FY2003 THIRD QUARTER REPORT

February 22, 2003 to May 16, 2003

Due to Public Law 108-18, the Balance Sheet has been restated

See Page 7

For additional Information, please see:

Press Release of December 2, 2003

UNITED STATES
POSTAL SERVICE

FINANCIAL CONDITION & RESULTS

RESULTS OF OPERATIONS QUARTER 3, FY 2003 COMPARED TO PLAN & QUARTER 3, FY 2002

For the quarter beginning February 22, 2003 and ending May 16, 2003, the Postal Service realized a net income of $224 million compared to a plan of $336 million. The $112 million unfavorable variance was due to a $483 million revenue shortfall which was only partially offset by a $371 million expense underrun. A materially positive event which occurred was that Public Law 108-18 (PL 108-18) was passed into law and signed by the President on April 23, 2003. This law corrected the situation where the Postal Service was on track to contribute substantially more money to the Federal Government's Civil Service Retirement System (CSRS) than was necessary to fund obligations arising from postal employment. Net income with the impact of the CSRS change was $483 million. The CSRS impact in Quarter 3 was $259 million.

Year-to-date net income is $1.9 billion compared to a plan of $1.5 billion, without the impact of PL 108-18. The favorable variance is due to an expense underrun of $1.4 billion which more than offsets the $1.1 billion revenue shortfall. Net income increases by $2.7 billion to $4.5 billion when adjustments resulting from PL 108-18 are included.

PL 108-18 changed Postal Service employer funding requirements for CSRS from "static" (7.0% of basic pay) to "dynamic" (17.4% of basic pay). Additionally, the $32 billion deferred retirement costs, which would have required a $3.9 billion payment on September 30, 2003, was recalculated under the new law and reduced to $5.8 billion. The first payment on revised deferred retirement costs is not due until September 30, 2004. The net income impacts attributed to PL 108-18 are the net of elimination of the September 30, 2003 payment on the deferred retirement costs and the increase in CSRS funding requirements (7.0% to 17.4%).

OPERATING REVENUE AND MAIL VOLUME

In Quarter 3, the Postal Service earned $16.0 billion in revenue on volume of 47 billion pieces of mail. Operating revenue grew 5.2% due to the impact of the June 30, 2002 rate increase. Total volume declined slightly compared to the same quarter last year. Operating revenue was $490 million below plan and volume was 785 million pieces below plan.

Revenue and volume of First-Class Mail, Priority Mail and Express Mail, our highest margin products, had the largest shortfalls to plan. The volume performance compared to plan was less unfavorable for Standard Mail. These results reflect the impact of electronic diversion, competition, and an economy growing less rapidly than had been forecasted.

In our Quarter 2 outlook, we said that in "Quarter 3 we believe that volumes will decline and expect that revenue growth will remain below 6%." Volume actually declined by 0.2% in Quarter 3 while operating revenue grew 5.2%.

First-Class Mail

First-Class Mail revenue of $8.7 billion was $352 million, or 3.9%, below plan. Higher rates implemented June 30, 2002 produced a 3.2% increase in revenue even though First-Class volume declined by 2.8% (671 million pieces) compared to the same quarter last year. This was the seventh consecutive quarter of declines in First-Class Mail volume. A source of particular concern is the drop in First-Class workshare mail volume. This was the fourth consecutive quarter of decline in this category which includes bills, statements and premium advertising messages.

The Quarter 2 outlook said that the weakness of the economic recovery and continuing inroads by electronic alternatives were having a negative impact on First-Class Mail. It also said that expectations for workshare volume growth were reduced and that it was expected First-Class volume declines would continue through the rest of this year. Confirming this assessment, total First-Class volume declined by 2.8% and workshare First-Class volume declined by 1.5% in Quarter 3.

Priority & Express Mail

Consistent with Quarter 1 and 2 results, Priority Mail volume fell 14.0% and revenues were 2.7% below the same quarter last year. Priority Mail volume and revenue were both under plan by 6.6%. Express Mail volume and revenue were also below plan by 3.3% and 4.7%, respectively. Express Mail volume dropped 12.3% and revenue dropped 4.3% from the same quarter last year. These product lines continue to be negatively affected by businesses moving packages to ground delivery services, the sluggish economy, and intense competition in the air and ground package delivery markets.

