Update to “Review and assessment of An Post’s application for changes to the charges for postal services within the scope of the universal postal service” – September 2012

A REPORT PREPARED FOR COMREG

December 2012

Update to "Review and assessment of An Post's application for changes to the charges for postal services within the scope of the universal postal service" – September 2012

Update to "Review and assessment of An Post's application for changes to the charges for postal services within the scope of the universal postal service" – September 2012

Executive Summary

On 3 February 2012 An Post submitted an application to ComReg for changes to the charges for postal services within the scope of the universal postal service, for items weighing up to 50g. Frontier Economics was commissioned to assist ComReg in determining whether to consent to the proposed price increase. On the 9th of October 2012 ComReg published an Information Notice with respect to An Post's application. Frontier's report was published alongside.

Following the publication of ComReg's Information Notice, An Post submitted an updated price application on the 19th October 2012 reflecting changes to the definition of the USO and updating forecasts to reflect the up to date trading environment. Frontier Economics has been commissioned to review An Post's updated price application and update the analysis contained in the previous report.

As with the first report, the key areas of assessment are as follows.

- An Post's volume and revenue forecasts, and the assumptions made around e-substitution in Ireland;
- Price elasticities in the Irish mail market and the resulting volume and revenue response to An Post's proposed price changes;
- The affordability of An Post's proposed price changes; and
- A review of costs and the cost reflectivity of An Post's proposals.

In carrying out our assessment and review we have taken account of all information provided to us as part of the initial price application and updated price application. This includes all information included in An Post's responses to a number of requests for further information.

An Post's proposals

An Post's revised price application has seen no change to the proposed price increases. It also still sets out a plan to provide discounts to certain customer segments. These include:

- a reduction of the volume threshold for meter customers to avail of discounts (from 350 to 200 items); and
- a discount for the purchase of stamps online, with a minimum order quantity of 300.

The main points to note in relation to the prices themselves, is that the revised price application now reflects the introduction of price increases on products >50g that occurred in May 2012.

An additional change that is reflected in the revised price application is ComReg's updated definition of the USO issued in July 2012. As a result of this update, the only bulk mail universal service products are now Discount 6 and Discount 9.

An Post have also made changes to the terms and conditions of the Discount 6 product to make it available to a wider proportion of customers. All other bulk mail products lie within the scope of the USO but are not universal service products. As such, their VAT status is currently under review. These products made up around 13-15% of total USO volumes and 10-12% of revenues in 2010 and 2011.

Context

Postal operators are facing challenges as they adapt to significant shifts in demand and falling volumes. Historically, there has been a strong link between economic growth and mail volume growth. In the early 2000s, this link started to breakdown as the importance of e-substitution increased. While economic growth remained an important driver of volumes, mail volumes initially grew by less than the economy, and then started to fall in absolute terms.

In consequence, over the last five years, a combination of the European-wide recession and increasing e-substitution by customers, have provided significant operational and financial challenges for operators and regulators. In Ireland, the economic crisis and its depressing impact on economic activity appear to have had a substantial negative impact on mail volumes.

Since 2007, An Post has experienced a year-on-year decline in mail volumes. Between 2007 and 2011, core mail volumes (excluding publicity post and election volumes) declined by 20%[1]. As part of this, domestic volumes declined by around 16%.

This decline in volumes has also impacted on the financial position of the USO. While An Post has implemented a cost reduction programme, the reduction in costs has not offset the decline in revenues associated with the USO.

Looking at the magnitude of the price increases requested by An Post, they appear to be substantially above inflation. Prices last increased in March 2007. Since then, inflation has been relatively modest, with the CPI increasing by 4.5%. If prices had increased in line with inflation over the period, the domestic price today for sending a stamped letter would be 2c higher at 57c. We note, however, it is recognised that per unit costs may increase when volumes decline.

---

1 In An Post's application it states that "[i]n the period from 2008 to 2011 An Post's mail volumes declined by 23.5%", page 6. In its response to Frontier's information request of 25th June 2012 it explains that this figure is based on core mail revenue, stating that '[v]olumes have actually declined by 20%" between 2007 and 2011.

An Post's volume and revenue forecasts

Our review of An Post's revised application finds that:

- The updated application forecasts an increased decline in volumes and revenues over the period. Specifically, An Post's updated forecast predicts a decline in volumes of 20.5% between 2010 and 2014. Revenues are forecast to decline by 16.0% over the same period.
- The forecast volumes and revenues are more closely aligned to recent trends and to international comparators.
- The updated information that An Post has provided on volumes for their top 20 customers, indicates that revenue declines (and therefore e-substitution) may have slowed substantially this year. This is clearly a positive and will hopefully be reflected in the full year-on-year comparisons.
- An Post's estimate of the proportion of volumes switching away from the USO to negotiated access looks optimistic for 2013, but it may reflect a reasonable equilibrium position.
- Looking forward, we recommend that An Post consider whether further improvements to the forecasting methodology could be made by looking at volume growth assumptions on a more disaggregated level.

The impact of An Post's proposals

Our review of An Post's revised application finds as follows.

- The overall impact of the proposed price changes is similar in magnitude between the original and updated price applications. Specifically, An Post's base case is that the price increase will increase the overall volume decline by 1.0 percentage point and reduce the overall revenue decline by 5.4 percentage points.
- As in the original forecast, An Post's baseline price elasticity estimates result in the 'best case' assessment of revenue and volume impacts. Sensitivity analysis shows that higher volume declines and lower revenue impacts may arise, particularly if the own price elasticity for bulk mail is closer to that from the time-series or LA/AIDS regression models. The most pessimistic scenario shows that the price increase will increase the overall volume decline by 4.4 percentage points and reduce the overall revenue decline by 2.5 percentage points.

- An Post estimates that the proposed changes will improve USO losses by €19.2 million in 2014. However, sensitivity analysis around this figure using alternative price elasticity estimates suggests that this improvement could be in the region of €13 million in 2014.

The affordability of An Post's proposals

Our original report found that there is unlikely to be a material affordability issue for residential customers. However, it identified that some business customers were likely to face substantial increases in postal costs. We further found that An Post had not provided evidence to demonstrate that its proposed increases would not give rise to affordability concerns for business customers.

An Post's updated application provides no substantive new evidence of the impact on affordability for business customers.

With respect to SMEs, An Post has argued that the previous application demonstrated that an affordability concern would not arise. They based this finding on:

- the fact that average spend for SMEs is low;
- research commissioned by The Research Perspective Ltd, on behalf of ComReg, which listed reliability as the most important aspect of postal services that drives satisfaction amongst organisations;
- price elasticity of demand estimates from Indecon;
- the fact that ComReg will be undertaking a public consultation, which may identify any serious affordability concerns for this group.

We note one additional potentially important proposal. This is that the terms and conditions for the Discount 6 product have been changed and in particular the volume threshold has been lowered substantially. The result is that some SMEs with relatively large volumes may be able to switch to this product.

Overall, however, our conclusions remain largely unchanged from our first report. The affordability impact for SMEs is not clear-cut. The majority of meter customers (97%) are likely to face an average annual increase in postage costs of around [redacted] per year. For a small proportion of customers, annual postage costs could increase more substantially (depending on the take up of the Discount 6 product).

Given An Post are not currently proposing to launch a DSA product, there may be some affordability issues for large customers. We note An Post's intention to enter individual negotiations with some large customers and other postal providers. However, a substantial number of An Post's large customers will face a price increase as a result of the current proposals.

The proposed increase in discount 6 is 10%. This implies, for example an average increase[2] of c.a. [redacted] for AP's largest 20 customers, and [redacted] for its largest. Given that these customers are potentially most at risk of substituting away either from the USO or postal services more generally (e-substitution) we suggest that careful consideration must be given to the impact of the proposed Discount 6 price increase. As the use of discount 6 by SMEs may ameliorate the impact of an increase in metered mail, this provides further cause for careful consideration to be given to the Discount 6 increase.

The cost reflectivity of An Post's proposals

An Post's revised application has included unit cost information per price point from An Post for stamp, meter, discount 6 and outbound products. This has enabled us to update the original analysis and extend it to international outbound products. Overall, our conclusions on cost reflectivity have not changed. An Post's proposed price changes improve cost reflectivity for most products, although there are some instances where cost reflectivity worsens.

