

Risks

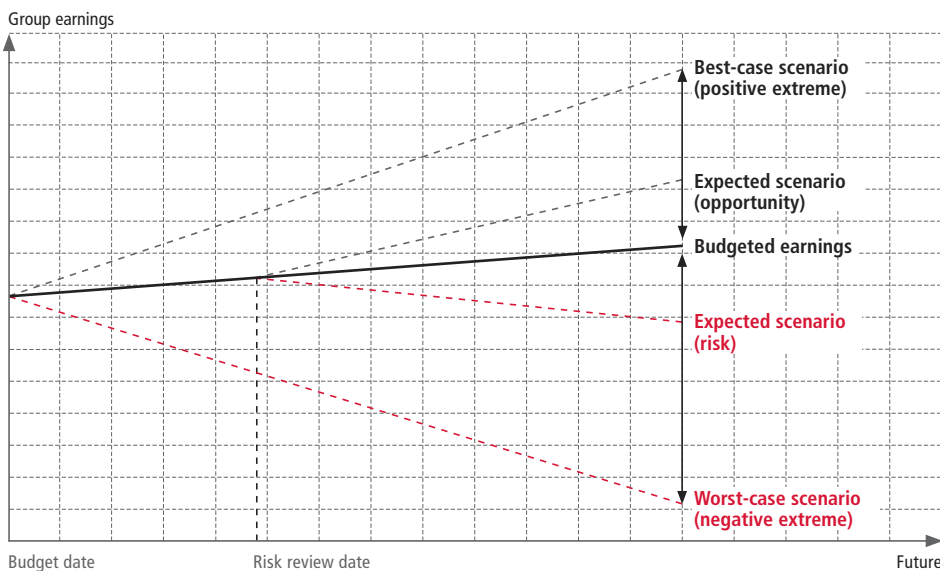
Opportunity and risk management

Group-wide opportunity and risk management

All business involves opportunities and risks. Our Group-wide opportunity and risk management system gives us a head start in dealing with potential changes and events. The process developed to serve this system is built around uniform methods to identify and analyse key trends and to communicate them to management. Clear presentation of opportunities, risks and possible countermeasures helps sustain the company's ongoing success.

Scenario analysis

Goal: Early detection of deviations from target



Opportunities and risks are identified and reviewed across the Group every quarter as part of controlling processes. Internal or external factors can cause positive or negative deviations from target. Major impacts of unforeseen events may trigger an ad hoc announcement.

Opportunity and risk analysis involves investigating major influencing factors as well as compiling action plans to avoid risks and make use of opportunities. Early warning indicators are determined to ensure timely detection of critical situations. The potential impact of a range of factors on Group earnings is evaluated using scenarios and each potential risk is assigned to one or more managers who take appropriate action as necessary.



Note 51.1

The Group uses a software application to collate and communicate individual risks. This multi-level reporting system ensures that managers are involved across various layers of the hierarchy, and the process is closely dovetailed with controlling to ensure regular exchange between controlling and management. Central risk control is organisationally part of Corporate Controlling and keeps the Board of Management abreast of key opportunities and risks in each division.

Postbank's risk control system complies with the bank-specific regulatory requirements in accordance with the *Kreditwesengesetz* (German banking act), the *Solvabilitätsverordnung* (German solvency regulation), the *Liquiditätsverordnung* (German liquidity regulation) and the Minimum Requirements for Risk Management (MaRisk, laid down by *Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin, Germany's federal financial supervisory authority). Until the agreed sale of Postbank to Deutsche Bank, Postbank remains integrated into the Group's opportunity and risk control process.

The risks set out in the following are those which we presently consider to have a significant potential negative impact on our net assets, financial position and results of operations. They are not necessarily the only risks to which the Group is exposed. Our business activities could also be adversely affected by risks of which we are currently unaware or which we do not yet consider to be material.

Risk categories and specific risks

Industry-specific risks shaped by general environment

Our business success depends critically on the financial health of our customers. The uncertain economic outlook in the wake of the financial crisis poses considerable potential risks for us and for the entire logistics sector. Many factors are at play here, including whether individual countries put together economic stimulus packages and what effect these produce. It is therefore hard to say anything about the duration and scope of the crisis.

The financial impact of any drop in revenue is minimised by our extensive cost-cutting programme. Starting in 2009, the Group aims to lower indirect costs substantially – by €1 billion by 2010. We also plan to increase our share of important domestic and international express and logistics markets. The restructuring of our US express business considerably reduces our cyclical risk in this hard-hit market.