The Quarter 2 outlook said that double digit declines in Priority Mail and Express Mail volumes were expected to persist in Quarter 3. This assessment was borne out by the respective 14.0% and 12.3% volume declines of Quarter 3.

Periodical Mail

The Quarter 2 outlook said that periodical volume would continue to decline but that the rate of decline would moderate from the 5.2% decline in Quarter 1, and the 3.6% decline in Quarter 2. The rate of periodical volume decline did moderate to 2.2% in Quarter 3.

Standard Mail

Standard Mail volume increased by 638 million pieces, and was 3.1% over the same quarter last year. This is the fourth consecutive quarter of growth for Standard Mail. Standard Mail revenue increased 10.0% compared to the same quarter last year, but was $56 million, or 1.4%, below plan.

The Quarter 1 and 2 outlooks said that Standard Mail volume was projected to grow and could be the only significant source of volume growth. As was mentioned, Standard Mail volume actually grew by 638 million pieces in Quarter 3, or 3.1% over the same period last year. This was the only source of significant volume growth. But this growth was insufficient to offset the volume declines in First-Class Mail, Priority Mail, Express Mail and Periodicals.

Package Services

Package Services revenue was $50 million over plan, or 11.0%, while Package Services volume was over plan, at 30 million pieces, or 13.7%. Compared to the same quarter last year, Package Services volume increased by 27 million pieces or 12.3%. Within Package Services, Parcel Post volume was 9.1% above last year. Parcel Post volume also exceeded plan by 6 million pieces or 7.9%.

The Quarter 2 outlook said that Package Services volume was expected to grow in Quarter 3.

INTEREST INCOME

Interest income for the third quarter totaled $14.3 million compared to a plan of $6.9 million. For the year, interest income is $37.6 million versus a plan of $24.2 million. Higher than planned net income, combined with lower than planned capital expenditures, have increased cash flow resulting in higher than projected short-term investment returns.

OPERATING EXPENSE

In Quarter 3, operating expense totaled $15.4 billion compared to a plan of $15.7 billion. This was $366 million or 2.3% below plan. Operating expense grew 1.0% compared to Quarter 3 of last year.

Personnel compensation was $46 million under plan or 0.4%. The underrun to plan in personnel compensation was due to continued reductions of employees through attrition and reductions in work hours. In Quarter 3, work hours were reduced 3.2% utilizing 25,400 fewer career employees than this same quarter last year and 4,660 fewer career employees than Quarter 2. Work hours for the period were 0.6 million over plan but 11.4 million below Quarter 3 of FY 2002.

With PL 108-18, personnel compensation expense decreases by $136 million. This is comprised of a decrease of $178 million due to a reduction in the deferred retirement expense, and a $42 million expense increase due to a change in the required employer retirement contributions from 7% to 17.4% that became effective May 3, 2003..

Non-personnel expenses were $319 million below plan, or 9.3%. For the quarter, transportation expense was $25 million, or 2.2% below plan, due in part to the decrease in transportation requirements and tighter contract controls. Supplies and services expense was $200 million or 27.2% under plan for the quarter. Supply chain management activities continue to drive down supplies and services expense, as did reduced needs due to lower volumes and declining complement.

INTEREST EXPENSE

Before considering the impact of PL 108-18, interest expense for the third quarter of $454 million was $5 million below plan. Interest expense includes interest on deferred retirement costs ($371 million) and on borrowings ($83 million). Interest expense on borrowing was $5 million below plan.

When the impact of PL 108-18 is considered, interest expense on the deferred retirement costs decreases by $123 million for the quarter.

TOTAL EXPENSE

Total expenses of $15.8 billion increased by $152 million, or 1.0%, from the same quarter last year but were $370 million under plan. When the impact of CSRS changes are considered: total expenses declined $107 million compared to the same quarter last year.

Year-to-date before the impact of the CSRS changes, total expenses of $46.9 billion are $375 million greater than last year but $1.4 billion below plan. After the impact of the CSRS changes, total expenses of $44.3 billion are $2.3 billion below last year at this time.

PRODUCTIVITY

Total Factor Productivity increased 1.5% in Quarter 3 compared to the same quarter last year. Workload declined 0.3% during the quarter in spite of a 1.4% delivery workload growth compared to the same quarter last year. At the same time resource usage was reduced by 1.8% compared to a plan decrease of 0.2%. This marks the sixteenth quarter of reductions in resource usage – an unprecedented trend. The reductions have been accomplished through careful management of work hours and tight cost controls. Output per work hour was up 2.6% over Quarter 3 last year.