Following the price increases, losses on stamp and meter products are reduced for letters, flats and packets. However, profit margins increase from an already high base for discount 6 flats, and international outbound packets.[3]

Relative to stamps (letters), the discount proposed by An Post for metered mail is greater than the discount offered for bulk stamp purchases despite the fact that revenue collection costs are similar. An Post has recently informed[4] us that flats and packets do not have sortation savings benefits due to payment method in the same way that letters have.

2 Calculations use current volumes and assume a 10% price increase across all bulk volumes

3 Volumes for these services are small

4 Letter to George Merrigan, 29 November 2012

1 Introduction

Earlier this year An Post submitted an application to ComReg for changes to the charges for postal services within the scope of the universal postal service, for items weighing up to 50g. Frontier Economics was commissioned to assist ComReg in determining whether to consent to the proposed price increase. On the 9th of October 2012 ComReg published an Information Notice with respect to An Post's application. Frontier's report was published alongside.

Following the publication of ComReg's Information Notice, An Post submitted an updated price application on the 19th October 2012. Frontier Economics has been commissioned to review An Post's revised price application and update the analysis contained in the previous report.

The key areas of assessment are as follows.

1. An Post's forecast volumes for no changes in charges and for the proposed changes in charges.
2. Whether An Post's proposed changes to its charges for postal services within the scope of the universal postal service are affordable.
3. The allocation of costs by An Post to postal services within the scope of the universal postal service, in order to assess whether its proposed changes to its charges are cost-reflective, and that its unit revenues and unit costs are aligned.
4. Whether the proposed changes to the charges for postal services within the scope of the universal postal service are transparent and non-discriminatory.

In order to conduct the updated review, we have taken account of all information provided to us as part of the initial price application and updated price application. This includes all information included in An Post's responses to a number of requests for further information.

This update to our previous report is structured as follows:

- section 2 provides the background to the revised price application and relevant changes to the mail market context since the original price application was submitted;
- section 3 reviews An Post's revised volume and revenue forecasts, including an updated assessment of the potential impact of e-substitution on An Post's forecast volumes;
- section 4 evaluates An Post's estimate of the revised volume and revenue responses to the proposed price changes;

- section 5 provides an updated assessment of the affordability impact of An Post's proposed price changes; and
- section 6 provides an updated review of the cost reflectiveness of the proposed changes.

2 Background

In this section we:

- provide a summary of the key findings from our October 2012 report; provide a brief overview of An Post's updated application;
- summarise any changes that should be noted in relation to the mail market context since our initial report was written; and
- highlight the key areas for review in this addendum.

2.1 Summary of Frontier's previous findings

Our October 2012 report highlighted a number of issues which ComReg should be mindful of as it considered whether to allow An Post's proposed price increase.

- An Post presented an optimistic forecast of volume and revenue trends to 2014. Our analysis suggested that volume declines to 2014 might be substantially higher than those estimated by An Post:
  - An Post's forecast volume decline was small compared to trends in the last few years. We had seen no evidence to suggest that the rate of volume decline was decreasing;
  - An Post was proposing the introduction of a Downstream Access (DSA) product, and was assuming that there would be a very substantial uptake of that service; and
  - an assessment of data for An Post's largest customers suggested e-substitution may not be as advanced in Ireland as in other jurisdictions.
- An Post's assessment of the impact of the proposed price increases also appeared likely to be optimistic, as it was based on the lowest estimates of price elasticity (from a range identified by analysis commissioned by An Post). Our sensitivity analysis suggested that the proposed price increases may have had a greater impact on volume declines and a less positive impact on revenues. In particular, our analysis found that, in a worst case scenario, An Post's proposed price increase might have resulted in a net revenue impact of 3.6% in 2014, while volume declines might be accelerated by as much as 3.2 percentage points.
- The revenue position could have been eroded further given that An Post's impact analysis assumed a high take up of its proposed DSA product. If the proposed DSA product take up had turned out to be lower, this might have

resulted in a further acceleration of volume declines, and could potentially have accelerated e-substitution.

- An Post indicated that its forward looking cost elasticity is low, at 0.2. This means that if the proposed price increase had a higher impact on volume declines than was anticipated there was relatively limited flexibility for costs to adjust to offset the impact. In consequence, the risk to the financial position of the USO associated with an unanticipated high impact of the proposed price increases was substantial.

- In terms of affordability, An Post's proposals were unlikely to give rise to affordability issues for Residential customers. For SMEs the evidence was less clear-cut. If they were to maintain their current mail volumes, the majority of SMEs (97%) would have faced an average annual increase in postage costs of [redacted] per year. However, for a small proportion of meter customers, annual postage costs may have increased by more than [redacted] per year. For large customers, it was less clear that they would have availed of An Post's DSA product. For customers that did not avail of the DSA product and maintained their current volume of mail, the increase in postage costs could have been substantial. For example, the 27 largest customers would have faced an average postage cost increase of in excess of [redacted] and An Post's largest customer would have faced an increase of ove[redacted] n postage costs per annum.

- An Post's proposed price changes appeared to improve cost reflectivity. In relation to the non-discrimination review, further information in relation to the costs avoided was required from An Post in order to support the proposed discounts.

2.2 An Post's updated price application

This section looks at three main areas in relation to the updated price application:

- proposed price changes;
- the update to the definition of the USO; and
- other price initiatives proposed by An Post.

2.2.1 Proposed price changes

The price changes that were previously proposed by An Post remain the same in the updated price application. Figures 1 and 2 provide a recap of the main domestic and international tariff increases proposed by An Post.

Figure 1. Main domestic tariff increases proposed by An Post

	Letters tariffs (€s)			Flats tariffs (€s)			Packets tariffs (€s)		
	Current	Proposed	% increase	Current	Proposed	% increase	Current	Proposed	% increase
Stamped	0.55	0.65	18.2%	0.95	1.05	10.5%	2.2	2.4	9.1%
Metered	0.54	0.60	11.1%	0.95	1.05	10.5%	2.2	2.4	9.1%
Bulk (Fully Paid)	0.54	0.60	11.1%	0.95	1.05	10.5%	2.2	2.4	9.1%
Bulk Discount 6	0.41	0.45	9.8%	0.76	0.84	10.5%			
Bulk Discount 9	0.44	0.48	9.1%	0.82	0.9	9.8%	2.0	2.19	9.5%

Source: Appendix 1 of An Post's updated price application

Figure 2. Main international tariff increases proposed by An Post

	Letters tariffs (€s)			Large envelopes tariffs (€s)			Packets tariffs (€s)		
	Current	Proposed	% increase	Current	Proposed	% increase	Current	Proposed	% increase
Zone 2 - Great Britain	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%
Zone 3 - Europe	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%
Zone 4 - Rest of World	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%

Source: Appendix 1 of An Post's price application

An Post's updated price application also takes into account the fact that the price increases on >50g USO products were introduced in May 2012.

2.2.2 Update to the definition of the USO

The updated application reflects ComReg's updated definition of the USO issued in July 2012. In ComReg 12/81 "Postal Regulatory Framework, Implementation of the Communications Regulation (Postal Services) Act 2011" ComReg set out the services to be provided by An Post with respect to the USO.

ComReg has decided to include two bulk mail services in the definition of the USO:

- 'delivery only' for mail sorted by delivery office; and
- 'deferred delivery'.

ComReg has also specified separate Registered and Insured services as universal postal services.

An Post has included Discount 9 as the 'delivery only' USO bulk mail product and Discount 6 as the 'deferred delivery' USO bulk mail product. In addition, An Post has made changes to the terms and conditions of Discount 6 to allow a wider customer base to avail of this product. In particular, these changes mean that this product is now:

- accepted at 43 acceptance points and delivered D+2, rather than D+3 if accepted at any point other than the mail centre; and
- available to meter customers posting 200 or more items in one delivery, and ceadunas customers posting 2,000 or more items.

This means that SME customers with moderate volumes may well now be able to avail of this service.

An Post's existing registered service will also now only entail a 'proof of delivery' facility and insurance will be available on standard services.

The updated application recognises that services specified in the 2012 Regulations as Universal Services, which are provided by An Post as the USP, are exempt from VAT. Services provided by An Post within the scope of the universal service are currently treated as VAT exempt. However, we understand that this is under review at present.

