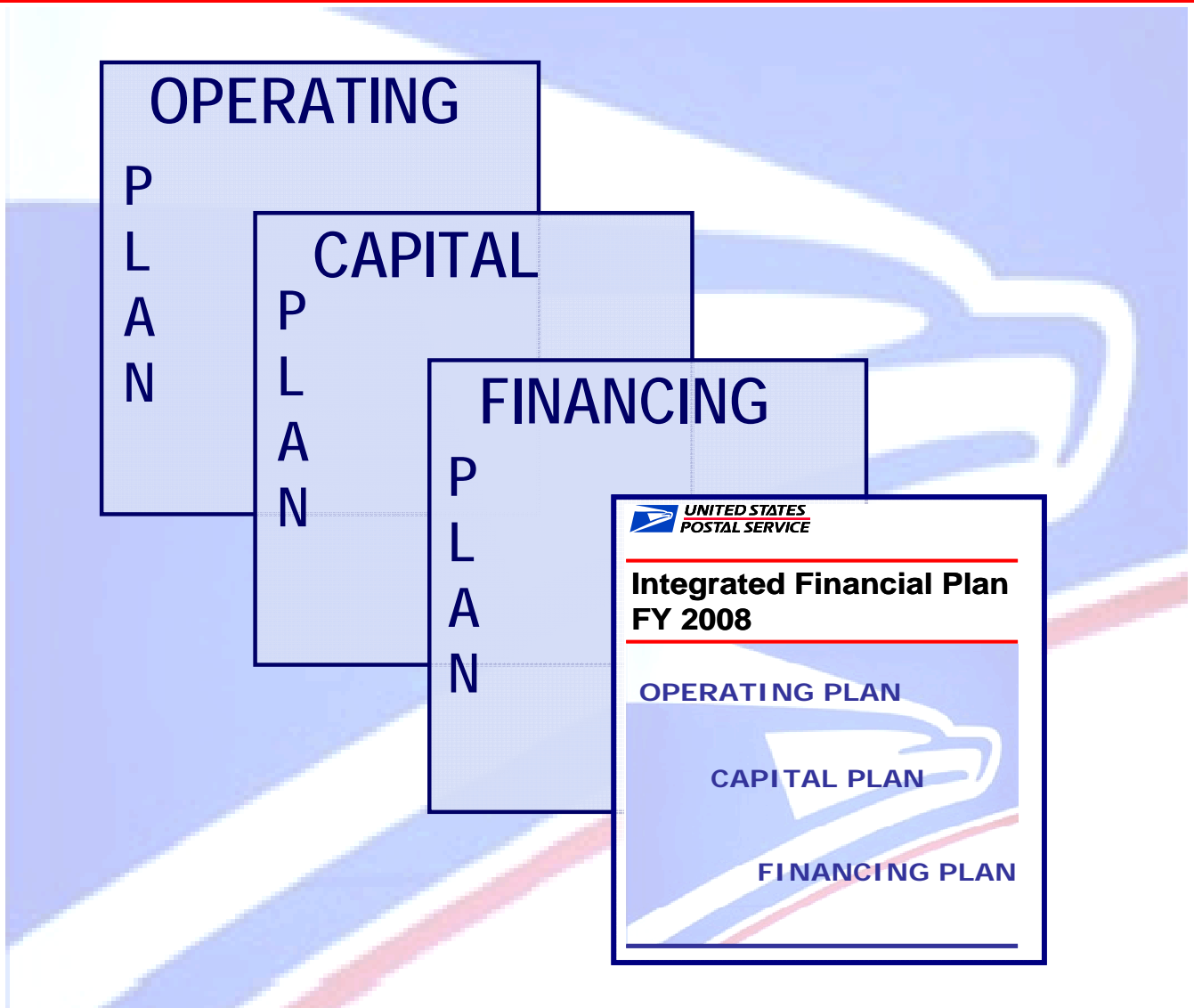


---

# Integrated Financial Plan FY 2008

---



## PREFACE

The United States Postal Service Integrated Financial Plan (IFP) for Fiscal Year (FY) 2008 has been developed by management and is hereby submitted to the Board of Governors.

This annual planning document provides the Board the Postal Service's estimated business needs as they review, evaluate and decide upon issues relating to the organization's financial condition and operations.

The IFP integrates three distinct annual plans, the Operating Plan, Capital Plan and Financing Plan. Each has been developed using FY 2007 estimated operating results as a starting point. These plans are dynamically linked and were developed under a four phase management cycle: Establish, Deploy, Implement and Review.

Establish, includes setting organizational indicators and targets for the fiscal year, beginning in December 2006. Deploy, calls for plans to achieve the targets and allocate resources, beginning in March 2007. Implementation will begin with the new fiscal year and the Review Phase is ongoing.

## TABLE OF CONTENTS

<b>PREFACE</b> .....	<b>i</b>
<b>EXECUTIVE SUMMARY</b> .....	<b>1</b>
<b>ASSUMPTIONS AND UNCERTAINTIES</b> .....	<b>3</b>
<b>OPERATING PLAN</b> .....	<b>5</b>
FY 2007 BASELINE VOLUME AND REVENUE ESTIMATES.....	5
FY 2008 VOLUME AND REVENUE PLAN.....	6
DELIVERY NETWORK .....	7
EXPENSES BY BUDGET CATEGORY .....	7
FIELD EXPENSES.....	7
CORPORATE EXPENSES .....	8
EXPENSES BY COMPONENT .....	10
PRODUCTIVITY .....	11
<b>CAPITAL INVESTMENT PLAN</b> .....	<b>12</b>
FY 2007 CAPITAL COMMITMENTS.....	12
FY 2008 CAPITAL COMMITMENTS.....	12
FY 2008 CAPITAL SPENDING PLAN .....	14
<b>FINANCING PLAN</b> .....	<b>15</b>
<b>IFP SUMMARY RECAP</b> .....	<b>16</b>

## EXECUTIVE SUMMARY

The FY 2008 Integrated Financial Plan (IFP) incorporates the Operating, Capital, and Financing plans that are built upon the projected FY 2007 financial results. Both the FY 2007 results and the FY 2008 IFP are significantly impacted by changes from the Postal Act, which was signed into law by President Bush on December 20, 2006.

The Postal Act of 2006 eliminates the \$3.0 billion escrow previously required under Public Law 108-18 and reduces payments into the Civil Service Retirement System (CSRS) by \$1.5 billion annually. The \$3.0 billion that the Postal Service

placed in a federally mandated escrow account in FY 2006 was designated to be placed in the newly created Postal Service Retiree Health Benefit Fund (PSRHBF). Generally accepted accounting principles dictate the \$3.0 billion be reported as an expense in FY 2007. The Postal Act of 2006 also mandates that an additional \$5.4 billion be placed in the PSRHBF starting in FY 2007. The overall financial impact of the Postal Act on the FY 2007 income statement is \$6.9 billion.