CAPITAL COMMITMENTS AND EXPENDITURES

Capital commitments for Quarter 3 of $112 million were $133 million less than planned.

Commitments for the Field Material Handling Systems program accounted for $24 million, Major Mail Processing Facilities projects accounted for $7 million, the Automated Package Processing System accounted for $6 million, and the Flats Remote Encoding System and the Biohazard Detection System accounted for $5 million during Quarter 3. The remaining $70 million was spread among all other capital programs.

Capital cash outlays of $276 million for the quarter were $225 million or 45% under forecast. All categories except customer service support equipment were under the forecast.

ASSETS

At the end of Quarter 3, total current assets increased by $2.1 billion compared to the end of FY 2002. The increase was the result of a $2.0 billion increase in cash. The Postal Service typically experiences strong positive cash flows during the early part of its fiscal year. When it is practical to do so, excess cash is applied toward debt reduction as discussed below. We used our positive cash flow to reduce debt outstanding by $3.8 billion from the balance at the end of the last fiscal year.

The net decline of $716 million in the property, plant, and equipment account represents the difference between the acquisition of additional assets and the depreciation of existing assets. Fixed assets increased $858 million, which was offset by depreciation of $1,574 million.

Deferred retirement costs were reduced to $5.8 billion due to PL 108-18. Changes to the liability are discussed below.

LIABILITIES

Current liabilities, excluding the current portion of debt, have decreased $2.1 billion for the year. This is primarily due to the reduction in retirement costs resulting from the enactment of PL 108-18.

Total debt has declined by $3.8 billion. Strong positive cash flows driven primarily by net income and moderate capital spending enabled this reduction. Cash flows during the year are enhanced because net income includes the non-cash expense accruals for workers' compensation which will not result in cash payments until September. Normally, debt increases between the end of the third quarter and the close of the fiscal year as large payments are made in September for workers' compensation and CSRS retirement costs. Last year these payments totaled $4.6 billion and debt increased by $4.2 billion. This year, however, as the result of PL 108-18, only the workers' compensation payment will be made and it is expected to be around $900 million.

Deferred Retirement costs payable have been reduced to $5.8 billion as a result of PL 108-18.

The workers' compensation liability, reflecting the estimated cost of employee injuries, has increased by $990 million for the year. Employee accumulated leave is unchanged from the year-end balance of last year.

POSTAL EQUITY

The Quarter 3 equity balance was a positive $955 million, versus a negative $3 billion on September 30, 2002. The net income generated from September 30th through May 16, 2003, produced a $3.9 billion improvement in net capital deficiency at quarter's end. This includes the impact of PL 108-18.

SUMMARY

Revenue and mail volume growth remained sluggish through the third quarter. However, tight control over expenses and resource usage resulted in net income YTD that was $373 million greater than planned without PL 108-18. Including the PL 108-18 impact, the plan variance is greater than $3 billion.

OUTLOOK

The outlook for the Postal Service's volume and revenue growth has been and continues to be soft due to the economic environment. Virtually all of the Postal Service's mail volume contains some type of marketing or advertising message, relates to financial activity, supports consumer or business transactions, or involves the shipment of goods. When the economy is weak, businesses pull back on advertising expenditures, financial activity ratchets down, fewer consumer and business transactions are executed, and fewer goods are purchased for shipment.

In June 2002 when the Postal Service was formulating its Operating Plan for this year, macroeconomic forecaster Global Insight projected that Gross Domestic Product (GDP) would grow 3.3% in FY 2003. Since then, Global Insight's FY 2003 GDP growth forecast has fallen to 2.3%. Other economic indicators have also fallen back. For example, Global Insight projected in June 2002 that private sector non-farm employment would grow by 1.2% in FY 2003, but now that we have actual data for most of the year, employment is expected to drop by 0.4%. Further, the change in the outlook for consumer spending has tracked the change in the outlook for GDP; projected FY 2003 growth for consumer spending has dropped from 3.3% to 2.3%. Because most mail volume originates and/or destinates at households, weak employment reports and sluggish consumer spending data presage weak mail volume growth.

Although many economic prognosticators believe that conditions are ripe for an accelerated economic recovery, there is little concrete evidence to suggest that rapid economic growth has begun. Until there are concrete signs of a quickening recovery, the Postal Service believes it is prudent to assume that the economic weakness experienced in the recent past will continue into the near future.