Although the changes to the definition of the USO affect 10 bulk mail products (two of which An Post are proposing to withdraw – discount 2 and discount 8), they only made up around 13-15% of total USO volumes and 10-12% of revenues in 2010 and 2011. Figure 3 below illustrates the breakdown of non-USO Ceadunas products as a proportion of total discounted Ceadunas products and non-USO Ceadunas products as a proportion of all products in 2010 and 2011. We can clearly see a differential between letters, flats and packets, with most discounted Ceadunas packet volumes and revenues coming from non-USO products in 2010 and 2011. The opposite can be seen for letters.

Figure 3. Analysis of non-USO Ceadunas products as a proportion of total discounted Ceadunas products and non-USO Ceadunas products as a proportion of all products in 2010 and 2011

	2010							
	Volumes				Revenue			
	Letters	Flats	Packets	All Formats	Letters	Flats	Packets	All Formats
% of total discounted Ceadunas products made up of non-USO volumes and revenue	28%	66%	100%	**28%**	29%	69%	100%	**31%**
% of total volumes made up of non-USO volumes and revenue	14%	7%	1%	**13%**	13%	6%	0%	**10%**

	2011							
	Volumes				Revenue			
	Letters	Flats	Packets	All Formats	Letters	Flats	Packets	All Formats
% of total discounted Ceadunas products made up of non-USO volumes and revenue	29%	72%	99%	**30%**	31%	76%	99%	**32%**
% of total volumes made up of non-USO volumes and revenue	15%	8%	1%	**15%**	14%	8%	1%	**12%**

Source: Frontier analysis of 'App 2 Revenue and Volumes Model 2010-2014'

2.2.3 Other initiatives proposed by An Post

An Post is still proposing to provide discounts to certain customer segments. These include:

- a reduction of the volume threshold for meter customers to avail of discounts (from 350 to 200 items);
- changes to the terms and conditions of the Discount 6 product, to make it available to a wider proportion of customers; and
- a discount for the purchase of bulk stamps online, with a minimum order quantity of 300.

2.3 Mail market context

In our original report we considered the extent to which the price increases requested by An Post were in line with, or above, inflation. Below we update this analysis. In particular, we assess how current prices would look if they had been CPI linked since their introduction in March 2007.

Table 1 illustrates what An Post's headline domestic prices would currently be if they had been linked to CPI. The domestic price for sending a stamped letter would be 2c higher at 57c. This compares to An Post's proposed tariff for the same product of 65c. We note, however, it is recognised that volume declines may have the impact of increasing per unit costs.

Table 1. Illustrative current headline prices if linked to CPI

	Letters tariffs (€s)		Flats tariffs (€s)		Packets tariffs (€s)	
	Actual	CPI linked	Actual	CPI linked	Actual	CPI linked
Stamped	0.55	0.57	0.95	0.99	2.20	2.30
Metered	0.54	0.56	0.95	0.99	2.20	2.30
Bulk (Fully Paid)	0.54	0.56	0.95	0.99	2.20	2.30
Bulk Discount 6	0.41	0.43	0.76	0.79		

Source: Frontier analysis - An Post current price data, Irish monthly CPI data (CSO)

3 Forecast volumes, revenues and e-substitution

In our previous report, we reviewed An Post's forecast revenues and volumes to 2014. Our assessment was that An Post's forecast appeared optimistic and there was a very substantial risk that, even before consideration is given to the impact of a price increase, volume declines would be significantly higher than those forecast by An Post.

We recommended that An Post should consider carefully whether there were improvements that could be made to both its forecasting methodology and its baseline forecast, in order to provide ComReg with a robust baseline forecast against which it can assess the sustainability of the USO and the impact of An Post's proposed price changes.

As part of the revised price application, An Post has submitted revised forecasts to 2014. Below we discuss four key issues contained in An Post's revised application:

- updated volume growth assumptions;
- the resulting volume and revenue forecasts and how these differ from the initial application;
- 2011-2012 volume information for An Post's top 20 customers and the implication of this for e-substitution; and
- An Post's decision not to launch the proposed DSA product at present.

3.1 Updated volume growth assumptions

An Post's updated revenue and volumes model includes actual values for volume growth in 2011, along with updated growth estimates for 2012. In addition, An Post has updated their volume growth assumptions for 2013 onwards.

3.1.1 Volume growth assumptions

Figure 4 below illustrates how these have changed. Differential rates are used for letters, flats and packets, with letter and flats volumes facing a larger decline and packet volumes stabilising. In particular, we see that:

- An Post is forecasting that letters will decline by 5% in 2013 and 2014 (compared to a previous forecast decline of 3%);
- An Post is forecasting that flats will decline by 6% in 2013 and 2014 (compared to a previous forecast decline of 3%); and

- An Post is forecasting that packet volumes will remain flat in 2013 and 2014 (compared to a previous forecast decline of 3% in 2014).

Figure 4. 2012-2014 volume growth assumptions used in An Post's revenue and volumes modelling

Volume growth assumptions – Initial application

	Letter	Flat	Packet	International mail
2011	-7.80%	-7.80%	-4.00%	-4.00%
2012	-5.90%	-5.90%	0%	-4.00%
2013	-3.00%	-3.00%	0%	-3.00%
2014	-3.00%	-3.00%	-3.00%	-3.00%

Volume growth assumptions – Updated application

	2012	2013	2014
Domestic			
Stamp			
- Letter	-4%	-5%	-5%
- Flat	-6%	-6%	-6%
- Packet	0%	0%	0%
Meter			
- Letter	-9%	-5%	-5%
- Flat	-11%	-6%	-6%
- Packet	0%	0%	0%
Bulk			
- Letter	-5%	-5%	-5%
- Flat	-7%	-6%	-6%
- Packet	0%	0%	0%
Parcels	10%	8%	5%
Overall	**-6%**	**-5%**	**-5%**
International Outbound			
Overall	0%	0.5%	0%

Source: An Post's initial and updated price applications

The volume growth assumptions for 2013 onwards now differ by format. However, they still do not differ by product. An Post have noted that they are undertaking further work to increase the granularity of their forecasting methodology.

3.1.2 Source of volume growth assumptions

An Post's derivation of volume growth assumptions for 2013 onwards comes from two sources:

- international benchmarking; and
- business intelligence.

As part of the updated price application, An Post carried out a benchmarking exercise against a range of international postal operators. This included growth rates from a number of other international postal operators' annual reports, such as Deutsche Post and Australia Post, as well as growth rates quoted in the "IPC Global Postal Industry Report 2011". "What is clear is that there are differing rates of decline across Europe and An Post appears to be at the mid-point in this range[5]"

The second source of information that An Post used in coming to the updated volume growth rates for 2013 was business intelligence. In particular, the derivation of the 2013 budget. This budget included analysis of the customer base by the An Post sales team and input by the finance team. An estimated 5% decline in overall USO mail volumes was considered an appropriate target based on the information available.

3.2 Updated volume and revenue forecasts

An Post's updated revenue and volumes model uses these volume growth assumptions. This allows us to forecast:

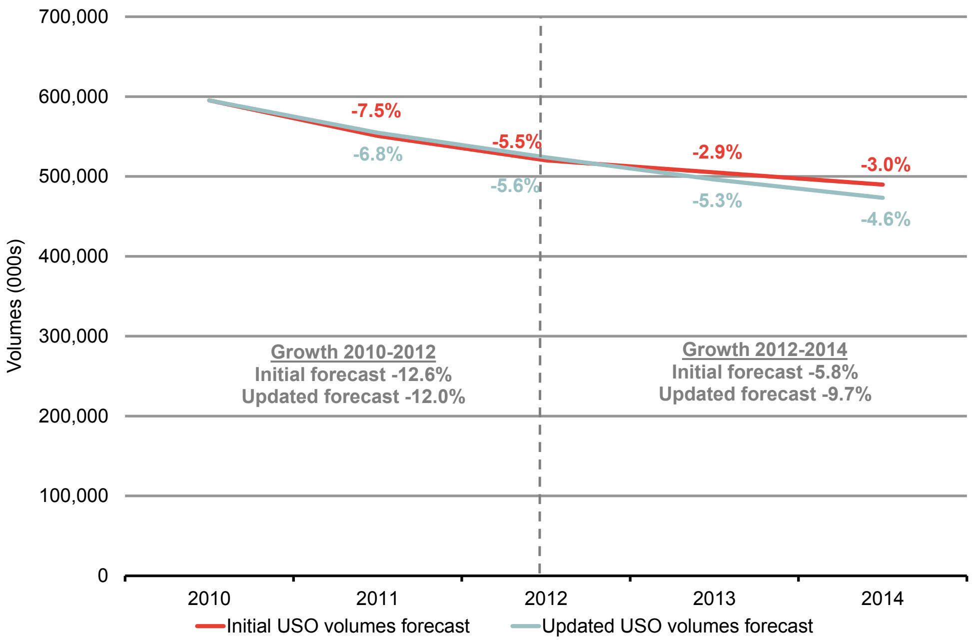
- domestic and international outbound USO volumes 2010-2014; and
- domestic and international outbound USO revenues 2010-2014.

