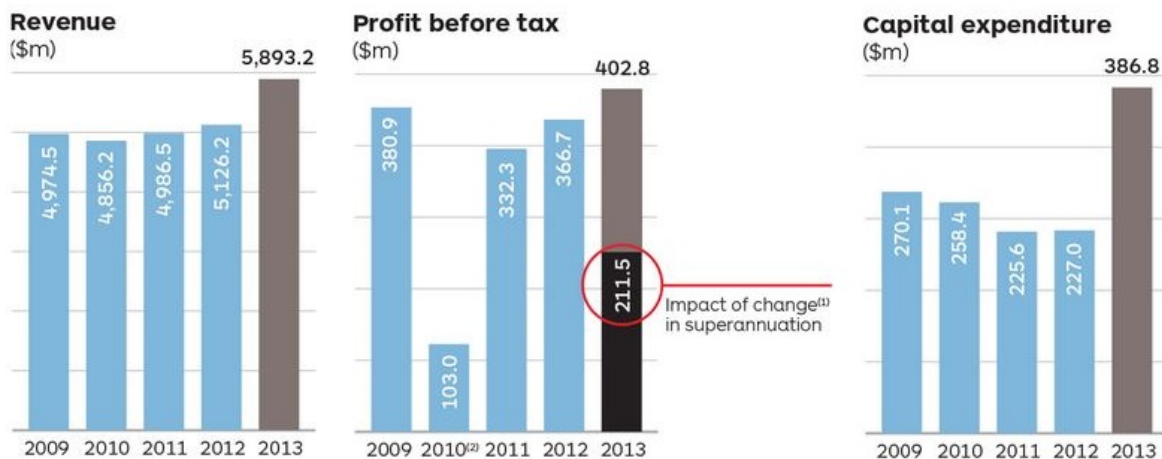
Financial performance of Australia Post

Australia Post is a large, profitable and growing enterprise. It has recorded profits of more than \$1.5 billion in the last five years and paid dividends to the Commonwealth of almost \$1 billion. It is currently engaged in a substantial capital investment campaign, including the acquisition of rival parcel delivery businesses. Such a strategy clearly suggests that the management of Australia Post have significant confidence in both the current and future financial position of the organisation.

While there is little doubt that the management of Australia Post would like the ability to lower the quality and frequency of their mail delivery service below the existing legislated standards, there is also no doubt that the current management have obligations to invest their shareholders funds prudently. In turn, if they did not believe that Australia Post was in a strong financial position, and that their recent acquisition of StarTrack Express (see below) would not strengthen that position further, then they would be remiss in their Directors duties to have approved the transaction.

As Figure 1 and the following quotations show, the management of Australia post are upbeat about the financial performance of their organisation.

Figure 1 5-year financials for Total Australia Post Group



Source: Australia Post Annual Report 2012-13¹

In relation to the Parcel & Express segment, the latest Australia Post Annual Report states:

Our Parcel and Express Services business grew from strength to strength this year returning a profit of \$354.8 million (up 29.1 per cent this year, or 13.1 per cent excluding StarTrack). Underpinning this result was growth in domestic parcel volumes of 9.3 per cent...

And Retail:

¹ Australia Post: <http://auspost.com.au/annualreport2013/index.html>

Retail Services business achieved revenue uplift of 2.0 per cent and a profit of \$200.6 million. This is a positive outcome given the pressure on Australia's retail sector resulting from waning consumer confidence and the growth in ecommerce...

And the 'Reserved' Mail Service:

While our parcel and retail businesses performed well this year, this was offset by the structural challenges facing our reserved mail business, which returned a trading loss of \$147.4 million (up \$33.0 million on last year).

Australia Post's recent investment in small parcels

In November 2012, Australia Post acquired 100 per cent of Star Track Express Holdings (comprising StarTrack Couriers, and all incorporated subsidiaries) via its transaction to purchase AUX Investments Pty Ltd.² The Australia Post financial statements show a large increase in capital commitments to the Parcel and Express segment in the most recent year.

This is a familiar path for national postal services. While Germany's Deutsche Telekom and Postbank were privatised in the 1990s, Deutsche Post remained in government ownership. With financial backing from the German government, Deutsche Post embarked on an aggressive global acquisition strategy. In 1998 it began acquiring the parcels operator DHL, gaining majority ownership in 2001. The German government gradually sold off its shares in Deutsche Post, and by 2005 the majority were in private hands. Today, the German government holds approximately 30 per cent of the company.

The parcel business is truly global, but it is dominated by a small number of large multinational companies including DHL (Germany), Fedex (USA), UPS (USA) and DPD (France). Nationally owned operators do not play a major role in the global industry.

The privatisation and deregulation of the global postal and parcel delivery industry is actively promoted by a number of major consulting firms. Price Waterhouse Coppers, for example, state:

² As part of the deal, Australia Post divested its Joint Venture stake in air freight company Australian air Express to Qantas Ltd.

