Financial Performance

CONTENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis (MD&A) comments on the financial condition and results of operations of Canada Post Corporation for the year ended December 31, 2006. The MD&A should be read in conjunction with the consolidated financial statements and accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles and are reported in Canadian dollars. The information in this MD&A is current to March 9, 2007, unless otherwise noted.

Management is responsible for the information presented in the Annual Report, including the MD&A.

Forward-Looking Statements

This Annual Report, including this MD&A, contains forward-looking statements that reflect management's expectations regarding the Corporation's objectives, plans, goals, strategies, future growth, results of operations, performance, and business prospects and opportunities. Forward-looking statements are typically identified by words or phrases such as "anticipates," "expects," "believes," "estimates," "intends," and other similar expressions. These forward-looking statements are not facts, but only expectations or estimates regarding future events. Although the Corporation believes that these statements are based on information and assumptions that are current, reasonable and complete, these statements are necessarily subject to factors that could cause actual results to vary significantly from the expectations or estimates. Such differences may be caused by factors that include, but are not limited to, the risks and uncertainties set forth in the Risk Management section on page 48 of this MD&A. The Corporation cautions that the factors are not limited to those risks and uncertainties.

Readers are urged to consider these factors carefully in evaluating these forward-looking statements and are cautioned not to place undue reliance on them. The forward-looking statements included in this Annual Report, including this MD&A, are made only as of the date of this Annual Report and the Corporation does not undertake to publicly update these statements to reflect new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the events contained in these forward-looking statements may not occur. The Corporation cannot assure that projected results or events will be achieved.

Materiality

In assessing what information is to be provided in the MD&A, management applies the materiality principle as guidance for disclosure. Management determines if the information is material if, under current circumstances, it is considered probable that its omission or misstatement would influence or change the decisions of our Shareholder or others with a reasonable knowledge of the business and economic activities of the Corporation.

Highlights

Canada Post Corporation recorded its 12th consecutive year of profitability in 2006, generating $7.3 billion in revenues and succeeding in a consistently challenging environment. We are one of the largest employers in Canada as well as one of Canada's top recognized brands and a substantial enabler of the Canadian economy.

Consolidated highlights

(in millions of dollars)

Year ended December 31	2006	2005	% Change	
Revenue from operations	7,264	6,944	4.6%	$7,264 million, up 4.6% from 2005, driven by a strong performance in Lettermail™ and Admail™ products, and by revenue from our Purolator Courier subsidiary
Cost of operations	7,116	6,681	6.5%	$7,116 million, up 6.5% from 2005, due to salary increases, growth in our points of call, and increasing pressures in pension and health benefits, driven largely by lower interest rates used to estimate the future pension obligation
Income from operations	148	263	(43.6%)	$148 million, down 43.6%, as benefit increases outpaced revenue growth
Income before income taxes	166	282	(40.9%)	
Net income	119	199	(40.1%)	$119 million, down 40.1% from 2005, driven by high benefit cost increases
Return on equity	8.4%	15.0%	(6.6%)	8.4%, down from 15.0% in 2005, due to reduction in net income
Dividends to be paid in 2007 (based on 2006 net income)	48	80	(40.1%)	$48 million, down 40.1%, consistent with decrease in net income in 2006 when compared to 2005
Dividends paid in 2006 (based on 2005 net income)	80	59	35.6%	$80 million, up 35.6%, consistent with increase in 2005 net income when compared to 2004
Capital expenditures	305	167	82.5%	$305 million, up 82.5% over 2005, driven by need to replace obsolete and aging equipment and facilities
Cash provided by operating activities	267	212	26.1%	$267 million, up 26.1%, primarily due to decreased net income more than offset by the positive impact of changes in accounts receivable, accounts payable and deferred revenue
Cash (used) by investing activities	(278)	(310)	(10.3%)	$278 million, down 10.3%, reflecting increased short-term investment in 2005, partially offset by increased capital investment in 2006
Cash provided by financing activities	36	75	(53.0%)	$36 million, down 53.0%, due to increased dividends paid and lower transitional funding received
Cash position	499	474	5.2%	
Productivity ratio (cost as a percentage of revenue)	98.0%	96.2%	1.8%	98.0%, up 1.8% from 2005, as cost increased faster than revenue and productivity cost reductions were not achieved

Our Business, Vision and Strategy

The Canada Post Group

The Canada Post Group (the "Group") is a key enabler of the Canadian economy. We deliver more than 40 million messages, pieces of mail and parcels every business day. Our 72,000 employees and 6,600 post offices, as well as the 14 million physical addresses we serve, are each a key link in a vast network.

We hold interests in Purolator Courier Ltd. (Purolator), Progistix-Solutions Inc. (Progistix), Innovapost Inc. (Innovapost), and Canada Post International Limited (CPIL).

As of October 31, 2006, we fully integrated the epost™ service into our Transaction Mail line of business to provide a more strategic alignment of physical and electronic services. As a result, EPO Inc. and EPO Holdings Inc. were wound up and dissolved.

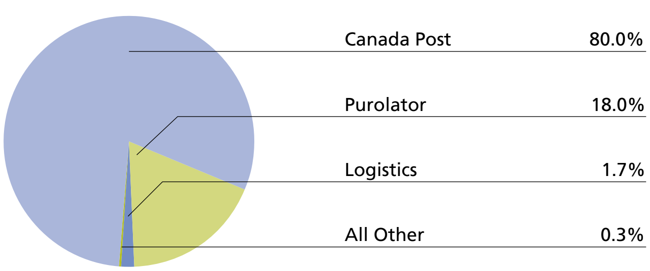
In January 2007, we sold our 50% interest in Intelcom Courier Inc., following an assessment of market dynamics against our strategic priorities.

Our Segments

Within this MD&A, we describe the Group in terms of four segments: the Canada Post Segment; the Purolator Segment; the Logistics Segment (Progistix, Intelcom); and the All Other Segment (Innovapost, CPIL).

Revenue from operations for The Canada Post Group reached $7.3 billion in 2006. The chart below illustrates the distribution of our operating revenues by segment, as percentages of the total revenue.

Revenues by Segment – 2006



Revenues by Segment	2006	2005	2004
Canada Post	80.0%	80.2%	80.6%
Purolator	18.0%	17.6%	17.1%
Logistics	1.7%	1.9%	1.9%
All Other	0.3%	0.3%	0.4%

Principal Markets

The companies that comprise The Canada Post Group operate within three distinct markets:

- **Communications:** We operate within a broad, $37-billion market of services – including telecommunications and broadcasting – that enables Canadians to communicate with one another and the rest of the world. Our postal and delivery services are organized around document-based communications, delivered in either physical or electronic form. We carry these documents from origin to destination through a trusted and reliable channel, enabling businesses and people to exchange information and conduct transactions. Our services include Lettermail for domestic correspondence, International Letter-post™, and epost, an electronic presentment service. Increasingly, we help businesses process and generate their documents, as well as manage their returns and responses.
- **Logistics:** We operate in several areas of the rapidly growing $42-billion Canadian supply-chain market, which includes services as diverse as order-taking and fulfillment, inventory management, transportation and delivery. Businesses use logistics services to plan, implement and control an efficient flow of materials, inventories and finished goods from their points of origin to consumption. In the $7.8-billion market for shipping and delivery services, our Parcels line of business and our Purolator subsidiary hold a significant proportion of the domestic segment. In supply-chain management, our Progistix subsidiary is considerably smaller than its global competitors, but it offers a more comprehensive suite of logistics services than any other Canadian firm.
- **Advertising:** Our Direct Marketing, Advertising and Publishing line of business competes in the $16-billion Canadian advertising market. Our focus is on direct marketing, a growing, profitable alternative to marketing media such as broadcast and print. Through direct mail, we enable businesses to reach current and prospective customers.

Trends, Opportunities, Threats

The Canada Post Group operates in an environment of intense competition in which traditional borders are disappearing – geographic borders and those previously seen as protecting certain segments of our business. The pace of the change has accelerated, further challenging the mandate and business of Canada Post and of all providers of postal services worldwide.

International Postal Trends

In the past 20 years, technological change and globalization have drastically affected the postal market. For example, re-mailers have entered the Canadian market. Their business model includes exploiting postal rates of other countries and the contravention of Universal Postal Union (UPU) rules and Canadian law. Mail is produced and collected by re-mailers in Canada and is shipped outside the country and inducted into a foreign postal stream by the re-mailers to the exclusion of Canada Post. Many of these re-mailers are owned and operated by or closely associated with foreign postal administrations.

As letter mail volumes have eroded, posts have increasingly looked to grow the direct marketing mail and competitive parcels and logistics segments. However, it is in the area of parcels and express/courier products where globalization has intensified competition and rendered geographic borders largely irrelevant. Internationally, this market is dominated by large, well-funded multinationals, including former postal administrations. Through trade liberalization, they have developed extensive cross-border networks, established themselves in other domestic markets, upgraded their products and networks, and provided customers with one-stop shopping.

As a result, many posts across the world face tough challenges. They are required to continue to provide universal services, while their most profitable product, letter mail, has ceased to generate substantial revenue growth. At the same time, globalization has opened up their competitive products to intense and increasing competition from well-capitalized global firms who come after the most profitable market segments.

Posts and their governments have responded to this new reality in various ways. Some have driven government-owned entities to achieve operational efficiencies, reduce restrictions on postal entities, introduce private sources of capital, diversify their product lines, and extend their geographic reach. Others have updated the legislation and regulations governing their postal markets to succeed in an increasingly complex marketplace.

Canadian Context

The Canadian postal market has not been immune to the trends noted above. Canada Post's Lettermail volumes have been relatively flat. In terms of competitive products, all four of the major global integrators, FedEx, UPS, DHL (Deutsche Post World Net's express division) and TNT (a division of the Netherlands Post) are active in Canada. Canada Post and Purolator still hold a major share of the domestic parcel market, but it is under increasing pressure.

Despite these changes and the general trends in the postal market, there has not been a parallel legislative/regulatory evolution in Canada. The crux of the legal and regulatory framework, the *Canada Post Corporation Act* and the *Financial Administration Act*, has remained largely unchanged since the early 1980s.

Other Trends

Electronic channels continue to experience growth and acceptance. In the middle of 2006, 82% of Canadian adults (18+) had access to the Internet, significantly more than the 77% reported in the same period in 2005. Increasingly, consumers and businesses are migrating to the electronic channel for both marketing and transactional activities. Growing cost pressures are forcing large commercial enterprises to find ways to move consumers to lower-cost channels of communication – from our traditional Lettermail service to electronic formats. In addition, corporations with multiple lines of business are consolidating their mailings to minimize costs. Their success in these efforts would clearly have a negative impact on the net income of Canada Post's traditional business.

The pressure on physical mail volumes is magnified by other factors. Our network grew by more than 200,000 new points of delivery last year, bringing the total to over 14 million. Although mail volumes might be steady or experiencing very limited growth, the number of pieces of mail per address delivered is decreasing annually.

Still today, most consumers prefer to receive messages through multiple channels – both paper and electronic. There is therefore an increasing need to offer trustworthy multi-channel solutions that meet the needs of both commercial customers and their customers.

Consumers are also seeking greater influence over the marketing they receive. This, coupled with the ongoing desire by marketers for a measurable, higher return on investment on their marketing spend, will likely drive more targeted marketing efforts. Advances in database and information management technologies are therefore expected to facilitate the adoption of direct-marketing techniques.

Strategy for Growth

Our vision is to *"be a world leader in providing innovative physical and electronic delivery solutions, creating value for our customers, employees and all Canadians."*

To achieve this, we must adapt to our changing markets. Our strategy is to provide Canada with a team of knowledgeable, customer-focused employees and a sophisticated, modern network that fulfills our brand promise: *"From anywhere... to anyone*™.*"* This means we must transform our workforce, equipment, methods and outlook so that we become stronger, faster and better at meeting customers' needs.

We have advanced along the path towards the Modern Post that we embarked upon in 2004, when we concluded that our model of product diversity, productivity gains and pricing alone would not sustain Canada Post over the long term. We recognized the need to reorganize ourselves around our customers' needs, so that we could better serve them and retain their business, increase their loyalty and establish ourselves as a trusted, reliable partner. With these outcomes, we expect to be better prepared to provide improved service, as well as secure jobs, competitive wages, pensions and other benefits for our employees.

In 2006, we continued to migrate our customer focus along three lines of business, each focused on its own market, but striving to realize synergies available across The Canada Post Group. This new management model places the customer at the centre of our service planning and delivery.

We also moved ahead in developing the resources we need to deliver real customer value. We advanced our employee engagement initiative, determined to reduce absenteeism, increase job commitment and satisfaction, and improve productivity.

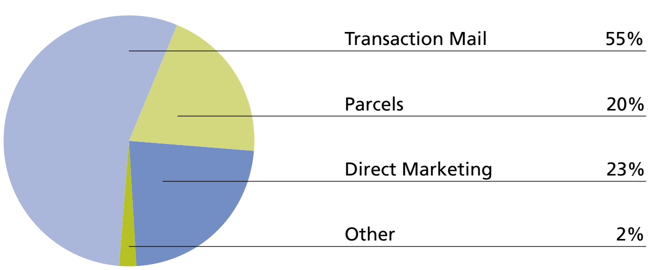
This work lays the foundation for our future. With increasing external and internal pressures, we must drive future change. During the year, senior management began work to clarify the long-term strategies for the Modern Post. To remain relevant in the future, we will seek to build stronger relationships with senders and receivers, connecting them through physical and electronic networks. Enabling change by engaging our employees will remain central to our strategies. We are working to define this long-term vision, as well as our investment plan to achieve our objectives.

Canada Post Segment

The Canada Post Segment represents 80% of our consolidated revenue. We are aligned along three lines of business, enabling us to focus on understanding and fulfilling our customers' needs. These lines of business include: Transaction Mail, Parcels and Direct Marketing.

The chart below illustrates the distribution of our operating revenues by line of business, as percentages of the segment's total.

Operating revenues by market – 2006



Operating revenues by market	2006	2005	2004
Transaction Mail	55%	56%	57%
Parcels	20%	21%	20%
Direct Marketing	23%	21%	21%
Other	2%	2%	2%

Transaction Mail

Canada Post delivers bills, statements, invoices, payments and other letters. On a typical day, we deliver the mail through trusted and reliable physical and electronic channels, enabling businesses to manage their relationships with their customers.

In the communications market, we offer three primary delivery services: domestic Lettermail, International Letter-post and epost. Our Lettermail service, the bulk of our business, enjoys an exclusive privilege over the collection, processing and delivery of letters under 500 grams. Competitive alternatives have emerged in the form of electronic substitution and consolidation of mailings to reduce delivery costs. Re-mailers have targeted the Canadian market as well.

Our International Letter-post service also faces competitive challenges from electronic substitution and re-mailers.

Our epost service is the sole electronic bill consolidator in Canada – a trusted intermediary between consumers, businesses and financial institutions. The epost service is available on the Web and at every chartered bank's Internet banking service. However, it faces increasing competition in the growing electronic bill presentment industry.

In the document processing industry, we produce, deliver and manage transaction communications for our customers. We transform customers' raw data into documents, then present these to their customers physically or electronically, depending on the preferences of the sender and the recipient.

Our Multi-Channel Mail Presentment Solutions service provides a switching service that manages a mailer's communications process from one end to the other, and presents the mailer's bills, invoices and statements in the channel of choice, including paper mail, fax and electronically at epost. Multi-Channel faces about a dozen primary competitors, almost all of them larger. Similarly, our Returns/Response Mail Management service faces these same competitors who provide value-added services along with Outbound mail management.

Vision and Strategy

Our Transaction Mail business aims to *"provide a multi-channel offering that merges the physical mail stream with the electronic channel in a way that is secure, certain, and beyond the capability of any other provider."*

Our strategy is to leverage our Lettermail service's market position and use its strength to develop and build new complementary businesses, products and services, and new paths to market. We aim to maintain or increase service quality, and aggressively pursue gains in productivity and efficiency.

This approach has three elements: to defend our market position, build capabilities to meet the needs of our evolving markets, and deliver additional services to our existing and new markets.

In defending our market position, we plan to maintain current revenue and margin by building deeper relationships with our customers and increasing their loyalty to the Canada Post brand. Through our Customer Value Management research with key constituencies, we have heard our customers describe the priority they place upon the certainty of delivery. Mailers want timely delivery, neither faster nor slower than promised. Above all, our aim is to enhance the commercial experience of our customers.

In building capabilities, we intend to invest in the services, multi-channel capabilities and platforms that allow us to offer better traditional document delivery and newer document processing.

Finally, to increase value, we intend to improve our marketing efforts by aligning our service choices more closely with our customers' needs, particularly through better market segmentation. We also aim to aggressively increase market share for our document processing services.

Progress Against Objectives

Transaction Mail revenue was $3.2 billion, a 3.2% increase over the previous year and $51 million over Plan. Revenue growth was mainly rate-related, with the overall volume of our Lettermail product essentially flat. *See 2006 Results on page 57.*

We made progress toward critical goals for developing line of business operations, penetrating the market for new services to increase revenue per customer, and enhancing customer offerings and interfaces to better satisfy customer needs and interaction.

We simplified the customer experience with Canada Post in a number of ways, for both our business customers and consumers:

- We introduced the PERMANENT™ stamp, sold at the prevailing rate of our Lettermail service but valid for an unlimited period of time, regardless of future price increases. For consumers, and small and medium-sized businesses, this improvement eliminates the inconvenience of buying additional one-cent stamps when rates increase and protects them against future rate increases.
- For our larger enterprise customers, we simplified our business process by collapsing various work-sharing discount categories into a much simpler schedule. We introduced a weight-based price split. We rewarded customers with lighter envelopes (0-30 grams) by holding their price flat, and increased the rate for those few mailers that are filling their envelopes to the 50-gram capacity, where our costs are higher.
- We also collaborated with customers to make additional charges more customer-friendly and transparent.
- We worked with some of our largest customers to speed up the mail induction process and increase the effectiveness of controls for getting their mail into the system and on to its destination.

For longer-term strategic initiatives, we exceeded market penetration goals for new services. Specifically, our steps included:

- formalizing a Returns/Response pilot program after demonstrating that the service could cut the average returned mail-processing time from a week to a day, while delivering data to help customers improve their mailing efficiency. We exceeded our customer acquisition goals for the year, and revenue is increasing rapidly;
- exceeding our commitment to acquire several new strategic customers for the Multi-Channel Mail Presentment Solutions service.

As a key commitment to improving multi-channel services, we completed the integration of the epost service into Transaction Mail. This allows us to offer mailers a wider, better-integrated range of options and value-added services.

Working with postage meter vendors, we also made significant progress toward converting user equipment from older analog models to networked digital models. The new technology is expected to provide information on the products used by meter customers and protect revenue by reducing fraud. It should also provide users with many enhanced use, control and reporting capabilities.

An independent professional services firm measures the performance of our Lettermail service. The results demonstrate that Canada Post consistently performs at a level in excess of 96% to the published standard.

Parcels

In the highly competitive parcels market, Canada Post and its Purolator subsidiary are leading players.

Our Purolator Courier subsidiary leads the competition in domestic market share, while larger multinational firms dominate international courier pickup and delivery. Purolator's business is further discussed in the section on the Purolator Segment on page 38.

Canada Post's Parcels line of business serves domestic destinations through our Regular Parcel™, Xpresspost™, Expedited Parcel™ and Priority Courier™ services. Our Regular Parcel and Xpresspost services are economical express alternatives to other courier services. Our Expedited Parcel service provides ground service to high-volume customers, while our Priority Courier service guarantees next-day delivery by noon between major centres.

Internationally, Canada Post provides a similar diversity of products, including Xpresspost-USA™, Xpresspost-International™ and Expedited Parcel-USA™.

Vision and Strategy

Our Parcels line of business pursues the vision of *"becoming the leading deferred express and non-express value-based parcel delivery service to the home, and the preferred domestic and international parcel delivery solutions partner to Canadian shippers."*

Our approach is to improve profitability and boost declining shipment volumes. We intend to:

- increase operational efficiencies by engaging employees in the success of the business;
- improve service quality and create a responsive customer-centred service culture;
- implement focused marketing and sales programs to effectively target and communicate to growth segments; and
- improve our tracing capability, a feature that is in high demand from our customers.

Canada Post is a leading market player. We have the largest retail network, serving both consumer and small business customers, and our strengths lie in the business-to-consumer home delivery segment. We see growth opportunities with small and medium-sized businesses served by commercial contracts, and also internationally in Inbound and Outbound markets.

By defending areas of strength and developing opportunities, we expect to build our business. Our ability to do so profitably, however, will depend on our ability to improve cost performance. Productivity gains are available from better management practices, re-engineering work methods, through capital investment to replace obsolete processing equipment and facilities, and by enhancing labour flexibility to be achieved through the collective bargaining process.

Renewed volume growth is expected to improve operating and delivery densities, enabling us to eventually realize better cost efficiencies and improved competitiveness. In the longer term, we expect this to allow us to sustain leadership in key areas of the Canadian shipping and delivery market. As well, with investment and in concert with The Canada Post Group partners, we expect to gradually assume an expanded role in the marketplace.

The intensively competitive nature of the parcels business places a premium on our ability to route items efficiently from pickup to delivery. We are about to complete a four-year program in which we have replaced contractors with our own employees. This increases our ability to manage processing and improve delivery experience. We are also preparing further improvements to our ability to handle, track and report on deliveries in ways that our customers prefer. An immediate focus is on increased scanning and tracking visibility.

Our real strength lies in the size of our delivery network, which reaches 14 million addresses, and our ability, where appropriate, to use the synergies available within The Canada Post Group. Our retail network, the largest in Canada, provides customers with convenient points to pick up or drop off parcels.

Progress Against 2006 Objectives

The focus for 2006 was to increase revenue growth, improve service performance, and improve contribution.

Parcel revenue totalled $1.2 billion, 1.9% higher than the previous year, but $33 million lower than Plan. Revenue growth was due to rate increases, as Domestic and International Outbound shipment volumes declined by 8.1%. International Inbound volumes increased, but most of this was due to a change in business processes redefining USA Inbound product. As a result of this change, the 2006 Inbound values are not comparable to the previous year. *See 2006 Results on page 57.*

Our service performance improved in 2006, with our Xpresspost and Expedited Parcel services scoring well against their service targets.

Investment in new packet sorting equipment is underway in Toronto. Plans are being made for further investment in Toronto and Montréal to improve service and reduce costs. We are further reducing costs by implementing, where appropriate, logistical synergies at commercial rates between The Canada Post Group companies.

We also invested in our capability to scan parcels and track data so we can improve our performance and customer service. We implemented initiatives to achieve complete bar-coding of our core parcels processed, and purchased more than 7,000 new leading technology portable scanners, which we are currently deploying. These measures are expected to improve our revenue from foreign shippers through the Universal Postal Union's new "pay-for-performance" rules and to address implications of the global trend toward enhanced border security in the customs clearance process.

To maintain leadership among consumers, we introduced our first online shipping solution in the fall of 2005. Our Ship-in-a-click™ service enables customers to book shipments without requiring registration or account numbers, and to create shipping labels, pay online and deposit their item in any letter box or at any post office. In February 2006, we offered new online convenience to small businesses offering items on eBay™. Through a strategic alliance, we integrated our shipping services onto the new eBay Canada shipping centre, allowing sellers to integrate shipping within their auction, receive payment, generate shipping labels automatically from registration data, and deposit their parcels in our letter boxes and at post offices.

In the small business arena, we continued to create opportunities through effective and targeted marketing campaigns. We strengthened our retail storefront advantage by partnering with Staples™, expanding our shipping centre presence from 104 to 270 Staples stores, and selling Purolator and Canada Post services under the Purolator banner.

We deployed parcels sales specialists to support our sales organization through team sales approaches in conjunction with other members of The Canada Post Group. We also improved our sales performance through database-driven marketing techniques.

Direct Marketing

The Canadian advertising market, estimated at $16 billion, includes a direct-marketing segment that has grown at an average 6.5% over the last five years. Driven primarily by the growth of Internet marketing, this segment is expanding more rapidly than mass advertising using print, broadcast and other formats.

Direct mail enables our customers to deliver targeted messages and offerings to highly defined target groups. It provides an attractive alternative to mass-media advertising by enabling marketers to create a measurable response. Marketers can therefore justify direct-mail investments and overcome the challenges that audience fragmentation poses for traditional mass-media advertising. Direct mail has high consumer acceptance and earns a strong return on investment (ROI) for advertisers compared to other media.

Our products include Addressed Admail™, which offers the ability to target promotional messages to specific individuals or businesses, and Unaddressed Admail™, which enables our customers to reach specific neighbourhoods or regions across Canada.

We are also a market leader in distributing periodicals, including newspapers, magazines and newsletters, putting more single copies into the hands of readers than newsstands or other distributors in Canada.

Canada Post has been supporting the industry through participation in the Canadian Heritage Publication Assistance Program and will continue to do so, as directed by the Government of Canada, until the program is restructured over the next two years.

Vision and Strategy

Our Direct Marketing, Advertising and Publishing line of business *"aims to be recognized as the foremost driver of effective, results-proven direct marketing in Canada."*

Our strategy is to develop our products and services, knowledge, and capabilities so we can help marketers meet their challenges. By providing new products, more product options, more services to improve campaign effectiveness, and greater measurability and solutions to privacy concerns, we aim to capture a greater share of rising direct-marketing expenditures. We expect more marketers to pursue a multi-channel approach, combining direct marketing with other marketing communications techniques in step with the advance of new media. This trend is expected to demand a greater analytical capability, and enable more personalization, attention to consumer preferences and sophisticated assessments of direct marketing's contribution to our customers' profit.

