

Australia Post – the last domino to fall?

Corporate focus

- **Australia Post is the last major commercial business remaining in Government hands. But with the monopoly letter delivery agency increasingly relying on other services such as promotional mail and parcel handling to boost revenue, the relevance of government ownership is continuing to diminish.**
- **Letters now account for only 34 per cent of Australia Post profits with 43 per cent from parcels and logistics.**
- **CommSec believes that there is a solid case to be made for the sale of Australia Post. At the very least, the Government should begin community discussion on Australia Post's future. Based on post-tax earnings of \$367.9 million, the Federal Government could reap around \$5-7 billion by selling Australia Post. Sale proceeds could be directed to new community priorities such as water security. Australia Post could utilise the increased capital to develop a globally-competitive parcels and logistics business.**
- **Australia Post paid a dividend of \$282.5 million to the Federal Government in the last financial year. Community Service Obligations “cost” Australia Post \$87.9 million in 2005/06.**

JUNE 4 2007

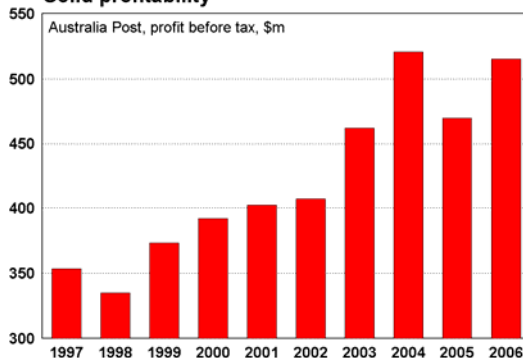
Produced by Commonwealth Research based on information available at the time of publishing. We believe that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made as at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, neither Commonwealth Bank of Australia ABN 48 123 123 124 nor any of its subsidiaries accept liability to any person for loss or damage arising from the use of this report. The report has been prepared without taking account of the objectives, financial situation or needs of any particular individual. For this reason, any individual should, before acting on the information in this report, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice. In the case of certain securities Commonwealth Bank of Australia is or may be the only market maker.

This report is approved and distributed in Australia by Commonwealth Securities Limited ABN 60 067 254 399 a wholly owned but not guaranteed subsidiary of Commonwealth Bank of Australia. This report is approved and distributed in the UK by Commonwealth Bank of Australia incorporated in Australia with limited liability. Registered in England No. BR250 and regulated in the UK by the Financial Services Authority (FSA). This report does not purport to be a complete statement or summary. For the purpose of the FSA rules, this report and related services are not intended for private customers and are not available to them. Commonwealth Bank of Australia and its subsidiaries have effected or may effect transactions for their own account in any investments or related investments referred to in this report.