The screenshot shows a PwC website page with the following elements:

- Header:** PwC logo, 'Global' text, a search bar, and a link for 'International PwC Sites'.
- Navigation:** Home, Industry sectors, Today's issues, Our services, About us, Research & insights, Careers, Press room.
- Main Content:**
 - Left Sidebar:** 'Transportation & logistics' with sub-links: Airlines & airports, Logistics & post, Rail & infrastructure, Shipping & ports, Publications, T&L 2030 series, CEO Survey industry summary.
 - Article Title:** 'Deregulation/liberalisation/privatisation'.
 - Article Text:** Discusses the liberalisation of the postal sector in Europe, starting in 1997 and moving towards full competition by 2012. It mentions the 'Universal Service of the Full Market' and the impact on incumbent operators.
 - Footer:** 'How PwC can help you'.
- Right Sidebar:**
 - Contacts:** Philippe Claeys, Tel: +32 2 7104623.
 - Of further interest:** Global Shipping Benchmarking Survey 2009, Post-event coverage from Ready for take-off, Impacts of aviation in the EU Emissions Trading Scheme, Opportunities and challenges for the shipping industry, Predicting the unpredictable: Protecting transportation & logistics companies against fraud, reputation and misconduct risk.

Analysis of Boston Consulting Group (BCG) report

Australia Post has provided advice to the Australian Government about their desired reform options. In turn, the Australian Government sought advice from BCG on the Australia Post report. Intriguingly, while the original Australia Post report to the Government is not yet public, the BCG analysis of the Australia Post report is. The following sections highlight some of the weaknesses in the analysis and interpretation of the BCG report.

The key themes in the BCG report are clearly designed to deliver the ultimate goal of outsourcing and privatising the mail delivery business in Australia. This is highlighted by dire warnings for the 'weak-link' of mail delivery, and the need to 'set free' the profitable-with-strong-outlook-but-competitively-pressured courier and retail businesses. The impacts of volumetric costs and pricing are only mentioned in dismissing their consideration.³ Of greater concern, however, is that a forecast horizon out 2023 is chosen. While projecting straight lines out for 10 years helps to make for some alarming reading, it is the lack of evidence on which such long run projections are made that should truly alarm readers of the BCG report.

Specific problems with the BCG report

The observed decline in mail volumes in Australia has been an average of just 5 percent each year historically over the last four years, and an estimated 4 percent for this year. The BCG report determines a comparison with a selection of other countries in its report, whereby average annual declines in mail volumes are: over 10 percent in Denmark, more than 6 percent in the UK and New Zealand, and 5 percent in the Netherlands over a similar time-period. BCG then extrapolates from these examples – in its econometric forecasts – a non-linear trend which compounds the rate of decline over time (out to the year 2023). As discussed below the Boston Consulting Group's range of forecast annual decline in letter volumes of 8-11% is much too pessimistic.

³ For instance, the Australian air Express air-freight mail distributed to regions is based on contracts for consignment where letters and parcels are mixed in together on a single volumetric rate.

Boston Consulting Group polling and advocacy: BCG has been a long term advocate of deregulating the postal industry in order to allow lower levels of customer service. In 2011, for example, they published *The Postman Always Brings Twice: Receiver-driven Transformation of the Mail Business Model*.⁴ The executive summary of which includes:


TRANSPORTATION, TRAVEL & TOURISM PUBLICATIONS


The Postman Always Brings Twice: Receiver-driven Transformation of the Mail Business Model
Bas van Heel, Marco Airoidi, Sjoerd Bos
March 2011

Postal organizations struggle to remain viable and competitive in this age of increasing reliability on digital media. In *The Postman Always Brings Twice*, results of a survey conducted by BCG indicate that redesigning the current postal business model clearly begins with understanding the requirements of the mail receiver.

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To better understand the receiver requirements, The Boston Consulting Group surveyed 5,600 mail receivers in 14 countries. The survey results reveal that in all 14 countries, the current service level exceeds receivers' requirements for delivery frequency, speed, quality, and predictability, as well as (collection) postbox and post office services. Service needs vary significantly across mail products but surprisingly little across customer segments such as heavy and low Internet users and urban and rural inhabitants. Our survey also points to an interest in other mailmen services (in addition to delivery) and carbon dioxide reduction initiatives that may offer some revenue-growth opportunities.

Our analysis indicates that about 20 to 30 percent of current operational costs can be eliminated with the adoption of a service level that matches the average receiver requirements. Combined with savings based on interventions that do not affect the service model, this will, for the next decade, close the annual 3 to 6 percentage-point decline in EBIT margin resulting from continuous volume loss.

Aligning the business model with market needs requires a clearly defined transformation that avoids the most common pitfalls. Managing a transformation successfully should follow a three-step approach: (a) develop a clear future-market view, (b) design a target business model, and (c) phase the waves of interventions.

Consistent with their long term international strategy, the Boston Consulting Group recently advised the Australian Government that the Australian postal system should be deregulated to allow lower quality and frequency mail delivery. Their report to the Australian Government, which is analysed below, includes dire warnings about the 'weak-link' of mail delivery, and the need to 'set free' the courier and retail businesses.