In 2006, as our line of business took shape, we developed a market-segmentation approach that focused our planning, development and execution on three distinct customer groups: small and medium-sized businesses, large enterprises, and direct retailers.

Small and medium-sized businesses seek easy, cost-effective ways to drive sales higher. But they often see direct mail as being too complex. Large enterprises with sophisticated marketing functions need ROI-based evidence that direct mail is more effective than other advertising media. Traditional retailers need help in developing profitable direct-to-home alternatives to other promotional channels. For each segment, we intend to concentrate on educating current and future customers to demonstrate that our products meet their needs and advance their businesses.

Progress Against 2006 Objectives

Our focus for 2006 was to increase the volumes and revenue of our Admail products, introduce new direct marketing and advertising solutions, and improve delivery.

Direct Marketing revenue was $1.3 billion, an increase of 9.9% year-over-year, and $32 million higher than Plan. Revenue rose due to strong volume growth in both our Addressed and Unaddressed Admail services. *See 2006 Results on page 57.*

We created three customer segment groups to lead the planning, development and execution of customer-focused solutions:

- We worked with *small and medium-sized businesses* to simplify direct-marketing experience turnkey products, supplemented by training materials and tools to implement successful campaigns. We delivered training seminars to educate businesses about direct marketing, and built a web-based portal called Direct Marketing Online™ to help businesses plan, create and distribute direct mail from home or office.
- For *larger enterprises*, we expanded our team of seasoned direct marketing advisors to build relationships with Canada's most sophisticated direct marketers and deliver insights to help them achieve their marketing objectives. We also developed and implemented a measurement methodology so our customers can test the effectiveness of alternative direct-mail mixes. Our approach built a new level of trust with many of our customers, showing we can support them in developing and implementing marketing strategy. We completed a series of pilot projects demonstrating that direct mail can accelerate sales above traditional growth rates.

- In *direct retailing*, we launched the lookbook™ catalogue pilot to help traditional retailers test cataloguing at low cost. This cost-effective approach to prospecting and mail order is proving to be effective, confirming that opportunities exist for catalogue retailing in Canada – a market still very undeveloped compared to the United States.

In 2006, we introduced measures to improve the performance of our Admail products. Specific plans were developed to improve predictability of delivery and address high-volume situations, a key operational challenge in some geographies. Implementation plans cover both 2006 and 2007 fiscal years.

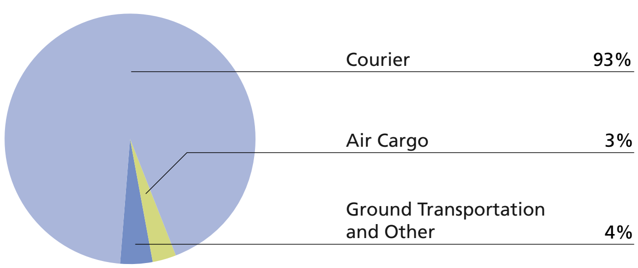
Purolator Segment

Canada Post owns 90.92% of the common shares of Purolator.

As Canada's leading overnight courier company, Purolator delivers innovative products and dependable service. Purolator has more than 10,500 employees, a fleet of more than 4,000 vehicles, and makes 275 million deliveries and pickups annually.

The chart below shows the distribution of the Purolator Segment's operating revenues by market, as percentages of its total.

Operating revenues by market – 2006



Operating revenues by market	2006	2005	2004
Courier	93%	95%	96%
Air Cargo	3%	2%	2%
Ground Transportation and Other	4%	3%	2%

Vision and Strategy

Purolator Courier aims to *"be the leading provider of integrated distribution solutions to, from and within Canada."* With customers' needs continually evolving, superior service remains key to achieving this objective. Service quality and reliability are important attributes in a courier service provider as is the ability to provide one-stop shopping and a wider array of services.

Purolator's strategy is to create:

- competitive advantage through investment in employees;
- sustainable market advantage through superior service and brand leadership;
- profitable growth through innovation in products and services; and
- continuous unit cost improvement through process innovation and technology.

In 2006, Purolator embarked on a five-year business transformation initiative, "Purolator 2010." It is working towards the replacement of technology with new systems intended to make Purolator more customer-responsive and efficient. It also developed designs for new terminals to improve package sorting and delivery, and stepped up the pace of several process improvements to better its capability and effectiveness.

This transformation requires significant investment in technology, infrastructure and internal coordination. By the year 2010, Purolator intends to have invested in its sorting plants and equipment, to have made significant investment in its new freight business, and to have further improved its cross-border capabilities to reduce operational costs and improve service. It also intends to invest significantly in its employees, ensuring they have the knowledge, skills and abilities to maintain Purolator's leading market share.

Through the four thrusts of its core strategy and the impact of the "Purolator 2010" initiative, Purolator expects to transform the company and enable its employees to deliver improved service and enhance the customer experience.

Progress Against Objectives

Purolator contributed $69 million to consolidated income before income taxes, exceeding Plan by $22 million. Purolator revenue totalled $1.3 billion, an increase of 7.4% over the previous year and $27 million over Plan. *See 2006 Results on page 57.*

Purolator improved service and brand leadership through the introduction of the Business Solutions team, a group of supply-chain professionals who provide solutions that improve service quality and introduce sustainable processes. The team plans to implement a partnership with Purolator customers, thus strengthening their loyalty.

Purolator also pushed ahead with plans to grow profit through innovation and new lines of business. Purolator Freight™, its premium less-than-truckload (LTL) service, further expanded its capability and increased revenues by a factor of five. Purolator strengthened its relationship with its international service provider to improve its U.S. and international service for Canadian clients. It also increased its U.S. and international marketing efforts to showcase these services.

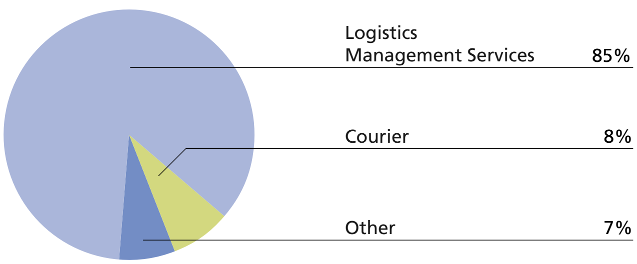
Logistics Segment

The Logistics Segment includes Progistix, a subsidiary of Canada Post, and Intelcom, a joint venture. Canada Post owns 98.7% of Progistix.

Canada Post's investment in Intelcom was sold in January 2007 following an assessment of market dynamics against our strategic priorities. In 2006, our 50% interest in Intelcom revenue was $10.8 million with income before income taxes of $0.5 million.

The chart below shows the distribution of the Logistics Segment's operating revenues by market, as percentages of its total.

Operating revenues by market – 2006



Operating revenues by market	2006	2005	2004
Logistics Management Services	85%	88%	88%
Courier	8%	7%	7%
Other	7%	5%	5%

Progistix

Progistix is the largest Canadian-owned third-party logistics company. It provides supply-chain management services for clients requiring complex solutions in the technology and retail industries.

Progistix offers complete order-management and inventory-management services encompassing call centres, order processing, warehousing and transportation. It has gained recognition across North America as a well-run logistics provider.

Progistix operates in a strong and growing market. Buoyed by the dual forces of strong global growth in outsourced services and increased recognition of the value of investment in supply-chain management, the industry is growing at double-digit levels. While the market is strong, it is crowded with large, capable global and regional players.

Market research confirms that service providers face profit pressures from clients that are forcing them to seek new sources of value such as supply-chain redesign, a deep knowledge of industry verticals, and a scale that clients cannot achieve on their own. Providers continue to consolidate to gain global coverage and scale in technology, back office and transport buying power. In addition, profitable Asian markets are funding global growth.

Vision and Strategy

Progistix aims to *"be the source for global, worry-free supply chain services with local solutions, and to be differentiated by world-class solutions that make clients' complex problems simply disappear."*

The strategic direction for 2007 and beyond is to continue to expand Progistix's presence in the Canadian market and build a presence in the U.S. market through acquisitions and partnerships.

In the fall of 2006, in support of this strategy, Progistix entered into a non-binding memorandum of understanding with a Canadian third-party logistics company to acquire all of its shares.

In 2007, Progistix intends to focus on the following key strategic initiatives:

- secure new profitable clients;
- deepen relationships with clients, employees and business partners;
- create a culture of innovation that responds to the changing needs of the market; and
- deliver committed profitability.

Progress Against Objectives

In 2006, Progistix incurred a loss before income taxes of $1 million, which was $13 million lower than Plan. Progistix revenue totalled $124 million, a decrease of 9.6% year-over-year, and $15 million less than Plan. *See 2006 Results on page 57.*

All Other Segment

The All Other Segment includes Innovapost, a joint venture, and CPIL, a wholly owned subsidiary. Canada Post's equity interest in Innovapost is 51%.

Innovapost

Innovapost is the information technology service provider to The Canada Post Group. Innovapost develops, maintains and operates the Group's computing and information systems, and provides application development and maintenance services. Infrastructure services are sub-contracted to CGI Information Systems and Management Consultants Inc, the minority (49%) shareholder.

Innovapost brings value to the Group by reducing costs, improving service levels, and providing consulting services. It also uses its relationship with strategic partners, such as CGI and Accenture Ltd., to add more value to customer solutions.

Innovapost's vision is to *"provide world-class information technology services, support the technology-based growth plans for its clients and their customers, and ensure that The Canada Post Group derives maximum advantage from its information technology investments."*

Its strategy is to:

- improve products and services to The Canada Post Group;
- improve its internal systems, processes and capabilities; and
- transform its application management and development services to world-class levels through industry-standard tools, processes and methodologies.

Since starting up in 2002, Innovapost concentrated on equipping Canada Post with the information systems and technologies it needs to operate competitively. The focus is shifting now to continuous improvement and cost reduction, principally through application development. Innovapost assumed responsibility in 2006 for technology services for our epost and Borderfree™ services, and intends to multiply its service offerings to help The Canada Post Group generate ideas, develop business and build on the strength of rapid application development. In this way, the Group expects to use Innovapost's technological skills to fuel its growth. Innovapost also plans to selectively explore opportunities to accelerate the development of new capabilities required to make the Group successful in its growth markets.

In 2006, Innovapost achieved its expected service levels and key metrics such as customer satisfaction, employee satisfaction and service quality.

Canada Post International Limited

Canada Post International Limited (CPIL), set up in 1990 to market Canada Post's management expertise to other postal administrations, has largely withdrawn from seeking new opportunities. The company is focused on managing commercial contracts with the Netherlands Antilles, Guatemala and Belgium. Its technology contracts have been assigned to Innovapost.

CPIL's prime responsibility is to resolve contract issues with the Government of the Netherlands Antilles, as the country's five territories prepare to disband in December 2008. CPIL has been serving the country since 2001, and the forthcoming jurisdictional realignment has created an opportunity for both sides to review areas of concern. The Government of the Netherlands Antilles has not enforced the reserved service area granted under the 2001 contract, which has reduced CPIL's earnings.

In 2006, CPIL revenue was $15.2 million with income before income taxes of $0.3 million.

Policy Framework

In December 1998, the Government of Canada approved a multi-year Policy Framework for Canada Post. This framework includes long-term financial and service objectives, as well as a price-cap formula for the basic letter rate.

These long-term financial objectives for The Canada Post Group are earnings before interest and taxes (EBIT) of $175 million, return on equity (ROE) of 11%, and a productivity ratio of 97%. EBIT equates with income from operations, as reported in the consolidated financial statements.

Each year, we review our prospects and priorities, and confirm our five-year Corporate Plan with our Shareholder. Our intention is to consistently meet the Policy Framework objectives, recognizing that we may not reach all in each year.

The table below sets out the Policy Framework objectives, the 2006 Plan, and our progress towards achieving them.

Policy Framework objectives

Policy Framework Objectives (in millions of dollars)		2006 Plan	2006	2005	2004
Income from operations (EBIT)	**$175**	$101	$148	$263	$238
Return on equity (Net income ÷ average equity)	**11%**	4.2%	8.4%	15.0%	12.1%
Productivity ratio	**97%**	98.6%	97.9%	96.2%	96.4%

In 2006, we exceeded our approved plans. However, as we had foreseen in the 2006 to 2010 Corporate Plan, we did not achieve the Policy Framework financial objectives, reporting income from operations of $148 million, a return on equity of 8.4%, and productivity (cost as a percentage of revenue) of 97.9%. This is a reflection of an increasingly competitive market and escalating cost pressures largely driven by increased benefit costs of $175 million in 2006.

Key Performance Drivers

As our markets grow steadily more competitive, our success depends on our ability to deliver superior value and service to Canadian businesses, enabling them in turn to serve their customers better. Canada Post relies on our employees and equipment to provide our customers with efficient, high-quality service. By ensuring we win our customers' repeat business, we create financial success.

At Canada Post, we set our priorities annually, confirm them with our Shareholder, and track our progress against objectives from four perspectives: customer value, employee engagement, delivery performance and financial results. These four dimensions provide the key metrics for our corporate team incentive plan. In 2006, we used a formal performance scorecard to track progress on our corporate priorities. In 2007, we intend to introduce a corporate dashboard with components that will more usefully indicate our strategic direction.

Customer Value

Canada Post introduced Customer Value Management in January 2006, replacing the previous Customer Satisfaction program. The new method identifies the drivers of customer value and loyalty through relationship surveys and transactional questionnaires. The relationship surveys explore our customers' mailing habits and practices, assess their loyalty to Canada Post, and capture their feedback on our products and services, delivery, price, reputation and image, and service culture. The transactional questionnaires ask customers about their recent experience with Canada Post, including our sales and customer service representatives, retail outlets, delivery personnel, and our website. These techniques provide insight about our quality of service, competitive advantage and areas requiring improvement.

Canada Post set Customer Value Index targets for 2006 and surpassed them. The targets have been raised for 2007, and we intend to focus on our ability to provide service that is simple, smart and timely.

Employee Engagement

We measure employee engagement through our employees' perception of their employer and working environment, and through quantitative measures of accidents, grievances and attendance.

In 2006, we included key engagement scores in our corporate scorecard. We use two engagement measures – one to track progress in implementing engagement plans at all levels of management and leadership, and another composite engagement indicator.

We also track absenteeism and accident frequency rates. Despite significant effort to improve working conditions and safety, the absenteeism and accident frequency rates remained unacceptably high.

Delivery Performance

Our delivery standards require us to deliver our Lettermail service's items consistently within two business days within the same metropolitan area or community; within three business days within the same province; and within four business days between provinces.

An independent professional services firm tests our Lettermail service by depositing mail through letter boxes and post offices, and tracking it to delivery points across the country. Our 2006 on-time service performance score, at 96.4%, topped our corporate target of 96%. Low variations in performance indicate that our delivery process was stable and consistent.

We also evaluate operational performance through the unit cost, cycle time and defect rate for our service transactions.

Financial Performance

The financial ratios tracked by our management appear on page 75.

Progress Against 2006 Objectives and 2007 Priorities

In this section, we summarize our progress toward meeting our 2006 objectives, and provide an overview of our priorities for 2007.

Our objectives for 2006 focused on the overarching goal of placing the customer at the centre of our business. We reorganized the Corporation around three lines of business, each focused on a specific set of customer needs. To make this focus clear, we also began to share, with our employees, insights that we receive from the front lines of our operations. Our priority is to engage our employees in our business – beginning with reduced absenteeism and moving up to an intense focus on customer satisfaction. These results are essential to secure a strong, sustainable future for Canada Post. Just as important, we set out to improve the workplace environment with an intensified focus on health and safety, and the equipment and physical workplace we provide to our employees.

Within the lines of business, we moved forward with the objectives set in our Corporate Plan. The key priority in Transaction Mail was to defend our paper mail business against substitution by electronic alternatives. We focused on providing service excellence in mail management and cost-effective multi-channel offerings that would allow us to integrate into our customers' business chains. In Parcels, we initiated infrastructure improvements aimed at ensuring we remain the leading service provider. In Direct Marketing, we upgraded our capability to provide leading-edge services throughout the direct marketing value chain.

Progress against 2006 objectives and 2007 priorities

Legend

●●● Achieved

●● Partially achieved

● Not achieved

Customer Value

2006 Objectives		2006 Results	2007 Priorities
Validate multi-channel (electronic and physical) delivery capabilities with beta customers	●●●	Exceeded new customer objectives and renewed contracts, validating multi-channel market potential	Establish long-term corporate vision and strategy to support Canada Post's transformation to the Modern Post
Launch Returns/Response Mail Management service capability	●●	Achieved customer acquisition objectives, despite shortfall in revenue expectations	Launch Direct Marketing Online to make direct marketing easier for customers
Attract new Direct Marketing customers by proving return on investment potential	●●●	Successfully completed Return on Investment pilots with several customers, meeting revenue objectives	Building on momentum from 2006, grow Returns/Response Mail Management service and Multi-Channel Mail Presentment Solutions service
Help direct marketers increase response rates through targeting tools and list generation	●●	Upgraded and added new functionalities to our targeting tools GeoPost™ and Snapshot™ Delayed launch of GeoPost new capabilities to early 2007 due to data integration issues	Upgrade Parcels process quality to competitive levels to further enhance customer service levels
Invest in Parcels infrastructure to increase service levels	●	Commenced investment, but development of optimal Parcels infrastructure solution took longer than planned, as it is being reviewed in context of the Corporation's broader strategy	Complete digital meter conversion to provide visibility on the products used by meter customers and enhance revenue verification

Progress against 2006 objectives and 2007 priorities (continued)

Employee Engagement

2006 Objectives		2006 Results	2007 Priorities
Invest in front-line human resources	●●●	Hired approximately 600 supervisors to improve mail operations and delivery efficiency, and build employee engagement	Create a healthy and safe workplace by delivering programs to increase employee safety and reduce accident rates
Invest in plants and depots	●●●	Invested $20 million in visible workplace improvements to raise employee satisfaction	Continue to improve work environment through investments in plants and depots
			Introduce "best-in-class" recognition programs
Communicate "big picture" to employees	●●●	Held regular executive discussion groups with employees to raise understanding of Canada Post strategy and business issues	Improve productivity through technical training
Promote a healthy workplace, reducing accident frequency rates and absenteeism levels	●	Established occupational health and safety and disability management teams supplemented with safety management programs. However, we have not yet seen declines in accident frequency and absenteeism rates	Implement face-to-face communication plans to improve internal communication
			Reach collective agreement with Canadian Union of Postal Workers (CUPW)

Delivery Performance

2006 Objectives		2006 Results	2007 Priorities
Achieve delivery service targets	●●●	Lettermail delivery service target achieved	Achieve delivery service targets
Identify and deliver process improvements to enhance Direct Marketing service	●●	Direct Marketing service was significantly enhanced. We made improvements in most market segments. However, some product categories remain below our objectives	Complete bar-coding of core parcel products to enhance tracking performance and visibility for our customers
			Enhance customer service experience – improve problem-resolution response rates
	●●●	Xpresspost and Expedited Parcel delivery service targets achieved	Consult communities, ensuring widespread knowledge and understanding of The Canada Post Group's existing and emerging issues

Financial Performance

2006 Objectives		2006 Results	2007 Priorities
Achieve The Canada Post Group's financial plan	●●●	Revenue and earnings before tax exceeded Plan by 0.8% ($58 million) and 49.5% ($55 million), respectively	Deliver Canada Post and The Canada Post Group earnings commitments
Achieve Canada Post's line of business revenue objectives	●●	Transaction Mail and Direct Marketing exceeded revenue objectives, but Parcels revenue fell short of Plan	Leverage new product and service offerings to drive profitable revenue growth across all lines of business
Deliver Operations efficiencies targets	●	Efficiencies fell short of target due to productivity shortfalls and higher-than-anticipated levels of employee illness and injury leave	Deliver Lettermail service and parcel process enhancements and information technology efficiencies to achieve cost of operations objectives

Capability to Deliver Results

As a service business facing increased competition and rising customer expectations, Canada Post needs people who will stretch for the customer, equipment that will help them do it, and adequate financing to support capital investments, while ensuring a continuing return on equity and dividend payout to our Shareholder.

Employees

Canada Post employs approximately 60,500 people, and our subsidiaries and joint ventures employ an additional 11,500. The consolidated enterprise is the sixth-largest employer among businesses in Canada.

The labour-intensive nature of our business means our customer value derives directly from the performance of our employees. Three factors now in play are expected to affect our ability to deliver value at the level we have targeted: the state of our labour relations; the engagement of our workforce; and our ability to retain and recruit the employees we need in the face of a significant wave of retirements.

Labour Relations

To develop and continuously improve the value we provide our customers, Canada Post must be able to avoid periodic disruption and conflict. We must also be able to implement change on a timely basis, which is challenging under the provision of certain collective agreements.

Canada Post Segment

In 2006, Canada Post reached collective agreements with three labour unions, and secured a tentative agreement in February 2007 with our largest union, the Canadian Union of Postal Workers.

Progress in achieving workplace stability

Bargaining Unit	# of Represented Employees*	Collective Agreement Expiry Date
CUPW (1)	42,010	January 31, 2007
CUPW-RSMC (2)	5,970	July 31, 2011
CPAA (3)	6,388	March 31, 2009
APOC (4)	3,620	March 31, 2009
PSAC/UPCE (5)	2,188	August 31, 2008
TOTAL	**60,176**	

* All figures include full-time and part-time employees only; excludes temporary, casual and term employees.
(1) CUPW = Canadian Union of Postal Workers
(2) CUPW-RSMC = Canadian Union of Postal Workers – Rural and Suburban Mail Carriers
(3) CPAA = Canadian Postmasters and Assistants Association
(4) APOC = Association of Postal Officials of Canada
(5) PSAC/UPCE = Public Service Alliance of Canada / Union of Postal Communications Employees

Canadian Union of Postal Workers (CUPW) – Urban Postal Operations
Canada Post and the CUPW, which represents approximately 42,000 urban postal operations employees (regular full-time and part-time), began negotiations in September 2006 to replace a four-year collective agreement set to expire January 31, 2007. On February 9, 2007, Canada Post announced a tentative agreement for a new collective agreement that would operate until January 31, 2011. This is expected to be submitted for ratification in March and April 2007.

Canadian Union of Postal Workers – Rural and Suburban Mail Carriers (CUPW-RSMC)
Canada Post and the RSMC, currently in the fourth year of an eight-year collective agreement, concluded an agreement in July 2006 on adding and revising certain provisions. Canada Post and CUPW-RSMC signed a Memorandum of Agreement on July 28, 2006, enabling the new provisions to take effect on August 1, 2006.

Purolator Segment

In 2007, Purolator and the Teamsters union, which represents approximately 8,900 operations personnel, will enter into negotiations to replace the collective agreement set to expire December 31, 2007.

Progress in achieving workplace stability

Bargaining Unit	# of Represented Employees*	Collective Agreement Expiry Date[1]
Teamsters	8,917	December 31, 2007
Other	1,075	December 31, 2008 December 31, 2009 February 1, 2010
TOTAL	**9,992**	

* All figures include full-time and part-time employees only; excludes temporary, casual and term employees.
[1] Multiple agreements

Logistics Segment

Progistix

In 2006, Progistix experienced a work stoppage that lasted six weeks during its busiest time of operation. During this period, management kept the business operating, retained its customer base, and was able to negotiate a labour agreement that is expected to improve its competitive position.

Progress in achieving workplace stability

Bargaining Unit	# of Represented Employees*	Collective Agreement Expiry Date
CEP[1] (Toronto)	302	December 31, 2009
CEP[1] (Montréal)	44	December 31, 2010
CEP[1] (Montréal CGS)	42	December 31, 2011
TOTAL	**388**	

* All figures include full-time and part-time employees only; excludes temporary, casual and term employees.
[1] Communications, Energy and Paperworkers Union of Canada

Employee Engagement

Canada Post Segment

Canada Post aspires to become the best place to work in Canada, with every employee contributing to and sharing in our success. Critical to achieving this goal is a highly engaged workforce that is committed to the company and willing to expend effort to help the company succeed.

We face significant symptoms of employee disengagement, evidenced in unacceptably high levels of absenteeism, grievances, accidents, conflict, and low employee satisfaction. Our goal is to reverse all of these indicators and begin to build the Modern Workplace as the cornerstone of the Modern Post.

In 2006, increasing employee engagement was designated our most important corporate priority. Our strategy focused on helping employees understand the company's strategic direction, explaining to them how their daily efforts advance us toward the company's goals, and showing them that Canada Post is worthy of their best performance. Our executive team led an aggressive face-to-face communication effort with front-line employees and team leaders. We rebalanced workloads and recruited approximately 600 supervisors, of which more than 350 were recruited from outside the company. We also initiated a supervisory training program to improve our front-line leadership. We reinforced employees' understanding of competitive requirements through an internal communications program that delivered customer insights to our Operations employees.

Recognizing that workplace conditions also drive employee satisfaction, we began to roll out a new national health and safety training program, and recruited additional professionals to support our managers and supervisors. The company also invested $20 million to improve our physical workplace.

In 2006, we were chosen as one of Canada's Top 100 employers by Mediacorp Canada Inc. As a result, we were featured in articles in *Maclean's* magazine, the Canwest chain of newspapers and a related book. In February 2007, the 10th edition of the *Commerce*-Léger Marketing survey ranked Canada Post third out of the 150 most admired businesses in Quebec. While we are proud of these achievements, there is much more work to do if we are going to become the best place to work in Canada.