Other factors which recently have had a negative impact on volume and revenue trends include electronic diversion, mail mix and transportation mode shifts to ground services in the package delivery markets, and a slowdown in the growth of financial and consumer accounts held by households. Management believes these factors will continue to operate on volume growth.

Looking forward, an event which could have a favorable impact on Postal Service volume and revenue growth is the Federal Communications Commission's new "do not call" list. This list will first become effective in September of this year and will inhibit the ability of direct marketers to conduct telemarketing. Mail is an alternative direct marketing channel and is much less intrusive and disruptive than telemarketing. Standard mail volume may benefit from this new marketing restriction.

As of July 1, 2003, year-over-year revenue comparisons will have the same rates in base and current years. Thus revenues will continue to grow through July 1, 2003, reflecting the impact of the 7.7% average rate increase that was implemented on June 30, 2002. However, year-over-year revenue comparisons are expected to be negative beyond June 30, 2003, offsetting the impact of the pre-July 1, 2003 growth.

Volume had risen by 1.5% in Quarter 1 and was flat in Quarter 2 and slightly negative in Quarter 3. Revenues had risen by 6.3% in Quarter 1 and 5.2% in Quarters 2 and 3. Following on these generally declining volume and revenue trends, we expect both volumes and revenues to be flat to negative in Quarter 4.

First-Class volume declines are expected to continue in Quarter 4. It is expected that the workshare category within First-Class will continue to be weak.

The double-digit rates of volume decline for Priority Mail and Express Mail are expected to moderate somewhat in Quarter 4 when the year-over-year impact of rate increases will begin to appear in both the base and current periods. However, it is also expected that volume from these categories will continue to divert to alternative services.

The rate of decline in Periodical volumes is not expect to ease much more going forward. Both consumer and business magazines are reporting losses in advertising pages in the most recently reported monthly data, which suggests re-emergent weakness in the conditions for periodical volume growth.

The situation for Standard Mail volume growth in Quarter 4 is uncertain. While the factors that have driven Standard Mail volume in the first three quarters of this year remain positive, the FY 2002 Quarter 4 base for Standard Mail was much stronger than the base for the previous three quarters. While the evidence is conflicting, on balance management believes this strong base could result in flat or slightly negative Standard Mail volume in Quarter 4 of this year.

Package Service volume jumped 12.3% in the last quarter, led by a 20.7% volume increase in the highly volatile bound printed matter category. Due in large part to the movement of package shipments from air to ground services, it is expected that Package Service volume will continue to grow moving forward.

On the expense side, management is projecting favorable impacts in Quarter 4 from implementation of expense reduction plans, low inflation rates and continued stringent cost controls. Expenses through Quarter 3 were well below plan and only slightly above last year. Similar results are likely in Quarter 4 of this year. Field Operations has been effective in matching work hour usage to declining workload over the last two years. More recently, significant progress has been made in controlling the growth of non-personnel expenses. The net income effect of the favorable outlook on expenses and the unfavorable outlook on revenue in Quarter 4 is such that management expects to finish the year exceeding the planned net income of $600 million, before allowing for the impact of PL 108-18. Under the revised funding formulas, and taking into account the timing of the law's passage, the Postal Service's FY 2003 contributions to Civil Service Retirement System (and Postal Service expenses) will be approximately $3.5 billion less than the amount that was anticipated in our FY 2003 operating plan.

This outlook is subject to a variety of risks. On the expense side, for example, fuel and other input prices could become volatile and erode operating margins. On the revenue and volume side, diversion could accelerate or the economy could fall into a double dip recession, although if further revenue and volume erosion were to occur, the primary impacts would be on FY 2004 operating results.