From a cash perspective, the impact from the Postal Act of 2006 in FY 2007 is a net outflow of \$600 million, as the additional \$5.4 billion payment into the PSRHBF is partially offset by the elimination of the \$3.3 billion escrow requirement and the reduction of \$1.5 billion in CSRS payments.

For FY 2008, the new law will have a negative \$1.0 billion net impact. The mandated payment of \$5.6 billion into the PSRHBF is partially offset by the elimination of the \$3.6 billion escrow requirement and \$1.5 billion CSRS payment from the previous law. Additional impacts from the new law are the elimination of the interest income from the escrow, projected to be \$0.3 billion in 2008, and the costs of complying with its various provisions, projected to be \$0.2 billion. These impacts are summarized in the table below.

The Postal Act of 2006 defines new requirements related to the separate tracking and reporting of financial activity for competitive and market-dominant products. The law requires a Competitive Products Fund be created in the US Treasury to capture financial activity associated with competitive products. The law also defines requirements with respect to borrowing, investments, and federal taxation to separate the financial activity and performance of competitive products. The Secretary of the Treasury, in consultation with the Postal Service and other advisors, is required to make recommendations to the Postal Regulatory Commission (PRC) concerning accounting practices and principles associated with competitive products by December 2007. The PRC must then issue final rules within 12 months of receiving Treasury's recommendations. The final PRC regulations will determine the extent to which new financial systems or changes to existing systems will be needed to support the reporting requirements.

Under the new law, the USPS is also required to comply with Section 404 of the Sarbanes-Oxley Act (SOX) beginning in 2010. Complying with SOX mandates management to be responsible for the effectiveness of internal controls over financial reporting. Provisions of SOX detail criminal and civil penalties for noncompliance, certification of internal auditing, and increased financial disclosure.

<b>Projected Income Statement</b>	
	FY 2007
Income from Operations	\$1.5
Impact from Postal Act of 2006 Escrow to PSRHBF	-\$3.0
PSRHBF Expense	-5.4
CSRS Savings	<u>+1.5</u>
Net Loss	<u>-6.9</u>
( <i>\$ in Billions</i> )	

<b>Summary of Costs from Postal Act of 2006</b>	
Compared to Assumptions in R2006-1 Rate Case	FY 2008 Estimate
Elimination of CSRS Contribution	\$1.5
Elimination of Escrow Payment	3.6
Required Payment to PSRHBF	-5.6
Removal of Interest Income on Escrow	-0.3
Projected Cost of Compliance with Postal Act Requirements	<u>-0.2</u>
Impact on Net Income	<u>-\$1.0</u>
( <i>\$ in Billions</i> )	

The Postal Service is projecting a net loss of \$5.4 billion for FY 2007, on revenue of \$75.0 billion and expenses of \$80.4 billion. Projected income from operations of \$1.5 billion is reduced by the \$6.9 billion income statement impact from the Postal Act of 2006, described previously.

The FY 2008 IFP includes an Operating Plan that anticipates a net loss of \$0.6 billion and a Capital Plan that commits \$3.0 billion to achieve process and service improvements, cost reductions, and infrastructure improvements. Capital cash outlays are planned at \$2.3 billion, in line with planned depreciation expenses. The FY 2008 Financing Plan includes debt in the amount of \$5.2 billion. Under the new law, required payments into the PSRHBF have increased the debt plan by \$1.0 billion.

**Operating Plan - Revenue**

The FY 2008 revenue of \$78.2 billion is a planned increase of \$3.2 billion over FY 2007. The forecasted revenue increase is driven by the full year effect of the 7.6 percent average rate increase implemented in May 2007. No additional rate increase is included in the plan.

The forecast assumptions in the FY 2008 plan are for continued Gross Domestic Product (GDP) growth of 2.6 percent and a Consumer Price Index (CPI) increase of 2.0 percent. Despite the expected growth in the economy, the 7.6 percent average rate increase in May 2007 will likely continue to suppress mail volume growth in FY 2008. All mail volumes are expected to decline except Standard Mail.

**Operating Plan - Expense**

Total FY 2008 expense of \$78.8 billion is a planned decrease of \$1.6 billion, or 2.0 percent, below FY 2007. After excluding the \$3.0 billion payment made in FY 2007 of the FY 2006 escrow into the PSRHBF, the planned expense increase in FY 2008 is 1.8%, which is below the expected rate of inflation. Planned cost reductions of \$1.0 billion, which includes a 28 million workhour reduction initiative, will control operating expense growth consistent with the Strategic Transformation Plan.

Although negotiations are

pending between the USPS and the National Rural Letter Carriers Association (NRLCA), successful labor agreements with the American Postal Workers Union (APWU), the National Postal Mail Handlers Union (NPHMU), and the National Association of Letter Carriers (NALC) are in place through FY 2011. Personnel-related costs are expected to be 79 percent of the total expense plan.

**Capital Plan**

The FY 2008 capital commitment of \$3.0 billion reflects the priorities outlined in the Strategic Transformation Plan. Capital commitments will be targeted toward projects that achieve improved service, provide a high return on investment, and/or afford necessary infrastructure improvements.

**Financing Plan**

Based on an operating plan with a net loss of \$629 million, the projected cash flow from operations for FY 2008 is \$1.3 billion including the required payment to the PSRHBF of \$5.6 billion. Capital cash outlays are expected to be \$2.3 billion and free cash flow is estimated at -\$1.0 billion. Debt outstanding on the last day of fiscal years 2007 and 2008 is projected to be \$4.2 billion and \$5.2 billion, respectively. Average daily debt outstanding during 2008 is estimated to be \$600 million.

<b>FY 2008 Financial Summary</b>		
	FY 2007 Estimate	FY 2008 Plan
Revenue	\$75.0	\$78.2
- Expense	<u>80.4</u>	<u>78.8</u>
= Net Income	-\$5.4	-\$0.6
+ Depreciation	2.1	2.3
+ Adjustments (includes relief from Escrow & CSRS)	8.8	5.2
- Payment to Retiree Health Benefit Fund	<u>8.4</u>	<u>5.6</u>
= Cash Flow From Operations	-\$2.9	\$1.3
+ Capital Cash Outlay	<u>(2.5)</u>	<u>(2.3)</u>
= Free Cash Flow	-\$5.4	-\$1.0
+ Cash From Financing	<u>2.1</u>	<u>1.0</u>
= Change in Cash	<u>-\$3.3</u>	<u>\$0.0</u>
Debt Outstanding at Year End	\$4.2	\$5.2
Average Debt Outstanding During Year	<u>\$0.1</u>	<u>\$0.6</u>
<i>(\$ in Billions)</i>		

## ASSUMPTIONS AND UNCERTAINTIES

### **The Economy**

The economic data and forecasts that underlie the Integrated Financial Plan were developed by Global Insight Inc., a respected and independent economic forecasting firm.