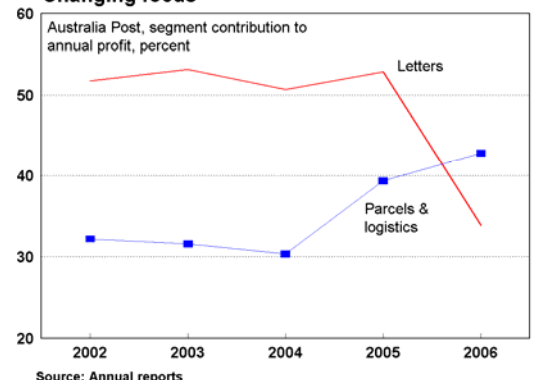
Overall analysis

- Some governments have floated their postal services businesses (Germany), some are preparing to privatise the operations (Japan) while other governments have at least thought about divesting the postal function from the public sector.
- In Australia there has been little debate about whether Australia Post should, or needs to, remain in public hands. This report attempts to facilitate public discussion on the issue.
- CommSec believes that there is a solid case to be made for the sale of Australia Post. At the very least, the Government should begin community discussion on Australia Post's future. The Federal Government could reap \$5-7 billion from the sale of Australia Post, enabling it to direct additional funds into new community priorities, such as water security and climate change. In turn, a privatised Australia Post could utilise the additional capital into developing a globally-competitive parcels and logistics business – a business that will prove valuable in boosting productivity and efficiency across Corporate Australia.
- While a number of government businesses have been sold over the past 15 years, it is interesting – to say the least – that there has been little discussion about the value of retaining Australia Post in public ownership. That is despite the fact that letter volumes are in long-term decline and that Australia Post is increasingly expanding into distribution, delivery services, retail operations and financial services in competition with private businesses.
- Just like Telstra, Qantas and Commonwealth Bank before, the key issue for the Government with Australia Post is determining whether the “essential service” aspects of the business preclude it from moving into private hands. Prior to the days of e-mail, websites, Bpay and broadband services, the “essential service” aspects of Australia Post business were significant. But parcels, promotional mail and banking services now dominate Australia Post revenues and the importance will only grow in coming years.
- Some in the community still perceive that Australia Post primarily delivers letters and sells stamps but that perception is starkly different from reality and the current strategic focus of the business. Australia Post is a major player in the commercial services and airfreight

Solid profitability

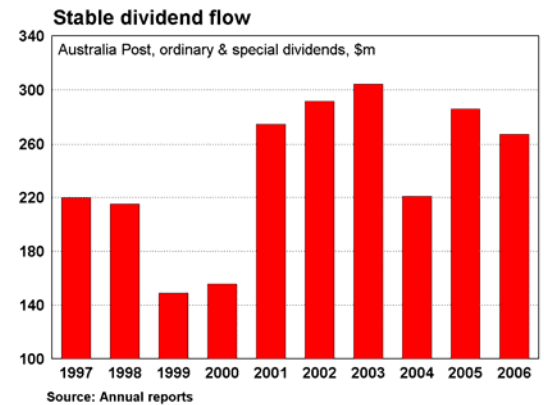


Changing focus



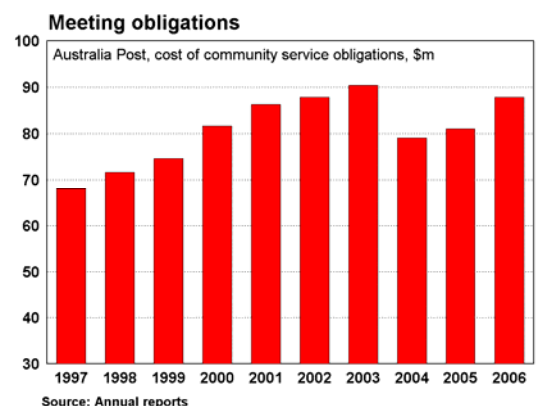
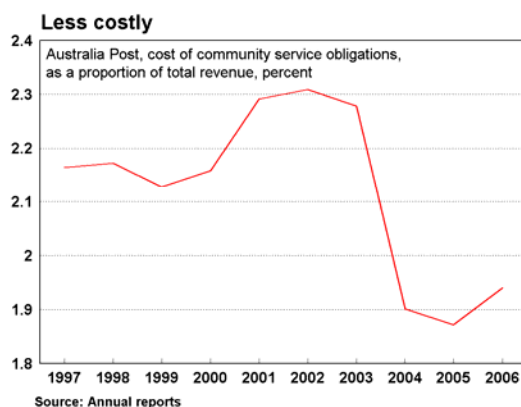
& logistics industries, competing strongly with a raft of private sector businesses. Most would know names like Star Track Express and Australian air Express but not link it with Australia Post.