Looking forward to 2007, our commitment to build employee engagement and a Modern Workplace remains unchanged. For example, we intend to expand our efforts to speak face to face with employees and team leaders. We plan to hold regional forums for a second year, and senior executives will continue to conduct front-line employee discussion groups. We aim to direct even greater focus to workplace health and safety through employee safety training and a leadership focus on safety management. In addition to the front-line supervisory training, we are planning to add a middle management program to support the leadership development efforts of the company. We also intend to invest a further $20 million in workplace improvements. Increasingly, the company aims to recognize employee contributions, resolve workplace conflict, and build a culture of fairness and respect.

Purolator Segment

Purolator is investing in its employees by ensuring that they have a safe place to work with the proper tools to do their job well. Purolator invited employees to participate in an Internal Effectiveness Survey (IES) late in the year. Through the survey, employees were able to provide anonymous feedback on what Purolator does well and where there's room for improvement. The results are expected early in 2007.

In 2006, Purolator graduated the first cohort from the "Leader's Edge" initiative, delivered in partnership with a leading business school. The program aims to retain and develop key talent, grow leadership skills, and improve business skills to facilitate internal transfers.

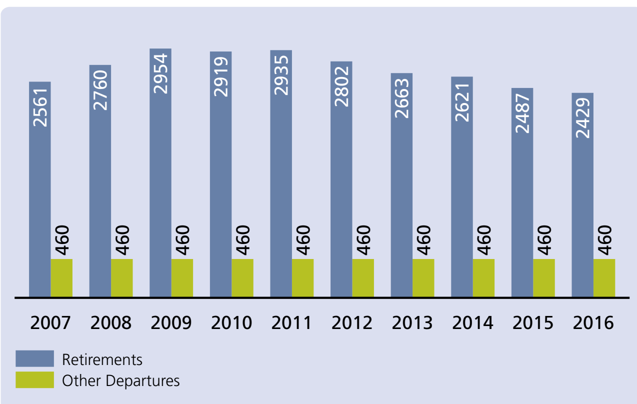
Purolator also invested in a safer, healthier workplace for employees. It launched a healthy workplace initiative to good success. It upgraded equipment, provided ergonomic design training for engineering, facilities and safety departments, and trained employees on safe manual material handling.

Finally, the 2006 internal capability initiative accelerated process improvements. A focused team looked at operations in customer administration, contact centres, hubs and terminals to find ways to improve overall capability and become more effective. Key to success is an investment in employees, involving a new comprehensive front-line supervisory training initiative.

Employee Attrition, Retention and Recruitment

Canada Post's ability to ensure a stable workplace and provide job satisfaction is expected to become increasingly important in the coming years, as we anticipate the need to replace many of the people now working for us. In the next decade, we expect approximately 27,000 employees to retire, and another 4,600 to leave the company through normal turnover.

Canada Post number of departures



We see this as a significant opportunity to align our work-force with our corporate objectives, as we seek to hire the skills we will need to support business goals. This should be helpful as our company comes to rely increasingly on technology and analytical capability for business success. We recognize that we will be recruiting in highly competitive labour markets – a key reason we must maintain a strong focus on becoming an employer of choice.

Being ever mindful of our responsibility as it relates to our employees and the uncertainty surrounding future mail volumes over the next 30 years, it is very important that the Corporation be allowed to implement the changes that will allow us to respond to the uncertainty of the marketplace without hurting our employees and customers.

Processing and Delivery

Canada Post has embarked on a series of initiatives to improve sorting and delivery, aiming to increase productivity in all areas.

Infrastructure

Our physical assets, including the processing facilities and retail network, must enable us to meet our service commitments and customer requirements. Our investments in basic infrastructure have lagged. Significant capital expenditures will be required to rejuvenate our asset base, modernize it, and use new technologies. *See Liquidity and Capital Resources on page 51.*

Canada Post Segment

In 2006, Canada Post invested $227 million in capital assets focused mainly on buildings, systems and equipment. We also allocated $20 million to a workplace enhancement program to improve many facilities. We developed more ergonomic workstations for employees in plants and sorting facilities, and implemented a route optimizer for letter carrier routes.

As part of our overall long-term strategy, we are developing a capital renewal plan that would include a major reinvestment in assets and equipment aimed at modernizing our plants, equipment and technology, and preparing us to deliver new services that Canadians will demand in the future.

In 2007 and beyond, we plan to replace aging and obsolete equipment, such as our multi-line optical sortation machines, to increase overall productivity. We also plan to upgrade our mail handling equipment and processing and delivery technologies to provide more timely information to customers on the status of their deliveries.

Purolator Segment

In 2006, Purolator capital expenditures totalled $73 million. The company embarked on a business transformation known as Purolator 2010, which is designed to focus on technology, infra-structure and internal capability. It began to install new systems that respond better to customer needs, improve efficiency, and set new standards for the courier industry. As well, it began a program to replace older facilities with new terminals to improve package flow within a healthy, safe work environment. Investment in its new freight service is also ongoing.

Logistics Segment

In 2006, Progistix capital spending was $5 million, which supported the restructuring program for a major customer and the expansion of services for existing clients.

Delivery

Canada Post Segment

Our current delivery methods and practices have been inherited from the 1970s and, therefore, do not address our current needs, given the changing composition of the mail that we are delivering, our growing knowledge of potential health and safety risks, and our aging workforce. This requires us to think more creatively about our delivery structure. We intend to explore ways to deliver the mail that are better aligned with current and future needs.

In 2006, we continued the ongoing restructuring of letter carrier routes and the implementation of more efficient and ergonomically designed workstations for letter carriers.

We also continued to improve delivery quality by upgrading tools, such as the Address Management system, to provide timely, accurate information and service. We extended the Parcel Delivery Model to nine cities, converting parcel delivery from contracted service providers to Canada Post employees. The model is expected to be fully installed in 2007, improving capability in 17 cities in total.

Our investment in bar-coding showed results in 2006, as customers increasingly used our Electronic Shipping Tools. In 2007, we expect to complete bar-coding of core parcel products to enhance tracking performance and visibility for our customers.

Rural and Suburban Mail Carrier Health and Safety

Approximately 843,000 residential and business addresses receive their mail through rural mailboxes (RMBs). These represent approximately 6% of our 14 million delivery points. Since September 2005, more than 800 of the Rural and Suburban Mail Carriers (RSMCs) who deliver to these boxes have expressed health (ergonomic) and safety (traffic/road) concerns. As a result, we moved approximately 10,000 customers from RMB delivery to a centralized delivery alternative such as a community mailbox (CMB).

On December 13, 2006, the Government of Canada directed Canada Post to develop and implement an operational plan to restore and maintain rural mailbox delivery within the next 18 months.

We have responded with an accelerated plan to restore and maintain delivery to those RMB customers affected within the next six months, while taking into consideration the health and safety of our employees, and respecting all applicable laws. Once the RMBs that are the subject of health and safety complaints have been addressed, potential safety hazards at all RMBs across the country will be assessed and addressed over a three-year period.

To help assess the safety of the RMBs, we engaged a third-party panel of experts to develop detailed traffic safety criteria to be used when assessing the safety of a RMB. For each RMB, the criteria measure the speed of passing traffic, the volume and type of traffic, and sightlines to the RMB. Also measured are the physical aspects at the RMB such as the width of the shoulder, the number of lanes of traffic and centre line marking, and legal restrictions such as a "no stopping" zone.

Ergonomic complaints are being addressed by hiring paid assistants on contract. The assistant sits in the passenger seat and completes the mail delivery and collection task to each RMB, while the RSMC drives. We are examining right-hand drive vehicles (RHD) as a solution to address the ergonomic issues. If this solution is implemented, the requirement for a paid assistant in the RSMC vehicle would be eliminated.

The cost to maintain service in rural Canada, by making use of community mailboxes in locations where potential health and safety risks may exist, is estimated to be $325 million over the next five years. By directing Canada Post to restore and maintain rural mailbox delivery, the cost is likely to be in the $474 million to $640 million range, depending on the outcome of the assessments of the sites.

Retail Network

Canada Post's 6,600 post offices form the largest retail network in Canada, enabling consumers and small businesses anywhere in the country to send and receive items. Approximately 60% of these post offices are owned by Canada Post. Private dealers operate the remaining outlets, typically as kiosks, with several thousand additional stamp shops offering complementary services.

Although the corporate post offices generate roughly 40% of retail revenues, they represent approximately 90% of total retail network operating costs. Most of our corporate-owned post offices are rural.

We recognized the need to transform our network, becoming more competitive and customer-focused, while continuing to meet our pledge of providing a universal and affordable postal service. This requires a change in how we manage our business, our openness to outside trends and influences, and our willingness to engage with private-sector partners. We continue to move toward this goal by increasing retail access, focusing on the dealer network, and simplifying our offering of core products and services. We continue to manage this change through a structured and responsible consultative process with stakeholders.

Retail Technology

In 2007, we intend to implement the Retail Automation project to deliver a more flexible and cost-effective Point of Service application, hardware platform and communications network. In 2008, we expect to upgrade non-automated post offices and implement a high-speed network with this application and new hardware, providing counter personnel with better tools to serve our customers.

Internal Controls and Procedures

Corporate Responsibility

At Canada Post, we continued to strengthen governance and improve our accountability by revising our delegation of authorities with the objective of streamlining the decision-making process.

Internal Controls

Canada Post has voluntarily adopted the spirit and intent for financial reporting set forth under Multilateral Instrument 52-109 prescribed by the Canadian Securities Administrators. As a result, we issued a Board-approved Internal Control Policy in 2005 to assess the design and effectiveness of internal controls.

In 2006, we undertook an initiative to assess the effectiveness of internal controls over financial reporting. This assessment revealed a generally good state of internal controls. As has been seen by many companies that have already complied with the Multilateral Instrument 52-109, we have found some areas needing improvement. We intend to implement the remediation plans identified in the assessment on a prioritized basis.

Liquidity and Capital Resources

We believe that the current cash position of $499 million and the cash anticipated to flow from 2007 operations will adequately fund the Corporation's short-term financial requirements in 2007. As described more fully in other sections of this MD&A, Canada Post does face certain pressures that could result in the Corporation requiring external financing at some point over the five-year planning horizon. *See Liquidity and Capital Resources on page 51.*

Risk Management

Risk Framework and Accountability

Globalization, technological advances and intensified competition have required us to change the way we deliver our services and also transformed our approach to making decisions about business strategy. The complexity of decisions has intensified, requiring Canada Post to ensure that its evaluation of alternatives takes into account all known factors, the probability that known factors may change, and the possibility that new factors yet unknown may subsequently come into play.

In 2006, the Corporation determined that a review of its risk management framework, with a view to further evolving the framework, would be prudent. We intend to undertake this review in 2007.

Summary of Risks

The following is a summary of the major sources of risk and uncertainty facing the Corporation at the time of this report.

Competition

Canada Post and our subsidiaries continue to face intense competition in all aspects of the business.

Our Lettermail product's volumes have been relatively flat. Consumers and businesses are migrating to the electronic channel and corporations are consolidating their mailings to minimize costs. The pressure on paper mail is further magnified by other factors. The Policy Framework limits price increases to the basic domestic letter rate to less than the rate of inflation, and requires us to deliver to all of the ever-increasing addresses in Canada. Although mail volumes are steady or experiencing very little growth, the number of pieces of mail per point of delivery is decreasing each year.

Globalization has opened up our competitive products to intense and increasing competition, especially in the areas of parcels and express/courier products, putting pressure on our market share. Many of our competitors are large, well-resourced multinational corporations and former national postal administrations. In addition, competition is limiting our ability to raise prices.

These trends and pressures could have a negative impact on our traditional business net income.

Public Policy

As a Crown corporation, Canada Post's ability to plan and execute business strategy is influenced by public policy considerations. Canada Post's legal and regulatory framework, last revised in 1981, requires the Corporation to provide a universal service, while operating as a commercial enterprise. Often, public policy objectives are not aligned with the commercial mandate of the Corporation. In such instances, for example the moratorium on rural office closures, commercial aspiration and profitability give way to the public policy priorities.

Under the statutes of the *Canada Post Corporation Act* and *Financial Administration Act*, the Government of Canada may issue public policy directives governing any aspect of the operation of the Corporation. As described in note 1 to the consolidated financial statements on page 86, the government issued two directives in 2006 respecting postage rate subsidies for Canadian publications and delivery services in rural Canada. Depending on their nature and scope, directives can add significant financial exposure to the Corporation.

Within our universal service, costs are rising, volumes are relatively flat, and price growth is constrained. Across our business, we face increased competitive pressure. Under the *Canada Post Corporation Act and Regulations*, a significant share of our business is protected from direct competition by means of our statutory exclusive privilege in the collection, transportation and delivery of letters. The exclusive privilege exists as a matter of public policy, allowing us a reasonable means to fund universal services to all Canadians.

At the time of this report, Canada Post is not aware of any intention to change its legal and regulatory framework. All changes in this domain could affect the nature of competition in markets where Canada Post operates, the cost of the provision of universal services, and the Corporation's ability to finance its operations.

Pension Investment

The Canada Post Pension Plan's primary risk exposure is to a decline in long-term real interest rates combined with weak returns on its assets that could result in higher contributions required to meet pension obligations. As was the case during the previous three years, the Canada Post Pension Plan's assets earned a competitive double-digit return in 2006. As a result of an increase in long-term benchmark interest rates witnessed during the year, pension obligations have decreased in 2006. These combined factors have had a positive impact on the financial projections included in the Canada Post Pension Plan's financial statements.

At the end of 2006, the Canada Post Pension Plan's most significant concentration of credit risk was with the Government of Canada, and the Provinces of Ontario and Quebec. This concentration is related primarily to the holding of $1.7 billion of securities issued by the Government of Canada, $379 million issued by the Province of Ontario, and $260 million issued by the Province of Quebec. Each investment portfolio within the total pension fund has a limit regarding exposure to any single corporate entity. No such entity represents more than $292 million, or 2.0%, of total plan assets.

Liquidity risk for a pension plan is the risk that more illiquid assets will need to be sold at inopportune times to meet benefit payments. The Canada Post Pension Plan has strong cash flows for some years to come, which mitigates liquidity risk.

In order to mitigate these risks, Canada Post ensures that investment decisions are made in accordance with the Canada Post Pension Plan Statement of Investment Policies and Procedures. The Pension Committee of the Board of Directors provides oversight of pension investments.

Fraud

Canada Post conducts a large volume of financial transactions presenting fraud opportunities. To mitigate this risk, we regularly review and enhance the security of our retail products, processes, and point-of-sale and other systems.

Human Resources

Canada Post's profitability depends upon our ability to maintain good relationships with our employees, to align their performance with the company's objectives, and to ensure that we replace retiring or departing employees with recruits who have the skills and competencies required to further drive customer value.

Through an extensive internal communications program, we are presenting employees with an opportunity to make a commitment to the company's success. Our executive team and management are directly engaging employees in a dialogue about the company's objectives, our customer focus and our need to improve our competitiveness. If we do not succeed, sub-standard employee performance will impair our ability to sustain profitability and fund our future growth.

Over the next 10 years, approximately one of every three Canada Post employees will retire, requiring us to recruit several thousand people with the skills needed to operate a customer-responsive, technology-based business service. Other employers will compete with us for these human resources. To reduce our risk exposure, Canada Post is working steadily to improve employee job satisfaction – principally through improved workplace conditions, stronger internal communications, and greater recognition of our employees' efforts.

Labour Relations

Uninterrupted service is as essential to our business as it is to our customers. Perceived or actual service disruptions significantly affect our financial results – both current and future.

A four-year collective agreement covering 42,000 postal operations employees expired on January 31, 2007. On February 9, 2007, Canada Post announced a tentative agreement with the Canadian Union of Postal Workers. The negotiated settlement would expire January 31, 2011. The tentative agreement is expected to be submitted for ratification in March and April 2007.

Canada Post plans to open negotiations in the fall of 2007 with the CUPW (Rural and Suburban Mail Carriers) on how to allocate an already-agreed-upon amount for wage increases and benefits. In the event the talks fail, the parties have agreed to use interest arbitration. No strike or lockout is allowed during the eight-year collective agreement.

Rising Employee Benefit Costs

Canada Post provides its employees and retirees with very competitive wages and benefits. The cost of health care benefits is expected to rise substantially over the next 10 years, driven by aging, the incidence of chronic disease, physician prescribing habits, public policy decisions and the rising cost of specialty pharmaceuticals. The cost of active and retiree health care programs are expected to grow two- to three-fold over the next 10 years, representing a real financial risk. In 2006, the Corporation focused on ensuring that the administration of the health care plan was efficient and effective. Canada Post is also working with policy makers and our labour unions to develop workable options to manage long-term costs, while preserving the value of our employee and retiree benefits. We intend to continue these efforts in 2007 along with increased focus on financial management, responsible use of benefit programs, and improving the overall health of employees.

Statutory and Regulatory Compliance

As a Crown corporation, we recognize our commitment to meet the highest standards in managing our business and complying with regulations. Compliance with certain requirements, that our competitors are not subject to, requires significant amounts of time on the part of management. Although these activities do not move the Corporation towards its business goals, they are required to meet our governance and public policy requirements.

Aging Infrastructure

Canada Post's rate of capital spending does not address basic obsolescence in a timely fashion, and less so for general modernization and leveraging technological advances for new business opportunities. If not addressed, the current state of our assets could result in service interruptions and jeopardize our ability to generate future earnings. Any pressures that reduce cash flow from operations could reduce our ability to fund these investments without incurring additional debt.

As part of our overall long-term strategy, we are developing a capital renewal plan that includes a major reinvestment in our processing, delivery and technology infrastructure. It is expected that the expenditure could well exceed $2.0 billion over the next five years. We will be exploring a number of financing options.

Transportation

Canada Post contracts extensively with carriers and is vulnerable to all of the transportation industry's risks. These include an increasing requirement for security, new legislation restricting driver operating hours, fluctuating fuel costs, and a decline in air cargo capacity as airlines increasingly adopt smaller aircraft. As a result, the Corporation needs to continually adjust our transportation network to satisfy customer demands.

Legal Risk

UPS – NAFTA

The International Trade Tribunal is expected to rule in 2007 on a complaint by United Parcel Service alleging discriminatory conduct by Canada and anti-competitive conduct by Canada Post. Although Canada Post is not a defendant, it is participating in the Government of Canada's defense. Canada Post believes in the merits of the defense case and that Canada is likely to prevail.

Pay Equity – PSAC

The Public Service Alliance of Canada (PSAC) has filed a complaint against Canada Post that office clerks did not receive pay commensurate for work of equal value compared to postal clerks and letter carriers. The Human Rights Tribunal found Canada Post liable and ordered payment for lost wages, discounted by 50% because of poor quality of evidence. Canada Post appealed to the Federal Court of Canada on points of law, and PSAC has also appealed. The Court has scheduled the case to be heard in November 2007.

Canada Post vs. Spring and Counterclaim

Canada Post has sought an injunction against Spring, a consortium of the Royal Mail, Netherlands Post and Singapore Post, for collecting mail in Canada, shipping it abroad and inducting it into foreign postal streams for delivery. The company contends the activity violated our exclusive privilege over International Outbound mail. The Ontario Superior Court of Justice granted a permanent injunction in May 2006, which has been stayed until an appeal decision has been reached.

Spring commenced action in February 2005 claiming that Canada Post had interfered in Spring's economic relations and had engaged in defamation. This action was brought in response to Canada Post's attempts to regain business unlawfully taken by Spring in contravention of Canada Post's exclusive privilege. This action is being held in abeyance pending the outcome of Canada Post's injunction applications to prohibit breaches of its exclusive privilege.

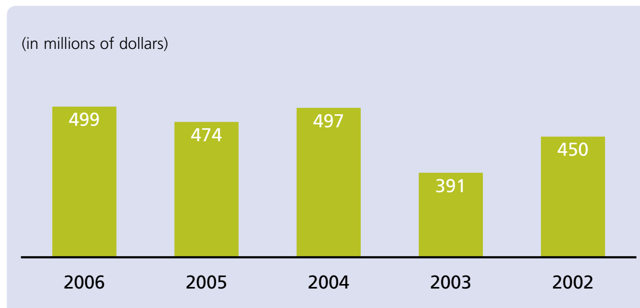
Should the ultimate resolution of these actions differ from management's assessments and assumptions, a material adjustment to the company's financial position and results of its operations could ensue.

Liquidity and Capital Resources

Capital/Liquidity Sufficiency

Cash and cash equivalents at the end of 2006 totalled $499 million, an increase of $25 million from $474 million at the end of 2005. Canada Post contributed $15 million and Purolator contributed $10 million of the increase. Cash and cash equivalent levels over the past five years are shown below.

Cash and cash equivalents



(in millions of dollars)	2006	2005	Change
Cash flows from operating activities	267	212	55
Cash flows used in investing activities	(278)	(310)	32
Cash flows from financing activities	36	75	(39)
Net increase (decrease) in cash	**25**	**(23)**	

Operating Activities

Cash flows from operating activities were $267 million, an increase of $55 million over the prior year. Cash was provided by Canada Post ($195 million) and Purolator ($83 million), and slightly offset by a use of cash within other segments ($11 million).

These cash flows were attributed to net income after adjusting for non-cash items of $806 million, an increase of $152 million in non-cash working capital, especially accounts payable, income taxes payable and deferred revenue, offset by payments for pension, other retirement and post-employment benefits of $691 million.

The increase in cash provided from operating activities of $55 million was primarily due to a decrease in net income more than offset by the positive impact of changes in accounts receivable, accounts payable and deferred revenue.

Investing Activities

Cash used for investing activities totalled $278 million, a decrease of $32 million from 2005.

Our net position in short-term investments increased by $23 million from normal cash management transactions. We invested $305 million in property, plant and equipment. The balance of $4 million related to proceeds received in the sale of property.

Financing Activities

Cash flows from financing totalled $36 million, a reduction of $39 million from 2005.

Transitional funding from the Government of Canada to assist with the incremental costs incurred to establish the Canada Post Pension Plan and Supplementary Retirement Arrangement totalled $131 million. This was offset by dividends of $80 million and $15 million in the repayment of debt.

The reduction in cash flow from financing of $39 million was due to $25 million less in transitional funding (a result of the declining support over 10 years ending in 2010), and increases in the dividend of $21 million, partially offset by reduced debt repayments of $6 million.

Capital/Liquidity Planning

In developing the financial management plan, we take into consideration our legislated mandate, Policy Framework objectives, long-term strategy, current economic conditions, as well as business environments, threats and opportunities. We consider a number of factors when assessing capital liquidity and sufficiency, including:

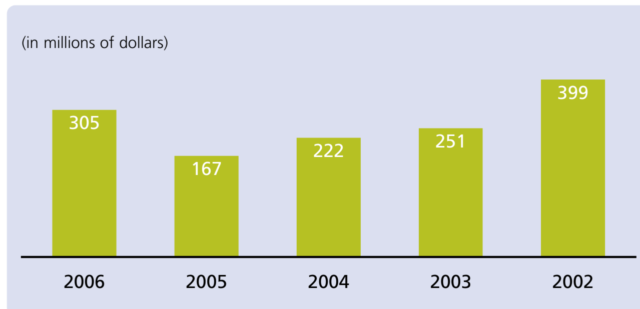
- our current and planned financial performance;
- the performance of the Canada Post Pension Plan;
- the liquidity and working capital we need on an ongoing basis, which determines the net working capital requirement;
- our available sources of capital;
- our planned financial leverage, which determines the amount of borrowing needed to finance investments; and
- our requirement for significant strategic investment to generate earnings in line with the Policy Framework's profitability goals.

Based on our assessment of these factors, we expect to have sufficient liquidity in 2007 to meet our planned investments.

The following elements could affect our liquidity going forward.

Capital Expenditures

Capital expenditures over the past five years are shown below.



In 2006, investment by The Canada Post Group on capital acquisitions and business development totalled $305 million versus a Plan of $427 million.

(in millions of dollars)	Actual	Plan	Variance
Canada Post – Capital	227	235	8
Canada Post – Business Development	–	100	100
Purolator	73	89	16
Logistics and Other	5	3	(2)
The Canada Post Group	**305**	**427**	**122**

Canada Post Segment

In 2006, capital investment within the Canada Post Segment totalled $227 million, $8 million less than Plan. The unspent portion, which we plan to spend in 2007, was caused by minor delays in implementation. The $100 million set aside for business development was not used. We are not expecting to use this money in 2007.

Our investments included:

- $89 million for asset maintenance/replenishment programs, predominantly for mailboxes, vehicles and motorized mail-handling equipment;
- $68 million for real estate programs to maintain national facilities and buildings;
- $61 million for technology infrastructure projects to replace a number of systems and machines; and
- $9 million for process improvements.

In 2007 and beyond, we expect our capital investment to rise in order to maintain and replenish equipment and facilities, drive business growth in key areas, and provide a sustainable solution to the issues in the RSMC network.

As part of our overall long-term strategy, we are assessing the investment requirements to renew our processing, delivery and technology infrastructure. It is expected that this renewal plan will require investment of more than $2.0 billion over the planning horizon. These plans are being developed and will be reviewed by the Board of Directors during 2007.

Purolator Segment

Capital acquisitions within the Purolator Segment totalled $73 million, $16 million less than Plan and $51 million higher than 2005, as it commenced a multi-year initiative to replace and automate its major hubs and transform its technology.