Risks associated with the general business environment primarily arise from the fact that the Group and its subsidiaries provide some of their services in a regulated market. Our statutory exclusive licence was abolished in Germany on 1 January 2008. However, the *Postgesetz* (German postal act) has allowed exceptions enabling competitors to operate within the weight and price ceilings laid down in our exclusive licence from January 1998 onwards. As a result, around 55% of the revenue generated by competitors in 2007, the last year of the exclusive licence, was within the weight ceilings stipulated in the exclusive licence. By the end of the year, the regulatory authority (*Bundesnetzagentur* – Federal Network Agency) had issued licences to around 2,500 competitors.

On 7 November 2007, the regulatory authority announced a benchmark decision specifying the conditions that apply from 2008 until the end of 2011 to regulation under the price cap procedure for mail prices requiring approval. This stipulates the key factors applicable to mail prices as being the general rate of inflation and the expected productivity growth rate for Deutsche Post AG. Prices have to be lowered if the inflation rate in the reference period is less than the productivity growth rate specified by the regulatory authority. Mail prices requiring approval remain largely unchanged in 2009. The regulatory authority accepted an application from Deutsche Post AG to this effect on 13 October 2008.

The third EU Postal Directive came into force on 27 February 2008. The Directive requires most EU member states to open up their markets by 2011, although the nine most recent members plus Greece and Luxembourg have an option to delay opening their markets until 2013. Until then, the previous limits continue to apply across the EU, with reservable services restricted to a maximum of 50 grams or two-and-a-half times the standard letter price. It is now possible to plan with certainty for the future regarding the date by which all national monopolies in Europe must fall.

Whilst liberalisation of postal markets poses risks for Deutsche Post AG due to increased competition in Germany, it also opens up new opportunities in other European postal markets. In 2008, cross-border mail in Europe between Deutsche Post AG and 14 other Western European postal operators was governed by the REIMS III agreement and with another eight Eastern European postal companies by the REIMS EAST agreement. REIMS III is the successor to REIMS II and came into force retroactively from 1 January 2008.

Discussions continue regarding the extent to which postal services should be exempt from value-added tax (VAT). An amendment to the *Umsatzsteuergesetz* (German value-added tax act) currently in preparation will reduce the VAT exemption for Deutsche Post AG. A bill to this effect was adopted by the German cabinet on 24 September 2008 and is set to become law on 1 January 2010. Under the new rules, a VAT exemption will only apply to specific universal services pursuant to the EU Postal Directive that are not subject to individual agreement or provided on special terms, for example, at discount rates. The VAT exemption is to apply to any enterprise providing all of these services nationwide in Germany. The German legislative process may be affected by a European Court of Justice (ECJ) decision expected for the second quarter of 2009. On 15 January 2009, the ECJ Advocate General delivered her opinion in the case concerned, which relates to the VAT exemption for postal services in the United Kingdom. The German bill has yet to be passed by the Bundestag and Bundesrat.

Concurring with Deutsche Post AG, the regulatory authority considers that the prices it approved are net prices not including VAT. VAT could therefore be added to the approved prices. However, it cannot be ruled out that the application of VAT would lead to a decrease in revenue and earnings.

At the European level, the scope of the VAT exemption for postal services is also the subject of infringement proceedings initiated against the Federal Republic of Germany by the European Commission on 10 April 2006. The Commission announced in its decision at the proceedings on 24 July 2007 that the VAT exemption for postal universal services provided by Deutsche Post AG was too broad and called on the German government to amend the applicable law. Germany responded to the European Commission at the proceedings that it considers the current VAT exemption to be in compliance with applicable law.

The Federal Republic of Germany is planning a major revision of its *Bundesdatenschutzgesetz* (BDSG – Federal data protection act). Parliamentary hearings have now begun following a cabinet resolution in December 2008. Under the current Act, postal addresses contained in data relating to groups of persons and “compiled in lists or otherwise combined” may be used for advertising purposes except where consumers explicitly withhold consent. If the revision leads to significant restrictions, it will directly affect our marketing business in Germany and may cause substantial loss of revenue and earnings.

Limiting business strategy risk

By agreeing to sell a stake in Postbank and withdrawing from the US domestic express market, we are strategically repositioning ourselves to concentrate in the future on our core competencies of mail, express and logistics.