- Far from being a business operating in communications or commercial services, Australia Post's operations span a range of sharemarket sectors including consumer services, retailing, financials, commercial services, and transportation.
- However like Telstra, a sticking point with any sale of Australia Post is community service obligations, especially for rural and regional areas. The bottom line being that Australians wouldn't want to lose their regular mail service, experience any decline in delivery times or pay a substantially higher cost for the service.
- Widespread community debate can ensure that current essential service obligations are maintained with a privatised Australia Post. But the key issue for the community is whether it is better to maintain Australia Post in public hands or to utilise the funds for different priorities.
- While it would have been almost an unthinkable proposition in the 1970s or 1980s to sell Australia Post, now the focus of Australians is on issues such as water security and the environment rather than getting mail delivered to your mailbox on time.
- Current and previous governments decided they shouldn't be in the business of banking, air travel or selling phone services. But given the shifting focus of Australia Post, both sides of politics must determine whether the Federal Government should be in the courier business or as a distributor of promotional mail. A key question is whether Australia Post maintains an advantage over smaller private businesses through its government ownership.
- At the end of the day, the community and Government may decide to leave Australia Post in public hands. Certainly Australia Post is a significant asset with growing and profitable businesses, requiring no form of government support or assistance. But to continue growing, Australia Post is likely to require greater access to capital, something that the Government may be reluctant to provide.
- When assessing options for Australia Post, the Government must be clearly focussed on the future. Mail (even promotional mail) and bill paying will continue to shift to electronic/direct methods. The internet is boosting the need for parcel delivery services. Trade is increasingly becoming global. And the shifts in mail and parcel delivery services are affecting government mail businesses across the globe. Governments are responding to these changes by focussing on deregulation of mail markets and privatisation/sale of government-owned businesses. The Australian Government will also need to develop a strategy for Australia Post to respond to global and technological change.



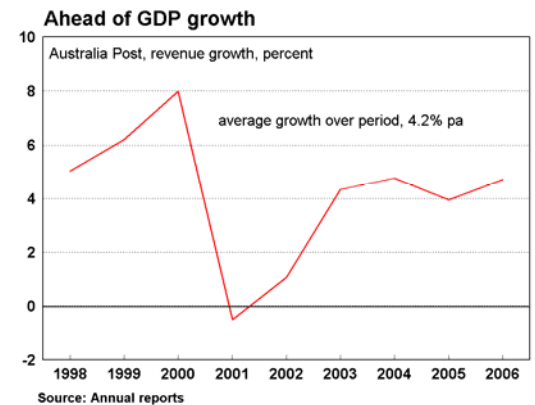
Key figures on Australia Post

- Australia Post reported a 9.7 per cent lift in profit before tax to \$515.6 million in the 2005/06 year. Net profit rose by 7.8 per cent to \$367.9 million. Revenue rose by 4.7 per



cent to \$4530.1 million. Consolidated assets rose by 14.7 per cent to \$4807.6 million. Return on equity was 18.7 per cent.

- Australia Post paid the government a dividend of \$282.5 million in the 2006 financial year.
- According to industry research firm IBIS, Australia Post is Australia's 53rd largest company measured by revenue, similar in size to Coca Cola Amatil and the Reserve Bank.
- Australia Post has 4,462 outlets, of which 2,563 are in rural or remote areas. Core businesses are letters; retail and agency services; and parcels and logistics. Staff numbers total 34,842 full-time and part-time employees.