For more details, link to: http://www.usps.com/financials/_pdf/ap0903.pdf

Income Statement
Quarter 3, 2003
(Without PL 108-18 Impact)

($ in Millions)	Quarter Ending		Year-To-Date	
	May 16, 2003	May 17, 2002	May 16, 2003	May 17, 2002
Operating Revenue	**$ 16,033**	**$ 15,246**	**$ 48,789**	**$ 46,238**
Operating Expenses:				
Compensation and Benefits	12,252	12,126	36,376	$ 35,852
Transportation	1,131	1,121	3,546	$ 3,614
Other	1,985	1,964	5,642	$ 5,729
Total Operating Expenses	**15,369**	**15,210**	**45,565**	**$ 45,194**
Income From Operations	**665**	**36**	**3,224**	**$ 1,044**
Interest and Investment Income	14	11	38	$ 26
Interest on Deferrred Retirement	(371)	(378)	(1,114)	$ (1,135)
Interest Expense on Borrowing	(83)	(83)	(268)	$ (243)
Net Income (Loss)	**$ 224**	**$ (414)**	**$ 1,879**	**$ (308)**
Unadutied				
Based on Postal Fiscal Year				

Income Statement
Quarter 3, 2003
(With PL 108-18 Impact)

($ in Millions)	Quarter Ending		Year-To-Date	
	May 16, 2003	May 17, 2002	May 16, 2003	May 17, 2002
Operating Revenue	**$ 16,033**	**$ 15,246**	**$ 48,789**	**$ 46,238**
Operating Expenses:				
Compensation and Benefits	12,117	12,126	34,824	$ 35,852
Transportation	1,131	1,121	3,546	$ 3,614
Other	1,985	1,964	5,642	$ 5,729
Total Operating Expenses	**15,233**	**15,210**	**44,013**	**$ 45,194**
Income From Operations	**800**	**36**	**4,777**	**$ 1,044**
Interest and Investment Income	14	11	38	$ 26
Interest on Deferrred Retirement	(248)	(378)	-	$ (1,135)
Interest Expense on Borrowing	(83)	(83)	(268)	$ (243)
Net Income (Loss)	**$ 483**	**$ (414)**	**$ 4,546**	**$ (308)**
Unaudited				
Based on Postal Fiscal Year				

Balance Sheet
Quarter 3, 2003 Compared to Ending Period Last Year

($ in Millions)	May. 16, 2003*	Sept. 30, 2002		May 16, 2003*	Sept. 30, 2002
ASSETS			**LIABILITIES**		
Current Assets			Current Liabilities	9,661	11,771
Cash & Cash Equiv.	$ 3,113	$ 1,156	Total Debt	7,275	11,115
			Deferred Retirement Costs _1/	-	30,046
Other Current Assets	1,263	1,124	Other Liabilities	10,273	9,085
Total Current Assets	**4,376**	**2,280**	**Total Liabilities**	**$ 27,209**	**$ 62,017**
			EQUITY		
Property Plant & Equipment - Net	23,420	24,136	Government Capital Contributions	$ 3,034	$ 3,034
Deferred Retirement Costs_1/	-	32,231	Deficit Since Reorganization	(2,079)	(6,036)
Other Assets	368	368	**Total Equity (Capital Deficiency)**	**$ 955**	**$ (3,002)**
Total Assets	**28,164**	**59,015**	**Total Liabilities & Equity**	**$ 28,164**	**$ 59,015**

