
Integrated Financial Plan FY 2009

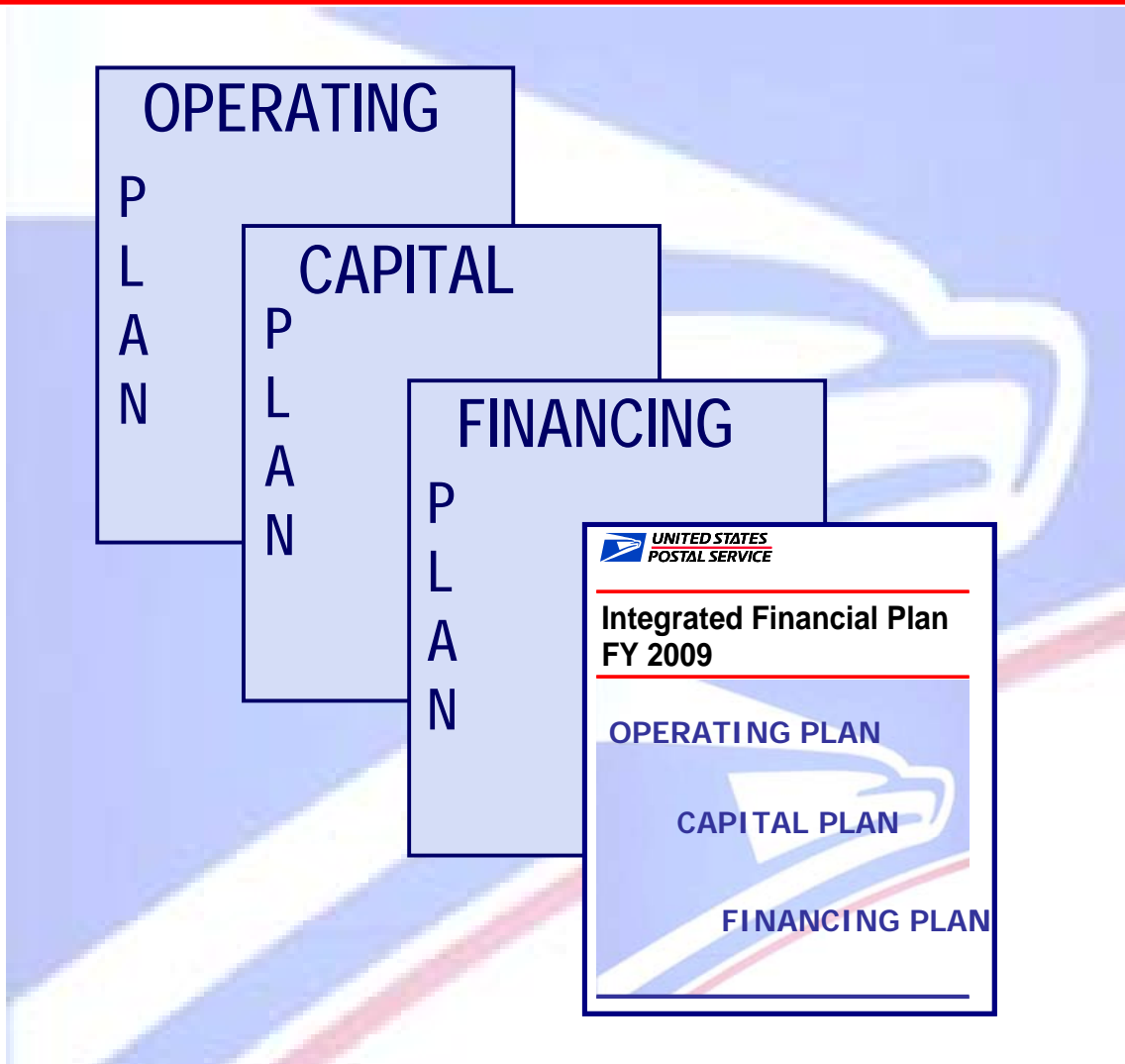


TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
ASSUMPTIONS AND OVERALL ENVIRONMENT	2
OPERATING PLAN	3
FY 2009 VOLUME AND REVENUE PLAN	3
DELIVERY NETWORK	4
EXPENSES BY COMPONENT	5
CAPITAL INVESTMENT PLAN	6
FY 2008 CAPITAL COMMITMENTS	6
FY 2009 CAPITAL COMMITMENTS	6
FY 2009 CAPITAL CASH OUTLAY PLAN	7
FINANCING PLAN	8
FY 2008 FINANCING ACTIVITY	8
FY 2009 FINANCING ACTIVITY	8

EXECUTIVE SUMMARY

The FY 2009 Integrated Financial Plan (IFP) was developed in the summer of FY 2008 and was built upon the projected FY 2008 financial results and the August economic forecast from Global Insights, Inc. The IFP incorporates the Operating, Capital and Financing plans of the US Postal Service. Since the approval of the IFP at the December 2008 session of the Postal Board of Governors, this document has been updated with actual FY 2008 results.