The high 'fixed cost' base of the mail delivery system assumed in BCG's estimation of 80% is opaque and at odds with standard economic analysis. As the BCG report is not transparent about its estimates, it is likely that it exaggerates the level of fixed costs to the segment.

The Australia Competition and Consumer Commission, in its February 2014 price notification decision for Australia Post's 'ordinary letter' service, states that it had not been able to form a

⁴ BCG (2011) *The Postman Always Brings Twice: Receiver-driven Transformation of the Mail Business Model*

http://www.bcg.com/expertise_impact/Industries/Transportation_Travel_Tourism/PublicationDetails.aspx?id=tcm:12-133493&mid=

view on the efficiency of Australia Post's cost base. The ACCC's sensitivity analysis demonstrated that even using different assumption metrics regarding appropriate contribution of shared costs to reserved services and the rate of return within the organisation, Australia Post is unlikely to recover more than an efficient level of costs and return.

The ACCC's sensitivity testing indicated Australia Post's reserved services costs to be overstated by around \$44 million in 2013-14 and 2014-15.

The forecasting analysis used as the basis for projected increasing losses in Australia Post's profit-before-tax, at 2023 of \$1.28 billion, flies in the face of the Lucas Critique in economics, defined as:

*[The] criticism of econometric policy evaluation procedures that fail to recognize that optimal decision rules of economic agents vary systematically with changes in policy. In particular, it **criticizes using estimated statistical relationships from past data to forecast the effects of adopting a new policy**, because the estimated regression coefficients are not invariant but will change along with agents' decision rules in response to a new policy.⁵*

The BCG analysis uses a 'regression model' that comprises 'coefficients' that are estimated from the averaging of 'past data' (i.e. trends in previous years).

A forecast of the postal services & telecommunications industry out to 2023 is quite a novelty. In addition, the way that the report provides a cumulative summation of the trend numbers to make them seem larger is an unnecessary presentational trick presumably designed to further alarm the reader.

In submission to a price notification decision by the Australia Competition and Consumer Commission (ACCC) Economic Insights presented similar projections to those contained in the BCG report, of which the ACCC notes:

...while the Economic Insights report contains a convincing argument regarding how the ACCC should not calculate cost forecasts, it does not offer clear guidance as to how the ACCC should forecast costs. In particular, the report does not provide all the information necessary to make appropriate cost forecasts. The key pieces of information provided by the report are the elasticities of costs to seven types of output. But the report does not provide forecasts of these seven types of output, which the ACCC would need if it were to estimate the effect of changes in these outputs on future costs.⁶

The international comparison used by BCG is selective in that it contains three Anglosphere and two Northern European countries: the UK, Canada, New Zealand, the Netherlands and Denmark, each with particular experience of deregulated postal services. The European Commission's Internal Market Branch has shown that over the period 2007 to 2011 the EU countries selected by BCG were those Western Europe countries with the largest percentage decline in domestic and inbound letter volumes. As mentioned above, BCG's comparison of Australian postal services with examples from these specific countries

⁵ New Palgrave Dictionary of Economics: *Lucas Critique*
http://www.dictionaryofeconomics.com/article?id=pde2008_L000159&q=lucas%20critique&topicid=&result_number=1

⁶ Australian Competition and Consumer Commission (2014) *Australia Post 'ordinary letter' pricing notification decision p. 21* <https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2014/notification-lodged>

has the effect of exaggerating the projected rate of decline in mail volumes in the BCG forecasts.

Overall, the BCG report insists heavily on its emphasises for:

- Reduced delivery speeds;
- Further centralisation and automation;
- Aversion to price increases on postage; and
- Outsourcing.