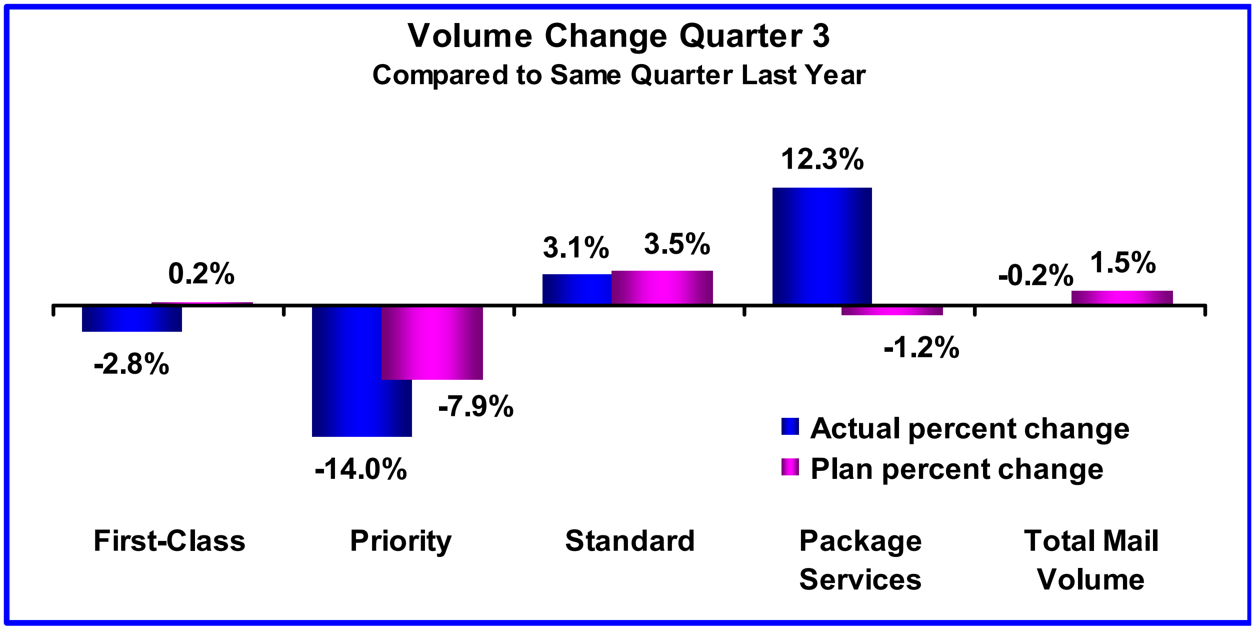
_1/ Financial statements for the third quarter have beeen revised to remove the Deferred Retirement Cost from our assets and our liabilities. Public Law 108-18, the Civil Service Retirement System Funding Reform Act of 2003, revised Postal Service funding of the Civil Service Retirement and Disability Fund (CSRDF) The normal cost contribution was increased from 7% to 17.4% of basic pay effective May 3, 2003. Additionally the law provides that the Office of Personnel Management (OPM) determine any potential supplemental liability on an annual basis. This determination will be both one year in arrears and subject to future adjustments. As a result of the uncertainty in determining this amount and consistent with accounting guidance for multiemployer retirement plans where only final amounts billed are reflected on the financial statements, the Postal Service will disclose the estimated CSRDF supplemental liability in our notes to the financial statements (currently estimated at $5.8 billion), and the annual expense charged to us by OPM will be recognized in the year billed.

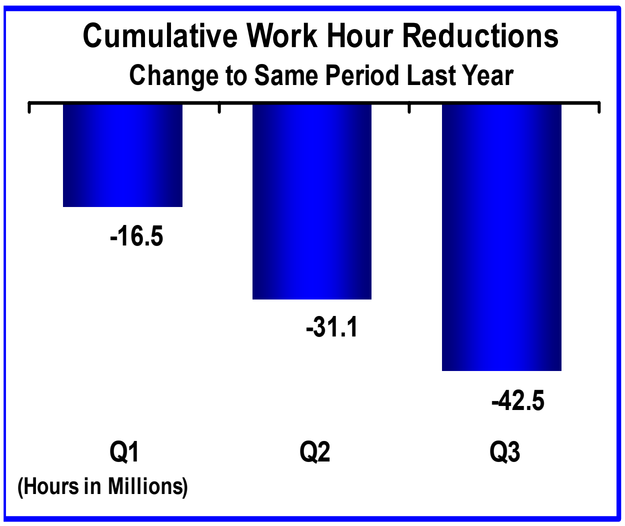
* Unaudited
Based on Government Fiscal Year

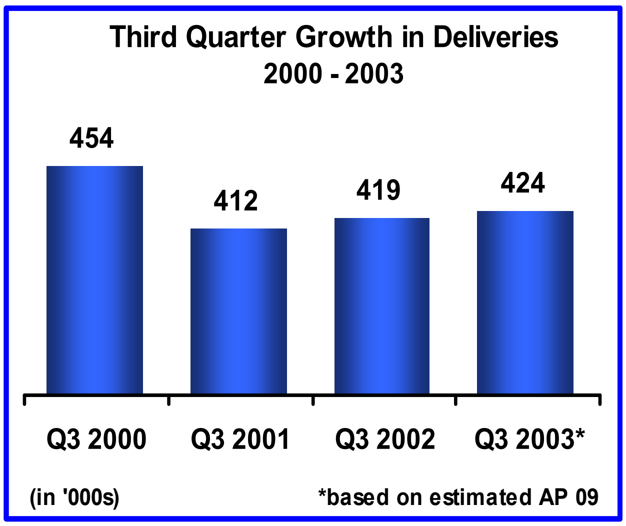
Statement of Cash Flows
October 1, 2002 through May 16, 2003