The Postal Service used Global Insight's July 2007 baseline forecast, which estimates that growth in the FY 2008 GDP will improve from FY 2007 levels. Growth in economic activity as measured by real GDP in 2006 averaged 3.3%. Growth slowed to 2.5% in Quarter I and 0.7% in Quarter II of FY 2007. GDP growth in Quarter II was revised from 1.3% down to 0.7% but the revision was concentrated in inventories, leaving sales and inventories in better balance—and paving the way for faster economic growth in the third quarter. Therefore, real GDP growth is anticipated to be 3.4% in Quarter III and 2.5% in Quarter IV for an annual growth of 2.3%, based on a stronger second half of the year. GDP growth in FY 2008 is forecasted to increase 2.6%.

### **Economic Assumptions**

	FY 2007	FY 2008
Gross Domestic Product (% Growth)	2.3%	2.6%
Retail Sales (% Growth)	2.1%	1.9%
Nonfarm Employment (% Growth)	1.5%	1.1%
Consumer Price Index (% Growth)	2.3%	2.0%

*Source: Global Insight, Inc. – July 2007 Baseline Forecast*

Although real GDP is the most recognized macroeconomic measure, three other economic variables tend to influence demand for postal services more directly: private sector non-farm employment, real retail sales and the Consumer Price Index (CPI). Growth in all three of these demand factors will abate in 2008.

Electronic alternatives to mail, such as Internet bill payment, will continue to erode volumes of First-Class Mail, Periodicals Mail, and Express Mail. Other forms of competition, such as private sector package and document delivery, will act to suppress volume growth of Priority Mail, Express Mail, and Parcel Post. When combined with the lingering effects of the 7.6 percent May 2007 rate increase, these factors will contribute to slow volume growth of only 0.1 percent in FY 2008, but will generate significant revenue. The volumes of all major mail classes are projected to decrease except Standard Mail, which is projected to increase only 1.1 percent. Since the demand for most postal services is inelastic with respect to postal prices, the increase in rates will result in increased revenues of 4.2 percent. As we will see in more detail on page 6 (FY 2008 Volume and Revenue Plan), revenues will increase for all classes of mail except Express Mail.

Increases in mail volume and related Postal Service revenue depend on the demand for postal services, which in turn depends on a variety of factors including economic growth, electronic diversion, and the attractiveness of competitive alternatives. FY 2008 total mail volume is projected to remain flat with a diminutive increase of 0.1 percent over the FY 2007 forecasted levels.

### **Energy Prices and Housing Market**

Trends in the macro economy are forecasted to again be dominated by two major factors in 2008: energy price volatility and the slowdown housing market. Volatility in energy prices has made forecasting economic growth and inflation challenging. Uncertainties in oil production and refinement have contributed to both high fuel prices and economic uncertainty. Supply disruptions, both real and feared, add to upward pressure on oil prices caused by increased demand from rapidly-growing Asian economies, particularly China. At the same time, the continued lag in the housing market may linger well into 2008. These two events may both reflect and affect the actions of the Federal Reserve with regard to interest rates.

Projected energy-related expenses are \$2.5 billion for FY 2007. Because of the nature of the business, the Postal Service is significantly impacted by changes in energy-related costs, particularly fuel prices. A change in fuel prices of one cent per gallon has an annual impact of \$8 million on expense costs.

The economic outlook according to the Energy Information Administration (EIA) indicates that energy and transportation consumables will increase in the ranges of 2.3 percent to 7.3 percent in FY 2008. USPS utilities and heating fuel costs are forecasted to grow by \$12 million or 1.8 percent over FY 2007, and transportation expenses are forecasted to increase by \$350 million or 5.4 percent over FY 2007.

<b>Price Summary</b>			
<b>Commodity</b>	<b>2007</b>	<b>2008</b>	<b>% Change</b>
WTI Crude (\$/barrel) a	67.61	71.25	5.4
Gasoline (\$/gallon) b	2.74	2.81	2.3
Diesel (\$/gallon) c	2.82	2.99	6.2
Heating Oil (\$/gallon) d	2.50	2.68	7.3
Natural Gas (\$/mcf) d	13.04	13.64	4.7
a West Texas Intermediate	b Average regular pump price		
c On-highway retail	d Residential average		
Source – Energy Information Administration			

**Labor Contracts**

The USPS has successfully negotiated agreements with three labor unions. The American Postal Workers Union (APWU) ratified a four-year Collective Bargaining Agreement on July 5, 2007. The National Postal Mail Handlers Union (NPMHU) negotiated a five-year agreement on April 7, 2007. And on September 11, 2007 a five-year collective bargaining agreement was ratified by the National Association of Letter Carriers (NALC). Negotiations are ongoing with the National Rural Letter Carrier Association (NRLCA).

Although the employer’s share of health insurance premiums will decrease slightly over these contract periods, the terms of these agreements will include increased wages, position upgrades, and cost-of-living adjustments that will make labor more costly. Labor costs account for approximately 79 percent of the Postal Services’ total expenditures.

**Workhour Reductions**

The FY 2008 plan reduces workhours by 28 million from the estimated FY 2007 total despite a projected 1.9 million increase in delivery points. The FY 2008 planned workhour reduction target is equivalent to approximately 14,000 full-time employees. The workhour reductions are a product of process improvements, capital investment programs, changes in mail mix and flattened volumes.

**Postal Act of 2006 – Rates Discussion**

The PRC proposed regulations in September to establish a system of ratemaking under the new law. These proposed regulations allow for market dominant products to have rates increase at the rate of inflation (CPI-U) while allowing competitive products to adjust rates in order to compete in the market place. The Commission’s rules were not finalized at the time this document was prepared; therefore, it has not been determined if USPS will file to increase rates in FY 2008. Accordingly, the FY 2008 volume and revenue forecasts underlying this IFP do not include any rate increases. The PRC expects to issue final rate making regulations this fall.

# INTEGRATED FINANCIAL PLAN

## FISCAL YEAR 2008

### OPERATING PLAN

The projected net loss for FY 2007 is \$5.4 billion, which is driven by legislative changes within the Postal Act of 2006. The new law directed the Postal Service to transfer \$3.0 billion previously held in escrow to the newly created Postal Service Retiree Health Benefit Fund (PSRHBF) and also established a current year requirement of \$5.4 billion to be paid into the PSRHBF. Although the FY 2007 planned escrow of \$3.3 billion and the \$1.5 billion elimination of the employer contributions to Civil Service Retirement System (CSRS) provided some relief to total expense, the financial implications from the new law are significant.

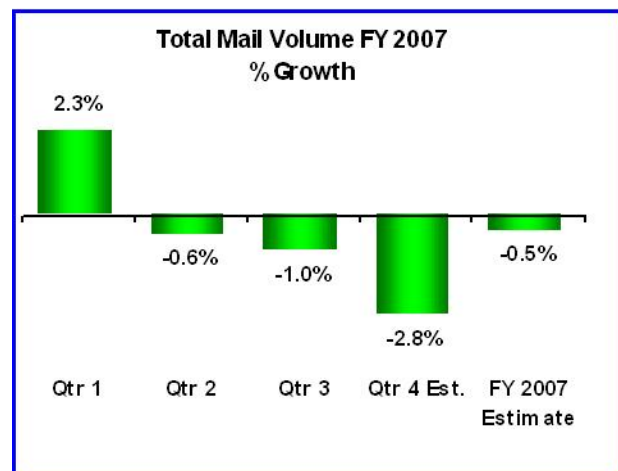
In FY 2008 the planned net loss is \$0.6 billion, which is an improvement of \$4.8 billion over FY 2007.