3.2.1 Volume forecasts

The updated volume growth assumptions that feed into An Post's revenue and volumes model now result in a forecast decline of 20.5% in overall domestic and international outbound volumes (excluding parcels) over the 2010-2014 period. That is a further decline of 9.4 percentage points compared to An Post's forecast in its original price application. Figure 5 illustrates how this difference accumulates over the period. It illustrates that the outturn in volume declines for the 2010-2012 period has been in line with initial expectations. For the 2012-2014 period, on the other hand, the forecast volume decline is much larger than initially forecast.

5 Application for changes to Charges for Universal Services weighing less than 50g in accordance with the Communications Regulation (Postal Services) Act No. 21 of 2011 ("the Act"), October 2012 – Page 18

Figure 5. Comparison of the initial and updated forecast of USO volumes (excluding parcels) 2010-2014



Source: An Post's Price Application - *App 2 Revenue and Volumes Model 2010-2014*

Breaking down this aggregate volume forecast of -20.5% by format reveals some interesting trends in the format mix of domestic volumes over the 2010-2014 period. In particular:

- letters are forecast to decline by 21%;
- flats are forecast to decline by 30%; and
- packets are forecast to decline by 3%.

In our October 2012 report, we also compared recent and forecast trends in volumes. This found that when initial forecast trends in USO mail volumes for 2011-2014 were compared with those seen since 2007, the forecast volume declines were significantly smaller than historic declines.

Figure 5 compares our previous analysis of CAGRs for the 2007-2011 and 2011-2014 period with the updated values. From this we can see that the CAGR for the updated 2011-2014 domestic volume forecasts is more in line with the CAGR over the 2007-2011 period, particularly since An Post has told us that the 2007-2011 figures are likely to be underestimates (by around 2-3 percentage points) due to methodological changes and advised that flats up to 100g should be included in the letters figures.

The CAGR for domestic packets reflects the recent slowdown in the volume decline for this format. With respect to outbound international, although the volumes aren't directly comparable between periods due to changes in methodology, they indicate a significant slowing of the decline in these volumes.

Figure 6. Comparison of CAGRs for USO mail volumes between 2007-2011 and 2011-2014

		2007-2011 Volumes CAGR	Initial 2011-2014 Volumes CAGR	Updated 2011-2014 Volumes CAGR
Domestic	**Letters**	-2%	-4%	-6%
	Flats	-12%	-4%	-7%
	Packets	-9%	-1%	0%
Outbound International*	**Letters**	-10%	-3%	0.1%
	Flats	-11%	-3%	-0.4%
	Packets	-18%	-3%	-0.2%

Source: An Post's price application - App 2 Revenue and Volumes Model 2010-2014

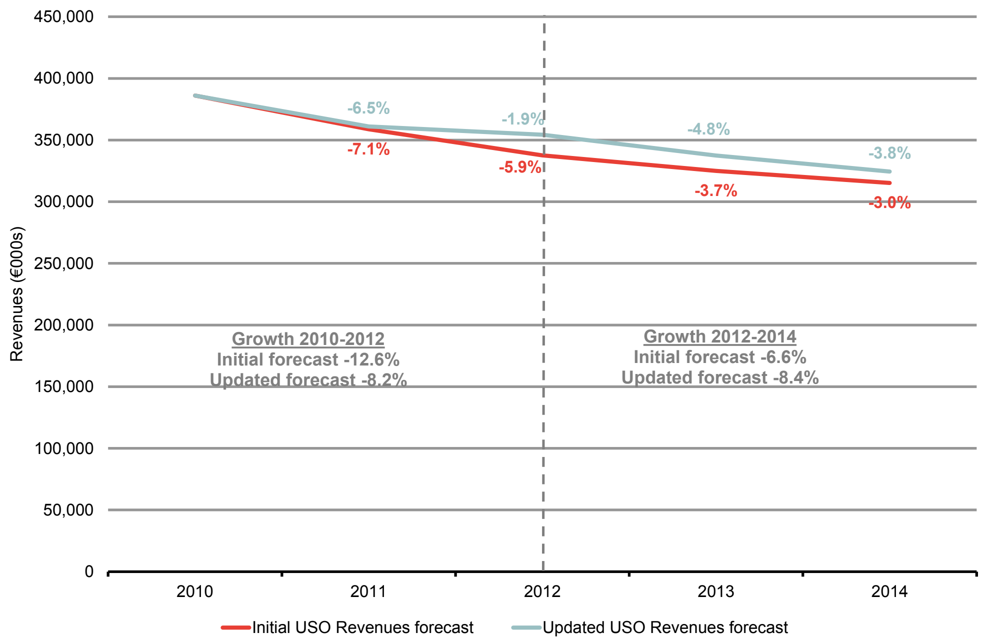
3.2.2 Revenue forecasts

The updated revenue growth assumptions that feed into An Post's revenue and volumes model result is a forecast decline of 16.0% in overall domestic and international outbound revenues (excluding parcels) over the 2010-2014 period.

That represents a further 2.4 percentage point decline when compared to the forecast in An Post's original price application. Figure 7 illustrates how this difference accumulates over the period. It also illustrates that the outturn in revenue declines for the 2010-2012 period has been better than initially forecast (this in part reflects the fact that the price increases for items in excess of 50g are now factored into the revenue figures)[6]. For the 2012-2014 period, the forecast revenue decline is greater than that initially forecast.

[6] Part of this improvement in revenue decline for the 2010-2012 period will reflect the May 2012 price increases on USO products >50g. An Post's initial baseline forecasts did not include this price increase.

Figure 7. Comparison of the initial and updated forecast of USO revenues (excluding parcels) 2010-2014



Source: Source: An Post's initial price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA_65C* and An Post's updated price application - *App 2 Revenue and Volumes Model 2010-2014*

As with volumes, breaking down this aggregate revenue forecast of -16.0% by format reveals some interesting trends in the format mix of domestic revenues over the 2010-2014 period. In particular:

- letters are forecast to decline by 23%;
- flats are forecast to decline by 24%; and
- packets are forecast to increase by 4%.

An Post have explained that the increase in packet revenues is due to the May 2012 price increases as the majority of packets are >50g.

3.2.3 Profitability impact

As part of the October price application, An Post has provided an updated version of the USO profit and loss figures for 2010-2014. Table 2 below compares the USO profitability between 2011 and 2014. This illustrates that the loss on the USO is set to increase by €12 million over this period. However, when interpreting these figures it is important to consider the change in the definition of the USO between these two years. The 2014 figure does not include non-USO bulk mail products.

Table 2. USO (Domestic and Outbound mail) profitability comparison between 2011 and 2014

	2011	2014
Revenues (€m)	368	272
Costs (€m)	415	331
Profit (€m)	**-47**	**-59**

Source: An Post's Price Application - *App 3 PL 2010-2014 forecasts*

3.3 E-substitution

Our initial report suggested that e-substitution in Ireland might not yet have fully impacted on postal volumes, indicating that there was potentially a lag compared to some jurisdictions.

As part of their revised application An Post have provided updated data for 2007-2011, and 2011-12 data for their top 20 customers. This has allowed us to perform a comparison of these top 20 customers over time.

Between 2010 and 2011, volumes from the current top 20 customers declined by [redacted] and revenues by [redacted] The evidence so far this year, suggests that the volume declines witnessed between 2011 and 2012 have eased considerably. An Post provided a comparison based on year to date (January to October) which shows a decline in revenues of just [redacted] for the same set of customers. This is clearly very encouraging. However, some caution is required in interpreting these findings until a full year-on-year comparison can be carried out to ensure that the indicative results reflect a real change in trend.