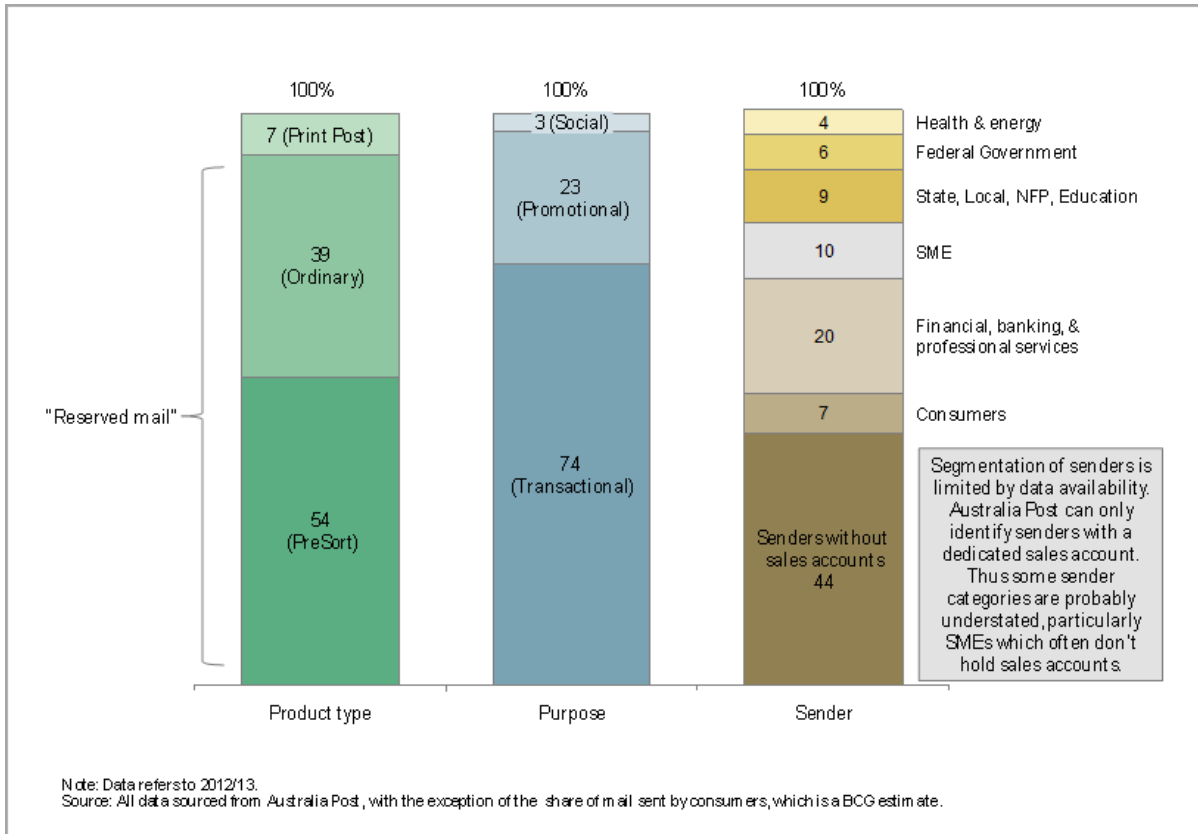
BCG's assumptions and construction of cost allocation to reserved mail

In attempting to replicate the \$2,360 million figure cited by BCG as the 2012-13 Operating Expenses of the CMS segment, it is apparent that 'bottom up' data cannot be constructed from the information available. However, Note 28 to the Australia Post financial statements (page 93) provides revenue and profit data by segment that can be reverse-engineered to approximate the BCG estimate. The financial data of the Annual Report is constructed so as to omit Expenses pertaining to each segment:

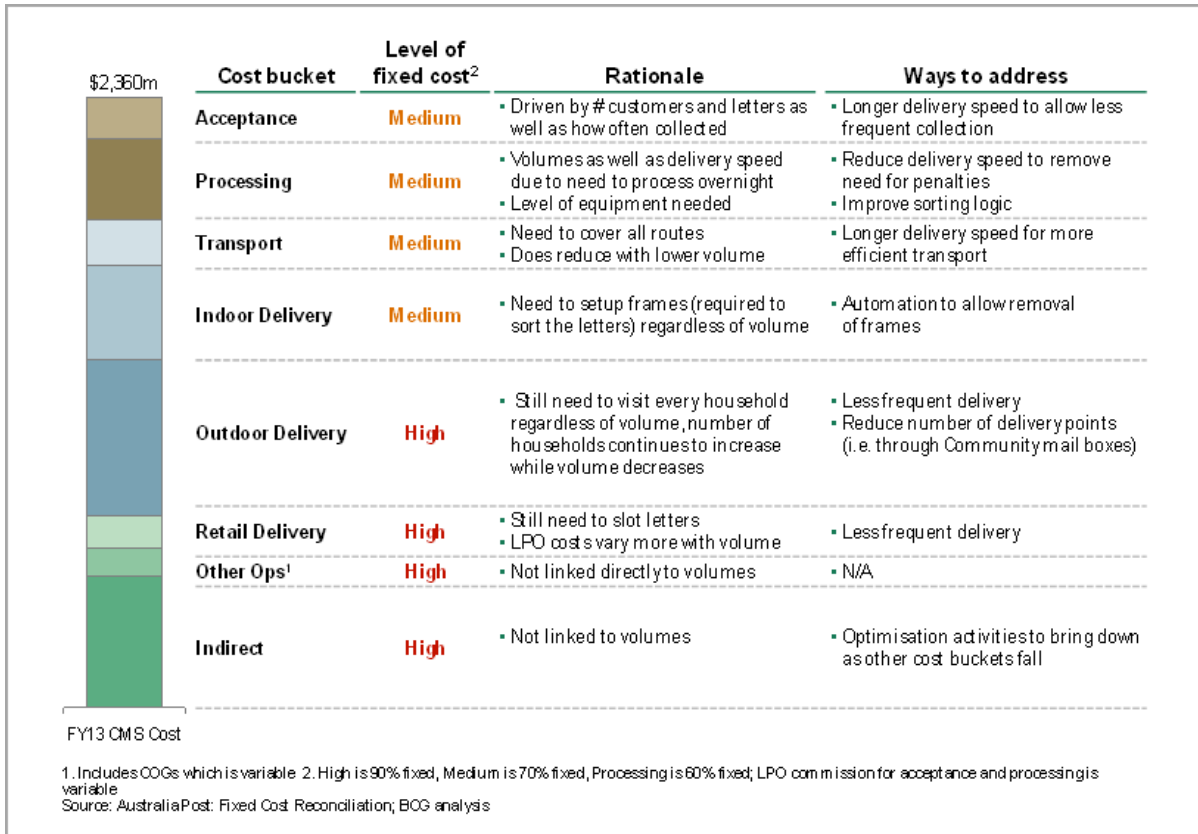
	2012	2013
Mail revenue (\$m)	2,312.1	2,207.8
Mail result (\$m)	(114.4)	(147.4)
Mail expenses (\$m)	(2,426.5)	(2,355.2)