FY 2008 Operating Budget				
	FY 2007 Estimate	FY 2008 Plan	Change	% Chg
Revenue	\$ 75,008	\$ 78,203	\$ 3,195	4.3%
Expense before 2006 Escrow	77,462	78,832	1,370	1.8%
2006 Escrow (07 Expense)	\$ 2,958	--	-2,958	NM
Total Expense	\$ 80,420	\$ 78,832	\$ -1,588	-2.0%
Net Income/Loss	-\$ 5,413	-\$ 629	\$ 4,784	NM
(\$ in Millions)				

### FY 2007 BASELINE VOLUME AND REVENUE ESTIMATES

Volume is projected to decrease 0.5 percent or 975 million pieces over FY 2006. After increasing 2.3 percent in the first quarter, volume dropped -0.6% and -1.0% in Quarters II and III, respectively. The projected 2.8 percent volume decrease in the fourth quarter is driven by assumptions that weak economic growth and impacts from the rate increase will negatively impact mail use.

The use of mail for advertising continues to increase in importance. For the third consecutive year, Standard Mail volumes exceeded First-Class Mail volumes. Standard (excluding non-profit) Mail volumes grew nearly 0.5 billion pieces (0.6 percent) while First-Class Mail lost 1.5 billion pieces (-1.5 percent). Within First-Class Mail, workshared letters, which contains increasing amounts of advertising grew 0.1 billion pieces (0.2 percent). These gains were more than offset by a 1.7 billion piece (4.0 percent) reduction in single piece letter volume. All First-Class letter mail continues to be adversely challenged by electronic diversion.



Priority Mail volume is projected to drop nearly 4.0 percent in FY 2007 and Express Mail volume is projected to decrease by 3.3 percent. Parcel Post volume is projected to decline by 5.6 percent due to changes within the package industry. The 5.6 percent decline in FY 2007 parcel post volumes is a



weighted average of the 5.1 percent decline in actual parcel post volumes through Quarter III, combined with a 7.5 percent projected volume decline for Quarter IV. The decline through Quarter III is the result of two factors. First, the January 2006 rate increase continued to depress volumes of retail parcel post through Quarter II. Secondly, the effects of the bankruptcy of APX, a large parcel consolidator, severely depressed Parcel Select volume. The projected volume decline in Quarter IV is 7.5 percent, a reflection of the 16 percent price increase on May 14, 2007.

Revenue is projected to increase \$2.2 billion or 3.0 percent over the previous year, driven by the previous two rate increases. The Postal Service continues to see downward pressure on revenue per piece caused by the shift from full-rate First-Class Mail to lower yield products such as Standard Mail and workshared letters.

### FY 2008 VOLUME AND REVENUE PLAN

Overall mail volume is expected to increase by 0.3 billion pieces or 0.1 percent in FY 2008. The Postal Service raised rates an average of 7.6 percent in May 2007. This increase will raise revenues but is expected to suppress volume growth. The volume and revenue projections used herein are based on the assumptions used in the Docket Number R2006-1 omnibus rate case.

First-Class Mail volume is expected to decline 0.6 percent. This decrease reflects the fact that First-

Class Mail rates were increased by 6.9 percent and demand for this product continues to be diverted to electronic alternatives. Priority Mail is expected to lose 1.7 percent of its volume, mostly due to a 13.6 percent average rate increase. Express Mail is expected to have the largest percentage decrease in volume (14.8%). This reflects that Express Mail rates increased an average 12.5 percent and that Express Mail is the most price-sensitive product. A 2.0 percent decline is projected for Periodical Mail volumes. This decline is the result of both an average rate increase of 12.3 percent and the long-term trend of circulation declines.

Revenue				
	FY 2007 Estimate	FY 2008 Plan	Change	% Change
First-Class Mail	\$ 37,576	\$ 38,593	\$ 1,017	2.7%
Priority Mail	5,199	5,553	354	6.8%
Express Mail	940	852	-88	-9.4%
Periodicals	2,212	2,415	203	9.2%
Standard Mail	20,815	22,137	1,322	6.4%
Package Services	2,323	2,467	144	6.2%
International	2,023	2,134	111	5.5%
Other*	3,920	4,052	132	3.4%
<b>Total</b>	<b>\$ 75,008</b>	<b>\$ 78,203</b>	<b>\$ 3,195</b>	<b>4.3%</b>
<i>(\$ in Millions)</i>				
* Special Services, Investment Income and Appropriations are included in the Other category				

picture for Standard Mail. First, FY 2008 does not include a fall election season, which suppresses ECR and Nonprofit ECR growth. Secondly, Standard Mail consists of advertising, which is particularly sensitive to the projected softness in the business cycle.

Volume				
	FY 2007 Estimate	FY 2008 Plan	Change	% Change
First-Class Mail	96,002	95,441	-561	-0.6%
Priority Mail	890	875	-15	-1.7%
Express Mail	54	46	-8	-14.8%
Periodicals	8,767	8,595	-172	-2.0%
Standard Mail	103,138	104,229	1,091	1.1%
Package Services	1,165	1,157	-8	-0.7%
International	825	801	-24	-2.9%
Other*	1,176	1,147	-30	-2.5%
<b>Total</b>	<b>212,017</b>	<b>212,291</b>	<b>274</b>	<b>0.1%</b>
<i>(In Millions)</i>				
* Postal mail and Free Mail for the Blind and Handicapped are included in the Other category				

Standard Mail volume is expected to increase 1.1 percent despite an average rate increase of 8.6 percent. There are four subclasses of mail that comprise Standard Mail. Standard Regular and Standard Nonprofit volumes are projected to increase 2.8 and 1.3 percent, respectively. Enhanced Carrier Route (ECR) and Nonprofit ECR volumes are forecasted to decrease by 1.2 and 7.6 percent respectively. All four classes are impacted by the effects of the May 14, 2007 rate increase. Two other factors play significant roles in the lackluster volume

With a rate increase of 14.1 percent, Package Services volume is expected to decline by nearly 0.7 percent. International mail volume is also expected to fall by 2.9 percent due to the large rate increases that took effect for these products in May 2007.

## DELIVERY NETWORK

The Postal Service delivery network is projected to increase by 1.9 million delivery points in FY 2007. The same level of increase is projected for FY 2008.