Changing focus

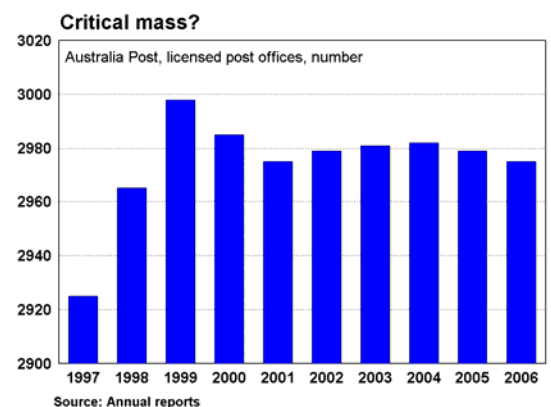
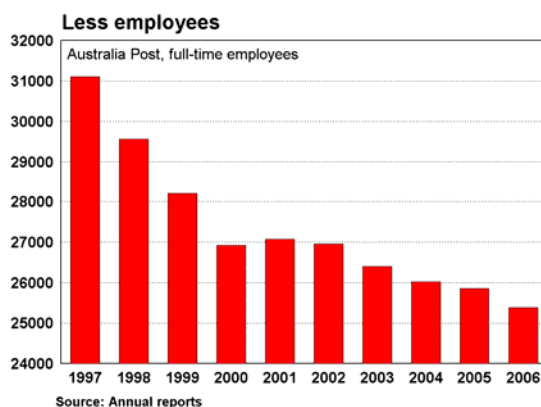
- Three years ago Australia Post decided that parcels and logistics would be the key platform for growth. And that change in focus has paid dividends. Profit on the parcels and logistics business was \$220.5 million in 2005/06, 43 per cent of total profit and the major contributor to bottom-line profit. Letters added \$174.6 million to profit with retail and agency services contributing \$85.8 million.
- While the volume of letters edged 0.5 per cent higher in the past financial year, the growth area is promotional or direct mail, up 6 per cent. Promotional mail makes up 16 per cent of all letters, still well behind transactional or business mail with 79 per cent but well ahead of social mail with 5 per cent of the total. Australia Post does acknowledge though that promotional mail volumes did fall in some markets as businesses shifted to electronic media.
- Australia Post has actively sought to expand the goods and services offered in its shops (post offices) including a raft of technology products and stationary items, passports, foreign currency and traveller's cheques.

Subsidiaries & Joint Ventures

- Australia Post has controlling interests in over a dozen companies including Sprintpak, JR Haulage and PrintSoft.
- Australia Post also maintains interests in six joint ventures:
 - Australian air Express Pty Ltd (express air freight)
 - iPrint Corporate Pty Ltd (printing services)
 - Star Track Express Holdings Pty Ltd (express freight)
 - Sai Cheng Logistics International Company Limited (international logistics services)
 - Multi Media Logistics Pty Ltd (logistics services)
 - Wetherill Park Partnership (warehousing facilities)

Community Service Obligations

- Australia Post lists its Community Service Obligations (CSOs) in its annual report and



they are also set out in section 27 of the Australian Postal Corporation Act (the Act), which requires that:

- the corporation provide a letter service for both domestic and international letter traffic
 - the service be available at a single uniform rate within Australia for standard letters
 - the service be reasonably accessible to all Australians wherever they reside
 - the performance standards for the service reasonably meet the social, industrial and commercial needs of the community.
- Australia Post has estimated the financial cost of meeting CSOs in 2005/06 at \$87.9 million. In other words, Australia Post is unable to structure prices appropriately to cover the cost of providing those services. But importantly, the cost of the CSOs is the same as it was five years ago and has hovered around \$80-90 million over that time.

Developments in global mail markets

- The **European Commission** has proposed full postal liberalisation in 2009, but a number of countries oppose the move. The UK mail market was fully opened to competition in 2005 while Germany and the Netherlands are planning to open their markets from January next year.
- **Deutsche Post** is probably the best known example of a privatised mail business. Deutsche Post World Net provides mail, express delivery and logistics services through brand names such as DHL, Postbank and Deutsche Post. Deutsche Post is listed on the German sharemarket and the government retains a 35 per cent stake in the company.
- **Japan's postal system** will be deregulated in October with Japan Post to be split into a postal savings bank, insurance company and two other entities. The process of privatisation will span 10 years with the postal bank and life insurance company to be listed within four years of their establishment. The government is required to sell-down two-thirds of its shareholding within that 10-year period. Japan Post plans to list on the stock exchange by at least 2011.

*Craig James,
Chief Equities Economist, CommSec
Work: (612) 9312 0265*