The severe economic downturn affecting the nation since 2007 had a significant impact on the actual financial performance of the Postal Service for FY 2008 and the FY 2009 forecast. The concurrent effect of the largest volume decline in the history of the Postal Service, along with significantly increasing expenses due to high inflation during the first three quarters of FY 2008, played a primary role in this decline. In addition, labor costs including cost of living expenses are expected to increase by \$3 billion over FY 2008, before any offsetting cost reduction efforts.

The FY 2009 IFP includes an Operating Plan with a net loss of \$3.0 billion and a Capital Commitment Plan that has been reduced to \$1.7 billion. Capital cash outlays are planned at \$2.1 billion, below planned depreciation expense. The FY 2009 Financing Plan includes anticipated borrowing of \$3.0 billion in FY 2009, which would bring the debt outstanding at year's end to \$10.2 billion, with year-end cash of \$2.1 billion on the balance sheet.

Operating Plan - Revenue

The FY 2009 revenue of \$76.2 billion is an increase of \$1.2 billion over FY 2008. The forecasted revenue increase is driven by the 2.9 percent average rate increase implemented in May 2008 and product-specific price increases in Shipping Services expected in January 2009. In addition, the FY 2009 forecast includes, for planning purposes, a projected price increase of 4.8 percent in Mailing Services in May 2009. Overall, volumes are expected to decline by 8.2 billion pieces in FY 2009.

The forecast assumptions in the FY 2009 plan include a negative Gross Domestic Product (GDP) growth of -1.1 percent and a Consumer Price Index (CPI) increase of 5.1 percent.

Operating Plan - Expense

Total FY 2009 expense of \$79.2 billion is a planned increase of \$1.4 billion, or 1.8 percent, above FY 2008. Management has identified and implemented an unprecedented level of cost reduction efforts to offset the rising costs from inflation experienced throughout almost all of FY 2008.

Labor agreements with the National Postal Mail Handlers Union (NPHMU) and the National Association of Letter Carriers (NALC) are in place through FY 2011; while labor agreements with the American Postal Workers Union (APWU), and the National Rural Letter Carriers Association (NRLCA) are in place through FY 2010.

Capital Plan

The FY 2009 capital commitment of \$1.7 billion is the lowest level in several years, due to the current economic environment. Capital commitments will be targeted toward projects that improve service, provide a high return on investment, and support our core initiatives and basic infrastructure needs.

Financing Plan

Based on an operating plan with a net loss of \$3.0 billion, the projected cash flow from operations before the payment into the Retiree Health Benefit Fund (RHBF) for FY 2009 is \$5.2 billion. Capital cash outlays are expected to be \$2.1 billion, providing free cash flow of \$3.1 billion prior to the legally required payment to the Postal Service Retiree Health Benefit Fund of \$5.4 billion. Borrowing of \$3.0 billion in FY 2009 will increase the year-end cash balance by \$0.7 billion to \$2.1 billion, which is needed for increased liquidity and as a hedge against the risks inherent in this plan. Debt outstanding on the last day of fiscal year 2009 is projected to be \$10.2 billion.

ASSUMPTIONS AND OVERALL ENVIRONMENT

The Economy

The macroeconomic data and forecasts underlying the Postal Service's volume and revenue forecasts used for the Integrated Financial Plan are based on the August 2008 forecasts of Global Insight, Inc., an independent economic forecasting firm. For volume, this gave us a forecast of 202 billion pieces, which would be even with FY 2008 volumes. Given the volatile economic environment and after discussions with major customers, trade groups and associations, we believe this to be far too optimistic and reduced the volume forecast to 194.5 billion pieces, which is the lowest level of volume since FY 1997.