Delivery Growth		
	FY 2007 Growth	FY 2008 Growth
City Carrier Deliveries	493	625
Rural Carrier Deliveries	1,177	1,045
Contract Delivery Services	98	135
Post Office Boxes	90	92
Total	1,858	1,897
<i>(Deliveries in Thousands)</i>		

## EXPENSES BY BUDGET CATEGORY

Total expenses are budgeted at \$78.8 billion; an increase of 1.8 percent above FY 2007 estimated expenses (excluding the FY 2006 Escrow payment into the PSRHBF). The FY 2008 expense plan includes productivity savings of \$1.0 billion. The following table details expenses by budget category.

Expenses By Budget Category				
	FY 2007 Estimate	FY 2008 Plan	Change	% Change
Field Operations	\$61,076	\$61,464	\$388	0.6%
Network Transportation	4,243	4,452	209	4.9%
Headquarters Administrative	1,379	1,407	28	2.0%
Programs/Corporate-wide Activities	2,395	2,431	36	1.5%
Service-wide	7,983	8,674	691	8.7%
Corporate Communications	170	172	2	1.2%
Office of the Inspector General (OIG)	205	216	12	5.8%
Postal Regulatory Commission	11	15	4	36.4%
Total Expense before Escrow	\$77,462	\$78,832	\$1,370	1.8%
2006 Escrow	2,958	--	-2,958	-100%
Total Expense	\$80,420	\$78,832	-\$1,588	-2.0%
<i>(\$ in Millions)</i>				

## FIELD EXPENSES

Field expenses are projected to increase by \$388 million, or 0.6 percent, in FY 2008. This increase is largely driven by change in the cost per workhour resulting from cost-of-living adjustments (COLAs), general wage and health benefit premium increases. The carryover impact of the September 2007 COLA, NALC Contract and health benefits alone will be \$529 million in FY 2008, which is 1.0 percent of projected bargaining unit salary costs. Projected increases in fuel costs also contribute to the overall increase in field expenses. The projected growth in field costs has been offset significantly by a number of cost reduction programs. Specifics of cost reductions are presented in the Cost Reductions section.

### **Continued Workhour Reductions**

The FY 2008 plan reduces workhours by 28 million despite the expected addition of 1.9 million delivery points. This workhour reduction target is equal to approximately 14,000 full-time equivalent employees. Planned workhour reductions are a product of process improvements, capital investment programs, changes in mail mix and flattened volumes.

### **Cost Reductions**

The initiatives that enable the cost reductions of \$1.0 billion in the FY 2008 plan are shown in the table. Operational efficiency benefits are spread across all functions. These initiatives employ a number of programs and productivity initiatives; process improvements, implementing best practices, standardization, consolidation of processing operations, complement management, and out-sourcing. Previous capital investment programs are projected to provide cost reductions totaling \$302 million, primarily from automation improvements, reduced manual mail processing and increased machine utilization and efficiency.

### **CORPORATE EXPENSES**

#### ***Network Transportation Expenses***

The plan anticipates corporate transportation expenses, a subset of total transportation costs, of \$4,452 million, a

4.9 percent increase over estimated FY 2007 spending. The major drivers of rising transportation expenses are the scheduled escalation in the transportation contracts and the expected increases in fuel prices.

#### ***Headquarters Administrative Expenses***

Headquarters administrative expense includes headquarters organizations, field support units, and the Postal Inspection Service. Headquarters administrative costs are projected at \$1.4 billion, which is 2.0 percent above the year-end estimate for FY 2007.

#### ***Programs and Corporate-wide Activities Expense***

Programs and Corporate-wide Activities serve as a centralized control for corporate activities performed throughout the Postal Service. Most of these activities directly support field operations. They are managed centrally to leverage the efficiencies of scale and provide management with transparency into the costs and returns for providing these key support services. Corporate-wide Activities and Programs are budgeted at \$2.4 billion, which is 1.5 percent above estimated FY 2007 program expenses. The following table lists the largest expense programs and is followed by a discussion of the major changes in these budgets.

<b>FY 2008 COST REDUCTION OVERVIEW</b>	
<b>ACTIVITY</b>	<b>SAVINGS</b>
<b>Breakthrough Productivity Initiatives:</b>	
Workforce Flexibility Management	\$100
Overtime Reduction Initiative	75
Employee Availability Management	50
P&DC Manual Letters Volume	98
P&DC Manual Flat Volume	37
Logistics and Distribution Centers	15
P&DC All Other Opportunity Hours	53
Function 2B City Delivery	178
Function 4 Manual Letters and Flats	54
Function 4 Retail and Administrative	33
Energy Consumption Reduction	25
<b>Operational Efficiency Gains</b>	<b>\$718</b>
<b>Capital Investments:</b>	
Additional DBCS Machines	49
OCR Enhancements for Letter Automation	35
Distribution Quality Improvement	27
Postal Automation Redirection System (PARS)	59
Automatic Induction Systems for AFSM 100	29
Integrated Dispatch & Receipt Program	27
Human Resources Shared Services	37
Other Miscellaneous Programs	39
<b>Total Reduction From Capital Investments</b>	<b>\$ 302</b>
<b>Total Cost Reductions</b>	<b>\$1,020</b>
<i>(\$ in Millions)</i>	

The Postal Service's largest expense program is the payment of Debit and Credit Card fees to card companies. Although the Postal Service has negotiated lower transaction fees in recent years, use of debit and credit cards in postal transactions has been increasing at double digit rates for the last several years. With the expansion of alternate revenue channels such as Click-N-Ship and Automated Postal Centers, this trend is expected to continue.

FY 2008 Program Spending Major Program Impacts				
Program	FY 2007 Estimate	FY 2008 Plan	Change	% Change
Debit/Credit Card Act	\$ 158	\$172	\$14	8.8%
Human Capital Enterprise/HR Shared Svcs	65	109	44	68.2%
Corporate Advertising	110	100	-10	-8.9%
Expedited Packaging Supplies	103	93	-10	-9.9%
Stamp Manufacturing	99	90	-9	-8.8%
Point of Service	81	85	5	5.6%
Purchased Mail Transport Equipment (MTE)	85	77	-8	-9.4%
Denver (CCM) National Service Center	81	76	-5	-6.2%
Telecom/Voice Service	4	76	72	NM
Advance Computing Environment (ACE)	75	72	-3	-4.0%
NOM Systems International	20	43	23	NM
ACQ – IMDAS Production	27	40	16	59.3%
Product Intelligence	30	30	0	0.6%
All Other Programs	1,457	1,368	-93	-6.4%
Total All Programs	\$ 2,395	\$2,431	\$36	1.5%
(\$ in Millions)				

Human Capital Enterprises/HR Shared Services Program, now called *PostalPeople*, plans a significant increase in spending in 2008 to substantially complete the replacement of the legacy human resources systems and processes with a more modern and efficient shared services system. The increase in expenses results from the full year national implementation and concurrent ramp-up of hiring in the Greensboro Service Center. The benefits of this program are included in other expense categories predominately in field operations.

Corporate Advertising is aimed at enhancing revenue growth for Postal Service products and services. The plan refocuses the advertising efforts for less expense.