A number of arbitrary assumptions were used by BCG to arrive at estimates for several variables within their analysis. For instance, in terms of items for Household Expenditure on reserved postal services the calculated annual expenditure (Pre-sort & Ordinary letters) is taken to be only 3% to 7% of the total volume, divided by 8.0 million households at a \$0.55 postage rate.⁷ This gives a figure of \$8.00 to \$19.00 per household in annual expenditure on reserved mail, which is separated from the \$68.00 per household recorded in the ABS Household Expenditure Survey 2009-10 for "Postal Services". Wholly excluded from these figures are estimates for Print Post (newspapers, catalogues, and magazines), which BCG has indicated makes up 7% of the segment's volumes.

⁷ The Basic Postage Rate (BPR) has been \$0.60 since 2010, having risen from \$0.55 in 2009. This is indicated on page 131 of Australia Post's *2012-13 Annual Report*.



Given that the BCG report and Australia Post 2012-13 Annual Report lists the CMS segment's operating expenses as ~\$2,360 million for that year, BCG has attributed a 'fixed cost' level of 80% or \$1,888 million for 2012-13 to the "cost bucket" analysis for the CMS segment ('Exhibit 7' on page 18 of the BCG report – reproduced below).



Page 17 of the BCG report describes their estimate of fixed costs in the letters business as “based on an outside-in consideration of network economics across each step of the value chain”. This is a dubious and opaque justification.

Australian Competition and Consumer Commission’s assessment

The ACCC, in its February 2014 price notification decision on ‘ordinary letter’ service, applies a “building block” model in conducting its assessment of Australia Post’s forecast costs. The cost components of the building block methodology are:⁸

- non-capital costs, representing operating costs;
- return of capital, representing depreciation costs; and
- return on capital, representing the required rate of return on the capital base.

Australia Post’s submitted ‘reserved services operating costs’ account for over 90 per cent of Australia Post’s reserved services cost base, and thus constitute the key component of Australia Post’s maximum allowable revenue (MAR).

Australia Post also submitted to the ACCC that it faces ‘fixed operating costs imposed by the existing regulatory framework’. Australia Post contended that its CSO-related standards effectively impose fixed costs on the letters sorting and delivery network.

⁸ Australian Competition and Consumer Commission (2014) *Australia Post ‘ordinary letter’ pricing notification decision p. 14* <https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2014/notification-lodged>

In 2009 the ACCC undertook a review primarily focussed on Australia Post's allocation of direct costs to reserved services. The ACCC's recent February 2014 review of Australia Post's cost allocation methodology (CAM) has mainly focused on Australia Post's allocation of non-operational (indirect costs) to reserved services.

Australia Post forecast that in 2013-14 its non-operational costs will total around \$1.4 billion, which represents around 23 per cent of Australia Post's total costs. The allocation of non-operational costs to reserved services will total \$440 million. Overall, the ACCC's assessment, on the basis of the information provided by Australia Post about its non-operational costs, was:⁹

Australia Post appears to effectively use the same approach to cost allocation for some direct and indirect activities. If the nature of cost incurrence is similar for both direct and indirect activities, such a practice may be appropriate. However, cost incurrence between direct and indirect activities is more likely to be different and therefore such a practice may not be cost reflective.

For some of Australia Post's indirect activities, Australia Post currently allocates costs to reserved and non-reserved services based on the relative number of 'transactions' undertaken. However, if the time taken to perform each transaction is very different, an allocation based on the relative frequency of transactions may not be reflective of the actual costs that are attributable to reserved and non-reserved services.

The ACCC's sensitivity testing based on improvements in Australia Post's cost allocation method (in particular, use of cost drivers may lead to a 10 per cent reduction in allocation of non-operational costs to reserved services) indicated Australia Post's reserved services costs to be over-stated by around \$44 million in 2013-14 and 2014-15.

Long-range forecasting

A forecast of the postal services & telecommunications industry out to 2023 is quite a novelty. The macroeconomic assumptions are provided by *Euromonitor* and many of the operational assumptions are taken from past averages or seemingly were invented from scratch.