From a technology perspective, Purolator began work on initiatives to replace most of its customer-facing technology platform with systems that allow it to be more responsive to customer needs, help set standards within the industry, and improve efficiency. This will include additional capability within the SAP system. Similarly, from an infrastructure perspective, Purolator began replacing some of its older facilities with newly designed terminals intended to improve the flow of packages, while maintaining a healthy and safe work environment. It also plans to build or upgrade existing facilities to support growth in key markets.

Leasing facilities on airport property in Montréal, as opposed to acquiring them as planned, is part of the reason for the lower capital expenditure. Spending more time in the design phase and deferring the build phase to 2007 for the customer experience delivery system makes up the balance of the underspend.

Canada Post Pension Plan

The Canada Post Pension Plan is required to file periodic actuarial valuations with the Office of the Superintendent of Financial Institutions. These actuarial valuations are required to set out the funded status of the Canada Post Pension Plan on a going-concern and a solvency basis. If the actuarial valuation reveals a shortfall of assets to liabilities on a solvency basis, then the *Pension Benefits Standards Act*, 1985 requires us to make special payments into the Canada Post Pension Plan to eliminate this shortfall over five years. Where the actuarial valuation reveals a shortfall of assets to liabilities on a going-concern basis, the *Pension Benefits Standards Act*, 1985 requires us to make special payments into the Canada Post Pension Plan to eliminate this shortfall over fifteen years. However, in November 2006, the federal government approved Solvency Funding Relief Regulations. These offer a choice of different forms of temporary solvency funding relief to federally regulated defined benefit pension plans, including extending the solvency funding period to ten years, subject to various terms and conditions. Under the Solvency Funding Relief Regulations, funding relief is available for the first actuarial valuation, showing a shortfall on a solvency basis, after December 30, 2005.

In December 2006, our Board of Directors authorized us to apply the 10-year funding rules, applicable to Crown corporations in the Solvency Funding Relief Regulations to the December 31, 2005, actuarial valuation of the Canada Post Pension Plan. Accordingly, we filed a revised December 31, 2005, actuarial valuation in January 2007. Although the going-concern ($351-million excess) and the solvency ($1,201-million shortfall) funded status of the Canada Post Pension Plan did not change as a result of re-filing the December 31, 2005, actuarial valuation, the required special payments for 2006 were reduced from $320 million to $153 million. Based on the original actuarial valuation filed in June 2006, the Corporation made $86 million in special payments to the Canada Post Pension Plan in 2006 over the minimum required amount. In addition, prior to introduction of the Solvency Funding Relief Regulations, a further $49 million was made to the Canada Post Pension Plan to satisfy future contribution requirements.

A preliminary estimate of the financial position of the Canada Post Pension Plan as at December 31, 2006, showed an expected solvency excess of approximately $500 million and a going-concern excess of $993 million, as compared with a solvency deficiency of $1,201 million and a going-concern excess of $351 million as at December 31, 2005. The expected elimination of the solvency deficiency in 2006 is due to special payments by the Corporation, return on plan assets, and a slight increase in long-term real return bond yields. As the Canada Post Pension Plan is expected to be in a solvency excess position as at December 31, 2006, special contributions to the Canada Post Corporation Pension Plan are no longer required until at least the year following the next actuarial valuation. If the Canada Post Pension Plan is fully solvent as at December 31, 2006, the Corporation will be required, at a minimum, to file the next actuarial valuation for the Canada Post Pension Plan as at December 31, 2009, or at an earlier date if required under the *Pension Benefits Standards Act*, 1985. However, as small changes in discount rates can significantly affect the results of actuarial valuations prepared on a solvency basis, the Corporation will continue to monitor carefully the impact of changes in discount rates, the return on plan assets, and changes in legislation on the financial position of the Canada Post Pension Plan on both a solvency and going-concern basis. *See Critical Accounting Estimates on page 67.*

Dividends

Consistent with the Policy Framework, the Corporation is expected to make an annual dividend payment to the Government of Canada of 40% of the prior year's actual consolidated net income. In 2006, we paid a dividend of $80 million. Dividends paid over the past five years total $236 million.

(in millions of dollars)	2006	2005	2004	2003	2002
Consolidated net income	119	199	147	253	71
Dividend paid	80	59	63	18	16
Dividend payout ratio	40%	40%	40%	25%	25%

Based on 2006 consolidated net income, we expect, subject to Board of Directors approval, to pay a dividend of $48 million in 2007.

Contractual Obligations and Commitments

A summary of the Corporation's total contractual obligations and commitments to make future payments is presented in the table below. For further details, see notes 10 and 12 to the consolidated financial statements on pages 102 and 103, respectively.

Summary of total contractual obligations and commitments

(in millions of dollars)	< 1 year	1-3 years	3-5 years	> 5 years
Long-term debt[1]	3	3	–	55
Interest on long-term debt	6	12	12	24
Operating leases[2]	133	200	107	189
Total	142	215	119	268

[1] Long-term debt includes $55 million of long-term bonds maturing March 2016. Interest at 10.35% is paid semi-annually.
[2] Operating leases include the future minimum payment obligations associated with facilities, transportation equipment and other operating leases with terms in excess of one year.

Related Party Transactions

As described in note 15 to the consolidated financial statements on page 106, the Corporation has a variety of transactions with related parties, both in the normal course of business and in supporting the Government of Canada's public policies.

Liquidity Risks Associated With Financial Instruments

Canada Post Corporation does not explicitly hedge any of its existing financial instruments. As a result, the cash flows associated with recognized financial assets or liabilities are readily determinable. Our investment policy for cash and segregated financial assets carries a low probability of default. Therefore, the value and timing of cash flows (interest- and principal-related) can be determined and are not subject to significant risk. Similarly, the value and timing of cash flows associated with debt can be determined with certainty.

Off Balance Sheet Arrangements

In the normal course of operations, we provide indemnifications that are often standard contractual terms in favour of third parties in transactions such as purchase and sale contracts, service agreements and leasing transactions. In addition, Canada Post has entered into indemnity agreements with each of its directors and officers. These agreements do not contain specified limits on our liability for compensation to a third party incurred as a result of certain events. Therefore, it is not possible to estimate our potential future liability under these agreements. Historically, we have not made any significant payments under such indemnifications and no amounts have been accrued in our financial statements with respect to these indemnities.

Upon termination or expiration of certain agreements with Innovapost, Canada Post and Purolator have agreed to purchase the assets being used on a dedicated basis and assume the obligations related to the purchase of those assets. Currently, we do not possess sufficient information to estimate the maximum potential future liability related to these agreements. Therefore, no amounts have been accrued in the financial statements. The terms of the agreements provide for no limitation to the maximum potential future payments.

There are no other off balance sheet arrangements that would have a material adverse effect on our liquidity, financial position or results of operations.

Financial Condition

The following is a discussion of the significant changes in our assets and liabilities between December 31, 2006, and December 31, 2005.

(in millions of dollars)

ASSETS	2006	2005	Change	%	Explanation of Change
Cash and cash equivalents	499	474	25	5.2%	*See Liquidity and Capital Resources on page 51*
Short-term investments	231	230	1	0.3%	Current investment
Accounts receivable	582	555	27	4.9%	Primarily international settlements receivable and an Innovapost receivable subsequently settled in 2007
Income tax recoverable	4	21	(17)	(82.5%)	Receipt of prior year refunds to Canada Post, offset by scientific research and experimental development investment tax credits receivable recognized by Innovapost
Prepaid expenses	69	73	(4)	(5.3%)	Primarily a reduction in retail products inventory
Current portion of segregated cash and investments	21	68	(47)	(69.6%)	Primarily settlement of employee termination benefits to APOC members. It is expected that the residual termination benefit portfolio will be liquidated through settlements in 2007
Current portion of future income tax assets	63	45	18	41.5%	Primarily epost loss carry-over recognized on integration with Canada Post, offset by reduction in current portion of employee future benefits
Total Current Assets	**1,469**	**1,466**	**3**	**0.1%**	
Segregated cash and investments	469	446	23	5.2%	Income earned on the portfolio, transitional support received from the Government of Canada relating to the establishment of the Canada Post post-retirement dental, term life and death benefit plans, partially offset by employee termination benefit and other payments
Property, plant and equipment	1,712	1,671	41	2.5%	Primarily increased capital acquisitions net of two real properties classified as held for sale
Accrued pension benefit asset	1,010	784	226	28.9%	Primarily attributable to solvency payments to the Canada Post Registered Pension Plan
Future income tax assets	135	93	42	45.3%	Primarily pension, other retirement and post-employment benefit plans' expenses in excess of tax deductible payments
Other assets	189	144	45	31.5%	Primarily two real properties classified in 2006 as held for sale and amortization of intangibles
Total Assets	**4,984**	**4,604**	**380**	**8.3%**	

Financial Condition *(continued)*

LIABILITIES AND EQUITY	2006	2005	Change	%	Explanation of Change
Accounts payable and accrued liabilities	453	400	53	13.4%	Primarily an increase in supplier payables and payables related to higher Purolator capital expenditures
Salaries and benefits payable	385	368	17	4.7%	Primarily numerous small changes, including grievances and overtime
Income tax payable	68	18	50	273.3%	Mainly an increase in Canada Post's taxable income due to a reduction in special pension fund deficit payments and the net impact of pension, other retirement and post-employment benefit plans' expenses in excess of tax deductible payments
Deferred revenue	177	148	29	19.6%	Primarily the introduction of the PERMANENT stamp resulting in higher stamp sales held for future use, and a 2007 payment received in December 2006
Deferred transitional support	–	30	(30)	(100%)	Transitional funding received in prior years was applied against incremental pension reform costs in 2006
Outstanding money orders	52	51	1	2.2%	Ongoing activity
Current portion of long-term debt	3	16	(13)	(81.2%)	Innovapost bank loan repaid and obligation under capital lease expired in 2006, partially offset by payments due to a third party resulting from epost's purchase of the webdoxs™ service in 2004
Current portion of future income tax liabilities	–	3	(3)	(100%)	Termination of Innovapost capital lease obligation
Current portion of accrued post-employment benefit liability	32	68	(36)	(52.5%)	Settlement of employee termination benefits for APOC members. The settlement to CPAA members, originally expected in 2006, is scheduled for 2007
Total Current Liabilities	**1,170**	**1,102**	**68**	**6.3%**	
Long-term debt	58	60	(2)	(4.3%)	Payments due to a third party due in December 2007 reclassified as current
Future income tax liabilities	19	21	(2)	(12.0%)	Primarily Purolator current year depreciation in excess of capital cost allowance, offset by excess of employee benefit payments over expense
Accrued pension, other retirement and post-employment benefit liability	2,247	1,973	274	13.9%	Primarily attributable to the Canada Post post-retirement health care plan due to current service cost, increasing medical drug costs and changes in discount rates
Other long-term liabilities	38	38	0	1.0%	Primarily three offsetting components – the unamortized balance of payments received by Progistix in 2006 for restructuring funding under a new contract with a major customer, offset by the recognition of an inducement paid in prior years, and the amortization of an outsourcing agreement
Total Liabilities	**3,532**	**3,194**	**338**	**10.6%**	
Non-controlling interest	19	16	3	17.9%	Minority interest on net income of Purolator Courier Inc.
Equity of Canada	1,433	1,394	39	2.8%	Consolidated net income of $119 million offset by the dividend of $80 million paid to the Government of Canada
Total Liabilities and Equity of Canada	**4,984**	**4,604**	**380**	**8.3%**	

2006 Results

The Canada Post Group – Consolidated Operating Results

Consolidated income statement Increase (Decrease)

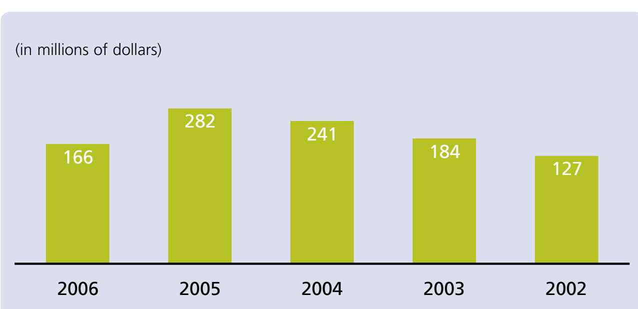
(in millions of dollars)	2006	2005	2004	2006 vs 2005	% Change	2005 vs 2004	% Change
Revenue from operations	7,264	6,944	6,651	320	4.6%	293	4.4%
Cost of operations	7,116	6,681	6,413	435	6.5%	268	4.2%
Income from operations	**148**	**263**	**238**	**(115)**	**(43.6%)**	**25**	**10.8%**
Non-operating income (expense)	18	19	3	(1)	(3.9%)	16	516.5%
Income before income taxes	**166**	**282**	**241**	**(116)**	**(40.9%)**	**41**	**17.3%**
Income tax expense	44	80	93	(36)	(44.9%)	(13)	(13.4%)
Non-controlling interest	3	3	1	0	18.7%	2	172.4%
Net income	**119**	**199**	**147**	**(80)**	**(40.1%)**	**52**	**35.8%**
Return on equity	**8.4%**	**15.0%**	**12.1%**		**(6.6%)**		**2.9%**

The Canada Post Group earned consolidated net income of $119 million in 2006, a reduction of $80 million, or 40.1%, from the previous year. Income before income taxes of $166 million was $116 million lower than last year but was partially offset by lower income tax expense.

Revenue from operations reached $7,264 million, increasing $320 million, or 4.6%, driven by a strong performance by Canada Post's Lettermail and Admail products and Purolator's courier revenue. Cost increases outpaced revenue growth. Increasing pressures in pension and health benefits, salary increases and points of call growth drove an overall 6.5% increase in costs.

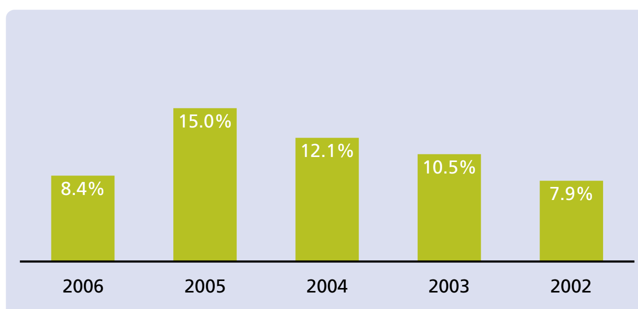
Over the last five years, consolidated net income before taxes amounted to $1 billion.

Income before income taxes



The return on equity to the Government of Canada dropped to 8.4% in 2006, 2.6% below the Policy Framework objective of 11%. This is a reflection of an increasingly competitive market and escalating cost pressures, especially pension and health benefits.

Return on equity



In 2006, performance improved in all segments when compared to 2005, except the Canada Post Segment, where income before income taxes fell by $151 million.

Segmented results – income before income taxes

(in millions of dollars)	2006	2005	2004	2006 vs 2005	2005 vs 2004
Canada Post	99	250	197	(151)	53
Purolator	69	57	50	12	7
Logistics	(1)	(7)	5	6	(12)
All Other	2	(5)	(8)	7	3
Intersegment and unallocated	(3)	(13)	(3)	10	(10)
The Canada Post Group	**166**	**282**	**241**	**(116)**	**41**

Consolidated Performance to Plan

The Canada Post Group exceeded its financial plan by $61 million, with net income of $119 million and income before income taxes of $166 million. Canada Post and Purolator contributed to this positive result, partially offset by lower than planned performance from the Logistics Segment.

The table below presents the Corporation's consolidated performance for the 2006 fiscal year compared to its Corporate Plan projections.

(in millions of dollars)	Actual	Plan	Variance
Revenue from operations	7,264	7,206	58
Cost of operations	7,116	7,105	(11)
Income from operations	**148**	**101**	**47**
Non-operating income (expense)	18	10	8
Income before income taxes	**166**	**111**	**55**
Income taxes expense	44	51	7
Net income before non-controlling interest	**122**	**60**	**62**
Non-controlling interest	3	2	(1)
Net income	**119**	**58**	**61**

Segmented Performance to Plan – Income Before Income Taxes

(in millions of dollars)	Actual	Plan	Variance
Canada Post	99	59	40
Purolator	69	47	22
Logistics	(1)	12	(13)
All Other	2	0	2
Elimination of intersegment	(3)	(7)	4
Income before income taxes	**166**	**111**	**55**

Consolidated Revenue – Variance to Plan

Consolidated revenue, totalling $7,264 million, was $58 million better than Plan. Explanations are summarized as follows:

(in millions of dollars)	Explanation	Amount
Canada Post Transaction Mail	Transaction Mail revenue was $51 million higher than Plan, mainly due to stable volumes as compared to planned erosion for our domestic Lettermail product	51
	Long-anticipated erosion of our Lettermail product remains a significant predictive challenge as e-substitution and bill consolidation have not come as quickly as expected and "one-time events" (elections, census, etc.) have consistently buoyed volumes	
	Some upside to Plan due to business migrating from the Parcels line of business as customers seek ways to reduce mailing costs	
	Revenue was also impacted with higher USPS settlement rates	
Canada Post Parcels	Parcels revenue was $33 million lower than Plan, primarily due to lower-than-expected results in Domestic and International Outbound parcels. Major explanations include: • From the Domestic side, a major customer migrated $10 million of their Parcels business to a Transaction Mail product • From an International Outbound perspective, $15 million of the shortfall was due to lower volumes from online pharmacies' shipments to the U.S. as a result of changes to U.S. regulations and strengthening of the Canadian dollar • The loss of a major client has also resulted in a shortfall of $6 million for International Outbound revenue • The fluctuation of foreign exchange rates also impacted International Inbound revenue negatively by $6 million	(33)
Canada Post Direct Marketing	Direct Marketing revenue was $32 million better than Plan	32
	Our Addressed and Unaddressed Admail products showed solid revenue growth in 2006, primarily due to higher-than-historical growth rates in Unaddressed Admail	
	Volumes for our Publications Mail™ product grew by 0.8%, while we anticipated some erosion due to the growing interest in Internet-based versions of periodic publications and newspapers	
Purolator	Purolator revenue was $27 million higher than Plan, primarily driven by an increase in revenue per shipment, as volumes were relatively flat	27
Logistics	Logistics revenue fell short of Plan by $14 million, mainly due to the restructuring of a significant contract with Progistix's largest customer	(14)
Other Revenue		(5)
Total		**58**

Consolidated Cost of Operations – Variance to Plan

Consolidated cost of operations, totalling $7,116 million, was $11 million higher than Plan. Explanations are summarized as follows:

(in millions of dollars)	Explanation	Amount
Canada Post Segment	Net productivity and absenteeism	(45)
	Employee benefit costs	(18)
	Building operations and amortization	9
	Transportation costs	11
	Other	14
All Other Segment	Primarily Innovapost	14
Other Segments		4
Total		**(11)**

Canada Post Segment

The Canada Post Segment contributed $99 million of income before taxes to the 2006 consolidated results, a decrease of $151 million from 2005. This performance was a result of increased cost pressures, especially in the area of salaries and employee future benefits.

Canada Post Segment Summary Increase (decrease)

(in millions of dollars)	2006	2005	2004	2006 vs 2005	%	2005 vs 2004	%
Revenue from operations	5,831	5,587	5,382	244	4.4%	205	3.8%
Cost of operations	5,761	5,374	5,197	387	7.2%	177	3.4%
Income from operations	**70**	**213**	**185**	**(143)**	**(67.1%)**	**28**	**15.2%**
Non-operating income (expense)	29	37	12	(8)	(19.8%)	25	204.6%
Income before income taxes	**99**	**250**	**197**	**(151)**	**(60.2%)**	**53**	**26.7%**

Canada Post – Revenue from Operations

Canada Post generated net operating revenue of $5,831 million in 2006, an increase of 4.4% over the $5,587 million achieved in 2005. The revenue increase was primarily generated through rate increases and volume growth in Direct Marketing.

The $244-million revenue increase comprised increases of $100 million in Transaction Mail, $23 million in Parcels, $118 million in Direct Marketing, and $3 million from other services.

Operating revenue by line of business Increase (decrease)

(in millions of dollars)	Revenue				Volume		
	2006	2005	2006 vs 2005	%	2006	2005	%
Transaction Mail							
Domestic/Outbound	3,092	2,987	105	3.5%	5,161	5,122	0.8%
Inbound[1]	114	119	(5)	(4.1%)	310	331	(6.2%)
Total Transaction Mail	**3,206**	**3,106**	**100**	**3.2%**	**5,471**	**5,453**	**0.3%**
Parcels							
Domestic/Outbound	1,053	1,063	(10)	(1.0%)	123	134	(8.1%)
Inbound[1]	134	101	33	33.0%	51	22	135.4%
Total Parcels	**1,187**	**1,164**	**23**	**1.9%**	**174**	**156**	**12.0%**
Direct Marketing							
Addressed	583	530	53	9.9%	1,470	1,400	5.0%
Unaddressed	339	297	42	14.4%	3,722	3,411	9.1%
Publications	275	263	12	4.3%	536	531	0.8%
Other	110	99	11	11.3%	60	65	(7.4%)
Total Direct Marketing	**1,307**	**1,189**	**118**	**9.9%**	**5,788**	**5,407**	**7.0%**
Other	131	128	3	2.8%	–	–	–
Total	**5,831**	**5,587**	**244**	**4.4%**	**11,433**	**11,016**	**3.8%**

[1] In 2006, Canada Post implemented changes in business processes redefining the USA Inbound mail product. As a result, the 2006 Inbound mail values are not comparable to prior years.

Transaction Mail

Transaction Mail revenue totalled $3.2 billion in 2006, an increase of $100 million, or 3.2%, when compared with 2005. The revenue growth was mainly rate related, with overall volumes slightly higher than last year. The majority of this growth was in our domestic Lettermail service. Our Lettermail product's basic rate increased one cent to 51 cents with the estimated overall impact due to rate/product mix accounting for $80 million, or 2.6%, of the growth.

The three largest commercial sectors, representing over $1.2 billion of revenue in 2006, include the financial, government and communication sectors. The government sector had the highest revenue growth at 5.7%, which included the census impact offsetting the election impact of the prior year. The competitive financial and communication sectors grew at 4.2% and 3.2%, respectively, as e-substitution and bill consolidation have not been as significant a factor as expected to this point. The remaining $1.2 billion of revenue in the commercial sales area, representing the small to medium-sized customers, was 2.9% higher than the prior year reflecting stable volumes after considering the effect of rate increases.

The retail network, which accounts for approximately $0.7 billion, including the introduction of the PERMANENT stamp, performed well in 2006 with rate increases and consumer demand resulting in revenue growth of 2.8% over 2005.

Inbound revenue of $114 million, which was $5 million lower than the prior year, included the impact of a change in business processes redefining USA Inbound product. Offsetting increases included favourable settlements with foreign postal administrations regarding rates and final volumes.

Other product revenue within the Transaction Mail area grew $7 million, or 22%, from managing the end-to-end communication process for the mailer, and the management of consumer Returns/Response. Revenue from epost of $0.7 million, which was brought in house in November 2006, is also included in this growth.

Parcels

Parcels revenue totalled $1.2 billion in 2006, increasing $23 million, or 1.9%, when compared with 2005.

Domestic parcels accounted for $13 million of the increase. The growth was mainly driven by price increases, which helped to offset a decline of 6.1% in volumes. This included the migration of a major customer to a Transaction Mail product.

International Inbound revenue showed a $33 million increase over 2005, mainly due to a change in business processes redefining the USA Inbound product. As a result of this change, the 2006 Inbound values are not comparable to the prior year. Some negative impact of foreign exchange was offset by customer growth and rate increases.

International Outbound revenue declined $25 million with a volume decline of 21.0%. A negative $15-million variance was primarily due to lower volumes from online pharmacies' shipment to the U.S. as a result of changes to U.S. regulations and strengthening of the Canadian dollar. In addition, the strong Canadian dollar has negatively affected the Retail Outbound business. The loss of a major customer resulted in a further loss of International Outbound revenue.

The other activities within Parcels generated an additional $2 million over 2005.

Direct Marketing

Direct Marketing achieved higher-than-expected revenue growth of 9.9% in 2006, ending the year just over $1.3 billion in net revenue. Overall volumes increased 7.0% over the prior year. The health of the Canadian economy, and particularly the strong results in the financial, retail and communication sectors, contributed to this growth.

Our Admail products grew by $95 million, or 11.5%, generating 80% of this line of business growth. Unaddressed Admail, one of two core Admail products, grew by 14.4% primarily from strong volume growth of 9.1%. In the context of relatively flat overall unaddressed market volume, this strong growth is a good indication that our plans to improve customer value and our operational performance are on the right track. The financial, communication and retail sectors accounted for over 50% of total Unaddressed Admail growth. The banking and communication sectors specifically, both under strong competitive rivalry, have positively contributed to the growth of our Unaddressed and Addressed Admail products.

Our Addressed Admail product also performed well in 2006 with 9.9% revenue growth, including 5.0% in volume growth. These results are particularly positive in the context of the flat volume growth of the previous few years. We believe the product is well positioned for growth in a context where marketers expect measurability, high return on investment and more personalized communications with their customer base. A strong economy, a gradual shift in media mix favouring direct marketing, and the implementation of our initial phase to build the business, all contributed to the strong growth in 2006. The creation of our Direct Marketing Advisor team and the development of new testimonial material and research to demonstrate the superior marketing results achieved with direct mail have been important developments in 2006 and contributed to the growth.