The goal of the MAIL Division in the liberalised German mail market is to minimise losses in revenue and earnings. Competitors primarily aim to entice business customers away from Deutsche Post. The division plans to secure its revenue through rigorous customer focus. We continue to improve on our already very high service quality. In 2008, in the course of deregulation, we gained greater flexibility in pricing mail comprising more than 50 items, allowing us to retain or win back key accounts. Apart from competition, revenue losses also loom as a result of ongoing digitisation. Conventional mail is increasingly giving way to electronic forms of communication, and we are responding by incorporating electronic communication into our own range of products and services.

The commercial situation of the EXPRESS Division varies from region to region. The division has expanded its international activities outside North America. In the US domestic market, however, fierce competitive pressure posed too great a risk for the Group. The infrastructure there was costing over US\$5 billion a year, whilst express shipment volumes were falling. Combined with the global economic downturn, the situation was no longer tenable. We therefore announced our withdrawal from the domestic express business in the USA on 10 November 2008. This will cut annual costs to below US\$1 billion and significantly reduce the risks for our express activities in the long term. We will refocus our US operations fully on the international express business. Restructuring will cost some €3 billion spread over two years. The majority of this amount has already been recorded in 2008.

The LOGISTICS Division was restructured in March 2008, creating two new divisions: GLOBAL FORWARDING/FREIGHT focuses on activities with low capital commitment. The division brokers and optimises transport capacity. SUPPLY CHAIN/CIS offers customised logistical and industry solutions at every link in the supply chain, plus outsourcing solutions for purposes such as address and document management. Both divisions aim for organic and profitable growth. This depends on the financial health of our customers and trading partners, who have recently suffered from the economic slowdown, and some of whom could even be threatened with insolvency. We endeavour to contain the effects of this development by improving processes and cutting costs. We are also expanding our service portfolio for new sectors. The crisis also harbours the opportunity, however, that customers may be more ready to outsource their requirements. Rapidly growing cost pressure on our customers could boost this tendency.

Our answer to risk: quality

Our global operations require a highly advanced operating infrastructure. Posting and collection, sorting, transport, warehousing, delivery and information technology must all meet high standards. Speed and reliability are key success factors in meeting our excellent standards of quality.

In the MAIL Division, for example, extensive automation ensures proficient and consistent service. Since downtime can severely disrupt the transport of mail items and merchandise, key infrastructure – sorting and conveyor systems, air hubs and data centres – is continuously monitored. Detailed process, emergency and contingency plans minimise the probability of business interruptions and of major financial consequences.

The EXPRESS Division is the market leader in the international express business in all markets outside the US. Whilst we have pulled out of the US domestic market, US international business remains a vital part of our global express network. At the same time, we are substantially reducing our infrastructure costs there. We illustrate the financial impact of these changes in the paragraphs on business strategy risks. Progress on the restructuring is monitored on an ongoing basis; it is expected to be finished by mid-2009. Transitioning our international customers to a standardised IT platform is going to be a key challenge during the first two quarters of 2009. We also aim to reduce costs and raise productivity outside the United States in order to offset the financial impact of the recession and the fierce competition. Moreover, we plan to make greater use of cross-divisional synergies and to improve our range of products and services.

Satisfied customers are a core goal for all divisions. Loss of customers could jeopardise the attainment of our revenue and earnings targets. In the logistics business, the risk of losing major accounts is particularly significant. Under our First Choice programme, we are rigorously aligning processes to customer needs. At the same time, we are also aiming to improve cost efficiency, which in some instances requires capital expenditure. Investment decisions in excess of €10 million are made by the Corporate Investment Committee. A lower threshold of €5 million applies to capital expenditures in Global Business Services. Approved projects are closely monitored, allowing material risks to be detected early at the Board level and appropriate action to be taken.

Sustainable practices counter environmental risks

Monitoring developments in environmental policy is an integral part of the Group-wide risk management process. We do not currently know of any environmental risks with significant potential financial implications for the Group over the period to 2011. During 2008, however, the debate advanced within the EU on the adoption of an emissions trading system for air transport and we expect that air transport will be included in emissions trading by 2012. The financial impact will depend heavily on how the emissions trading system is set up. It also remains to be seen what volume of emission allowances will be needed and at what price they will trade. It is therefore not yet possible to estimate reliably the specific financial consequences of emissions trading for air transport in Europe. In our opinion, however, the Group is generally well placed to minimise the financial risks by virtue of its GoGreen programme.