Purchased Mail Transportation Equipment is a centralized function for acquiring all new rolling containers, sacks, trays, lids, and pallets for processing, transporting, and delivering all classes of mail. The FY 2008 budget for these programs was significantly reduced as a result of the redesigned Material Distribution and Inventory Management System (MDIMS), better demand forecasting, inventory reduction, and order shortage reduction.

A \$23 million increase over FY 2007 is expected in the International segment of the Network Operations Management (NOM) System, due to growth strategies undertaken by the Global Business group.

### ***Servicewide Expenses***

Servicewide expenses are national-level controlled expenses that are not charged to individual operating or administrative units. The largest component of servicewide expenses is the cost of retiree health benefits. The Postal Act of 2006 required the Postal Service to expense the FY 2006 Escrow of \$3.0 billion into the Postal Service Retiree Health Benefit Fund (PSRHBF) and also requires the USPS to make an additional \$5.4 billion payment into the fund in FY 2007, and \$5.6 billion in FY 2008.

The projected cost of complying with the provisions of the Sarbanes-Oxley Act and segmenting all products into market-dominant and competitive fund categories is expected to be \$100 million in FY 2008.

### ***Office of the Inspector General (OIG) and the Postal Regulatory Commission (PRC)***

The budgets of the OIG and the PRC are developed by those organizations and are reviewed and approved directly by the Board of Governors. The FY 2008 plan for the OIG calls for expenses of \$216 million. The FY 2008 plan for the PRC is \$15 million. The increases in both groups from the previous year are related to the changes necessitated by the Postal Act of 2006.

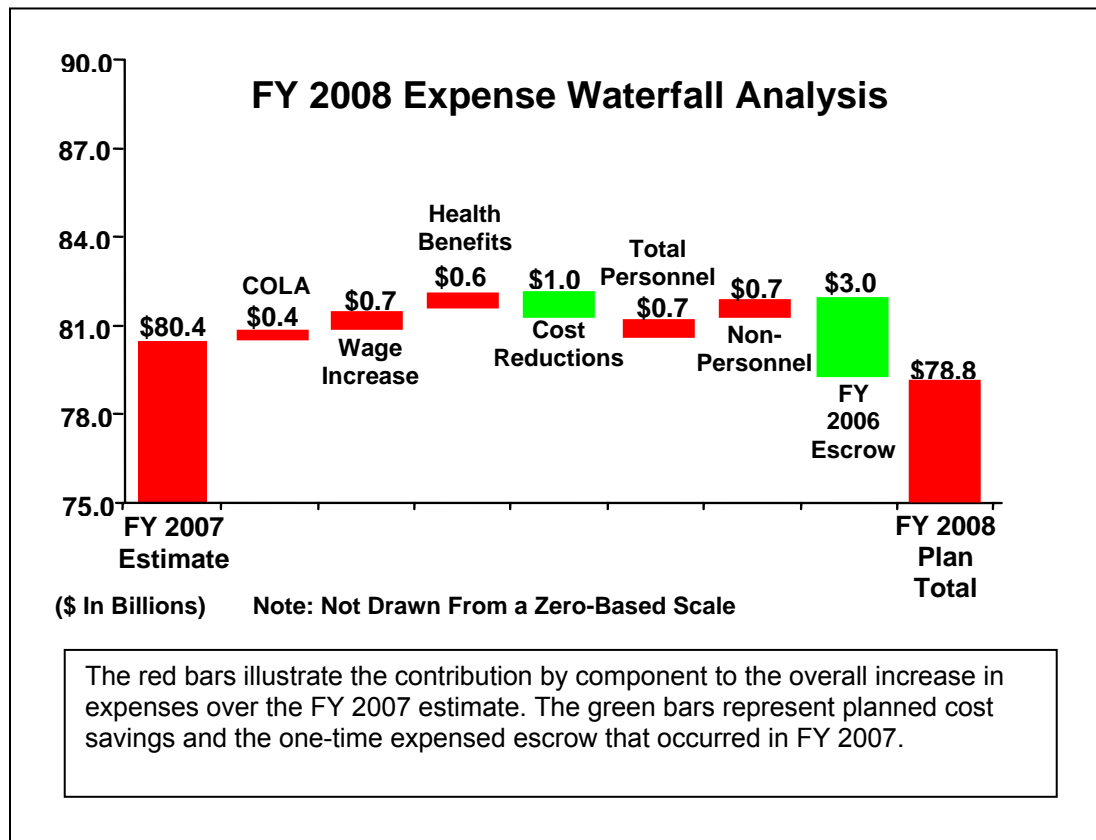
## EXPENSES BY COMPONENT

Examining expense growth by component provides another perspective on the FY 2008 Operating Plan as reflected in the following chart. The plan projects that personnel expense, including salaries, employee and retiree benefits, and workers' compensation, will increase by \$658 million, or 1.1 percent. Personnel costs represent 79 percent of the total expenses.

Expenses By Component				
	FY 2007 Estimate	FY 2008 Plan	Change	% Change
Personnel	\$ 55,986	\$ 56,444	\$458	0.8%
Retiree Health Benefit Fund	5,400	5,600	200	3.7%
Non-Personnel	9,532	9,894	362	3.8%
Transportation	6,544	6,894	350	5.4%
Subtotal Expenses	\$77,462	\$78,832	\$1,370	1.8%
Escrow – Restricted Cash	2,958	--	-2,958	-100%
Total Expenses (\$ Millions)	\$80,420	\$ 78,832	-\$1,588	-2.0%