The overall outlook for the economy for Fiscal Year 2009 is volatile. Since Fiscal Year 2003 economic growth as measured by real Gross Domestic Product (GDP) growth rates has increased each year. Global Insight forecasts GDP to shrink by 1.1 percent for Fiscal Year 2009.

Although GDP is the most widely used statistic in discussions of economic growth, postal mail volumes are more strongly correlated with other metrics such as employment and retail sales. Growth in private sector non-farm employment, a driver of First-Class Mail demand, is projected to be 0.2 percent in FY 2008 and -1.5 percent in FY 2009. Growth in real retail sales, which is a determinant of Standard Mail and Priority Mail volumes, is forecasted at -0.5 percent in FY 2008 and -3.6 percent in FY 2009.

Economic Assumptions

	FY 2008	FY 2009
Gross Domestic Product (% Growth)	1.7%	-1.1%
Retail Sales (% Growth)	-0.5%	-3.6%
Non-farm Employment (% Growth)	0.2%	-1.5%
Consumer Price Index (% Growth)	4.5%	5.1%

Source: Global Insight, Inc. – August 2008 Pessimistic Forecast

The turmoil in the economy is driven by several well known fundamental factors. The housing crisis and the subprime mortgage meltdown with their broader related financial woes are primary drivers. Banks, financial institutions and real estate firms are heavy users of advertising mail. Recent fluctuations in energy prices have added uncertainty to an already troubled economic slowdown. One of the few bright spots in the economy is growth in exports, helped by weakness in the U.S. dollar. That strength in exports should result in international mail volume growth in FY 2009.

In addition, cost inflation has been forecasted to rise dramatically. The Consumer Price Index for all urban consumers (CPI-U) is expected to be 4.5 percent in FY 2008 and 5.1 percent in FY 2009.

Financial Services Industry, the Housing Market, and Energy Prices

Trends in the macro economy are forecasted to again be dominated by three major factors in 2009: the continuing effects of the crisis in the financial services industry, the slowdown in the housing market, and by volatility in energy prices. The financial crisis among credit institutions is dominating economic events, and a recession is a virtual certainty. The lack of available credit will plague already slumping housing prices, and excess inventories are sharply inhibiting growth.

Volatility in energy prices has made forecasting economic growth and inflation challenging. Uncertainties in oil production and refinement could contribute to rapid swings in fuel prices in either direction. Supply disruptions, both real and feared, could add to upward pressure on oil prices caused by increased demand from rapidly-growing Asian economies. Conversely, a recession that is deep or prolonged would likely exert downward pressure on oil prices, which could substantially lower overall inflation.

INTEGRATED FINANCIAL PLAN

FISCAL YEAR 2009

OPERATING PLAN

The net loss for FY 2008 was \$2.8 billion, and was driven by unprecedented decreases in mail volume and high energy costs. For FY 2009, we are again planning on lower volumes, a reduction of 8.2 billion pieces, and cost inflation of \$4.2 billion.

As daunting as the expectation is for a \$3 billion loss in FY 2009, the outlook would be much worse if it were not for the aggressive cost reductions that have been put into place to counter the effects of declining volume. Management has identified \$4.7 billion in cost reduction opportunities throughout the organization, and is working to capture as many of these opportunities as quickly as possible without negatively effecting service to our customers, but some cost reduction opportunities will not be fully realized until FY 2010.

FY 2009 Operating Budget				
	FY 2008	FY 2009		%
	Actual	Plan	Change	Change
Revenue	\$75.0	\$76.2	\$1.2	1.7%
Expenses	72.2	73.8	\$1.6	2.2%
Operating Income (1)	\$2.8	\$2.4	-\$0.4	---
RHBF Payment	5.6	5.4	-\$0.2	
Net Loss	-\$2.8	-\$3.0	-\$0.2	
<i>(1) Before RHBF Payment</i>				
<i>(\$ in Billions)</i>				

FY 2009 VOLUME AND REVENUE PLAN

Mail volume trends are affected by a number of factors. As discussed previously, the economy plays a critical role. Other factors include population growth, price changes (both for postal and competitors products), and long term trends. The most important long term trend is the steady erosion of First-Class Mail volume to alternate electronic media, most recently to the Internet. For 2009, we plan another dramatic decline in volume.

The volume plan for FY 2009 is set at 194.5 billion pieces, which includes revenue stretch initiatives. Associated revenues are determined by applying average revenues per piece and price increases to the volume plan.