A submission to the ACCC's price notification decision by Economic Insights presented similar projections to those contained in the BCG report, of which the ACCC notes:

...while the Economic Insights report contains a convincing argument regarding how the ACCC should not calculate cost forecasts, it does not offer clear guidance as to how the ACCC should forecast costs. In particular, the report does not provide all the information necessary to make appropriate cost forecasts. The key pieces of information provided by the report are the elasticities of costs to seven types of output. But the report does not provide forecasts of these seven types of output, which the ACCC would need if it were to estimate the effect of changes in these outputs on future costs.^{10 11}

⁹ Australian Competition and Consumer Commission (2014) *Australia Post 'ordinary letter' pricing notification decision* p. 12 <https://www.accc.gov.au/regulated-infrastructure/postal-services/australia-post-letter-pricing-2014/notification-lodged>

¹⁰ *Ibid.* p. 21

Based on BCG’s modelling assumptions for the CMS segment:

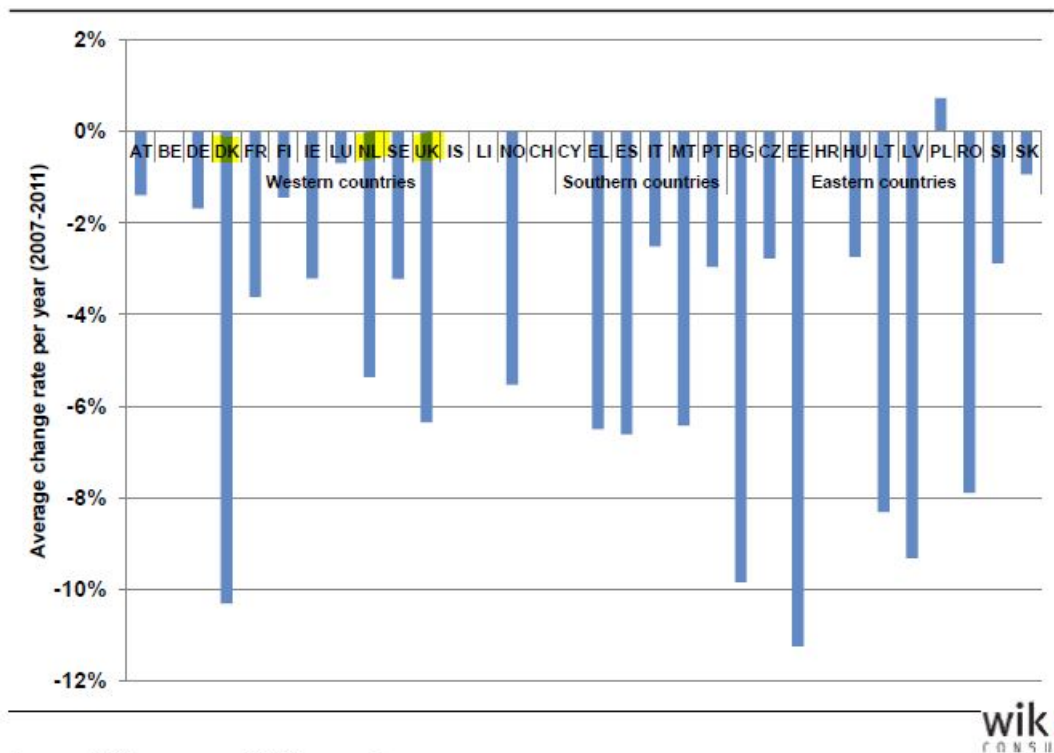
After the end of the plan period in FY17, it is assumed retail costs grow at 3% and margin reduces to 2%; MyPost Digital Mailbox grows at 3% with constant margins; PES grows at FY14-17 trend.

There is no discussion of how or why this is going to occur and no explanation of the factors that will bring this scenario about.

Selective inclusion of international examples in the BCG report

The international comparison is selective. It contains three Anglosphere and two Northern European countries: the UK, Canada, New Zealand, the Netherlands and Denmark; of which the European Commission’s Internal Market Branch shows that over the period 2007 to 2011 the EU countries selected by BCG were those Western Europe countries with the largest percentage decline in domestic and inbound letter volumes.¹²

Figure 3-9 Average change rate per year for domestic and cross-border inbound letter post volume



Source: WIK survey and WIK research

Note: BE (2007, confidential), CY, HR, IS and LI; 2007 and 2011 figures of CH not comparable due to change in measurement method (see PostReg, Tätigkeitsbericht 2010, p. 26).

Source: European Commission (2014) *Main Developments in the Postal Sector (2010-2013)*

¹¹ The Lucas critique is, in essence, a negative result. It tells economists, primarily, *how not* to do economic analysis.

¹² European Commission (2014) *Main Developments in the Postal Sector (2010-2013)*
http://ec.europa.eu/internal_market/post/doc/studies/20130821_wik_md2013-final-report_en.pdf

12

The first privatised national postal operator in the world – and the only fully privatised one – is the Dutch postal service, whose transition to a private entity is a complicated story. The then-joint Dutch Post and Telecom Service (called KPN) was floated on the stock market in 1994; in 1996, it bought the private Australian integrator TNT in a friendly takeover. The service was then separated into post and telecoms in 1998. Post was still majority-owned by the Dutch government; it was renamed TPG in 1998, then re-branded as TNT in 2005 and fully privatised in 2006.