3.4 An Post is not currently introducing a DSA product

As discussed briefly in section 2.2.3, An Post is not currently introducing a 'Downstream Access (DSA)' product. The aim of this product was to mitigate the adverse impact of price increases on large customers. An Post's revenues and volume model assumed a take up rate for this new product of [redacted] of current bulk mail customers in 2012 and [redacted] in 2013.

The proposed DSA product would lie outside of the USO. If introduced, the product would therefore be subject to VAT. Although some proposed customers would be able to claim this back, others, such as providers of financial services, have VAT exempt status and therefore would not be able to do so.

An Post previously informed us that the composite rate of the DSA product would have been [redacted] At a 23% VAT rate, VAT exempt customers would therefore have faced a composite rate of [redacted] for the product itself, and possibly some additional costs associated with meeting the requirements of the product. This compares to a proposed rate of €0.45 for Discount 6 Ceadunas and €0.48 for Discount 9 Ceadunas.

As a result, An Post is not going to launch this new product at present. Instead, they propose to negotiate with other postal operators and individual customers. Although the rate will differ by operator (on a non-discriminatory basis), the rate projected for the revenue and volume model is [redacted] It is assumed that [redacted] of current bulk volumes will switch to individual negotiations. These individual negotiations will be subject to VAT, they would therefore face a price of [redacted] rather than [redacted] (based on a VAT rate of 23%). As such, An Post assume that take up of this product will come from bulk customers that aren't VAT exempt.

However, we are concerned that a forecast take up rate for 2013 of [redacted] is overly optimistic. Currently An Post has not negotiated access with any other postal operator or customer. It is hard to imagine therefore that [redacted] of bulk volumes will switch inside the next year. Moreover, [redacted] of An Post's top 20 customers, representing [redacted] of revenue are currently VAT exempt, and would therefore appear unlikely to switch away from a USO product.

3.5 Summary

In summary, our review of An Post's revised application finds that:

- The updated application forecasts an increased decline in volumes and revenues over the period. The forecast volumes and revenues are more closely aligned to recent trends and to international comparators.

- The updated information that An Post has provided on volumes for their top 20 customers, indicates that revenue declines (and therefore e-substitution) may have slowed substantially this year. This is clearly a positive and will hopefully be reflected in the full year on year comparisons.

- An Post's estimate of the proportion of volumes switching away from the USO to negotiated access looks optimistic for 2013, but it may reflect a reasonable equilibrium position.

- Looking forward, we recommend that An Post consider whether further improvements to forecasting methodology could be made which looks at volume growth assumptions on a more disaggregated level.

4 The impact of An Post's proposed price changes

In the October 2012 report, we reviewed An Post's assessment of the likely revenue and volume impacts associated with its proposed price changes. We found that:

- The consumer survey evidence provided by An Post suggested there may be considerable consumer resistance to the proposed price increases.
- The independent price elasticity analysis commissioned by An Post provided a reasonable range of estimates for price elasticity, and was based on standard econometric approaches to the estimation of price elasticities.
- An Post had used only the lowest of the price elasticity estimates in its analysis, and in consequence it had presented the 'best case' assessment of the revenue and volume impacts of the proposed price increases. An Post had also included as its base case, a high take up rate for its proposed DSA bulk mail product.
- Sensitivity analysis showed that higher volume declines and lower revenue impacts may arise.
- The sensitivity analysis was unable to capture the impact of lower DSA product take up. Customers that did not opt for the DSA product would have faced a price increase, this should have resulted in greater volume declines than those estimated by An Post.

Based on the information that we have received since the October report, we have identified the following updates to consider:

- An Post's updates to the modelling methodology based on the proposed price changes;
- the resulting volume and revenue forecasts and how these differ from the initial application;
- sensitivity analysis of An Post's updated volume and revenue forecasts; and
- the updated profitability impact of An Post's proposed price changes.

4.1 Modelling updates

Given the timing of the updated price application in relation to the original application, a number of changes have been made to An Post's revenue and volumes model in how it models the proposed price changes.

The proposed prices themselves have not changed and neither have the price elasticity estimates that are used in the model. The modelling updates are therefore linked to the timing of price increases.

In the original revenue and volumes model, the impact of the proposed price increase was phased. To do this, the model allowed for half of the price change impact to be felt in 2012 and half in 2013. This was done in order to reflect the expectation that the proposed price changes would be implemented half way through 2012.

In the revised revenue and volumes model the impact of the price increases in May 2012 for products >50g is built into the forecast. The full impact of this increase was modelled in 2012 and now occurs in both the 'with' and 'without' price increase scenarios. The impact of the proposed price increases for products <50g is now modelled to occur in 2013 under the 'with' price increase scenario only.

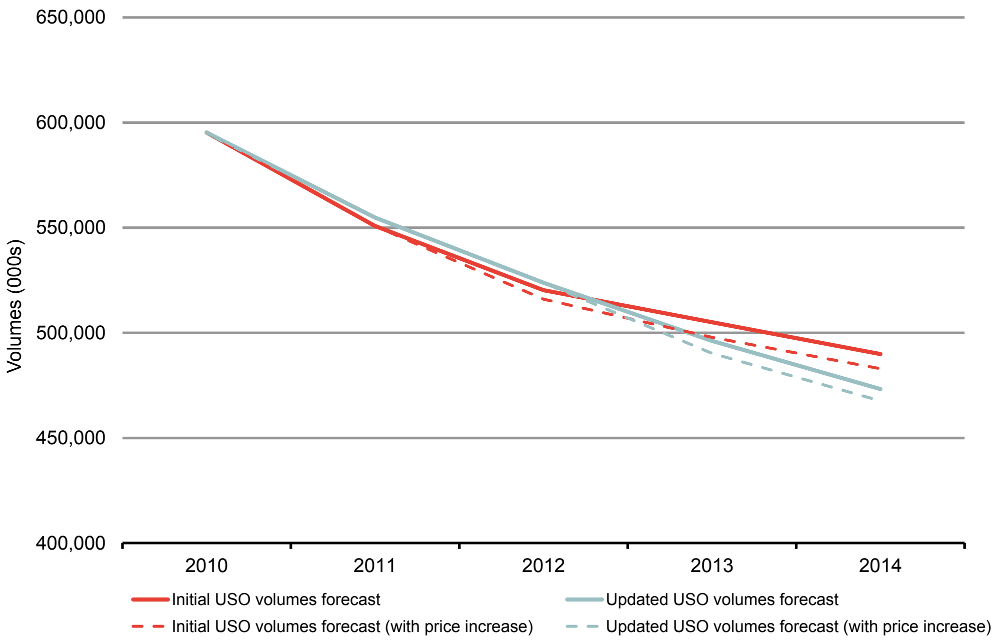
4.2 Updated volume and revenue forecasts with the proposed price changes

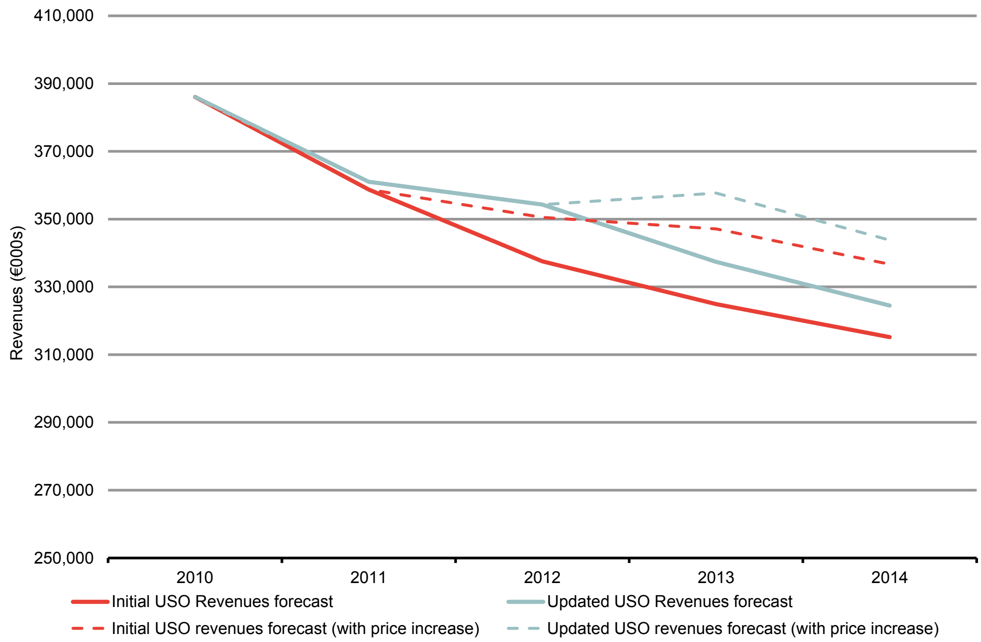
As with An Post's baseline volume and revenue forecasts, their updated model allows us to forecast:

- domestic and international outbound USO volumes 2010-2014 without proposed price increases for products <50g; and
- domestic and international outbound USO revenues 2010-2014 with the proposed price increases for products <50g.