A good proportion of the improvement in growth rate can be traced to the communication and retail sales sectors, which grew respectively by 23% and 17% in 2006, compared to negative growth in these two sectors in 2005. Small and medium-sized business in Ontario, mostly from the retail and service sectors, has grown by 14% representing 30% of the product line's year-over-year growth.

The revenue from our Publications Mail service has grown by 4.3%, mostly from price increases in a relatively flat market.

Canada Post continued to support the publishing industry by implementing cost reduction and subscription-building opportunities. Our Change of Address service, part of our smartmoves™ solutions for moving Canadians, has achieved positive growth, in part due to our online Change of Address service.

Our growth results in 2006 are encouraging and a sign that we are on the right path to becoming a more outward-looking, customer-focused company. We drove change on many fronts in 2006 to improve the effectiveness of direct mail, simplify the experience, and ensure our customers achieve strong and measurable results on their direct mail investment.

Canada Post – Cost of Operations

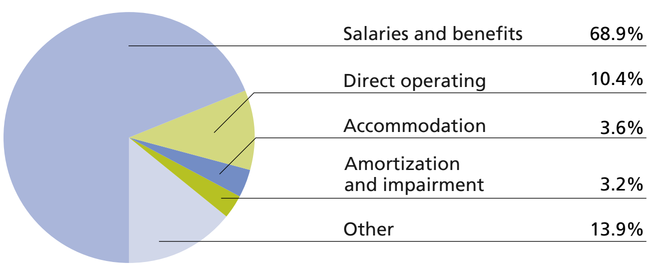
In 2006, the Canada Post Segment's cost of operations totalled $5,761 million, an increase of $387 million, or 7.2%, over the prior year.

Cost of operations Increase (decrease)

(in millions of dollars)	2006	2005	2004	2006 vs 2005	%	2005 vs 2004	%
Salaries	3,089	2,934	2,838	155	5.3%	96	3.4%
Benefits	885	724	650	161	22.1%	74	11.6%
Total salaries and benefits	**3,974**	**3,658**	**3,488**	**316**	**8.6%**	**170**	**4.9%**
Collection, processing and delivery	597	559	518	38	6.7%	41	8.1%
Accommodation	206	215	212	(9)	(3.8%)	3	1.1%
Amortization	183	188	198	(5)	(2.8%)	(10)	(4.8%)
Other	801	754	781	47	6.3%	(27)	(3.5%)
Total	**5,761**	**5,374**	**5,197**	**387**	**7.2%**	**177**	**3.4%**

The chart below shows the breakdown of costs as a percentage of total cost of operations. Salaries and benefit costs comprise 68.9% of the total cost, demonstrating the labour-intensive nature of the business.

Cost of operations – 2006



Cost of Operations	2006	2005	2004
Salaries and benefits	68.9%	68.1%	67.1%
Direct operating	10.4%	10.4%	10.0%
Accommodation	3.6%	4.0%	4.1%
Amortization and impairment	3.2%	3.5%	3.8%
Other	13.9%	14.0%	15.0%

The cost of salaries increased $155 million, or 5.3%, to reach $3,089 million. A significant portion of this increase was due to wage increases to employees. An increase of more than 200,000 points of call and a 9.1% growth in our Unaddressed Admail product put additional pressure on delivery costs. In addition, the Corporation promoted or recruited new supervisors and initiated a supervisory training program to support front-line employees. Safety issues and higher absenteeism levels also contributed to the increase. Again this year, improvements in productivity partially offset rising costs.

Employee benefit costs increased by $161 million, or 22.1%, to reach $885 million in 2006. This increase was primarily driven by escalating retirement health benefit expense, pension expense, and a reduction in transitional funding from the Government of Canada. Escalation in post-retirement health benefit expense is largely due to the combined effect of a decrease in the discount rate (from 6.1% to 5.1%), an increase in the medical drug trend, changes in employee demographic assumptions, and an increase in participation. Benefits for active employees also contributed to the growth.

Income from segregated assets is used to reduce benefit costs. The weighted average rate of return on the segregated cash and investments for employee termination benefits was 3.7% in 2006, an increase of 0.1% compared to 3.6% in 2005. The increase was due to higher interest rates for most of 2006. The funds were primarily held in short-term money market securities in anticipation of the payouts from the portfolio. The portfolio for employee termination benefits is expected to be liquidated through payouts in early 2007.

The weighted average rate of return on the funds held for the post-retirement benefits earned during 2006 was 4.2%, an increase of 0.4% compared to 2005. This increase was also due to higher interest rates for most of 2006.

The table below shows the summary of benefit changes.

Employee benefit costs Increase (decrease)

(in millions of dollars)	2006	2005	2006 vs 2005	%
Retirement health benefits	253	203	50	24.9%
Pension expense	310	271	39	14.5%
Transitional funding	(162)	(209)	47	22.7%
Active employee benefits	395	375	20	5.3%
Other	109	102	7	5.7%
Interest on segregated assets	(20)	(18)	(2)	(14.6%)
Net benefit costs	**885**	**724**	**161**	**22.1%**

Contracted collection, processing and delivery costs increased by $38 million, from $559 million in 2005 to $597 million in 2006. This increase was primarily due to points of call growth, higher fuel costs and inflation.

Accommodation costs decreased $9 million to $206 million. This decrease is mainly attributable to reduction in facilities management costs and decreased utility costs.

Amortization and impairment expenses totalled $183 million in 2006, a decrease of $5 million, or 2.8%, from the prior year. This decrease reflects the aging of our capital infrastructure.

Other expenses increased by $47 million, from $754 million in 2005 to $801 million in 2006. This increase was mainly due to increases in operating initiatives, consulting and contracting, and one-time adjustments in 2005.

Purolator Segment

The Purolator Segment contributed $69 million of income before income taxes to the 2006 consolidated results, an increase of $12 million from 2005.

Purolator Segment Summary Increase (decrease)

(in millions of dollars)	2006	2005	2004	2006 vs 2005	%	2005 vs 2004	%
Revenue from operations	1,347	1,254	1,156	93	7.4%	98	8.5%
Cost of operations	1,275	1,195	1,103	80	6.7%	92	8.4%
Income from operations	72	59	53	13	22.4%	6	10.9%
Non-operating income (expense)	(3)	(2)	(3)	(1)	(82.7%)	1	47.2%
Income before income taxes	**69**	**57**	**50**	**12**	**20.5%**	**7**	**14.8%**

Purolator – Revenue from Operations

Purolator generated net operating revenue of $1,347 million in 2006, an increase of $93 million over the $1,254 million achieved in 2005.

This growth was primarily attributed to increases in revenue per shipment across the various lines of business. The expanding Purolator Freight and Purolator-USA™ divisions have continued to drive volume growth. These divisions are expected to continue to grow at double-digit growth rates in 2007. Air cargo revenues have also seen double-digit growth rates, as Purolator's strong service levels continue to attract volume from its competitors.

The strong revenue performance of 2006 reflects the premium service that the Purolator brand represents. With relatively flat volumes and continuing service level improvements on Air and Ground delivery times, satisfied customers continue to support Purolator's growth.

Purolator – Cost of Operations

In 2006, the cost of operations totalled $1,275 million, an increase of $80 million over the prior year.

Cost pressures in 2006 were significant. Fuel prices continued to spike, and the ripple effect of the booming western Canadian economy on local staffing and network equilibrium was a challenge that required considerable management focus. Like most large Canadian companies, Purolator has also felt the effects of escalating pension and benefit costs. The significant capital investment of the last few years, which has enabled Purolator's strong growth, has also affected its depreciation costs. Excluding the above cost pressures, Purolator was able to keep its remaining year-over-year cost increases at 3%.

Logistics Segment

The Logistics Segment includes the financial results of Progistix and Intelcom. The 2006 financial results improved by $6 million this year, but the segment remained in a loss position of $1 million.

Progistix

In 2006, Progistix reported a loss in the amount of $1 million. The key drivers of the loss were the renewal of a contract with the company's largest customer, upon which it is economically dependent, as well as a work stoppage that lasted six weeks.

Revenue totalled $124 million, a decrease of $13 million from the previous year. The decrease is attributed to a reduction in revenue from the largest customer.

In 2006, Progistix negotiated a contract renewal with its largest customer that will extend until 2010. In conjunction with the contract renewal, the customer sought significant price reductions. In response, Progistix commenced a restructuring program in 2006 and this is expected to continue in 2007. The cost of the total restructuring program is estimated to be $14.5 million and will be incurred over 2006 and 2007. The customer agreed to pay for these costs in exchange for reduced ongoing costs and a capped margin. Due to revenue recognition guidelines, the payment is amortized over the contract renewal period to 2010, while the costs are expensed as incurred. The impact of this policy on 2006 income before taxes is $7.3 million.

Logistics Segment Summary Increase (decrease)

(in millions of dollars)	2006	2005	2004	2006 vs 2005	%	2005 vs 2004	%
Revenue from operations	134	143	137	(9)	(6.1%)	6	4.1%
Cost of operations	136	149	131	(13)	(8.2%)	18	13.3%
Income from operations	**(2)**	**(6)**	**6**	**4**	**61.5%**	**(12)**	**(187.2%)**
Non-operating income (expense)	1	(1)	(1)	2	235.8%	(0)	(25.2%)
Income (loss) before income taxes	**(1)**	**(7)**	**5**	**6**	**87.8%**	**(12)**	**(217.2%)**

All Other Segment

The All Other Segment includes the financial results of Innovapost, CPIL and epost up to October 31, 2006.

This segment continues to perform within expectations. There is nothing of significance to report.

All Other Segment Summary Increase (decrease)

(in millions of dollars)	2006	2005	2004	2006 vs 2005	%	2005 vs 2004	%
Revenue from operations	177	181	192	(4)	(2.3%)	(11)	(6.2%)
Cost of operations	173	184	199	11	(6.3%)	(15)	(7.1%)
Income from operations	**4**	**(3)**	**(7)**	**7**	**220.4%**	**4**	**30.1%**
Non-operating income (expense)	(2)	(2)	(1)	(0)	(54.3%)	(1)	(162.8%)
Income (loss) before income taxes	**2**	**(5)**	**(8)**	**7**	**132.7%**	**3**	**14.9%**

Critical Accounting Estimates and Accounting Policy Developments

Critical Accounting Estimates

Our significant accounting policies are described in note 2 to the consolidated financial statements on page 86. The preparation of financial statements in accordance with Canadian generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The critical accounting estimates described below require us to make particularly complex or subjective judgments about matters that are inherently uncertain or where it is likely that materially different amounts could be reported under different conditions or using different assumptions. The Audit Committee of the Board of Directors has reviewed the disclosures described in this section.

Property, Plant and Equipment

Property, plant and equipment are amortized over their useful lives. Useful lives are based on management's estimates of the periods of service provided by the assets, and are provided in note 2(e) to the consolidated financial statements on page 87. The useful lives of these assets are periodically reviewed for continued appropriateness. Due to the long lives of many of the assets, changes to the estimates used would cause significant variations in the carrying values that could result in a material impact on the consolidated financial statements.

A change in the remaining useful lives will affect the amortization expense as reported in the Corporation's results of operations. A change of one year in the composite useful life of the Corporation's property, plant and equipment asset base would impact annual amortization expense by approximately $10 million.

Long-lived assets are tested for impairment when events or circumstances indicate that the carrying value is not recoverable from future cash flows. If future conditions were to adversely differ from management's best estimate of key economic assumptions and associated cash flows were to materially decrease, the Corporation could potentially experience future material impairment charges in respect of its property, plant and equipment.

Goodwill

Goodwill is not amortized but is tested at least annually for impairment at the reporting unit level. Goodwill is tested by comparing the fair value of the reporting unit to its carrying value. The Purolator Segment represents the significant portion of goodwill in the consolidated financial position. The estimated fair value of this reporting unit is based on a discounted cash flows analysis, which includes making assumptions and estimates in a number of areas, including future cash flows, cash flow periods, terminal values and discount rates.

In estimating future cash flows of the Purolator Segment, the Corporation uses its approved plans. These plans reflect management's best estimates; however, they are subject to change as they involve inherent uncertainties that management may not be able to control. In addition, growth and profitability levels are compared to other competition in the industry, and general economic conditions prevailing at the valuation date. The discount rate applied to the future cash flows of the Purolator Segment is equal to the estimated weighted average cost of capital. In addition, the range of terminal value multiples is determined by adjusting the weighted average cost of capital by an amount reflecting a sustainable real growth rate for the reporting unit beyond the forecast period. A change in the weighted average cost of capital could have a significant impact on the estimate of the fair value of goodwill, and related impairment charge, if any.

Contingencies

Contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Disclosure is required when the amount of the loss is not estimable, or if there is a reasonable possibility that the ultimate loss will exceed the recorded provision. Contingent liabilities are often resolved over long time periods. Further information on the Corporation's contingencies is provided in note 12 to the consolidated financial statements on page 103.

An estimate of the liability for grievance claims is recorded based on the estimated likelihood of making a payment on settlement of the grievance and an estimation of the settlement amount. Changes to the likelihood of settlement and the estimated payment amounts of certain grievance claims may have a material impact on the financial statements in future years.

Pension and Other Retirement and Post-employment Benefits

The Canada Post Group sponsors plans that provide pensions and other retirement benefits for most of its employees. The Corporation believes the accounting estimates related to its employee benefit plan costs are critical accounting estimates because: (1) the amounts are based on complex actuarial calculations using several assumptions; and (2) given the magnitude of the estimated costs, differences in actual results or changes in assumptions could materially affect the consolidated financial statements.

Due to the long-term nature of these benefit plans, the calculation of expenses and obligations depends on various assumptions such as discount rates, expected long-term rate of return on plan assets, health care cost trend rates, projected salary increases, retirement age, mortality rates, and termination rates. These assumptions bear the risk of change as they require significant judgment and have inherent uncertainties that management may not be able to control. Other than the discount rate, the assumptions are determined by management and are reviewed annually by The Canada Post Group's actuaries.

The Group's discount rate assumptions, which are set annually at the measurement date, are used to determine the present value of the projected benefit obligation at the end of the year and the net periodic benefit cost for the following year. The discount rate is used to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments with a rating of AA or better, would provide the necessary cash flows to pay for the benefit plans as they become due. The actuary determines the discount rate using a yield curve approach, which is based on pricing and yield information for high quality AA-rated corporate bonds. The selected discount rate will have a cash flow pattern that resembles that of the plan being valued. The actuary determines the future benefit payments based on assumptions, which include the respective plans' demographics, retirees' profile and medical trend.

The expected rate of return on plan assets assumption is based on the statement of investment policies and procedures. It is a long-term assumption for which the accuracy can only be measured over a long period based on past experience. The investment strategy for the assets in the pension plans is to maintain a diversified portfolio of assets, invested in a prudent manner to maintain the security of funds, while maximizing returns within the guidelines provided in the investment policy.

The rate of compensation increase is another significant assumption in the measurement of the accrued benefit obligation for pension benefit plans and some of the other non-pension benefit plans. The short-term assumptions for projected salary increases are as reflected in the current active collective agreements, otherwise, an assumption of 3% is used. The long-term salary increases assumption is also 3%.

The corporate team incentive, which is included in the pensionable earnings of the Group's major pension plan, is assumed to be paid at 100% payout level.

The demographic assumptions are used to project the future number of retirees and dependants from year to year that will be eligible for benefits under the benefit plans. These assumptions include expected mortality, termination and retirement experience. An experience study to update the demographic assumptions is performed triennially.

Other assumptions are based on actual experience and management's best estimates. Actual results that differ from the assumptions result in actuarial gains or losses, which, in accordance with the recommendations of the Canadian

Institute of Chartered Accountants (CICA), are accumulated and amortized over future periods, and therefore, generally affect recognized expense and the recorded liability in future periods. The amortization of all employee future benefits other than post-employment benefits are amortized over the expected average remaining service life of the active employee group covered by the plans only to the extent that the unrecognized net actuarial gains and losses are in excess of 10% of the greater of the accrued benefit obligation and the market-related value of plan assets as at the beginning of the year. Gains or losses arising at the measurement date of post-employment benefit plans are amortized over the average duration of the respective obligations without the use of the 10% limit.

In note 7 to the consolidated financial statements on page 93, a table has been included that quantifies the impact of these differences in each of the last two years. These differences relate primarily to: (1) actual versus expected return on plan assets; (2) actual actuarial gains/losses incurred on the benefit obligation versus those expected and recognized in the consolidated financial statements; and (3) actual past service costs incurred as a result of plan amendments versus those expected and recognized in the consolidated financial statements.

The benefit obligations and associated expense are very sensitive to actuarial assumptions, namely changes in the discount rate, expected long-term return on plan assets, rate of compensation increase and medical trend rate assumptions. A lower discount rate results in a higher benefit obligation and a lower funded status. Similarly, poor fund performance results in a lower fair value of plan assets and a lower funded status. In either situation, the cash contributions to the benefit plans are affected.

Sensitivity to changes in key assumptions for our principal pension plans follows:

	Change in assumption	
(in millions of dollars)	Increase	Decrease
Change in discount rate of 10 basis points		
Increase (decrease) in annual pension expense	(28)	28
Increase (decrease) accrued pension obligation	(213)	217
Change in expected return on plan assets of 0.25%		
Increase (decrease) in annual pension expense	(30)	30

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

	Change in assumption	
(in millions of dollars)	Increase	Decrease
Change in discount rate of 10 basis points		
Increase (decrease) in annual health care expense	(6)	6
Increase (decrease) accrued health care obligation	(47)	49
Change in health care cost trend rates of 1%		
Increase (decrease) in annual health care expense	99	(77)
Increase (decrease) accrued health care obligation	544	(417)

For further details on our annual expense and obligation, see note 7 to the consolidated financial statements on page 93.

Income Taxes

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

Future income tax assets and liabilities are comprised of temporary differences between the carrying amount and tax basis of assets and liabilities as well as tax losses carried forward. The timing of the reversal of the temporary differences is estimated, and the tax rate substantively enacted for the period of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are based upon the amounts recorded in the financial statements and are therefore subject to accounting estimates that are inherent in those balances. The Corporation has significant deductible temporary differences, however, future tax assets have only been recorded to the extent that they are more likely than not to be realized. The deductible temporary differences that are not expected to reverse relate mainly to the accrued other retirement and post-employment benefit liability. See note 8 to the consolidated financial statements on page 100 for more detailed information.

The tax basis of assets and liabilities as well as tax losses carried forward are based upon the applicable income tax legislation, regulations and interpretations, all of which in turn are subject to interpretation. Assumptions underlying the composition of future income tax assets and future income tax liabilities include expectations about future results of operations and the timing of reversal of deductible temporary differences and taxable temporary differences. These assumptions also affect classification between income taxes recoverable and future income tax assets. The composition of future income tax assets and future income tax liabilities is reasonably likely to change from period to period because of the significance of these uncertainties.

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

Accounting Policy Developments

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP) as set out in the Canadian Institute of Chartered Accountants (CICA) *Handbook of Standards and Guidance Collection*. The impact of current year and future changes in Canadian GAAP is described below:

Current Year Accounting Changes

Non-Monetary Transactions

Effective January 1, 2006, the Corporation has prospectively adopted the recommendations in CICA Section 3831, *Non-Monetary Transactions*. This section revises and replaces the previously existing standards on non-monetary transactions. The recommendations require non-monetary transactions to be measured at the fair value of the asset given up or the asset received, whichever is more reliable, unless the transaction lacks commercial substance. The application of this standard has not had a material impact on the Corporation's consolidated financial statements in fiscal 2006.

Future Year Accounting Changes

Implementation in 2007

Financial Instruments – Recognition and Measurement, Hedges and Comprehensive Income

In January 2005, the CICA issued three accounting standards related to financial instruments: (i) *Financial Instruments – Recognition and Measurement*, (ii) *Hedges*, and (iii) *Comprehensive Income*, effective for fiscal years beginning on or after October 1, 2006, although earlier adoption is permitted.

All financial instruments, including derivatives, are to be included on a company's balance sheet and measured either at their fair values or, in limited circumstances when fair value may not be considered most relevant, at cost or amortized cost.

The standards also specify when gains and losses, as a result of changes in fair values, are to be recognized in the income statement (other comprehensive income provides a new financial statement location for temporarily recording such gains and losses).

Hedge accounting is optional, and certain financial instruments may be designated as hedges under specific circumstances.

The Corporation has identified the appropriate accounting treatment for its financial instruments according to these standards and determined the impact on opening balances as at January 1, 2007. Cash equivalents, short-term investments and investments segregated to fund accrued other retirement and post-employment benefits will be designated as held-for-trading as at January 1, 2007. Future purchases of such investments will be designated as held-for-trading, unless specified otherwise on initial recognition.

The adjustment to reflect the carrying amount of held-for-trading financial instruments at fair value does not materially impact the financial statements. The application of the effective interest method to calculate the amortized cost of other financial assets, including loans and receivables, and financial liabilities is not expected to result in a significant impact on the consolidated financial statements. As a result of a review of significant contracts entered into subsequent to January 1, 2003, there were no financial instruments that are derivatives, or contain embedded derivatives requiring bifurcation, identified as at January 1, 2007.

Accounting Changes

In July 2006, the CICA revised the recommendations in Section 1506, *Accounting Changes*, effective for fiscal years beginning on or after January 1, 2007, although earlier adoption is encouraged. Under the revised recommendations, voluntary changes in accounting policy will only be permitted if they result in the financial statements providing reliable and more relevant information. Changes in accounting policy will be applied retrospectively unless doing so is impracticable, or where the change in accounting policy is made on initial application of a primary source of GAAP, in accordance with the specific transitional provisions under the new requirement. New disclosures will also be required in respect of changes in accounting policies, changes in accounting estimates and correction of errors.

Implementation in 2008

Capital Disclosures

In December 2006, the CICA issued a new accounting standard Section 1535, *Capital Disclosures*, to converge with recent amendments to International Financial Reporting Standard IAS 1, *Presentation of Financial Statements*. This new standard will be effective for fiscal years beginning on or after October 1, 2007, although earlier adoption is permitted. Section 1535 requires an entity to disclose information about its objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, as well as its compliance with any externally imposed capital requirements.

Financial Instruments Disclosures and Presentation

In December 2006, the CICA issued a new accounting standard on disclosures about financial instruments. Section 3862, *Financial Instruments – Disclosures*, improves upon the disclosure requirements in existing Section 3861, *Financial Instruments – Disclosure and Presentation*, and converges with International Financial Reporting Standard IFRS 7, *Financial Instruments: Disclosures*. Section 3862 must be implemented in the first fiscal year beginning on or after October 1, 2007, although earlier adoption is permitted.

Section 3862, like Section 3861, is based on the fundamental principle that entities should provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance. However, Section 3862 places an increased emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how those risks are managed.

Concurrent with the release of Section 3862, the CICA also issued Section 3863, *Financial Instruments – Presentation*, which carries forward unchanged the presentation requirements of Section 3861 and must be applied at the same time that Section 3862 is adopted.

Convergence With International Reporting Standards

In early 2006, the CICA ratified a strategic plan that will result in Canadian GAAP, as used by public companies, being converged with International Financial Reporting Standards; this changeover is expected to occur in 2011. As this convergence initiative is very much in its infancy as of the date of these consolidated financial statements, it would be premature to assess the impact of the initiative, if any, on the Corporation at the present time. We will be assessing the impact on the Corporation in 2007 and 2008.

Outlook for 2007

Continued steady economic conditions are expected to support ongoing performance. In 2007, we aim to generate revenue of $7.6 billion, up 4.3% from 2006. Although our return on equity is projected to fall short of the Policy Framework target, we will strive to improve performance through continued focus on productivity.

Economic Outlook

The demand we face for our services has traditionally been derived largely from the overall condition of the Canadian economy. Weakness may occur in 2007, but real GDP growth is expected to average about 2.7% annually over the next few years with inflation moderate at about 2% per year. Even so, energy prices are expected to remain high and unstable, leading to the imposition of fuel surcharges where possible in order to offset the impact of high fuel costs.

Household formation growth is expected to remain strong in the next few years, but it is forecast to start moderating after 2010, as population growth slows. This, in turn, will slow down the growth in points of delivery (POD), since households account for more than 90% of POD.

Calendar years	History (2003-2005)				Economic Outlook			
Percent change	2003	2004	2005	2006	2007	2008	2009	2010
ECONOMIC								
Real Gross Domestic Product	2.0	2.9	2.9	2.7	2.5	2.7	2.8	2.8
Real Final Domestic Demand	3.6	3.9	4.3	4.5	3.2	3.1	3.0	3.1
Inflation (Consumer Price Index)	2.8	1.9	2.2	2.0	2.0	2.2	2.0	2.1
Prime Lending Rate (%)	4.7	4.0	4.4	5.8	5.8	5.5	5.8	5.8
DEMOGRAPHIC								
Total Population	1.0	1.0	0.9	0.9	0.8	0.8	0.8	0.8
Households	1.6	1.7	1.7	1.7	1.6	1.5	1.5	1.4

Sources:
The economic outlook is based on Statistics Canada data, the December 2006 Canadian Outlook of The Conference Board of Canada, and the December 2006 Global Insight Macro Economic forecast. Forecasts from the major banks were also used for the first two years of the forecast.
The demographic indicators are based on actual data from Statistics Canada and projections from Global Insight and Canada Post.

Canada Post Segment

In addition to general economic factors, our outlook takes into account that competition, already powerful, will intensify across all our businesses as we and our competitors harness the forces of technology, globalization and customer empowerment.