But despite its early mover advantage, the postal business was not a success for TNT. Its shareholders first decided to sell the parcels unit, and then split the remaining company into TNT (international express) and NLPost (national mail service) in 2011. This extended privatising process has been a disaster. The Dutch have been forced to accept numerous concessions in the provision of postal outlets, frequency of delivery and more in order to have a national postal service at all.¹³

So why was the recent privatisation of Royal Mail such a success for investors? Like any long-established postal operator, 500-year old Royal Mail owns a great deal of real estate in prime city centre locations. Assets like these can easily be sold off when there is a manufactured perception that the mail business is declining and that local customers rarely visit a post office.

Irregularities in Australia Post financial statements¹⁴

This section highlights the complexity of the way in which Australia Post is reporting its financial position. The issues included below are included to highlight to readers that simple stories about Australia Post needing to reduce the frequency and quality of their mail delivery service are just that, simple stories.

Australia post is a large, complex, profitable and growing enterprise. While the removal of legislative quality levels would likely increase the profitability of the firm, it would do so by reducing the quality of the service Australians rely on.

Cross-subsidization for loss-making ‘regulated mail’, but not for CSO commitments of reserved mail

The separation of ‘regulated mail services’ (international letters and small parcels) from ‘reserved mail’ (domestic letters) in the 2012-13 Annual Report, effectively isolates the letter delivery segment as a loss-making entity, while the international letters component is then cross-subsidised by the lucrative parcel segment. The *2012-13 Annual Report* (page 92) details the internal restructuring of business segments within the organisation as follows:

Certain products have been realigned to different segments in the current period to better reflect the way the business unit results are analysed internally. The primary change has been to reclassify regulated international inbound letters and packets (<2kg) from the “Mail” segment to the “Parcel & Express” segment.

Where trends in volume information has resulted in a change to cost allocations, the prior year information has been restated to enable like for like comparison.

¹³ Finger, M. 12 November 2013. *No money in post, so why was Royal Mail a good buy?*

<http://theconversation.com/no-money-in-post-so-why-was-royal-mail-a-good-buy-20110>

¹⁴ There is a structural purpose for these items that would warrant further detailed investigation.

Five-year trends

	2009	2010	2011	2012	2013
Mail volumes (m)	5,323.4	5,145.0	5,038.2	4,843.0	4,580.2
Revenue (\$m)	4,974.5	4,856.2	4,986.5	5,126.2	5,893.2
Profit before tax (\$m)	380.9	103.0	332.3	366.7	402.8
Profit after tax (\$m)	260.5	89.5	241.2	281.2	311.9
Profit/(loss) from reserved services (\$m) ⁽¹⁾	(69.2)	(250.1)	(66.5)	(114.4)	(147.4)
Operating profit/(loss) from regulated mail services (\$m)	N/A	N/A	(122.4)	(186.9)	(218.4)
Operating profit/(loss) from non-regulated services (\$m)	N/A	N/A	457.5	555.2	648.1
Return on equity (%) ⁽²⁾	17.2	6.2	15.0	16.8	18.5
Return on average operating assets (%)	12.2	3.8	10.9	11.5	11.4
Debt to debt plus equity	23.3	26.4	23.6	29.1	27.3
Ordinary dividend – cash (\$m)	277.8	171.9	78.5	193.9	243.7
Special dividend – cash (\$m)	150.0	0.0	0.0	0.0	0.0
Interest cover (times)	11.0	4.6	10.9	10.8	13.7

(1) Amounts prior to 2011 included the collection, processing and distribution of international inbound letters and packets (weighing less than 2kg) in accordance with the arrangement of the Universal Postal Union. This is now included within regulated services.

(2) Return on equity is calculated as profit after tax as a percentage of equity. Equity has been normalised to remove the impact of the group's net superannuation liability/asset.

\$400 million play on AUX Investments

On 13 November 2012, the corporation acquired the remaining 50% of the issued share capital of AUX Investments Pty Ltd, which is the parent company of StarTrack Express and StarTrack Couriers. Prior to this date the corporation owned a 50% share of AUX Investments Pty Ltd and accounted for this as a joint venture entity. As part of the deal, Australia Post divested itself of its 50% interest in Australian air Express to Qantas. On 7 May 2014, StarTrack was rebranded to include Australia Post 'post horn' in StarTrack blue colours. StarTrack also took responsibility of Australia Posts "Messenger Post couriers" under the StarTrack brand as "StarTrack Courier".¹⁵

The fair value of identifiable assets and liabilities of AUX Investments Pty Ltd as at the date of acquisition were:

¹⁵ Australia Post, 7 May 2014 'Rebranding of 'Messenger Post couriers' to 'StarTrack Courier'
<http://auspost.com.au/about-us/rebrand-messenger-post-couriers.html>

	Consolidated fair value at acquisition date
	\$m
Cash and cash equivalents	59.2
Trade and other receivables and accrued income	141.6
Property, plant and equipment	232.1
Intangible assets	224.5
Deferred tax asset	31.9
	689.3
Trade and other payables	92.0
Provisions	108.7
Net superannuation liability	5.9
Non interest bearing liabilities	532.4
Deferred tax liability	55.9
	794.9
Fair value of identifiable net assets/(liabilities)	(105.6)
Goodwill arising on acquisition (note 16)	493.6
Less investment previously held	(194.0)
Consideration transferred	194.0

The acquisition included \$493.6 million for 'Goodwill' and 'Intangibles' valued at \$224.5 million. Page 113 of the *2012-13 Annual Report* details this to include computer software (\$38.2 million), customer relationships (\$125.0 million) and brand names (\$61.3 million).