Figure 8 below provides a comparison of the impact of proposed price changes on volumes and revenues between An Post's original and revised revenue and volumes model.

Figure 8. Volume and revenue impact of An Post's proposed changes





Source: An Post's initial price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA_65C* and An Post's updated price application - *App 2 Revenue and Volumes Model 2010-2014*

In the original price application, the proposed price changes were forecast to increase the overall volume decline by 1.2 percentage points and reduce the overall revenue decline by 6.0 percentage points.

In the revised price application, the same proposed price changes are forecast to increase the overall volume decline by 1.0 percentage points and reduce the overall revenue decline by 5.3 percentage points. The overall impact of the proposed price changes is therefore of a similar magnitude in both the original and revised price applications.

As shown in Figure 9 below, this impact differs by destination and format. For domestic mail, flats were forecast to see the largest percentage point volume and revenue differences between the two scenarios in the original price application. The update maintains this result for volumes, but letters are now forecast to see the largest differences. For international mail, letters were forecast to see the largest percentage point volume and revenue differences between the two scenarios in the original price application. The update now forecasts that flats will see the largest differences.

Figure 9. Comparison between the initial and updated price application of the volume and revenue impact of An Post's proposed price changes

	Initial Application				Updated Application			
	Volume growth 2011-2014		Revenue growth 2011-2014		Volume growth 2011-2014		Revenue growth 2011-2014	
	Without price increase	With price increase	Without price increase	With price increase	Without price increase	With price increase	Without price increase	With price increase
Overall	**-11.1%**	**-12.3%**	**-12.1%**	**-6.1%**	**-14.7%**	**-15.7%**	**-10.1%**	**-4.8%**
Domestic	**-11.3%**	**-12.5%**	**-12.8%**	**-6.6%**	**-15.7%**	**-16.7%**	**-13.0%**	**-7.1%**
- Letters	-11.5%	-12.7%	-14.3%	-8.0%	-15.7%	-16.7%	-17.5%	-10.0%
- Flats	-10.2%	-11.8%	-10.5%	-3.0%	-20.5%	-20.8%	-12.1%	-10.9%
- Packets	-3.0%	-4.5%	-3.0%	-2.8%	-1.2%	-1.3%	25.1%	25.3%
- Registered	-11.5%	-11.9%	-11.5%	-7.9%	-11.5%	-11.5%	-2.1%	-2.1%
International Outbound	**-8.0%**	**-9.8%**	**-8.4%**	**-3.6%**	**0.1%**	**-1.5%**	**5.5%**	**8.2%**
- Letters	-8.7%	-10.9%	-8.7%	-1.1%	0.3%	-2.0%	0.3%	8.0%
- Flats	-8.7%	-10.7%	-8.7%	-2.1%	-1.2%	-1.6%	12.2%	13.3%
- Packets	-8.7%	-9.9%	-8.7%	-6.0%	-0.7%	-0.8%	7.9%	8.0%
- Registered	-8.7%	-9.2%	-8.7%	-7.0%	0.5%	0.5%	5.5%	5.5%

Source: Frontier analysis of An Post's initial price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA_65C* and An Post's updated price application - *App 2 Revenue and Volumes Model 2010-2014*

4.3 Sensitivity analysis of An Post's updated forecasts

As in our original report, in order to check the sensitivity of An Post's conclusions, we have used the estimates derived from the alternative specifications of the price elasticity regression analysis.[7] Table 6 compares the revised volumes and revenue growth forecasts for 2011-2014, with the proposed price changes, under different price elasticity estimates.

As in our original report, our sensitivity analysis shows that higher volume declines and lower revenue impacts may arise. This is illustrated in the Table below. This shows that, in the most pessimistic scenario (the time series scenario) revenues would improve by only 2.5 percentage points in comparison to the baseline ‘no price increase’ scenario.

7 Note: Our updated sensitivity analysis uses the same price elasticity estimates as our original analysis as these estimates have not been revised.

Table 3. Comparison of the volume and revenue impact of alternative price elasticity estimates

Price elasticity estimates used in An Post's model	Volume 2011	Volume 2014	Volume growth 2011-2014	Revenue 2011	Revenue 2014	Revenue growth 2011-2014
Baseline – no price increase	**554,828**	**473,282**	**-14.7%**	**361,031**	**324,470**	**-10.1%**
PCAIDS (calibrated on meter postage – used by An Post)	**554,828**	**467,681**	**-15.7%**	**361,031**	**343,815**	**-4.8%**
LA/AIDS[8]	554,828	456,000	-18%	361,031	339,700	-6.0%
PCAIDS (calibrated on stamp postage)	554,828	465,765	-16.1%	361,031	341,601	-5.4%
Time-series regression	554,828	449,200	-19.1%	361,031	333,554	-7.6%

Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA_65c*

In our original analysis the time-series regression model elasticity estimates had the largest impact, with the other estimates yielding results very similar to those using An Post's baseline estimates. There is now a greater spread of results, depending on the elasticity specification used.

In particular:

- the LA/AIDS elasticities suggest a revenue decline between 2011 and 2014 as high as -6.0% (compared to -10.1% in the absence of a price increase); and

8 In the LA/AIDS model estimated by Indecon, the own price elasticity estimate for bulk mail is not statistically significant in the 3 product model as bulk mail does not have a share equation.

- the time-series regression model elasticities suggest a revenue decline between 2011 and 2014 as high as -7.6% (again, compared to -10.1% in the absence of a price increase).

In all scenarios, we see that the revenue impacts have decreased, and that for the LA/AIDS and time series scenarios, the potential volume declines have increased. We suggest that this may be driven by the fact that An Post is not currently proposing to launch a new DSA product at this time. As a result, [redacted]% of bulk volumes that were originally modelled to switch to this product (at a cheaper price than those proposed on Discount Ceadunas) are now expected to stay with Discount 6 or Discount 9 and therefore face a price increase. Both the LA/AIDS and time-series regression models have own price elasticity estimates of greater than -0.6.

The high elasticity for bulk mail products is unsurprising given that this typically relates to large clients that may have greater options in terms of switching either to alternative providers or to non-mail alternatives (e-substitution). We suggest that careful consideration needs to be given to the proposed Discount 6 price increase, as this appears to be the price increase that may give rise to the highest elasticity effects.

4.4 Updated profitability impact of An Post's proposed price changes

An Post estimates that the proposed price changes will lead to a positive profitability impact of €19.2 million by 2014 (in comparison to €22 million from the original forecasts). Under the baseline 'no price increase' case, as illustrated in Figure 11, An Post estimates that the USO profitability on domestic and international outbound mail will continue to decline from a loss of €47 million in 2011, resulting in a loss of €59 million by 2014[9].

In terms of sensitivity analysis, using the volume and revenue impacts associated with the time series elasticities shows that the loss may only be reduced by c.€13 million to €45 million.[10]

---

9 Note: due to the changes in the definition of the USO between 2011 and 2014, An Post's profitability estimates for these years aren't directly comparable.

10 The 2011, '2014 – An Post Baseline' and '2014 An Post with price changes' revenue and cost figures are taken from An Post's price application – 'App 3 PL 2010-2014 forecasts'. The sensitivity analysis revenue estimates presented here are those produced from the reapplication of An Post's model using Indecon's LA/AIDS model price elasticity estimates. The cost estimate for this scenario is calculated using the costs under '2014-An Post with price changes'. It is assumed that these costs would be reduced due to the addition loss of volumes in line with An Post's cost elasticity estimate of 0.2.