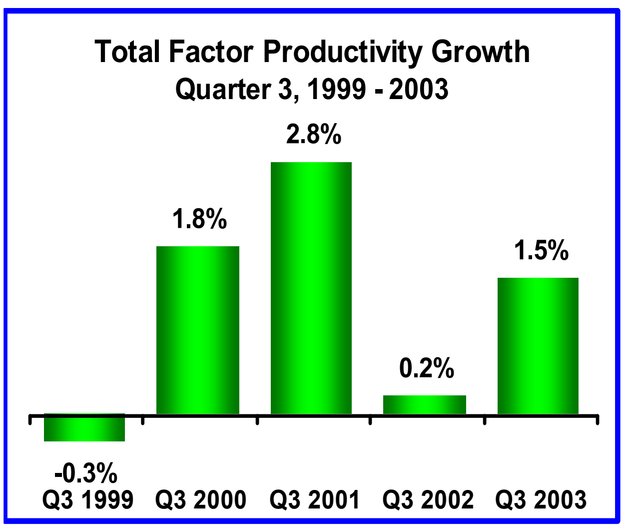
($ in Millions)	May. 16, 2003*	Sept. 30, 2002
Cash Flows from Operating Activities:		
Net Income (Loss) (Government Fiscal Year)	$ 3,957	$ (676)
Depreciation and Amortization	1,574	2,296
Changes in Non Current Assets & Liabilities	3,373	892
Changes in Current Assets & Liabilities	(2,250)	(1,081)
Net Cash Provided by Operating Activities	**6,654**	**1,431**
Cash Flows from Investing Activities:		
Sale of Securities, Property and Equipment	1	42
Purchase of Property and Equipment	(858)	(1,705)
Net Cash Used by Investing Activities	**(857)**	**(1,663)**
Cash Flows from Financing Activities:		
Appropriation Balance	-	583
Increase/(Decrease) in Debt	(3,840)	(200)
Net Cash Provided by Financing Activities	**(3,840)**	**383**
Net Change in Cash and Cash Equivalents	**1,957**	**151**
Cash & Cash Equivalents at Beginning of Period	1,156	1,005
Cash & Cash Equivalents at End of Period	**$ 3,113**	**$ 1,156**

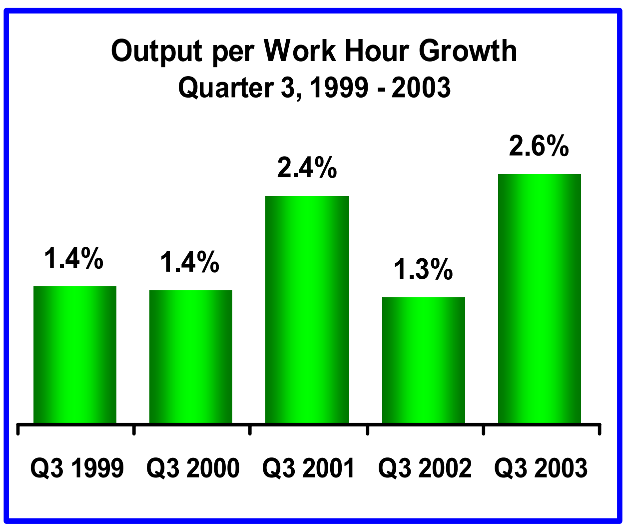
* Unaudited
Based on Government Fiscal Year


Volume Change Quarter 3
Compared to Same Quarter Last Year
First-Class
Priority
Standard
Package Services
Total Mail Volume
-2.8%
0.2%
-14.0%
-7.9%
3.1%
3.5%
12.3%
-1.2%
-0.2%
1.5%
Actual percent change
Plan percent change


Cumulative Work Hour Reductions
Change to Same Period Last Year
-16.5
-31.1
-42.5
Q1
Q2
Q3
(Hours in Millions)


Third Quarter Growth in Deliveries
2000 - 2003
454
412
419
424
Q3 2000
Q3 2001
Q3 2002
Q3 2003*
(in '000s)
*based on estimated AP 09


Total Factor Productivity Growth
Quarter 3, 1999 - 2003
-0.3%
1.8%
2.8%
0.2%
1.5%
Q3 1999
Q3 2000
Q3 2001
Q3 2002
Q3 2003


Output per Work Hour Growth
Quarter 3, 1999 - 2003
1.4%
1.4%
2.4%
1.3%
2.6%
Q3 1999
Q3 2000
Q3 2001
Q3 2002
Q3 2003