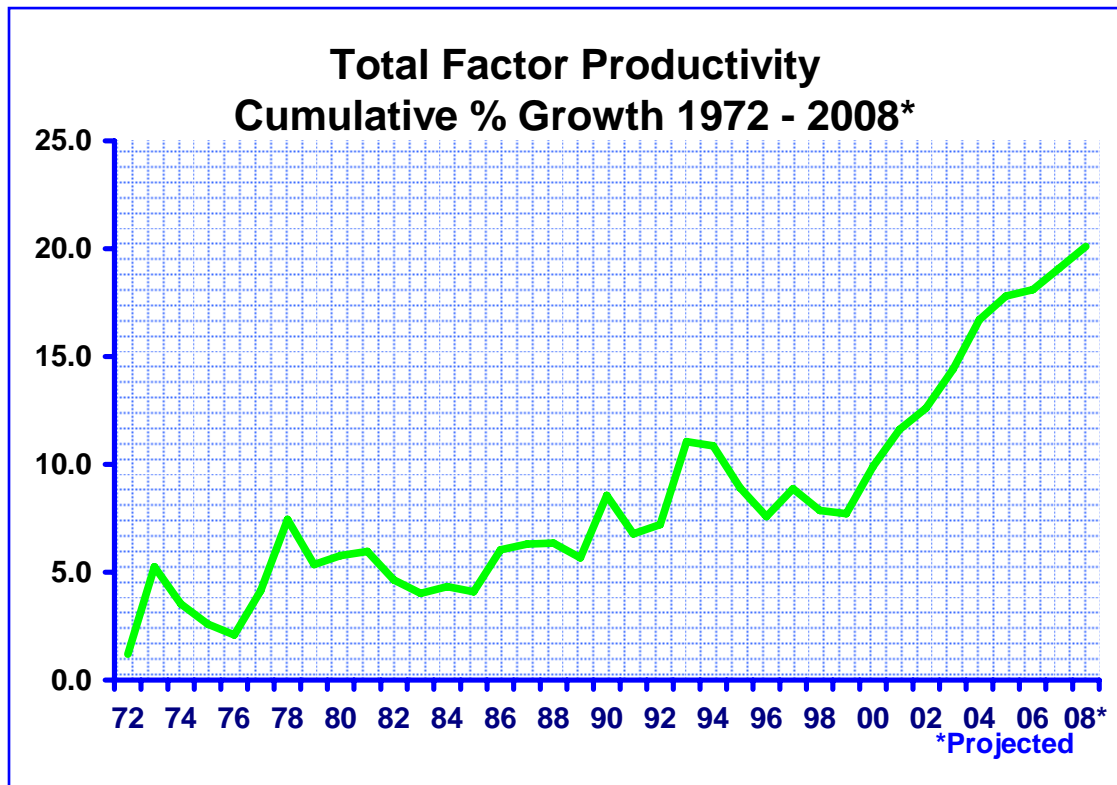
This growth in personnel expense is largely offset by planned workhour reductions. The major drivers of the personnel expense increase include changes in the cost per work hour from cost-of-living adjustments (COLAs), general wage increases, and health benefit expense increases. Health insurance premiums are assumed to increase by 7 percent for current employees in January 2008. Total health benefits expenses for current employees and retirees, including the required payment into the PSRHBF, are expected to exceed \$13 billion, or one-sixth of FY 2008 expenses.

Non-personnel expenses consist of a wide variety of national, field and headquarters costs. These include purchased services, utilities, rent, vehicle maintenance, and depreciation. The non-personnel increases in FY 2008 are driven by projected inflation. Total transportation costs are expected to grow approximately \$350 million, due to contractual obligations and expected increases in energy prices.



## PRODUCTIVITY

In order to keep overall growth in costs below the CPI-U cap on future rate increases it will be even more important to increase productivity throughout the Postal Service. Total Factor Productivity (TFP) measures the change in relationship between outputs (workload) and all resources used in producing those outputs, including labor, materials, and capital. TFP is estimated to grow 1.0 percent in FY 2007 over the previous year and will mark the eighth consecutive year of productivity growth. The following chart shows the cumulative growth in Total Factor Productivity from the first year of Postal Reorganization (1972) through the projection for FY 2008.



Productivity increases in FY 2007 were driven by reducing resource usage faster than declines experienced in weighted mail volume, while absorbing an increase in delivery points. In FY 2008 planned productivity increases will again be achieved by continued absorption of delivery point growth and the implementation of cost reduction programs to more than offset workload. Achieving the targets in the IFP will generate a 1.0 percent increase in TFP, a ninth straight year of positive TFP.



## CAPITAL INVESTMENT PLAN

### FY 2007 CAPITAL COMMITMENTS

In FY 2007, capital commitments will amount to \$2.8 billion. Noteworthy projects approved are: Phase One of the Flat Sequencing System (FSS) will deploy 100 systems to between 30 to 35 facilities. The FSS sorts and sequences flat mail to carrier delivery point. The tray handling systems automatically deliver mail to system feeders and dispatch points. The FSS includes automatic induction, mail preparation stations, buffer/transport, and auto-feed on first pass. The FSS will fully automate delivery point sequencing of flat mail for selected delivery sites, reducing carrier in-office sortation of flat shaped mail.

The Carrier Route Vehicles project purchased 5,856 vehicles. These vehicles will be used to complete a three-part acquisition plan to provide vehicles to rural routes per agreement with the National Rural Letter Carrier's Association.

Additional Delivery Bar Code Sorter 6 (DBCS 6) and Stacker Modules will include 211 new DBCS 6 machines and 797 stacker modules for existing machines. The additional equipment will increase the amount of letter mail processed in automated operations and provide labor savings by reducing manual handling.

### FY 2008 CAPITAL COMMITMENTS

The FY 2008 capital commitment plan will focus primarily on funding projects that provide high returns on investment and address infrastructure requirements for flats sequencing and improved network efficiency. Capital Commitments include \$861 million of generative (G), \$980 million of sustaining (S), and \$1.2 billion of maintenance (M) related projects. A list of the top 20 projects is identified below.

FY 2008 TOP 20 CAPITAL PROJECTS		
Overhaul of the Advanced Facer Cancellor	G	\$310
Automate the forwarding of flat mail	G	153
Additional funding for Flat Sequencing System	G	112
New construction for Richmond P&DC	S	93
New construction for Aliso Viejo, CA P&DC	S	81
Fund projects to reduce energy consumption	S	75
Funds expansion of Sacramento P&DC	S	68
Funds expansion of St Paul P&DC / BMC	S	65
New construction Miami, FL mail processing facility	S	55
Funds the renovations at Morgan P&DC	M	46
Build system for revenue assurance through automation scans	S	46
Replace Integrated Data System infrastructure	S	44
Expand Providence, RI P&DC for FSS	S	32
Support Facilities handicap accessibility requirements	M	30
Expand Springfield, MA BMC for FSS	S	27
Replace IRTs w/ POS	S	25
New construction of Las Vegas, NV Dest. Proc Ctr.	S	25
Expand Mid-Island, NY P&DC for FSS	S	24
Expand San Jose, CA P&DC for FSS	S	23
Purchase & Renovate Bldg for 9 DDCs & FSS	S	20
Sub-total		\$1,354
All Other Commitments		\$1,681
Total Project Commitments		\$3,035
( <i>\$ in Millions</i> )		

The major functional categories of the Capital Investment Plan are identified in the table below.

**Mail Processing Equipment**

The FY 2008 capital plan for equipment is \$1.0 billion or 35 percent of the total plan. The majority is for programs that raise productivity and reduce operating costs.

The Advanced Facer Cancellor System (AFCS) 200 program will replace 800 existing AFCS machines, and install nine machines at the National Center for Employee Development, and one at the Maintenance Technical Support Center. This program replaces AFCS machines that have reached end of life; adds new switchback modules facing all the mail in the same direction; provides the ability to read, spray, and verify POSTNET and intelligent mail bar codes; and incorporate a new image camera and a 2-level 12-stacker bin configuration. The program intent is to reduce re-handling of mail and maintenance costs.