Figure 10. USO profitability impact of An Post's proposed price changes (Domestic and International Outbound mail)

	2011	2014	2014 - An Post with price change	2014 - Sensitivity analysis with price change
Revenues (€m)	368.29	271.96	290.12	280.84
Costs (€m)	414.95	330.60	329.58	326.02
Profit (€m)	-46.66	-58.64	-39.46	-45.18
		-11.98	19.18	13.46

Source: Frontier analysis of An Post data

4.5 Summary

In summary, our review of An Post's revised application finds that:

- The overall impact of the proposed price changes is similar in magnitude between the original and updated price applications. An Post's base case is that the price increase will increase the overall volume decline by 1.0 percentage points and reduce the overall revenue decline by 5.3 percentage points.

- As in the original price application, An Post's baseline price elasticity estimates result in the 'best case' assessment of revenue and volume impacts. Sensitivity analysis shows that higher volume declines and lower revenue impacts may arise, particularly if the own price elasticity for bulk mail is closer to that from the time-series or LA/AIDS regression models. The most pessimistic scenario shows that the price increase will increase the overall volume decline by 4.4 percentage points and reduce the overall revenue decline by 2.5 percentage points.

- An Post estimates that the proposed changes will improve USO losses by €19.2 million in 2014. However, sensitivity analysis around this figure using alternative price elasticity estimates suggests that this improvement could be in the region of €13 million in 2014.

5 Affordability

In our October 2012 report we noted that An Post argued that there will be no affordability issues with respect to any customer groups. In particular An Post suggested that:

- for residential customers, customer research suggested price was not a major factor for customers, and post made up a small proportion of total expenditure;
- for SMEs, An Post argued that the majority of customers would face only a negligible increase in costs and/or would be able to avail of additional discounts as a result of lower thresholds for discount products; and
- for large customers, An Post argued that the availability of its proposed DSA bulk mail product provided these customers with an effective discount and so there could be no affordability issues.

In reviewing An Post's assessment, we found that:

- for small customers there appeared to be no substantial affordability impact, as even for the lowest decile income group the price increase resulted in a less than 0.1% decline in disposable income;
- for SMEs the evidence was less clear-cut. The majority of meter customers (97%) faced an average annual increase in postage costs of [redacted] per year. However, for a small proportion of customers, annual postage costs could increase by more than [redacted] per year; and
- for large customers, it was less clear that they would avail of An Post's DSA product. For customers that do not avail of the DSA product, the increase in postage costs could be substantial. For example, the 27 largest customers would face an average postage cost increase of in excess of [redacted] and An Post's largest customer would face an increase of over [redacted] in postage costs per annum. We noted that while these costs appeared large in absolute terms, they might not necessarily raise an affordability issue in relation to the entity concerned. It was possible, however, that they would encourage large business consumers to consider substitutability options for An Post's service.

Based on the information that we have received since the October report, there are three key points to consider:

- evidence in relation to affordability for SMEs;
- affordability for large customers that may be affected by the DSA decision; and

- the impact of the May 2012 price increase.

5.1 SMEs

An Post have provided no substantive new evidence of the impact on affordability for this group. An Post have argued that their previous application demonstrated that an affordability concern would not arise. They based this finding on:

- the fact that average spend for SMEs is low;
- research commissioned by The Research Perspective Ltd, on behalf of ComReg, which listed reliability as the most important aspect of postal services that drives satisfaction amongst organisations;
- price elasticity of demand estimates from Indecon;
- the fact that ComReg will be undertaking a public consultation, which may identify any serious affordability concerns for this group.

We note one additional potentially important change compared to An Post's first application. This is that the terms and conditions for the Discount 6 product have been changed and in particular the volume threshold has been lowered substantially. The result is that some SMEs with relatively large volumes may be able to switch to this product.

Overall, however, our conclusions remain unchanged from our first report:

- the affordability impact for SMEs is not clear-cut;
- the majority of meter customers (97%) are likely to face an average annual increase in postage costs of around [redacted] per year; and
- for a small proportion of customers, annual postage costs could increase more substantially.

5.2 Large customers

Given An Post are not currently proposing to launch a DSA product, there may be some affordability issues for large customers. We note An Post's intention to enter individual negotiations with some large customers and other postal providers. However, a substantial number of An Post's large customers will face a price increase as a result of the current proposals.

The proposed increase in Discount 6 is 10% for letters. This implies, for example an average increase[11] of ca. [redacted] for An Post's largest 20 customers,

[11] Calculations use current volumes and assumes a 10% price increase across all bulk volumes

and [redacted] for its largest. Given that these customers are potentially most at risk of substituting away either from the USO or postal services more generally (e-substitution) we suggest that careful consideration must be given to the impact of the proposed price increase.

5.3 Impact of the May 2012 price increases

An Post has argued that there has been little adverse reaction to the May 2012 price increases from any customers. According to An Post this demonstrates that affordability is not a concern.

An Post has conducted analysis[12] looking at volumes and revenues between May and October 2012. This shows that overall stamp, meter and bulk revenues declined by 4% compared to a volume decline of 8% in the four months to April. A breakdown of revenue declines by product shows that:

- stamp revenues declined by 2%;
- meter revenues declined by 10%;
- bulk revenues declined by 3%; and

Although it is correct that revenue declines have been generally slower than volume declines, it is worth noting that mail weighing more than 50g makes up a significantly smaller proportion of mail than for 0-50g mail. In addition, even if a similar impact was seen for 0-50g, this is still potentially worrying for SMEs as a large proportion of SMEs are meter customers, for whom the impact is 10%.

5.4 Summary

An Post's proposed price increases are unlikely to lead to affordability issues for residential customers.

The impact of price increases on SMEs is less clear cut. Although lowering the volume threshold for the Discount 6 product could lead to greater take up of this product, most SMEs face an increase in annual postage costs of around [redacted] and some SMEs could face considerably higher increases.

For large customers, who are most at risk of switching away from postal services, the proposed price changes could lead to considerable cost increases. In consequence, the impact of the price increase for Discount 6 must be given careful consideration.

---

12 Sch 6 STAMP METER BULK - May 2012.

6 Review of the cost reflectivity of An Post's proposals

In this section we review the cost reflectivity of An Post's proposals. In our October report we found that:

- A comparison of unit costs and An Post's price proposals suggested that the changes An Post proposed would improve cost reflectivity (as benchmarked against An Post's current costs).
- An Post set out that the proposed changes to the level of discounts offered are justified on the grounds of cost difference. However, ComReg had previously made clear that discounts must reflect only the difference in avoided cost associated with the payment method.

Based on the information that we have received since the October report, we provide an update below in relation to both these issues.

6.1 Cost reflectivity

In our original report we compared the unit cost information that An Post provided[13] for each of their products, and the proposed prices. At the time the report was written, An Post had not provided us with cost information for each price point so we had to apply weighting assumptions in order to make costs and prices comparable[14]. Our analysis enabled us to draw some conclusions around cost orientation and non-discrimination, but these had to be considered in the context of the weighting assumptions that we were required to make. In our October report we found that the proposed price changes generally improved cost reflectivity.

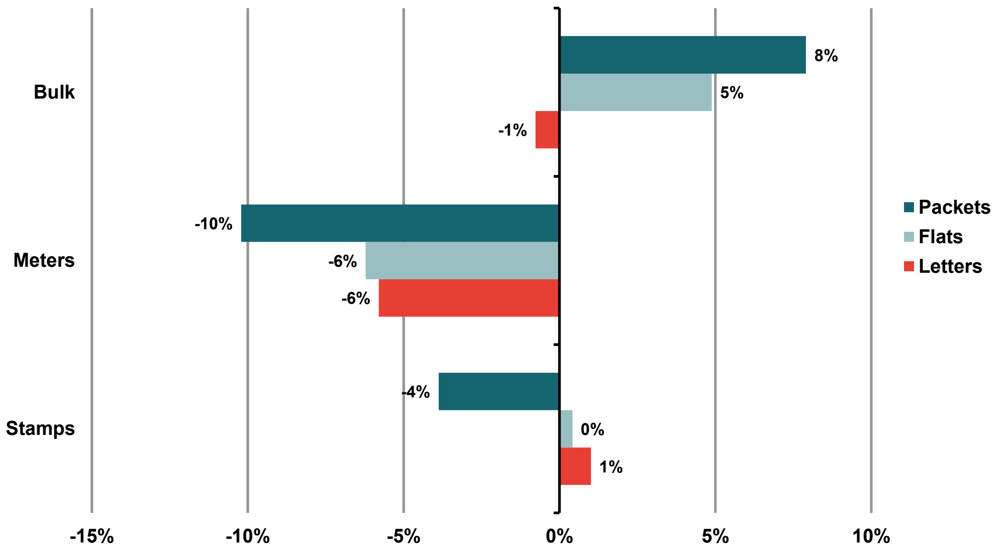
We have now received new unit cost information from An Post. The new information shows that unit costs have changed for most products. We have

13 It was outside the scope of this work to review the accuracy of the unit cost information provided to us by An Post. This has been covered in Analysys Mason's August 2012 report 'Review and assessment of An Post's compliance with the Accounting Direction'.