Transaction Mail

While our Lettermail product's volumes remain flat today, the rate of decline remains difficult to predict. With steady economic growth expected, we have assumed that volumes will remain steady over the short and medium term. Even if volumes decrease more than expected and as our customers move from our Lettermail product to electronic alternatives, our epost service provides an ideal way for us to maintain our relationship with existing customers and to forge relationships with new ones.

We will also look to refine and improve our addressing and technology capabilities and platforms, creating a distinct competitive advantage. We intend to focus aggressively on growing our Returns/Response Mail Management and Multi-Channel Mail Presentment Solutions services.

Increasing our connection with Canadians is central to our ability to serve Canadian businesses. In the coming years, we plan to continue to expand our electronic services, giving Canadians additional choices around the communications they receive.

Parcels

Canada Post is a leading market player, serving both consumer and small business customers, and in the business-to-consumer home delivery segment. We see growth opportunities with small and medium-sized businesses served by commercial contracts, and in International Outbound and Inbound markets.

By defending our areas of strength and by seizing growth opportunities, we expect to be able to build our volume within the shipping and delivery market. In tandem with volume growth, maximizing operational efficiencies and controlling cost drivers are expected to be the keys to increased profitability. Our prices are very competitive, which leaves relatively little room for increases that are above inflation. A key focus in 2007 is to upgrade our process quality to competitive levels to further enhance customer service levels, and to complete bar-coding of core Parcels products to enhance tracking performance and visibility for our customers.

Direct Marketing

We anticipate continued growth for the Direct Marketing line of business in 2007. Based on the economic outlook, we anticipate that the growth of direct mail will exceed that of the advertising industry, as marketers increasingly turn to direct mail as an effective way to reach their existing and targeted customers.

In 2007, we intend to continue pursuing opportunities to simplify our offering and provide our customers with more options and flexibility to achieve their marketing objectives. In collaboration with the industry, we plan to provide better tools and analytical capabilities to improve our customer's return with direct mail. We also plan to aggressively pursue opportunities to improve customer experience across all our interactions. We are looking ahead to the introduction of the Direct Marketing Online solution, making direct marketing easier for our customers.

Purolator Segment

Purolator is going through a major change in its business – the Purolator 2010 vision. It is expected to make progress in 2007, improving revenues, making productivity gains, and increasing the diversity of services that have enabled it to be a leading player in the domestic market for shipping and delivery.

Investments in technology and processing capability are expected to bear fruit this year, as Purolator brings on improved capacity to handle its growing volumes. As well, Purolator Freight is now well-positioned to manage growth in this increasingly important segment of the market.

Logistics Segment

Growth and profitability are the ideas driving Progistix in 2007, as it works to diversify its client base and expand into industries adjacent to its current markets. Progistix will also work to deepen relationships with its current clients, its employees and its business partners. Its strong customer focus will also underpin its work to create a culture of innovation that responds to the changing needs of the market, while aiming to ensure that it maintains its profitability.

All Other Segment

Our Innovapost operation will continue to drive improvements to information technology and management across The Canada Post Group. Along with improving its internal capabilities, processes and controls, Innovapost also intends to concentrate on its ability to develop effective, world-leading applications within a process that increasingly meets industry standards for best practices.

Innovapost plans to take on additional work from Canada Post in 2007 in the epost and Borderfree services, and to support Canada Post in offering complementary new services.

ADDITIONAL INFORMATION

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

Consolidated Ratios	Policy Framework	2006	2005	2004	2003	2002
Profitability						
(1) Return on equity of Canada *	11.0 %	**8.4 %**	15.0 %	12.1 %	10.5 %	7.9 %
(2) Operating profit margin		**2.0 %**	3.8 %	3.6 %	2.9 %	2.5 %
(3) Productivity	97.0 %	**98.0 %**	96.2 %	96.4 %	97.1 %	97.5 %
Leverage						
(4) Total debt to total capital	40.0 %	**4.9 %**	5.8 %	7.8 %	9.6 %	12.0 %
(5) Cash flow to debt		**364.7 %**	246.3 %	(124.0) %	38.4 %	278.2 %
Liquidity						
(6) Current ratio		**1.25**	1.33	1.18	1.09	0.97
(7) Gross interest coverage		**14.58**	25.62	21.29	14.72	14.70
Investment						
(8) Cash flow to capital expenditures		**87.7 %**	127.0 %	(59.2) %	19.0 %	103.9 %
(9) Capital asset investment rate		**6.7 %**	3.5 %	5.1 %	5.9 %	9.7 %
Dividend payout						
(10) Dividend payout ratio **	25.0 %	**40.0 %**	40.0 %	40.0 %	25.0 %	25.0 %
Dividend payout ratio once return on equity of Canada ≥ 11%	40.0 %					

* For 2003, the return on equity of Canada has been adjusted to take into consideration the income tax benefit of $142 million resulting from the curtailment of the employee termination benefit plan.

** The dividend for 2006 is based on the rate established in the Policy Framework. It remains subject to Board of Directors' approval.

(1) Net income ÷ ((equity of Canada beginning of year + equity of Canada end of year) ÷ 2)
(2) Income from operations ÷ revenue from operations
(3) Cost of operations ÷ revenue from operations
(4) (Total debt + long-term financial obligation) ÷ (total debt + long-term financial obligation + equity of Canada)
(5) Cash flows from operating activities ÷ (total debt + long-term financial obligation)
(6) Current assets ÷ current liabilities
(7) Income from operations ÷ (interest expense + long-term financial expense)
(8) Cash flows from operating activities ÷ cash acquisition of property, plant and equipment
(9) (Acquisition of property, plant and equipment – proceeds from sale of property, plant and equipment) ÷ ((cost of property, plant and equipment beginning of year + cost of property, plant and equipment end of year) ÷ 2)
(10) Dividend ÷ net income

AUDITORS' REPORT ON ANNUAL COST STUDY CONTRIBUTION ANALYSIS

To the Board of Directors

Canada Post Corporation

We have audited the Annual Cost Study Contribution Analysis of Canada Post Corporation for the year ended December 31, 2006, prepared in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis. This financial information is the responsibility of the Corporation's management and has been prepared using Canada Post Corporation segment revenues and expenses contained in note 18 to the audited consolidated financial statements for the year ended December 31, 2006, and other unaudited operational data extracted from Canada Post Corporation's systems. Our responsibility is limited to expressing an opinion, based on our audit, on the financial information resulting from the application of the Cost Methodology.

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

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

In our opinion:

(a) the Annual Cost Study Contribution Analysis presents fairly, in all material respects, the contribution of services by lines of business, market and the contribution by exclusive privilege, competitive and concessionary services for the year ended December 31, 2006, in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis, and using Canada Post Corporation segment revenues and expenses contained in note 18 to the audited consolidated financial statements for the year ended December 31, 2006, and other unaudited operational data extracted from Canada Post Corporation's systems; and
(b) using the Cost Methodology described in the notes, Canada Post Corporation did not cross-subsidize its competitive services group or any market grouping of competitive services, using revenues protected by exclusive privilege for the year ended December 31, 2006.

PricewaterhouseCoopers LLP

Chartered Accountants
Ottawa, Canada
March 27, 2007

ANNUAL COST STUDY CONTRIBUTION ANALYSIS

Canada Post Corporation

As a multi-service firm, Canada Post Corporation employs a common infrastructure to provide its various services in each of the three lines of business in which it operates. Canada Post Corporation has developed over many years, in conjunction with expert accountants and economists, an activity-based, incremental costing methodology that allocates costs among its services. Canada Post Corporation applies this methodology each year in its Annual Cost Study. The Annual Cost Study provides costing data that serves as the basis for ensuring that Canada Post Corporation is not competing unfairly by cross-subsidizing its competitive services with revenues from exclusive privilege services.

The methodology, which is summarized in the notes to the Annual Cost Study Contribution Analysis, recognizes that some costs are caused by the provision of individual services or groups of services while others are common costs of Canada Post Corporation's infrastructure. Approximately 63% of the total non-consolidated costs of Canada Post Corporation are allocated to the Competitive grouping of services in the Annual Cost Study.

As the Annual Cost Study Contribution Analysis indicates, for the year ended December 31, 2006, the Competitive grouping of services generated positive long-run incremental contribution. Under the methodology in the Annual Cost Study, a positive long-run incremental contribution for the Competitive grouping of services establishes that this grouping of services has not been cross-subsidized using revenues from exclusive privilege services.

Canada Post Corporation reorganized along its three lines of business: Transaction Mail, Parcels and Direct Marketing. As such, the Lines of Business grouping of services has replaced the Market grouping of services in the Annual Cost Study Contribution Analysis. The Market grouping of services has been included in the notes to the 2006 Annual Cost Study Contribution Analysis for comparison purposes.

Annual Cost Study Contribution Analysis

Year ended December 31, 2006
(in millions of dollars)

I – Long-Run Incremental Contribution by line of business:

	Transaction Mail	Parcels	Direct Marketing	Other	Total
Revenue from operations	$ 3,206	$ 1,187	$ 1,307	$ 131	$ 5,831
Long-run incremental costs	(1,601)	(1,051)	(758)	(108)	(3,518)
Long-run incremental contribution to the fixed costs	**$ 1,605**	**$ 136**	**$ 549**	**$ 23**	**$ 2,313**
	50%	11%	42%	18%	40%
Unallocated fixed costs					(2,243)
Contribution before the under noted items					**$ 70**
Investment and other income					35
Interest and other expenses					(6)
Income from the CPC segment before income taxes					**$ 99**

II – Long-Run Incremental Contribution of exclusive privilege, competitive, and concessionary services:

	Exclusive Privilege	Competitive	Concessionary	Other	Total
Revenue from operations	$ 3,789	$ 1,642	$ 178	$ 222	$ 5,831
Long-run incremental costs	(1,983)	(1,309)	(171)	(170)	(3,633)
Long-run incremental contribution to the fixed costs	**$ 1,806**	**$ 333**	**$ 7**	**$ 52**	**$ 2,198**
	48%	20%	4%	24%	38%
Unallocated fixed costs					(2,128)
Contribution before the under noted items					**$ 70**
Investment and other income					35
Interest and other expenses					(6)
Income from the CPC segment before income taxes					**$ 99**

The accompanying notes are an integral part of the Annual Cost Study Contribution Analysis.

NOTES TO ANNUAL COST STUDY CONTRIBUTION ANALYSIS

Year ended December 31, 2006

1. General

The Annual Cost Study calculates the long-run incremental contribution from exclusive privilege services, competitive services and concessionary services. The long-run incremental contribution is defined as the revenues from such services, less their long-run incremental cost.

2. Cost methodology

a) **Long-run incremental cost** • The cost methodology employed by Canada Post Corporation measures the long-run incremental cost of individual services and groups of services according to the current operating plan. Long-run incremental cost is the total annual cost caused by the provision of a service.

b) **Activity base** • Services provided by Canada Post Corporation are analyzed to determine the various activities performed to deliver the services. Each activity is then analyzed to determine the causal relationship between the costs of the activity and the services that require the performance of that particular activity. Service volumes or other data are used to attribute those activity costs to services.

c) **Attribution principles** • The causal relationships between the cost of resources and the activities performed and between the activities performed and the services delivered are identified. Those activity costs, which are incurred because of the provision of a service, are attributed to that service. Costs, which cannot be attributed to the provision of a service, are business sustaining or common fixed costs to more than one service. Where a business sustaining or common fixed cost is specific to a group of services, those activity costs are attributed at that higher level of aggregation. The remaining business sustaining or common fixed costs are "unallocated fixed costs".

d) **Source data** • The source of financial data used in the costing methodology is the Canada Post Corporation general ledger revenues and costs. All Canada Post Corporation costs are categorized either into service attributable, specific fixed or non-attributable activity costs.

   Operational time, volume and weight/cubage data are used to attribute general ledger costs to activities and activity costs to services. Operational volume data is used to determine revenue by services. Where operational data is not available, an appropriate proxy is used to make the attribution.

e) **Reconciliation to financial records** • Total revenues and costs considered in the Annual Cost Study are agreed to the total revenues and expenses forming the Canada Post Corporation segment of the audited consolidated financial statements, which have been reported on by another firm of chartered accountants.

f) **Cross-subsidization test** • Under the Cost Methodology in the Annual Cost Study a positive long-run incremental contribution (revenue exceeds long-run incremental cost) for a Line of Business, Market and Competitive grouping of services establishes that the grouping of services has not been cross-subsidized using revenues from other services or groups of services.

3. Prior year comparative

Market grouping of services • In 2006, the Lines of Business grouping of services has replaced the Market grouping of services in the Annual Cost Study Contribution Analysis. The Market grouping of services has been included in the notes to the Annual Cost Study Contribution Analysis for comparison purposes

I – Long-Run Incremental Contribution of services by market:

	Communication	Physical Distribution	Advertising	Publications	Other	Total
Revenue from operations	$ 3,217	$ 1,154	$ 924	$ 275	$ 261	$ 5,831
Long-run incremental costs	(1,576)	(1,015)	(533)	(198)	(192)	(3,514)
Long-run incremental contribution to the fixed costs	**$ 1,641**	**$ 139**	**$ 391**	**$ 77**	**$ 69**	**$ 2,317**
	51%	12%	42%	28%	26%	40%
Unallocated fixed costs						(2,247)
Contribution before the under noted items						**$ 70**
Investment and other income						35
Interest and other expenses						(6)
Income from the CPC segment before income taxes						**$ 99**

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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

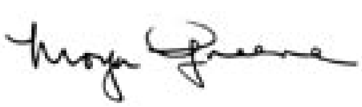
In support of its responsibilities, management maintains financial and management control and information systems and management practices which are of high quality, consistent with reasonable cost. These systems and practices are designed to provide reasonable assurance that relevant and reliable financial information is produced and the assets are safeguarded and controlled in accordance with the *Financial Administration Act* and regulations, as well as the *Canada Post Corporation Act* and by-laws of the Corporation. Internal audits examine and evaluate the adequacy of the system of internal control to assess and manage the Corporation's risks, and reports are issued to senior management and the Audit Committee of the Board of Directors.

The Audit Committee of the Board of Directors is composed of five directors who are not officers or employees of the Corporation, including the Chairman of the Board of Directors (ex-officio). The Audit Committee meets regularly to oversee the internal audit activities of the Corporation and review the financial performance of the Corporation. Annually, the Audit Committee reviews the consolidated financial statements and management's discussion and analysis with management and the external auditors and recommends the consolidated financial statements to the Board of Directors for approval.

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

Canada Post Corporation is a Crown corporation named in Part II of Schedule III of the *Financial Administration Act* since 1989. In accordance with the *Financial Administration Act*, each year, the Governor in Council appoints the Corporation's external auditors after consultations with the Corporation's Board of Directors on this matter. In June 2005, the *Financial Administration Act* was amended to provide inter alia that the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each Crown corporation unless the Auditor General waives the requirement of being so appointed. The Auditor General did not waive the requirement of being so appointed, and KPMG LLP were appointed as joint auditors of the Corporation for the year ended December 31, 2006. The Auditor General and KPMG LLP audit the consolidated financial statements and report to the Audit Committee of the Board of Directors, as well as the Minister of Transport, Infrastructure and Communities.

The *Financial Administration Act* specifies that the Corporation is subject to a special examination at least once every five years and at such additional times as the Governor in Council, the Minister of Transport, Infrastructure and Communities or the Board of Directors of the Corporation may require. The special examination, a type of value-for-money audit, serves to provide an independent opinion to the Board of Directors on whether the Corporation's financial and management control and information systems and management practices were maintained in a manner that provided reasonable assurance that: the assets of the Corporation were safeguarded and controlled; the financial, human and physical resources of the Corporation were managed economically and efficiently; and the operations of the Corporation were carried out effectively. Deloitte & Touche LLP carried out the last special examination with respect to the Corporation, which covered the period from August 1 to December 31, 2003.



President and Chief Executive Officer

Vice-President, Finance and Comptroller

March 9, 2007

AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

To the Minister of Transport, Infrastructure and Communities

We have audited the consolidated balance sheet of Canada Post Corporation as at December 31, 2006 and the consolidated income and equity of Canada statement and the consolidated cash flow statement for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

The consolidated financial statements as at December 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those consolidated statements in their report dated March 6, 2006.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
March 9, 2007, except as to Note 19 which is as of March 28, 2007

KPMG LLP

Chartered Accountants

CONSOLIDATED BALANCE SHEET

As at December 31 (in millions of dollars)	**2006**	2005
Assets		
Current assets		
Cash and cash equivalents	**$ 499**	$ 474
Short-term investments	**231**	230
Accounts receivable	**582**	555
Income tax recoverable	**4**	21
Prepaid expenses	**69**	73
Current portion of segregated cash and investments	**21**	68
Current portion of future income tax assets	**63**	45
	1,469	1,466
Segregated cash and investments (note 5)	**469**	446
Property, plant and equipment (note 6)	**1,712**	1,671
Accrued pension benefit asset (note 7)	**1,010**	784
Future income tax assets (note 8)	**135**	93
Other assets (note 9)	**189**	144
	$ 4,984	$ 4,604
Liabilities and Equity of Canada		
Current liabilities		
Accounts payable and accrued liabilities	**$ 453**	$ 400
Salaries and benefits payable	**385**	368
Income tax payable	**68**	18
Deferred revenue	**177**	148
Deferred transitional support	**–**	30
Outstanding money orders	**52**	51
Current portion of long-term debt	**3**	16
Current portion of future income tax liabilities	**–**	3
Current portion of accrued post-employment benefit liability	**32**	68
	1,170	1,102
Long-term debt (note 10)	**58**	60
Future income tax liabilities (note 8)	**19**	21
Accrued pension, other retirement and post-employment benefit liability (note 7)	**2,247**	1,973
Other long-term liabilities	**38**	38
	3,532	3,194
Non-controlling interest	**19**	16
Equity of Canada	**1,433**	1,394
	$ 4,984	$ 4,604

Commitments and contingencies (note 12)

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

Approved on behalf of the Board:

Chairman of the Board of Directors

Chairperson of the Audit Committee

CONSOLIDATED INCOME AND EQUITY OF CANADA STATEMENT

Year ended December 31 (in millions of dollars)	2006	2005
Revenue from operations	**$ 7,264**	$ 6,944
Cost of operations		
Salaries	**3,641**	3,472
Benefits	**1,005**	830
Collection, processing and delivery	**1,049**	990
Accommodation	**279**	287
Amortization and impairment (note 9)	**215**	230
Other	**927**	872
	7,116	6,681
Income from operations	**148**	263
Non-operating income (expense)		
Investment and other income	**29**	30
Interest and other expense	**(11)**	(11)
	18	19
Income before income taxes	**166**	282
Income tax expense (note 8)	**44**	80
Net income before non-controlling interest	**122**	202
Non-controlling interest in net income of subsidiaries	**3**	3
Net income	**119**	199
Retained earnings, beginning of year	**239**	99
	358	298
Dividend	**80**	59
Retained earnings, end of year	**278**	239
Contributed capital	**1,155**	1,155
Equity of Canada	**$ 1,433**	$ 1,394

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

CONSOLIDATED CASH FLOW STATEMENT

Year ended December 31 (in millions of dollars)	**2006**	2005
Cash flows from (used in) operating activities		
Net income	**$ 119**	$ 199
Items not affecting cash:		
Accrued pension, other retirement and post-employment benefits	**703**	604
Amortization and impairment	**215**	230
Future income tax expense (benefit)	**(65)**	44
Other income, net	**(5)**	(3)
Transitional support offsetting pension reform incremental costs	**(161)**	(209)
	806	865
Pension, other retirement and post-employment benefit payments	**(691)**	(693)
Change in non-cash operating working capital (note 13)	**152**	40
	267	212
Cash flows from (used in) investing activities		
Net (increase) decrease in short-term investments and segregated assets	**23**	(154)
Acquisition of property, plant and equipment	**(305)**	(167)
Proceeds from sale of property, plant and equipment	**4**	12
Other investing activities, net	**–**	(1)
	(278)	(310)
Cash flows from (used in) financing activities		
Transitional support received from the Government of Canada	**131**	156
Repayment of long-term debt	**(15)**	(21)
Dividend paid	**(80)**	(59)
Other financing activities, net	**–**	(1)
	36	75
Net increase (decrease) in cash and cash equivalents	**25**	(23)
Cash and cash equivalents, beginning of year	**474**	497
Cash and cash equivalents, end of year	**$ 499**	$ 474

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(December 31, 2006)

1. Incorporation and Directives

Canada Post Corporation (the "Corporation") was established by the *Canada Post Corporation Act* in 1981 to operate a postal service on a self-sustaining financial basis while providing a standard of service that will meet the needs of the people of Canada. Canada Post Corporation is a Crown corporation included in Part II of Schedule III to the *Financial Administration Act* and is an agent of Her Majesty.

The Corporation has been issued two directives pursuant to section 89 of the *Financial Administration Act*.

The Corporation has been directed to continue its financial contribution to the Publications Assistance Program until March 31, 2009. This financial contribution shall not exceed $15 million per year.

The Corporation has also been directed to deliver mail at rural roadside mailboxes that were serviced by the Corporation on September 1, 2005. As required by the directive, the Corporation submitted its implementation plan to the Minister of Transport, Infrastructure and Communities. Under the plan, the cost to restore and maintain rural mailbox delivery is estimated to be significant and funding sources will need to be identified. The plan is under review with the Minister. In the interim, corrective action has already begun.

2. Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Canadian generally accepted accounting principles require management to make estimates and assumptions that affect reported amounts and disclosures in the consolidated financial statements and accompanying notes. The significant areas requiring the use of management estimates and assumptions are: useful lives of property, plant and equipment; fair value measurement; pension, other retirement and post-employment benefits; income taxes; measuring the impairment of long-lived assets and goodwill; and assessing the resolution of contingent liabilities. Actual results may differ from those estimates.

Certain comparative figures have been reclassified in order to conform to the presentation adopted in 2006.

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

(a) Consolidation • These consolidated financial statements include the accounts of the Corporation and its subsidiaries, as well as its proportionate share of the accounts of its joint ventures (collectively referred to as "The Canada Post Group"). Purolator Courier Ltd (Purolator), Progistix-Solutions Inc. (Progistix) and Canada Post International Limited (CPIL) are the principal subsidiaries while the joint ventures are Intelcom Courrier Canada Inc. (Intelcom) and Innovapost Inc. (Innovapost). Effective November 1, 2006, EPO Inc. (epost™) was dissolved as a separate legal entity and its operations were integrated into the Corporation and Innovapost. The Canada Post Group does not have any variable interest entities.

(b) Cash equivalents • Cash equivalents are recorded at cost, which approximates market value, and consist of money market instruments with maturities of three months or less from the date of acquisition.

(c) Short-term investments • Investments with original maturities greater than three months are classified as short-term investments and include money market instruments and high quality bonds. Investments in money market instruments are carried at cost whereas investments in bonds are recorded at amortized cost. The carrying value of the short-term investments approximates their market value.

The weighted average effective rate of return on short-term investments held as at December 31, 2006 is 4.2% (2005 – 3.4%).

2. Significant Accounting Policies (continued)

(d) Segregated cash and investments • The Corporation has segregated certain investments, along with an amount of cash, for the purpose of managing certain cash flows relating to accrued other retirement and post-employment benefits (note 5). Segregated cash and investments, which include money market instruments and high quality bonds with maturities no greater than 10 years, are presented separately on the balance sheet. Investments in bonds are written down to their market value if the decline in value is considered other than temporary.

(e) Property, plant and equipment • Property, plant and equipment transferred from the Government of Canada on incorporation were recorded at their fair value at that date, determined as follows:

Land	Market value based on existing use
Buildings	Amortized replacement cost
Plant equipment, vehicles, sales counters, office furniture and equipment, and other equipment	Amortized replacement cost or original cost less estimated amortization

The market value of land and the amortized replacement cost of buildings transferred by the Government of Canada were determined by independent appraisals.

Property, plant and equipment acquired or developed subsequent to incorporation are recorded at cost.

Amortization commences when the assets are placed into service and is recognized over the estimated useful lives of the assets, using principally the straight-line method as follows:

Buildings	25, 30 and 40 years
Leasehold improvements	Initial fixed lease term plus period of first renewal option
Plant equipment	5 to 20 years
Vehicles (other than passenger and light-duty commercial)	3 to 10 years
Sales counters, office furniture and equipment and software	2 to 20 years
Other equipment	5 to 20 years

Passenger and light-duty commercial vehicles are amortized on a declining balance basis at an annual rate of 30%. Office equipment and software under capital lease are amortized over the same useful life as purchased assets of the same asset category.

(f) Intangible assets • Intangible assets consist mainly of acquired customer contracts recorded at cost and amortized on a straight-line basis over the term of the respective contract plus the period of first renewal option, if any, for total terms of approximately 6 and 10 years.

(g) Long-lived assets to be disposed of by sale • Long-lived assets classified as held for sale are presented separately on the consolidated balance sheet, and recognized at the lower of carrying amount or fair value less disposal costs. A write-down to fair value less disposal costs is recorded as a charge to net income and no further amortization is recorded.

(h) Impairment of long-lived assets • Long-lived assets, excluding goodwill, that are held for use, are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable, as measured by comparing their carrying amount to the estimated future undiscounted cash flows generated by their use and eventual disposition. For the purpose of assessing recoverability, long-lived assets are grouped at the lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. An impairment loss is equal to the amount by which the carrying amount of the asset exceeds its fair value, determined using the expected present value of future cash flows.