Direct costs of \$8.5 million relating to "the acquisition and integration of AUX Investments Pty Ltd" are disclosed as part of 'Supplier Expenses' in the Operating Statement.

(d) Purchase consideration – cash outflow	
The cash outflow on acquisition is as follows:	
	\$m
Net cash acquired with the subsidiary	(59.2)
Consideration transferred	194.0
Payments for investments in controlled entities (net of cash acquired)	134.8
Repayment of debt	266.2
Total consolidated cash outflow	401.0

Capital transfers to Parcel & Express

Note 28 to the financial statements (page 93) include the valuation of assets by segment, which shows the result of significant capital investment occurring in the Parcel & Express segment over the last two years:

	Consolidated	
	2013 \$m	2012 \$m
Mail	1,293.5	1,359.8
Retail	542.4	554.1
Parcel & Express	1,853.8	862.8
Unallocated & Eliminations	1,323.6	2,071.7
Total	5,013.3	4,848.4

	Consolidated	
	2012 \$m	2011 \$m
Mail	1,556.3	1,583.6
Parcel & express	770.6	739.8
Retail	557.3	558.5
Unallocated & eliminations	1,964.2	1,933.2
Total	4,848.4	4,815.1

\$800 million dollar increase in 'Other commitments' (contractors)

Note 2 to the Schedule of Commitments on page 57 of the 2012-13 Annual Report states:

The majority of these commitments relate to carriage and delivery of letters and parcels by contractors. Commitments are recognised for these items when it is considered probable that the outflow will occur.

Other commitments:		
Operating leases	677.6	513.9
Other commitments ⁽²⁾	2,709.1	1,875.7
Total other commitments	3,386.7	2,389.6
Total commitments payable	3,526.6	2,455.3
Net commitments	3,111.2	2,097.1

Assets held for sale (valued at cost)

The Balance Sheet contains 'Assets classified as held for sale' of \$48.8 million. During the period to 30 June 2013, Australia Post committed to a plan for asset sales classified as land and buildings. Australia Post's efforts to sell the assets had commenced at the date of the Annual Report, with sale of the full allocated items expected to occur during the current 12 month period.

	Consolidated	
	2013 \$m	2012 \$m
8 Assets classified as held for sale		
Land and buildings (at cost)	48.8	-
Total assets classified as held for sale	48.8	-

Write-downs of assets & revenue

The notes to the 2012-13 Annual Report Financial Statements include a significant 'write-down' of \$29.7 million on investments, property plant & equipment, inventories & receivables, and intangibles (including goodwill).

	Consolidated	
	2013 \$m	2012 \$m
(b) Reconciliation of net profit after tax to net cash provided by operating activities		
Net profit for the year	311.9	281.2
Depreciation and amortisation	246.3	201.6
Changes in joint venture entities not received as dividends	(6.6)	(2.0)
Net revaluation (gain)/loss on investment property	(11.7)	1.6
Write-down of investments	0.5	0.4
Write-down of property, plant and equipment	7.9	-
Write-down of intangibles (including goodwill)	10.9	0.4
Write-down of receivables and inventory	10.4	11.7
Gain arising on acquisition of subsidiary	(44.9)	-
Net gain from sales of property, plant and equipment	(26.4)	(1.1)
Hedge ineffectiveness and other non cash finance costs	(3.5)	2.9
	182.9	215.5

Interest-bearing liabilities

Significant irregular movements occurred in Australia Post's holdings of bonds and other debt instruments in the 2012-13 Financial Statements, indicated in Note 19 on page 85 of the financial statements.

	Consolidated	
	2013 \$m	2012 \$m
19 Interest-bearing liabilities		
Current		
Short-term borrowings	15.0	-
Fixed rate unsecured bonds payable – within one year	327.4	-
Total current interest-bearing liabilities	342.4	-
Non-current		
Fixed-rate unsecured bonds payable – in one to five years	290.5	617.5
Total non-current interest-bearing liabilities	290.5	617.5

The corporation's \$605 million bonds

These bonds are unsecured and repayable in full, with \$325 million due on 25 March 2014 and the remaining \$280 million maturing on 6 February 2017.

Revolving committed facility

The group has a 3 year revolving committed facility of \$200 million expiring 8 October 2015 and a 5 year revolving credit facility of \$200 million expiring 8 October 2017, both of which are available for draw down as required. Amounts drawn are repayable on 30-day terms.

Bank overdraft facility

The group has a bank overdraft facility of \$15 million available for draw down as required. Amounts drawn are repayable on demand.

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