<b>FY 2008 Capital Commitments</b>		
	<b>FY 2007 Estimate</b>	<b>FY 2008 Plan</b>
Mail Processing Equipment	\$1,245	\$1,049
Facilities	980	1,581
Infrastructure and Support	470	377
Retail	--	27
Vehicles	105	1
<b>Total</b>	<b>\$2,800</b>	<b>\$3,035</b>
<i>(\$ in Millions)</i>		

The objective of the Postal Automated Redirection System (PARS) for Flats is to automate the current Flats Forwarding Terminals (FFT). The PARS for flats will identify undeliverable-as-addressed flats during the first handling and redirect them to the customers' new address. This will increase productivity of the FFT and the non-mechanized operations, save transportation costs, and improve delivery efficiency.

**Facilities**

The planned commitment for facilities is \$1.6 billion or 52 percent of the total plan. This portion of the plan reflects continued efforts to increase investments in facility infrastructure replacements and major mail processing facilities. A portion of the facility plan is dedicated to supporting the FSS. Certain selected facilities will be upgraded or expanded to serve the purposes of the FSS system.

The Customer Service Facility Priority System will be updated. Funds have been designated for priority replacement of Customer Service Facilities. With an expected growth of 1.9 million delivery points in FY 2008, the facility infrastructure will be maintained through ongoing repair and alteration projects.

**Infrastructure and Support**

The Infrastructure and Support category is planned at \$377 million. Investments in this category include information/communications network and system requirements. Additional commitments to the Permit Revenue Protection program are included in this category. This project exposes mailings associated with a high risk of revenue loss. Offline analysis by US Postal Inspectors will provide a relational flagged data trail between mailings and accounts paid and identify anomalies for further investigation. Additional benefits of the Permit Revenue Protection program include an enhanced Wide Field of View PC, more efficient use of the Remote Computer Reader infrastructure, and better visibility into the use of permits in the system.

This category also includes support funds for major automation programs as well as funds for maintenance equipment such as forklifts, scrubbers, scissors lifts, and office equipment.

**Retail**

In FY 2008, \$27 million will be committed to the Integrated Retail Terminal (IRT) project. This initiative will replace terminals that are 20 years old and are causing increased costs to maintain due to: 1) inability to add new products/services; 2) separate credit/debit devices that are not compatible with payment switch; 3) additional on-going cost of hardware and software maintenance; and 4) costs of the production/distribution of diskettes for rate changes and software updates. This project will also result in improved service to customers and provide better data for management.



**Vehicles**

There are no major vehicle purchases planned. In FY 2008, the planned commitment for vehicles totals \$1 million for the purchase of various vehicle support equipment. These include liftgates, snow removal equipment, hydraulic lifts, and other vehicle maintenance equipment.

**FY 2008 CAPITAL SPENDING PLAN**

The plan provides for \$2.3 billion in cash outlays, which approximates depreciation expenses. About \$1.7 billion of the planned outlays relate to commitments made in prior years. The remaining \$600 million planned cash outlays are for FY 2008 commitments.

<b>FY 2008 Capital Cash Outlays</b>		
	<b>FY 2007 Estimate</b>	<b>FY 2008 Plan</b>
Mail Processing Equipment	\$1,030	\$786
Facilities	801	1,058
Infrastructure and Support	652	433
Vehicles	24	49
<b>Total</b>	<b>\$2,507</b>	<b>\$2,326</b>
<i>(\$ in Millions)</i>		

## FINANCING PLAN

### ***FY 2007 Financing Activity***

Current FY 2007 estimates of a \$5.4 billion net loss lead to a projected cash flow from operating activities of \$5.5 billion before payments into the Postal Service Retiree Health Benefits Fund (PSRHBF). The Postal Act of 2006 requires the Postal Service to pay into the newly created PSRHBF the \$3 billion that was held in escrow at the end of FY 2006 plus an additional \$5.4 billion for total payments of \$8.4 billion in FY 2007. Expected capital cash outlays are \$2.5 billion, leaving free cash flow of -\$5.4 billion. Cash is projected to decrease by \$3.3 billion and the estimated net increase in debt for the year is \$2.1 billion. Total debt outstanding at the end of the year is projected at \$4.2 billion.

The debt balance will reach its highest level on the last business day of the fiscal year, as a Worker's Compensation payment and the PSRHBF payment of \$5.4 billion are made in September. It is important to note that the year-over-year increase is not the result of a particular transaction or activity, but rather the cumulative effect of all transactions occurring throughout the year. It is anticipated that debt will be in the form of short-term borrowing. Consistent with established practice, all available cash flow will be applied towards debt reduction on a daily basis, minimizing both cash and debt during the course of the year.

### ***FY 2008 Financing Activity***

Based on an operating plan with a net loss of \$629 million, the projected cash flow from operations for FY2008 is \$6.9 billion, before the \$5.6 billion payment to the PSRHBF, or \$1.3 billion afterwards. Capital cash outlays are expected to be \$2.3 billion, leaving estimated free cash flow at -\$1.0 billion. With no change in cash planned, the projected net increase in debt for the year is \$1.0 billion. Debt outstanding on the last day of FY 2008 is projected to be \$5.2 billion.

FY 2008 Financing Plan		
	FY 2007 Estimate	FY 2008 Plan
Beginning Year:		
Unrestricted Cash	\$1.0	\$0.7
Restricted Cash	3.0	0.0
Cash Flow from Operations (Before HB Payment)	\$5.5	\$6.9
Payment to HB Fund	-8.4	-5.6
Capital Cash Outlays	<u>-2.5</u>	<u>-2.3</u>
= Free Cash Flow	-\$5.4	-\$1.0
Cash from Financing (U.S. Treasury)	<u>2.1</u>	<u>1.0</u>
= Change in Cash	-\$3.3	\$0.0
End of Year Cash	\$0.7	\$0.7
Average Debt	\$0.1	\$0.6
Debt Outstanding at Year End	\$4.2	\$5.2
<i>(\$ in Billions)</i>		

## IFP SUMMARY RECAP

To recap, the FY 2008 USPS Integrated Financial Plan results in a projected net loss of \$629 million. The Postal Service will employ process improvements and transformation strategies to continue its productivity improvements despite projected flattened volumes, increasing delivery points, and forecasted economic impacts.

<b>FY 2008 Financial Summary</b>		
	FY 2007 Estimate	FY 2008 Plan
Revenue	\$75.0	\$78.2
- Expense	<u>80.4</u>	<u>78.8</u>
= Net Income	-\$5.4	-\$0.6
+ Depreciation	2.1	2.3
+ Adjustments (includes relief from Escrow & CSRS)	8.8	5.2
- Payment to Retiree Health Benefit Fund	<u>8.4</u>	<u>5.6</u>
= Cash Flow From Operations	-\$2.9	\$1.3
+ Capital Cash Outlay	<u>(2.5)</u>	<u>(2.3)</u>
= Free Cash Flow	-\$5.4	-\$1.0
+ Cash From Financing	<u>2.1</u>	<u>1.0</u>
= Change in Cash	<u>-\$3.3</u>	<u>\$0.0</u>
Debt Outstanding at Year End	\$4.2	\$5.2
Average Debt Outstanding During Year	<u>\$0.1</u>	<u>\$0.6</u>

(\$ in Billions)