14 The unit cost information initially provided by An Post was only available at an aggregated level, rather than split by price-point. For most products, we were able to map across to the proposed tariff structure. However, to enable us to carry out a comparison between unit costs and price, we first had to calculate weighted average prices across the weight steps for each product. Due to the weighting, the figures produced by this comparison are only estimates and should be treated as such. Given the nature of the international tariff structure we were unable to carry out this comparison for international outbound products.

been informed by An Post that the changes are likely to be driven by changes in volumes[15].

Figure 11. Changes in unit costs since Frontier October report



Sources: Frontier analysis of An Post data: App 5 - Schedule of cost per price point, Per unit cost analysis workbook

We have also received unit cost information per price point from An Post for stamp, meter, discount 6 and outbound products. This has enabled us to update the original analysis and extend it to international outbound products. Overall, our conclusions on cost reflectivity have not changed. An Post's proposed price changes improve cost reflectivity for most products, although there are some instances where cost reflectivity worsens.

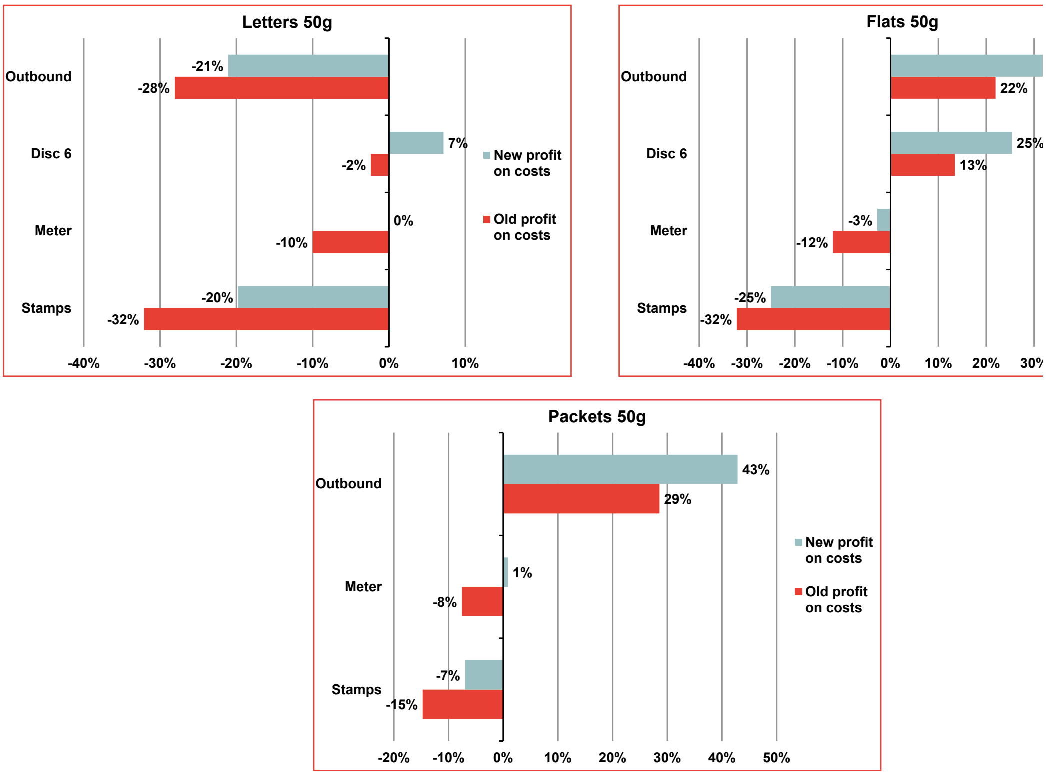
Following the price increases, losses on stamp and meter products are reduced for letters, flats and packets. However, profit margins increase from an already high base for Discount 6 flats, and international outbound packets[16]. This is shown in Figure 12.

---

15 Meeting with ComReg and An Post, 12 December 2012

16 Volumes for these services are small

Figure 12. Gross profits on costs before and after price changes



Source: Frontier analysis of AP data: Sch 2 and 3 Cost per unit graphs, Sch 10 - App 1 Proposed Prices

6.2 Non-discrimination

In our October report we analysed whether the price differential between different sets of products is representative of the cost differential between these products, and to what extent the proposed prices changed this. In particular we compared:

- standard stamp and meter;
- standard stamp and bulk stamp; and
- meter and other bulk.

In the case of the first two sets of differentials, the price discounts provided by An Post for meter mail and bulk purchases of stamps are related to the payment method. To be considered non-discriminatory, these discounts should therefore reflect the cost avoided with the use of the payment method. We therefore look at the costs associated with revenue collection for these products.

6.2.1 Standard stamp and meter

In our October report we were unable to judge whether the differential between standard stamp and meter were discriminatory or not due to insufficient information on avoided costs. Currently 50g stamp letters are priced at 55c and 50g meter letters are priced at 54c, a difference of only 1c. Under current proposals this differential will widen to 5c while the cost differential is 21c.

We understand that the bulk of this cost difference relates to sorting costs. In particular, we understand that there are sorting cost savings associated with meter mail[17]. However, the avoided costs associated with payment method are considerably smaller. Recent information from An Post shows that the revenue collection cost for meter (letters) is 2c, and this is only slightly (1c) lower than the revenue collection cost for stamp (letters)[18].

6.2.2 Standard stamp and bulk stamp

In the case of standard stamp and bulk stamp (5% discount for customers buying more than 300 stamps online equivalent to 3.25c), we could not (in our October report) assess whether the proposed discount was justified since we did not know the avoided costs associated with the payment method.

Recent information revealed that the revenue collection costs associated with regular stamp (letters) is 3c. An Post has highlighted[19] that the online stamp purchase initiative was introduced to try to mitigate the price increases for SMEs. One key consideration was the commission of 5% that stamp retailers (i.e. shops that sell stamps, rather than post offices) charge on any stamp sales. In considering what discount to give online customers, An Post want to avoid a situation where they are creating an arbitrage opportunity for retailers by having a discount greater than 5%.

In comparison to the discount offered to customers buying stamps online, the discount for meter (letters) relative to standard stamp (letters) is higher at 5c. It is not clear to us why the two discounts should be so different, given that they are both linked to payment method and the avoided costs associated with it are similar.

6.2.3 Meter and other bulk

In our October report we found that although the cost differentials between metered mail and bulk mail were greater than the price differentials, they were more representative of the cost savings associated with bulk in comparison to

---

17 As all meter mail must be front facing, sorted by size, sorted between Dublin and all other places etc

18 Sch 8 Table Nov 12

19 Meeting with ComReg and An Post, 12 December 2012

meter than in the case of stamped and metered mail. We further found that under the proposed tariff changes, this was set to improve further for both letters and flats. Our analysis of the recent information provided by An Post has not changed our conclusions for these products.

6.3 Summary

The new information provided by An Post shows that the proposed price changes improve cost reflectivity for most products. This is true for all stamp and meter products. It is not true, however, for Discount 6 flats, where the proposed price change would result in an increased margin on this product.

Relative to stamp (letters), the discount proposed by An Post for metered mail is greater than the discount offered for bulk stamp despite the fact that revenue collection costs are similar. An Post has recently informed[20] us that flats and packets do not have sortation savings benefits due to payment method in the same way that letters do.

20 Letter to George Merrigan, 29 November 2012

FRONTIER ECONOMICS EUROPE
BRUSSELS | COLOGNE | LONDON | MADRID

Frontier Economics Ltd 71 High Holborn London WC1V 6DA
Tel. +44 (0)20 7031 7000 Fax. +44 (0)20 7031 7001 www.frontier-economics.com