2. Significant Accounting Policies (continued)

(i) Goodwill • Goodwill represents the excess of the purchase price over the fair value of net identifiable assets upon acquisition of a business. Goodwill is tested for impairment at least annually, or more frequently if events and circumstances indicate that a possible impairment issue may arise earlier. An impairment loss is recognized when the carrying amount of a reporting unit's goodwill exceeds its fair value, which is determined using the expected present value of future cash flows.

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

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

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

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

(k) Incentive and lease inducement • The incentive received upon signing of a 10 year outsourcing contract in 2002 was deferred, and is being amortized on a straight-line basis over the term of the contract. Lease inducements received during the year are also deferred, and are amortized on a straight-line basis over the initial fixed lease term plus the period of the first renewal option, if any. Amortization of the incentive and the lease inducements is presented as reduction of expense. The current portion of the deferred incentive and lease inducement is presented in deferred revenue, and any remaining unamortized balance is presented in other long-term liabilities.

(l) Pension, other retirement and post-employment benefit plans • The actuarial determination of the Corporation's accrued benefit obligations for pensions, other retirement and post-employment benefits uses the projected benefit method prorated on service. This method incorporates management's best estimate of future salary levels or cost escalation, as well as demographic and other financial assumptions. The discount rate used is based on market rates as at the measurement date. For the purpose of calculating the expected return on plan assets, these assets are valued at market-related values, whereby actuarial gains (losses) on plan assets for a year are recognized on a straight-line basis over five years. Actuarial gains (losses) arise from the difference between the actual return on plan assets for a year and the expected return on plan assets for that year, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain (loss) over 10% of the greater of the benefit obligation and the market-related value of plan assets at the beginning of the year is amortized over the average remaining service period of active employees. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period up to the full eligibility date of employees active at the date of amendment.

2. Significant Accounting Policies (continued)

On October 1, 2000, the Corporation assumed the responsibility for a health care retirement benefit plan. The Corporation applied the accounting standards on employee future benefits to this obligation on a prospective basis. The transitional obligation represents the amount of unrecognized deficit in the plan and is amortized on a straight-line basis over 8 years, the average remaining service period up to the full eligibility date of employees expected to receive benefits under the plan as of that date. The funding excess results from the *Federal Public Sector Pension Reform*, effective October 1, 2000, and represents the excess amount of the assets, transferred by the Government of Canada to the Corporation's pension plan, over the obligations assumed by the Corporation for the pension plan. The funding excess is deferred and amortized on a straight-line basis over 11 years, the average remaining service period of the active employees covered by the pension plans as of that date.

The Government of Canada, as part of the *Federal Public Sector Pension Reform*, has committed to provide declining transitional support to assist the Corporation with the incremental costs incurred as a result of establishing the Canada Post Corporation Pension Plan and the associated ancillary benefits. Receipt of the transitional support is conditional on the Corporation maintaining other retirement enhancements similar to those offered to the *Public Service Superannuation Act* participants and, also, the Corporation showing visible commitment and progress towards achieving the financial and service performance objectives set out in the Policy Framework and reflecting them in future corporate plans. Therefore, transitional support is accounted for only when received. The entire amount of transitional support is deferred and drawndown on a first-in, first-out basis to cover the annual incremental costs. The Corporation is scheduled to receive $256 million over the next four years as follows: $106 million in 2007, $81 million in 2008, $56 million in 2009 and $13 million in 2010.

The Corporation is also subject to the *Government Employees Compensation Act* and, therefore, is not mandatorily covered under any provincial workers' compensation act. As a self-insured employer, the Corporation is responsible for the obligation incurred since incorporation. The Corporation's obligations, for workers' compensation benefits and post-employment benefits for employees in receipt of long-term disability benefits, are based on known awarded disability and survivor pensions and other potential future awards with respect to accidents that occurred up to the measurement date. The actuarial determination of these accrued benefit obligations uses the projected benefit method. This method incorporates management's best estimate of cost escalation, as well as demographic and other financial assumptions. Management's best estimate also takes into account the experience and assumptions of provincial workers' compensation boards. The actuarial gains (losses) are amortized over a 9 or 10 year period, representing the average duration of these obligations.

The average remaining service periods of the active employees covered by the benefit plans are as follows:

As at December 31	**2006**		2005	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Canada Post Corporation	11 years	3 to 11 years	11 years	3 to 11 years
Purolator	11 to 17 years	N/A	13 to 17 years	N/A
Progistix	15 years	17 years	15 years	17 years
Innovapost	11 years	N/A	12 years	N/A

Defined contribution plan accounting was applied to the multiemployer defined benefit plan of CPIL's subsidiary.

2. Significant Accounting Policies (continued)

(m) Income taxes • On March 27, 1994, the Corporation became a prescribed Crown corporation for tax purposes and, as such, is subject to federal income taxation under the *Income Tax Act*. The Corporation's subsidiaries and joint ventures are subject to federal and provincial income taxes.

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

Investment tax credits are recorded using the cost reduction method, whereby the credits are recorded as a reduction of current cost of operations or property, plant and equipment, when there is reasonable assurance that the investment tax credit will be realized.

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

3. Recent Accounting Pronouncements Requiring Implementation in Future Years

(a) Financial instruments • The Canadian Institute of Chartered Accountants ("CICA") issued new accounting requirements for the recognition and measurement of financial instruments, Handbook Section 3855. Under these new accounting requirements, all financial instruments will be included on the consolidated balance sheet and measured according to their classification, either at fair value or, in limited circumstances, at cost or amortized cost. On January 1, 2007, The Canada Post Group will implement the new accounting requirements and amend its accounting policy for investments. Investments will then be classified as held for trading and measured at fair value, with changes in fair value recorded in net income as they occur. Currently, The Canada Post Group accounts for its investments at cost or amortized cost. Measuring the investments at fair value on January 1, 2007 will not have a material impact on the consolidated financial statements. Any adjustments will be recognized in opening retained earnings. Prior years' results will not be restated.

(b) Accounting changes • In July 2006, the CICA revised their standards for accounting changes effective for fiscal years beginning on or after January 1, 2007, although earlier adoption is encouraged. Most significantly, the new standards stipulate that voluntary changes in accounting policy are made only if they result in the consolidated financial statements providing reliable and more relevant information.

4. Regulation of Customer Postage Rates

The Corporation establishes customer postage rates through regulations under the *Canada Post Corporation Act* ("the Act") for domestic Lettermail and international Letter-post items, as well as fees for certain other services such as Registered Mail. These regulations are subject to approval by the Government of Canada, the sole shareholder and, therefore, a related party of the Corporation. The Act permits the Corporation to offer rates that differ from approved rates under certain circumstances, such as when the customer agrees to mail in bulk.

The Act states that regulated postage rates must be fair and reasonable, and consistent so far as possible with providing revenue, together with any revenue from other sources, sufficient to defray the costs incurred by the Corporation in the conduct of its operations under the Act. The domestic basic letter rate prescribed under the *Letter Mail Regulations* is determined by a price-cap formula, which limits increases to 66.67% of increases in the Consumer Price Index, implemented no more than once a year. In January 2006, the domestic Lettermail rate increased by one cent from $0.50 to $0.51 (January 2005 – from $0.49 to $0.50) based on the price-cap formula.

The regulated pricing approval process requires that proposed rate changes be published in the *Canada Gazette* to provide interested persons with 60 days to make representations to the Minister responsible for Canada Post. Subsequently, the final form of the proposed rate changes is approved by the Corporation's Board of Directors and submitted to the Minister responsible for Canada Post for approval by the Government of Canada, specifically the Governor in Council. The rate changes are deemed approved 60 days after submission to the Governor in Council, unless the Governor in Council previously approved or refused to approve the changes.

Under the provisions of the Act, the Corporation is required to provide services free of charge for certain Government mailings and for mailing of materials for the blind. The Government of Canada provides compensation to the Corporation in respect of these services (note 15).

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

5. Segregated Cash and Investments

Cash and investments have been segregated to partially meet the Corporation's obligations for employee termination benefits and other retirement dental and life insurance benefits. The cash and investments have been allocated as follows:

As at December 31 (in millions of dollars)	**2006**	2005
Employee termination benefits	$ 21	$ 83
Other retirement dental and life insurance benefits	469	431
	490	514
Less current portion	21	68
	$ 469	$ 446

Segregated cash and investments for other retirement dental and life insurance benefits relate to the ancillary benefits inherited from the *Federal Public Sector Pension Reform* for which temporary funding is received via the transitional support. Consequently, the Corporation is obligated to limit the use of these funds to the sole purpose for which they have been segregated.

The current portion of segregated cash and investments relates to the scheduled settlement of employee termination benefits.

The weighted average effective rate of return on the segregated investments held as at December 31, 2006 is 3.7% (2005 – 3.6%) for employee termination benefits and 4.2% (2005 – 3.8%) for other retirement dental and life insurance benefits.

The market value of segregated cash and investments as at December 31, 2006 is $21 million (2005 – $83 million) for employee termination benefits and $470 million (2005 – $430 million) for other retirement dental and life insurance benefits.

6. Property, Plant and Equipment

As at December 31 (in millions of dollars)			**2006**	2005
	Cost	**Accumulated amortization**	**Net carrying value**	Net carrying value
Land	$ 198	$ –	$ 198	$ 237
Buildings	1,641	935	706	652
Leasehold improvements	164	115	49	44
Plant equipment	757	590	167	163
Vehicles	211	115	96	85
Sales counters, office furniture and equipment and software	800	657	143	182
Office equipment and software under capital lease	–	–	–	11
Other equipment	687	420	267	242
Assets under development	86	–	86	55
	$ 4,544	**$ 2,832**	**$ 1,712**	$ 1,671

Amortization expense relating to property, plant and equipment was $212 million (2005 – $213 million).

7. Pension, Other Retirement and Post-Employment Benefit Plans

The Corporation has a number of funded and unfunded defined benefit plans that provide pension, other retirement and post-employment benefits for most of its employees. Unfunded plans are plans where benefits are paid directly by the Corporation. With funded plans, the Corporation transfers funds to external trusts and the benefits are paid directly from these external trusts. The Corporation's pension plan is a funded plan based on length of pensionable service, the average of the best five consecutive years of pensionable salary and retirement age. The plan provides for retirement pension, survivor's pension or a refund after termination of employment or death. Pension benefits that are not permissible in the registered pension plan are provided by the retirement compensation arrangement, as defined under the *Income Tax Act*. Pension benefits in pay are indexed annually. Both the Corporation's contributions and the employees' contributions to the external trusts are made in accordance with the plan document.

Other retirement benefit plans include unfunded health care and dental and life insurance plans. The benefit costs covered by the Corporation and the costs assumed by the retirees, relative to these plans, are determined in accordance with the plans' rules and the provisions of labour contracts. The post-employment benefit plans include unfunded employee termination benefit, health and dental coverage for employees receiving long-term disability benefits, as well as unfunded workers' compensation benefits for employees injured on the job. Workers' compensation benefits are provided in accordance with the applicable provincial workers' compensation legislation while the benefit entitlements in the three Territories are based on the Alberta legislation. The benefit costs covered by the Corporation and the costs assumed by the employees on long-term disability are determined in accordance with the plan's rules and the provisions of labour contracts.

The Corporation's employee termination benefit plan was previously based on an employee's basic salary as of the date of termination of employment and the number of completed years of continuous employment, up to a maximum number of years. However, since 2003 the Corporation has progressively curtailed this plan for all of its employees. The curtailment of the plan froze the employees' entitlement based on the accumulation of years of service as of the curtailment date, and further benefit entitlements based on years of service was discontinued. On curtailment, employees were given the option of settlement by receiving the cash value of their accrued termination benefit or the option of deferring receipt of their benefit until departure, at which time the benefit would reflect their salary at retirement or their salary at the curtailment date if they resign or are terminated. Most employees chose the option of settlement and by December 31, 2006 all settlements have been completed, except for Canadian Postmasters and Assistants Association (CPAA) members whose settlement is scheduled for 2007. For 2006, a settlement loss of $6 million was recognized (2005 – settlement loss of $2 million and curtailment loss of $8 million).

Purolator has a number of funded defined benefit pension plans. The defined benefit plans are based either on length of pensionable service and salary paid each year or on negotiated benefit rates, depending on the type of employees. Since these defined benefit plans are subject to the maximum pension payable under the *Income Tax Act*, a supplementary pension plan, based on length of pensionable service and final average salary, is offered to designated employees. Purolator also provides pension benefits to eligible employees through a defined contribution plan. Plan members are not required nor permitted to contribute to any of the pension plans.

CPIL's subsidiary participates in a multiemployer defined benefit pension plan. According to the concession agreement (described in note 12 (c)), the Government of the Netherlands Antilles is responsible for all pension benefits accrued prior to May 2003.

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Certain employees of Progistix presently belong to a pension plan sponsored by Progistix' former owner, Bell Canada. The BCE Inc. Pension Plan is a non-contributory, defined benefit pension plan that provides for benefits based on length of pensionable service and final average salary. Pension benefits in pay are indexed annually. The assets of the pension plan are invested in units of the BCE Master Trust Fund with Royal Trust acting as custodian/trustee. In accordance with the terms of the Share Purchase Agreement between Bell Canada and the Corporation, the employees of Progistix will commence participation in a new, separate pension plan. The pension plan assets and liabilities for pensions and related benefits accrued at the date of change of ownership will be transferred to the new pension plan on completion of the related actuarial valuations, pending regulatory approval. The amounts of assets and liabilities included in these consolidated financial statements represent current estimates of the amounts to be transferred to the new Pension Plan, adjusted for all activity subsequent to the change of ownership. The estimate of the transfer amount relating to plan assets does not include the effect of certain events related to the BCE Inc. Pension Plan that occurred prior to the purchase of Progistix by the Corporation, however, the estimate was revised in 2005 based on new information provided by BCE Corporate Services. The amounts to be transferred into the new, separate Pension Plan can only be transferred once regulatory approval has been obtained. In 2005, a supplementary pension plan was created for designated employees to replace the current plan, whereby employees that reach the maximum pension payable from the registered plan would receive the excess pension payable by Progistix. The results for this plan are included with those of the regular plan. After the acquisition, a defined contribution provision was added to Progistix' pension plan. The membership of the defined contribution plan consisted of employees of Progistix' subsidiary, as well as Progistix' management and administrative employees.

The other retirement benefit plans pertaining to Progistix' employees consist of medical and dental benefits, and life insurance after retirement. Progistix pays the full cost of these benefits, except for the dental plan which is paid 100% by the retirees who choose this coverage.

Innovapost has a funded defined benefit pension plan. Like the Corporation, pension benefits that are not permissible in the registered pension plan are provided by a retirement compensation arrangement. Pension benefits, based on length of pensionable service and average pensionable salary, are indexed according to the annual increase in the consumer price index. Employer and employees' contributions are made in accordance with the plan. After October 31, 2002, no new members are eligible to join Innovapost's pension plan.

The accrued benefit obligations and the fair value of plan assets are measured for accounting purposes as at December 31 of each year.

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

A reconciliation of the defined benefit plan obligations, defined benefit plan assets and the funded status of the benefit plans to the amounts recorded in the consolidated balance sheet follows:

Year ended December 31 (in millions of dollars)	**2006**		2005	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations				
Balance, beginning of year	$ 13,079	$ 3,260	$ 11,037	$ 2,641
Current service cost	625	110	534	92
Interest cost	677	165	672	158
Benefits paid	(259)	(130)	(214)	(117)
Actuarial (gains) losses	(402)	(63)	1,048	491
Plan amendments	2	(17)	2	(13)
Corporate restructuring giving rise to special termination benefits (note 18)	7	–	–	–
Curtailment	–	–	–	8
Settlement	–	2	–	–
Balance, end of year	13,729	3,327	13,079	3,260
Plan assets				
Fair value, beginning of year	12,675	–	10,717	–
Revised estimated amount of surplus transfer from BCE Inc.	–	–	13	–
Actual return on plan assets	1,792	–	1,440	–
Employer regular contributions	255	–	267	–
Employer special solvency contributions	304	–	307	–
Employee contributions	161	–	145	–
Benefits paid	(259)	–	(214)	–
Fair value, end of year	14,928	–	12,675	–
Funded status of plans – surplus (deficit)	1,199	(3,327)	(404)	(3,260)
Unamortized net actuarial (gain) loss	(64)	1,139	1,354	1,293
Unamortized past service costs	17	(86)	17	(82)
Unamortized transitional obligation	–	7	–	11
Unamortized funding excess	(153)	–	(185)	–
Accrued benefit asset (liability) – defined benefit	999	(2,267)	782	(2,038)
Accrued benefit liability – defined contribution	(1)	–	(1)	–
Accrued benefit asset (liability)	**$ 998**	**$ (2,267)**	$ 781	$ (2,038)
Presented in the consolidated balance sheet as:				
Accrued pension benefit asset	$ 1,010	$ –	$ 784	$ –
Current portion of accrued post-employment benefit liability	–	(32)	–	(68)
Accrued pension, other retirement and post-employment benefit liability	(12)	(2,235)	(3)	(1,970)
	$ 998	**$ (2,267)**	$ 781	$ (2,038)

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

Included in the above accrued benefit obligations and fair value of plan assets at year end are the following amounts with respect to plans that are in a deficit position:

As at December 31 (in millions of dollars)	**2006**		2005	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations	$ 331	$ 3,327	$ 12,946	$ 3,260
Fair value of plan assets	273	–	12,430	–
Funded status – plan deficit	**$ (58)**	**$ (3,327)**	$ (516)	$ (3,260)

The financial position of Canada Post Corporation's pension plan changed from a deficit as at December 31, 2005 to a surplus as at December 31, 2006.

The fair value of total pension plan assets consists of:

As at December 31	**2006**	2005
Equity securities	**66 %**	64 %
Debt securities	**27 %**	28 %
Real estate	**1 %**	1 %
Other	**6 %**	7 %
	100 %	100 %

Included in the fair value of total pension plan assets are $2,146 million (2005 – $1,985 million) of securities issued by the Government of Canada, its agencies and other Crown corporations, as well as $121 million (2005 – $125 million) of refundable taxes held by Canada Revenue Agency.

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

The elements of employee future benefit costs recognized in the year are as follows:

Year ended December 31 (in millions of dollars)			**2006**			2005
	Incurred in year	**Adjustments***	**Recognized in year**	Incurred in year	Adjustments*	Recognized in year
Pension benefit plans						
Current service cost, net of employee contributions	$ 464	$ –	$ 464	$ 399	$ –	$ 399
Interest cost	677	–	677	672	–	672
Return on plan assets	(1,792)	948	(844)	(1,440)	686	(754)
Actuarial (gains) losses on accrued benefit obligations	(402)	470	68	1,048	(1,046)	2
Plan amendments	2	–	2	2	(1)	1
Special termination benefits	7	–	7	–	–	–
Amortization of funding excess	–	(32)	(32)	–	(31)	(31)
Defined benefit costs	(1,044)	1,386	342	681	(392)	289
Defined contribution costs	1	–	1	1	–	1
Multiemployer defined benefit costs	1	–	1	1	–	1
Total pension benefit costs	(1,042)	1,386	344	683	(392)	291
Transitional support from the Government of Canada	(120)	–	(120)	(177)	–	(177)
Net pension benefit costs	**$ (1,162)**	**$ 1,386**	**$ 224**	$ 506	$ (392)	$ 114
Other benefit plans						
Current service cost	$ 110	$ –	$ 110	$ 92	$ –	$ 92
Interest cost	165	–	165	158	–	158
Actuarial (gains) losses on accrued benefit obligations	(63)	150	87	491	(431)	60
Plan amendments	(17)	4	(13)	(13)	3	(10)
Curtailment loss	–	–	–	8	–	8
Settlement loss	6	–	6	2	–	2
Amortization of transitional obligation	–	4	4	–	3	3
Defined benefit costs	201	158	359	738	(425)	313
Transitional support from the Government of Canada	(41)	–	(41)	(32)	–	(32)
Net other benefit costs	**$ 160**	**$ 158**	**$ 318**	$ 706	$ (425)	$ 281

* Adjustments to allocate costs to different years so as to recognize the long-term nature of employee future benefits.

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

The significant assumptions used in measuring the defined benefit plans are as follows:

As at December 31	**2006**		2005	
	Pension benefit plans	**Other benefit plans**	Pension benefit plans	Other benefit plans
Accrued benefit obligations:				
Discount rate	5.0% to 5.3%	4.7% to 5.3%	5.0% to 5.3%	4.6% to 5.1%
Long-term rate of compensation increase	3.0% to 4.0%	3.0%	3.0% to 4.0%	3.0%
Benefit costs:				
Discount rate	5.0% to 5.3%	4.6% to 5.3%	6.0% to 6.3%	4.5% to 6.3%
Expected long-term rate of return on plan assets	6.5% to 7.5%	N/A	4.5% to 7.5%	N/A
Long-term rate of compensation increase	3.0% to 4.0%	3.0%	3.5% to 4.0%	3.5%
Assumed health care cost trend rates:				
Initial health care cost trend rate	N/A	7.1% to 8.9%	N/A	7.1% to 8.8%
Cost trend rate declines to	N/A	4.5% to 5.3%	N/A	4.6% to 5.3%
Year that the rate reaches the rate it is assumed to remain at	N/A	5 to 10 years	N/A	6 to 10 years

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have had the following effects for 2006:

(in millions of dollars)	**Increase**	**Decrease**
Total of service and interest costs	**$ 54**	**$ (41)**
Accrued benefit obligations	**$ 545**	**$ (418)**

Cash payments for pension, other retirement and post-employment benefits are as follows:

Year ended December 31 (in millions of dollars)	**2006**	2005
Benefits paid directly to beneficiaries for unfunded other benefit plans	$ 130	$ 117
Employer regular contributions to funded pension plans	255	267
Employer special solvency contributions to funded pension plans	304	307
Total cash payments for defined benefit plans	689	691
Contributions to defined contribution plans	1	1
Contributions to multiemployer defined benefit plan	1	1
Total cash payments	**$ 691**	$ 693

7. Pension, Other Retirement and Post-Employment Benefit Plans (continued)

The Canada Post Group's funding policy for its defined benefit pension plans complies with regulatory authorities' requirements and is determined by actuarial valuation conducted at least on a triennial basis and annually when a solvency shortfall has occurred. A solvency shortfall normally must be eliminated by special payments over a period not exceeding five years. However, in November 2006 the Government of Canada issued new *Solvency Funding Relief Regulations* to provide temporary funding relief for federally regulated defined benefit pension plans. Under the new Regulations, the solvency funding requirements will be based on amortizing the solvency shortfall evenly over 10 years. The Corporation decided to apply these Regulations and filed an amended actuarial valuation as at December 31, 2005. Since the special payments made on an interim basis were greater than the required payments in the amended actuarial valuation, the Corporation did not make its last payment.

The most recent actuarial valuation of the defined benefit pension plans for funding purposes and the next required valuation are as of the following dates:

	Most recent actuarial valuation for funding purposes	**Next required actuarial valuation for funding purposes**
Canada Post Corporation	December 31, 2005	December 31, 2006
Purolator	December 31, 2005	December 31, 2006
Progistix	December 31, 2003	December 31, 2006
Innovapost	December 31, 2004	December 31, 2007

On a solvency basis, the values of the pension plans' assets and liabilities are related to the corresponding values calculated as though the pension plans were wound up and settled on the valuation date. Since the Corporation is expecting its pension plan to have a solvency surplus as at December 31, 2006, the special solvency payments for the consolidated pension plans of The Canada Post Group are estimated to amount to $13 million in 2007.

8. Income Taxes

The sources of the temporary differences giving rise to net future income tax assets (liabilities) are as follows:

As at December 31 (in millions of dollars)	**2006**	2005
Net future income tax assets		
Property, plant and equipment	$ 30	$ 26
Accounts payable and accrued liabilities	9	8
Salaries and benefits payable	20	11
Obligation under capital lease	–	7
Accrued pension, other retirement and post-employment benefits	84	56
Recognition of losses carryforward	28	–
Other	8	6
Net future income tax assets	**$ 179**	$ 114
Presented in the consolidated balance sheet as:		
Future income tax assets:		
Current	$ 63	$ 45
Long-term	135	93
	198	138
Future income tax liabilities:		
Current	–	(3)
Long-term	(19)	(21)
Net future income tax assets	**$ 179**	$ 114

Deductible temporary differences for which no future income tax assets have been recognized amount to $772 million (2005 – $1,096 million) and relate mainly to the accrued other retirement and post-employment benefit liability. These differences are not expected to reverse in the foreseeable future.

The major components of the income tax expense (benefit) are as follows:

Year ended December 31 (in millions of dollars)	**2006**	2005
Current income tax expense	$ 109	$ 36
Future income tax expense (benefit) relating to:		
Origination and reversal of temporary differences	(50)	68
Previously unrecognized difference in post-employment benefits	–	(24)
Previously unrecognized losses carryforward	(22)	–
Reduction in tax rate	7	–
Income tax expense	**$ 44**	$ 80

8. Income Taxes (continued)

A reconciliation of the income tax expense (benefit), related to income before income taxes, to the amount of income tax using the statutory rate follows:

Year ended December 31 (in millions of dollars)	2006	2005
Income before income taxes	$ 166	$ 282
Federal tax at the applicable tax rate	$ 47	$ 103
Provincial tax	11	13
Large corporation tax	–	4
(Increase) decrease in future income taxes resulting from:		
Previously unrecognized difference in post-employment benefits	–	(24)
Previously unrecognized losses carryforward	(22)	–
Reduction in tax rate	7	–
Other	1	(16)
Income tax expense	**$ 44**	$ 80

9. Other Assets

As at December 31 (in millions of dollars)	2006	2005
Goodwill	$ 123	$ 123
Assets held for sale	48	–
Intangible assets, net of accumulated amortization and impairment of $20 million (2005 – $17 million)	10	13
Other	8	8
	$ 189	$ 144

The Corporation has classified two properties as held for sale. Negotiations for the sale of each of these properties are underway with prospective buyers. It is anticipated that the carrying amounts of each property, of $10 million and $38 million, will be fully recovered through the respective sale proceeds.