Strong position in the competition for talent

Like any other company, we have to compete for highly qualified specialists and managers. Workforce fluctuation can lead to losses of expertise and customer relationships. Action is taken on various fronts to counter this risk.

We promote initial and further training for our workforce and identify outstanding managerial talent. Upcoming talent is nurtured in various ways, including through international educational opportunities, the Group's own university and challenging responsibilities. We offer performance-based pay packages with performance assessment which is standardised Group-wide, linked to human resources development activities tailored for each employee target group. This enhances the Group's attractiveness overall along with our prospects in the competition for highly qualified specialists and managers. We aim at all times to be the first choice for customers and our workforce. Our success in this regard is repeatedly borne out by Group-wide employee surveys. An element of financial risk remains despite these measures, although we do not estimate this risk to be great.

On 30 January 2009, we discontinued our domestic express business in the USA and are now concentrating on international business in that market. We began the restructuring process in November 2008, which will further reduce the number of employees there by 9,500. As reported in connection with business strategy risks, the overall cost of the restructuring, including severance payments, will run to some €3 billion and the majority of this cost has already been recorded in 2008.

IT security is indispensable

Information technology is a key success factor for our logistics and service processes. Systems must be accessible and available at all times; unauthorised access to data and data manipulation must be prevented, and it is important to ensure that software is not delivered with defects or too late.


Various precautions are taken to minimise the probability of occurrence for IT risks. We will have two main data centres in future – in Malaysia and the Czech Republic. Important applications and data are replicated between our data centres in real time. We have detailed emergency plans and disaster recovery centres in place. Due to the use of redundant systems, the risk of major business interruptions is considered to be low despite the closure of our data centre in the USA.

We continuously improve our security mechanisms to fend off unauthorised data access and data manipulation. Our IT is organised with data security as a prime objective. Plans and strategies to this end take into consideration the workforce, networks and applications. The success of IT security depends critically on employees observing security guidelines and we have therefore acted to raise risk awareness. Amongst other things, we have set up an Information Security Knowledge Centre – an interactive platform with key information on IT security. Thanks to the action taken, we do not expect any significant financial consequences from this risk.

Our services require the use of frequently updated and in some cases newly developed software. Delays and functional deficiencies can never be entirely avoided, however, when developing complex new software and putting it into operation. This risk is reduced by an efficient project management system spanning the entire process from software design to introduction. We expect only minor financial impacts in individual business units.

Management of financial risks

Information on financial risk management is provided in the Notes.

 Note 51.2

Risks from pending legal proceedings

Information on legal risks is provided in the Notes.

 Note 54

Other risks faced by the Group

Our insurance strategy separates insurable risks into two categories. The first category comprises risks with a high probability of occurrence and low individual cost. These risks are insured via what is known as a captive – an insurance company owned by the Group, which is able to cover such risks at a lower cost than external insurers. This category accounts for the majority of insurance expenses. Besides achieving major savings, this also makes for cost stability as the Group is unaffected by changes in the availability and price of outside insurance. The second category consists of risks that have a low probability of occurrence but could entail high losses, such as air transport risks. These risks are transferred to external insurers.

Natural disasters or accidents involving aircraft could have a negative impact particularly on our air-based express operations and the cost of external insurance. As most of our insurance expenditure is incurred in relation to events that have a high degree of predictability – that is, a high probability of occurrence but low individual cost – the effects of such disasters on the size of insurance premiums or on the availability of insurance to cover them are limited.

Audits are currently under way at DHL Express (USA) and Airborne Inc. in line with the unclaimed property laws in the United States. Under these laws, unclaimed property must either be returned to its rightful owner or the home country of the most recent owner or, if this is not known, the country in which the company is domiciled.

In the course of its expansion, the Group has recognised significant amounts of goodwill. According to IAS 36, goodwill must be tested for impairment at least once a year. If goodwill is determined to be impaired, an impairment loss must be recognised.

As a service provider, we do not conduct research and development in the narrower sense. There are therefore no material risks to report in this area.



Note 26

Overall assessment of the Group's risk position

The Group faces significant risks relating to general operating conditions and liberalisation of the German mail market. The global financial crisis and fierce competition are also capable of significantly affecting Group earnings. The majority of the cost of restructuring the us business has already been recorded in 2008.

In the past financial year, there were no identifiable risks for the Group which, individually or collectively, cast doubt upon the company's ability to continue as a going concern. Nor are any such risks apparent in the foreseeable future. For a description of the risk position of Postbank please also refer to the Postbank Group's risk report.



ir.postbank.com