Amortization expense relating to intangible assets and other assets was $3 million (2005 – $10 million, including a $4 million impairment charge related to a customer contract under renegotiation).

The changes in the carrying amount of goodwill are as follows:

Year ended December 31 (in millions of dollars)	2006				2005
	Canada Post segment	Purolator segment	All other segments	Total	Total
Goodwill, beginning of year	$ –	$ 120	$ 3	$ 123	$ 130
Integration of epost™	3	–	(3)	–	–
Impairment	–	–	–	–	(7)
Goodwill, end of year	**$ 3**	**$ 120**	**$ –**	**$ 123**	$ 123

In 2005, the Corporation recorded a $7 million impairment charge, which represented all the goodwill related to the Logistics segment. Uncertainties arising from the renegotiation of an operating contract with a major customer, on which it is economically dependent, and the ensuing restructuring plan, resulted in a decline in the fair value of the goodwill of this reporting unit.

10. Long-Term Debt

As at December 31 (in millions of dollars)	**2006**	2005
Non-redeemable bonds maturing March 2016, interest at 10.35%	$ 55	$ 55
Notes due to BCE Emergis Inc., plus accrued interest at the Bank of Canada overnight rate plus 1%, maturing in December 2007 and December 2008	6	5
Bank loan that matured in October 2006	–	6
Obligation under capital lease that expired in December 2006	–	10
	61	76
Less current portion	3	16
	$ 58	$ 60

Interest expense on long-term debt was $6 million (2005 – $7 million).

The scheduled long-term debt repayments are as follows:

(in millions of dollars)	
2007	$ 3
2008	3
2016	55
	$ 61

The fair value of the non-redeemable bonds maturing March 2016, based on rates currently available to the Corporation for debt with similar terms and maturity, is $80 million as at December 31, 2006 (2005 – $83 million).

The estimated fair value of the notes approximates their carrying value.

11. Share Capital

The *Canada Post Corporation Act* provides for the establishment of a share capital structure. The Corporation is authorized to issue shares to the Government of Canada based on the net asset value of the Corporation on the date of the first issue of shares, as determined by the Board of Directors, with the approval of the Treasury Board. No such shares have been issued.

12. Commitments and Contingencies

(a) Two complaints have been filed with the Canadian Human Rights Commission ("the Commission") alleging discrimination by the Corporation concerning work of equal value.

One complaint was filed by the Public Service Alliance of Canada ("PSAC") in 1983, retroactive to October 16, 1981, when Canada Post Corporation became a Crown corporation. The hearings of the Canadian Human Rights Tribunal ("the Tribunal") and final argument of the parties were completed in August 2003. The Tribunal rendered its decision on October 7, 2005, concluding that the Corporation had participated in "systemic discrimination" in the setting of wages for a group of PSAC members contrary to Section 11 of the *Canadian Human Rights Act*. This decision cannot be implemented until the wage gap has been determined by the parties, and the Tribunal retained jurisdiction to deal with any issues that may arise in the implementation of its decision on an as needed basis.

The Corporation appealed the decision of the Tribunal to the Federal Court Trial Division on October 7, 2005, claiming that the Tribunal had not only incorrectly applied and interpreted the law, but had also reached its conclusions in the face of substantial evidence that there had been no violation of Section 11 of the *Canadian Human Rights Act*.

On November 18, 2005, PSAC commenced its own appeal in the Federal Court against the decision.

The appeals are scheduled to be heard in the Federal Court Trial Division in November 2007.

Another complaint was filed by the Canadian Postmasters and Assistants Association initially in December 1982, seeking retroactivity to October 16, 1981. In December 1991, the Commission decided not to deal with the complaint. This complaint was refiled in November 1992. The Commission did not fully investigate the complaint. It did attempt to mediate/conciliate a resolution to the complaint without success. On February 28, 2006, the most recent conciliator recommended to the Commission that the Commission decline to deal with the complaint at this time because the complaint is one that could more appropriately be dealt with under the *Canada Labour Code*.

The outcome of these complaints is not currently determinable and as a result no provision has been recorded in the consolidated financial statements. Settlement, if any, arising from resolution of these matters, is presently planned to be recovered in future postal rates (as determined in accordance with the *Canada Post Corporation Act*) and/or from the Government of Canada.

(b) The Corporation and Purolator have made certain commitments that apply upon expiration or termination of certain agreements with Innovapost. These agreements were signed for a 10 year period that commenced in 2002, with an optional renewal period of five years. The Corporation and Purolator have agreed to purchase the assets, used on a dedicated basis at the time of expiration or termination of the agreements, for an amount equal to net book value and shall be required to assume certain obligations related to the purchase of these assets. In addition, on expiration or termination of the agreements, Innovapost shall have the obligation to transfer or assign to the Corporation or Purolator any contract applicable to the services provided to the Corporation or Purolator, respectively; however, should Purolator terminate its agreement for a significant event, as described in the agreement, it has the option to reject the transfer or assignment of these contracts. It is not practicable, at this time, to determine the value of assets used on a dedicated basis, nor the carrying value of the contractual obligations, at the time of expiration or termination of the agreements.

The terms of the agreements provide for no limitation to the maximum potential future payments under the above commitments, and the Corporation and Purolator do not currently possess sufficient information to estimate the maximum potential future liability.

12. Commitments and Contingencies (continued)

(c) CPIL and its subsidiary entered into an agreement with the Government of the Netherlands Antilles to provide postal and postbanking services, to the residents of the five islands that comprise the Netherlands Antilles, for a 20 year period that commenced in May 2003. The assets transferred by the Government of the Netherlands Antilles and the former concession holder to the CPIL subsidiary must be replaced, maintained or kept in good working order, normal wear and tear excepted. At the conclusion of the agreement, all ownership held in the original assets or assets acquired during the term of the agreement will be transferred to the Government of the Netherlands Antilles at no cost, unless otherwise agreed by the parties. It is not possible, at this time, to estimate the potential value of these assets.

(d) In the normal course of business, the Corporation has entered into agreements that include indemnities in favour of third parties. In addition, the Corporation has entered into indemnity agreements with each of its directors and officers to indemnify them, subject to the terms of these agreements, against claims and expenses incurred by them as a result of serving as a director or officer of the Corporation or as a director, officer or in a similar capacity of another entity at the request of the Corporation.

These agreements generally do not contain specified limits on the Corporation's liability and, therefore, it is not possible to estimate the potential future liability under these indemnities. No amounts have been accrued in the consolidated financial statements with respect to these indemnities.

(e) The Corporation is involved in various claims and litigation in the normal course of business for which provisions have been made to the extent determinable.

(f) The Corporation's employees are permitted to accumulate unused sick leave. However, such leave entitlements do not vest and can be used only in the event of illness. The amount of accumulated sick leave entitlements which will become payable in future years cannot reasonably be determined. Payments of sick leave benefits are included in current operations.

(g) The future minimum payments with respect to facilities, transportation equipment and other operating leases with terms in excess of one year, are as follows:

(in millions of dollars)	
2007	$ 133
2008	118
2009	82
2010	61
2011	46
2012 and thereafter	189
	$ 629

Included in the above commitments are leases in the amount of $13 million with a related party, the Government of Canada, for premises used in postal operations.

(h) In the normal course of business, the Corporation enters into contractual arrangements for the supply of goods and services over periods extending beyond one year. Disbursements largely depend on future, volume-related requirements and are subject to the Corporation's contractual rights of termination.

13. Cash Flow Information

Year ended December 31 (in millions of dollars)	2006	2005
Change in non-cash operating working capital		
Increase in accounts receivable	$ (29)	$ (75)
Decrease in income tax recoverable and increase in income tax payable	66	99
Increase (decrease) in accounts payable and accrued liabilities	53	(9)
Increase in salaries and benefits payable	19	18
Increase (decrease) in deferred revenue	37	(3)
Decrease in other non-cash operating working capital items	6	10
	$ 152	$ 40
Supplementary information		
Interest paid	**$ 6**	$ 7
Income tax paid (received)	**$ 45**	$ (67)

14. Significant Joint Venture

The Corporation has a 51% ownership interest in Innovapost, The Canada Post Group's primary information technology service provider. Virtually all of Innovapost's services are provided to The Canada Post Group based on consideration contractually established and agreed to by the related party. Cost of operations included in the consolidated financial statements of the Corporation, includes approximately $276 million (2005 – $283 million) of expenses related to these services. The Corporation's proportionate share of the assets and liabilities of Innovapost at year end is $75 million (2005 – $75 million) and $50 million (2005 – $55 million), respectively.

15. Related Party Transactions

The Corporation had the following transactions with related parties in addition to those disclosed elsewhere in these consolidated financial statements:

(a) **Government of Canada, its agencies and other Crown corporations** • The Government of Canada compensates the Corporation for foregone postage revenue from Government free mail services and mailing of materials for the blind (note 4), as well as for the Food Mail Program, under which services are provided at rates less than cost pursuant to an agreement with the Department of Indian Affairs and Northern Development. Compensation payments on behalf of postal users amounting to $62 million (2005 – $59 million) are included in revenue from operations.

The Corporation has also incurred net operating costs of $1 million (2005 – $2 million) with respect to real property agreements with Public Works and Government Services Canada. These transactions are measured at the exchange amount. In addition, the Corporation has other transactions with the Government of Canada, its agencies and other Crown corporations in the normal course of business at normal commercial prices and terms.

For the year ended December 31, 2006, the amounts of accounts receivable and deferred revenue from these related parties are $19 million (2005 – $35 million) and $5 million (2005 – $4 million), respectively.

(b) **Directors** • In the normal course of business, the Corporation may interact with companies whose directors or officers are directors of the Corporation. The affected directors always recuse themselves from all discussions and decisions related to transactions between the companies. Such a case of company interaction occurred during the year, whereby the Corporation provided $26 million (2005 – $27 million) of services to Davis + Henderson, Limited Partnership, and similarly, in the last four months of the year, $15 million of services were provided to, and $2 million of services were received from, Telus Corporation.

16. Publications Assistance Program

Under the Government of Canada's Publications Assistance Program, the Government and the Corporation subsidize a portion of the distribution costs incurred by eligible publishers of eligible publications using the Corporation's publications mail service. Although subsidy payments payable to eligible publishers vary over the Government's fiscal year, the Government's contribution to the Program was capped at $45 million in its fiscal year 2006/2007 ($45 million in 2005/2006). The Corporation's contribution to the Program was capped at $15 million in 2006/2007 ($15 million in 2005/2006) and is included in cost of operations.

17. Financial Instruments – Other

(a) **Fair values** • The fair value of financial instruments not otherwise disclosed in the consolidated financial statements approximate their carrying values due to their expected short-term settlement. Such financial instruments include accounts receivable, accounts payable and accrued liabilities, salaries and benefits payable and outstanding money orders.

(b) **Concentration of credit risk** • The Corporation does not believe it is subject to any significant concentration of credit risk. Amounts owing from and to each foreign postal administration, other than the United States Postal Service, are offset, according to the terms of the agreements and normal practices providing for such international settlements on a net basis, and are reported as a net receivable or payable in the consolidated balance sheet accordingly. Commencing in 2006, amounts owing to and from the United States Postal Service are not settled on a net basis, according to the terms of the most recent agreement, and, therefore, are no longer offset in the consolidated balance sheet.

18. Segmented Information

The Corporation manages its operations and, accordingly, determines its operating segments on the basis of the legal entities. Three reportable operating segments have been identified: Canada Post, Purolator and Logistics.

The Canada Post segment provides transaction mail, parcels and direct marketing services, as well as other mail products and services. The Purolator segment derives its revenues from specialized courier services. The Logistics segment, made up of Progistix and Intelcom, provides third-party logistics services in supply chain management, as well as same day courier services.

Operating segments below the quantitative thresholds, for determining reportable operating segments, are combined and disclosed in the "all other" category. Their revenues are attributable to information technology services, sale of Canadian postal technology, international postal consulting services and postal/postbanking services in the Netherlands Antilles. EPO Inc. (epost™), which provided web-based electronic mail delivery services, is also included in this "all other" category until October 31, 2006.

The accounting policies of the operating segments are the same as those described in the significant accounting policies (note 2).

Transactions occur between the operating segments at normal commercial prices and terms comparable to those given to other customers and suppliers and without subsidy between the operating segments. On a consolidated basis, no individual external customer's purchases account for more than 10% of total revenues.

Year ended, and as at, December 31, 2006
(in millions of dollars)

	Canada Post	Purolator	Logistics	All other	Elimination of intersegment	The Canada Post Group
Revenue from external customers	$ 5,811	$ 1,310	$ 124	$ 19	$ –	$ 7,264
Intersegment revenue	20	37	10	158	(225)	–
Revenue from operations	$ 5,831	$ 1,347	$ 134	$ 177	$ (225)	$ 7,264
Income (loss) before the undernoted items	$ 253	$ 99	$ 1	$ 8	$ (2)	$ 359
Amortization and impairment	(183)	(27)	(3)	(4)	2	(215)
Investment and other income	35	–	1	2	(9)	29
Interest and other expense	(6)	(3)	–	(4)	2	(11)
Income (loss) by segments	$ 99	$ 69	$ (1)	$ 2	$ (7)	162
Unallocated amounts and adjustments in consolidation						1
Income tax expense						(44)
Net income						$ 119
Assets by segments	$ 4,617	$ 548	$ 82	$ 250	$ (508)	$ 4,989
Unallocated amounts and adjustments in consolidation						(5)
Total assets						$ 4,984
Acquisition of property, plant and equipment	$ 227	$ 73	$ 5	$ 2	$ (2)	$ 305

18. Segmented Information (continued)

Year ended, and as at, December 31, 2005
(in millions of dollars)

	Canada Post	Purolator	Logistics	All other	Elimination of intersegment	The Canada Post Group
Revenue from external customers	$ 5,566	$ 1,224	$ 132	$ 22	$ –	$ 6,944
Intersegment revenue	21	30	11	159	(221)	–
Revenue from operations	$ 5,587	$ 1,254	$ 143	$ 181	$ (221)	$ 6,944
Income (loss) before the undernoted items	$ 401	$ 82	$ 10	$ 2	$ (1)	$ 494
Amortization and impairment	(188)	(23)	(16)	(5)	2	(230)
Investment and other income	44	–	–	1	(15)	30
Interest and other expense	(7)	(2)	(1)	(3)	2	(11)
Income (loss) by segments	$ 250	$ 57	$ (7)	$ (5)	$ (12)	283
Unallocated amounts and adjustments in consolidation						(4)
Income tax expense						(80)
Net income						$ 199
Assets by segments	$ 4,387	$ 474	$ 68	$ 264	$ (584)	$ 4,609
Unallocated amounts and adjustments in consolidation						(5)
Total assets						$ 4,604
Acquisition of property, plant and equipment	$ 143	$ 21	$ 1	$ 2	$ –	$ 167

The Logistics segment incurred costs under a restructuring plan approved in conjunction with the renewal of its operating contract with a major customer on which it is economically dependent.

In 2006, the major customer made payments totalling $15 million to the Logistics segment to assist with the restructuring. As these payments formed part of the overall revenue arrangement with this customer, the amount has been deferred and is being amortized into revenue on a straight-line basis over the 5 year term of the contract.

Restructuring costs of $10 million were recorded in 2006 (2005 – $1 million). These costs include workforce reduction costs of $9 million, mostly consisting of special termination benefits, and facility consolidation costs of $1 million. These restructuring activities are expected to be completed in 2007.

19. Subsequent Event

On March 28, 2007, the Corporation declared a dividend of $48 million payable to the Government of Canada on May 17, 2007.

HISTORICAL FINANCIAL INFORMATION

(in millions of dollars)	**2006**	2005	2004	2003	2002
OPERATIONS					
Revenue from operations	**7,264**	6,944	6,651	6,344	6,154
Cost of operations	**7,116**	6,681	6,413	6,162	5,998
Income from operations	**148**	263	238	182	156
Per cent of revenue from operations	**2.0 %**	3.8 %	3.6 %	2.9 %	2.5 %
Non-operating income (expense)	**18**	19	3	2	(29)
Income before income taxes	**166**	282	241	184	127
Income tax expense (benefit)	**44**	80	93	(69)	56
Net income before non-controlling interest	**122**	202	148	253	71
Non-controlling interest in net income of subsidiaires	**3**	3	1	–	–
Reported net income	**119**	199	147	253	71
Return on equity of Canada *	**8.4 %**	15.0 %	12.1 %	10.5 %	7.9 %
Add back: Amortization of goodwill	**–**	–	–	–	10
Adjusted net income	**119**	199	147	253	81
BALANCE SHEET					
Assets					
Current	**1,469**	1,466	1,287	1,742	1,138
Segregated cash and investments	**469**	446	505	443	835
Property, plant and equipment	**1,712**	1,671	1,721	1,733	1,687
Accrued pension benefit asset	**1,010**	784	497	374	128
Other	**324**	237	304	266	314
	4,984	4,604	4,314	4,558	4,102
Liabilities and equity of Canada					
Current	**1,170**	1,102	1,092	1,596	1,171
Accrued pension, other retirement and post-employment benefit liability	**2,247**	1,973	1,818	1,637	1,845
Other liabilities	**115**	119	137	143	149
Non-controlling interest	**19**	16	13	12	2
Equity of Canada	**1,433**	1,394	1,254	1,170	935
	4,984	4,604	4,314	4,558	4,102
ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT					
Land and buildings	**65**	42	48	71	229
Operating equipment	**163**	99	134	91	68
Office and other equipment	**77**	26	40	89	42
Office and other equipment under capital leases	**–**	–	–	–	60
	305	167	222	251	399

* For 2003, the return on equity of Canada has been adjusted to take into consideration the income tax benefit of $142 million resulting from the curtailment of the employee termination benefit plan.

HISTORICAL FINANCIAL INFORMATION

	2006	% Change	2005**	% Change	2004	% Change	2003
OPERATING DIMENSIONS							
REVENUE FROM OPERATIONS BY LINE OF BUSINESS * (in millions of dollars / trading day adjusted per cent)							
Transaction mail							
Domestic mail/mail to foreign postal administrations	**3,092**	**3.5 %**	2,987	3.2 %	2,919	2.7 %	2,830
Mail from foreign postal administrations***	**114**	**(4.1) %**	119	(9.2) %	132	(9.8) %	146
Canada Post segment	**3,206**	**3.2 %**	3,106	2.6 %	3,051	2.1 %	2,976
All other segments	**4**	**(1.9) %**	4	73.6 %	3	9.3 %	2
Elimination of intersegment	**(6)**		(5)		(7)		(7)
The Canada Post Group	**3,204**	**3.2 %**	3,105	2.8 %	3,047	2.1 %	2,971
Parcels							
Domestic mail/mail to foreign postal administrations	**1,053**	**(1.0) %**	1,063	7.8 %	994	6.7 %	929
Mail from foreign postal administrations***	**134**	**33.0 %**	101	45.7 %	70	11.7 %	62
Canada Post segment	**1,187**	**1.9 %**	1,164	10.3 %	1,064	7.0 %	991
Purolator segment	**1,347**	**7.4 %**	1,254	9.3 %	1,156	6.7 %	1,079
Logistics segment	**134**	**(6.1) %**	143	5.0 %	137	10.6 %	124
Elimination of intersegment	**(61)**		(56)		(42)		(37)
The Canada Post Group	**2,607**	**4.0 %**	2,505	9.1 %	2,315	7.0 %	2,157
Direct marketing							
Addressed Admail	**583**	**9.9 %**	530	4.1 %	513	3.9 %	492
Unaddressed Admail	**339**	**14.4 %**	297	11.4 %	269	9.2 %	245
Publications	**275**	**4.3 %**	263	5.3 %	252	6.7 %	235
Other	**110**	**11.3 %**	99	10.6 %	90	4.5 %	86
Canada Post segment	**1,307**	**9.9 %**	1,189	6.6 %	1,124	5.8 %	1,058
All other segments	**–**	**(100.0) %**	2	(64.6) %	5	857.2 %	1
The Canada Post Group	**1,307**	**9.8 %**	1,191	6.3 %	1,129	6.2 %	1,059
Other revenue							
Canada Post segment	**131**	**2.8 %**	128	(9.8) %	143	1.3 %	140
All other segments	**173**	**(1.4) %**	175	(4.5) %	184	(11.4) %	207
Elimination of intersegment	**(158)**		(160)		(167)		(190)
The Canada Post Group	**146**	**2.4 %**	143	(9.9) %	160	1.0 %	157
Revenue from operations							
Canada Post segment	**5,831**	**4.4 %**	5,587	4.7 %	5,382	3.8 %	5,165
Purolator segment	**1,347**	**7.4 %**	1,254	9.3 %	1,156	6.7 %	1,079
Logistics segment	**134**	**(6.1) %**	143	5.0 %	137	10.6 %	124
All other segments	**177**	**(2.3) %**	181	(4.8) %	192	(9.2) %	210
Elimination of intersegment	**(225)**		(221)		(216)		(234)
The Canada Post Group	**7,264**	**4.6 %**	6,944	5.3 %	6,651	4.4 %	6,344

HISTORICAL FINANCIAL INFORMATION

	2006	% Change	2005**	% Change	2004	% Change	2003
OPERATING DIMENSIONS							
VOLUME BY LINE OF BUSINESS * (in millions of pieces / trading day adjusted per cent)							
Transaction mail							
Domestic mail/mail to foreign postal administrations	**5,161**	**0.8 %**	5,122	1.3 %	5,099	0.3 %	5,064
Mail from foreign postal administrations***	**310**	**(6.2) %**	331	6.1 %	314	8.9 %	287
Canada Post segment	**5,471**	**0.3 %**	5,453	1.5 %	5,413	0.7 %	5,351
Elimination of intersegment	**(7)**		(7)		(7)		(6)
The Canada Post Group	**5,464**	**0.3 %**	5,446	1.5 %	5,406	0.7 %	5,345
Parcels							
Domestic mail/mail to foreign postal administrations	**123**	**(8.1) %**	134	(3.3) %	139	(6.4) %	148
Mail from foreign postal administrations***	**51**	**135.4 %**	22	37.7 %	16	17.4 %	14
Canada Post segment	**174**	**12.0 %**	156	0.9 %	155	(4.4) %	162
Purolator segment****	**140**	**0.3 %**	139	4.4 %	134	4.2 %	129
Elimination of intersegment	**(2)**		(2)		(1)		(1)
The Canada Post Group	**312**	**6.4 %**	293	2.4 %	288	(0.7) %	290
Direct marketing							
Addressed Admail	**1,470**	**5.0 %**	1,400	2.1 %	1,383	0.6 %	1,369
Unaddressed Admail	**3,722**	**9.1 %**	3,411	8.1 %	3,180	2.0 %	3,105
Publications	**536**	**0.8 %**	531	(0.8) %	540	(1.5) %	546
Other	**60**	**(7.4) %**	65	(8.2) %	71	10.4 %	64
The Canada Post Group	**5,788**	**7.0 %**	5,407	5.4 %	5,174	1.4 %	5,084
Total volume							
Canada Post segment	**11,433**	**3.8 %**	11,016	3.4 %	10,742	1.0 %	10,597
Purolator segment	**140**	**0.3 %**	139	4.4 %	134	4.2 %	129
Elimination of intersegment	**(9)**		(9)		(8)		(7)
The Canada Post Group	**11,564**	**3.7 %**	11,146	3.4 %	10,868	1.0 %	10,719
EMPLOYMENT							
Full-time employees	**61,064**	**1.1 %**	60,405	(1.6) %	61,409	10.3 %	55,683
Part-time employees	**10,805**	**(2.0) %**	11,028	(3.8) %	11,465	5.5 %	10,867
Total employees	**71,869**	**0.6 %**	71,433	(2.0) %	72,874	9.5 %	66,550
MAIL NETWORK							
Post offices	**6,602**	**(1.8) %**	6,724	(1.0) %	6,795	(0.9) %	6,860
Points of delivery (in thousands)	**14,293**	**1.7 %**	14,053	1.8 %	13,808	1.9 %	13,548
Pick-up points (in thousands)	**1,019**	**0.1 %**	1,018	2.1 %	997	(0.7) %	1,004

* The revenues and volumes have been reclassified to reflect Canada Post's three main lines of business. In 2003, the Corporation implemented and enhanced the methodology that allocates revenues earned from the sale of stamps and postage meter fills. Since this methodology yields different comparatives, the 2002 values are not reported.

** The 2005 Canada Post segment revenues and volumes have been restated to reflect the 2006 change in methodology that now allocates a portion of the sale of commemorative stamps to transaction mail and parcels. The % change from 2004 to 2005 on transaction mail without this change is 2.0% and 1.0% for revenues and volumes respectively (no significant impact on parcels).

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

**** The Purolator volumes have been restated to reflect a change in measurement methodology and source data.