The deteriorating performance of the overall economy will drive the decline in mail volume. Long term trends such as electronic diversion affect First-Class Mail and Standard Mail. Due to the current economic conditions we expect further erosion from virtually all customer segments.

Volume				
Major Mailing Services Classes	FY 2008	FY 2009		%
	Actual	Plan	Change	Change
Standard Mail	99,084	93,443	-5,641	-5.7%
First-Class Mail	91,697	89,129	-2,568	-2.8%
Periodicals	8,605	8,098	-507	-5.9%
Package Services	846	870	24	2.8%
All Other	2,471	2,988	517	20.9%
Total USPS Volume	202,703	194,528	-8,175	-4.0%
<i>(in Millions)</i>				

Standard Mail includes direct mail advertising. Although Standard Mail has held its own in terms of its share of the advertising market, it nonetheless is subject to downturns in the business cycle. Volume changes in FYs 2008 and 2009 reflect this link to the economy. Standard Mail ended FY 2008 at 99.1 billion pieces, 4.4 billion pieces, or 4.2 percent, less than in FY 2007. The FY 2009 volume plan results in Standard Mail volumes continuing to fall 5.7 percent to 93.4 billion pieces.

First Class Mail had a total volume of 91.7 billion pieces in FY 2008, 4.6 billion pieces or 4.8 percent, below 2007. The volume plan for 2009 calls for a further decrease to 89.1 billion pieces, a decline of 2.4 percent. First-Class Mail is driven by the sluggish economy, specifically weakness in the financial sector, and the on-going, long-term diversion of mail volumes to electronic alternatives.

Periodicals Mail volume is not particularly sensitive to price changes. However, it is adversely affected by long term declines in reading hard copy material. Periodicals Mail declined by 193 million pieces, or 2.2 percent, to 8.6 billion pieces in FY 2008. The plan calls for a further decline in Periodicals of 0.5 billion pieces, or 5.9 percent, in FY 2009.

Package Services is a mixture of parcels, books, and heavy weight advertising materials. In FY 2008 this category had a volume of 846 million pieces or 7.5 percent decline compared to the previous year. In FY 2009 Package Services are expected to increase in volume by 2.8 percent. All Other Mail includes Free Mail for the Blind and Handicapped, Postal Penalty Mail and Shipping Services.

Total mail volumes declined 9.5 billion pieces, or 4.5 percent, to 202.7 billion pieces in FY 2008. The FY 2009 plan assumes a continued decline of 8.2 billion pieces (4.0 percent) to 194.5 billion pieces.

Total revenue for FY 2008 was \$75.0 billion, even with total revenue in FY 2007. Two price increases, 7.6 percent in May 2007 and 2.9 percent in May 2008, boosted revenue per piece by approximately 5.3 percent. The difference in revenue is the result of volume changes and changes to the mail mix. Based on planned volumes, revenues for 2009 are expected to increase \$1.2 billion or 1.7 percent to \$76.2 billion. Revenues will benefit from the May 2008 2.9 percent price increase and next May's assumed 4.8 percent increase in Mailing Services, along with product specific price increases in Shipping Services expected in January 2009.

Revenue				
Major Mailing Services Classes	FY 2008 Actual	FY 2009 Plan	Change	% Change
First-Class Mail	\$38,179	\$37,691	-\$488	-1.3%
Standard Mail	20,586	20,128	-458	-2.2%
Periodicals	2,295	2,261	-34	-1.5%
Package Services	1,845	1,897	52	2.8%
Other*	<u>12,063</u>	<u>14,243</u>	<u>2,180</u>	<u>18.1%</u>
Total USPS Revenue	\$74,968	\$76,220	\$1,252	1.7%

(\$ in Millions)
 * Special Services, Real Estate Sales, Investment Income and Appropriations are included in the Other category

Adverse mail mix changes occur when classes of mail with low unit revenue grow at a faster rate than classes with high unit revenue. Within First-Class Mail single piece letter volume declined from 2007 to 2009 by 8.5 percent while workshared letter volume declined by 1.7 percent over the same period. These trends suppress revenue growth at the class level as the overall revenue per piece is reduced.

DELIVERY NETWORK

The Postal Service delivery network increased by 1.2 million delivery points in FY 2008 and is projected to increase by the same amount in FY 2009. This rate of growth is considerably lower than the 1.4 to 1.8 million annual increases in delivery points experienced earlier this decade.

Delivery Growth		
	FY 2008 Growth	FY 2009 Growth
City Carrier Deliveries	403	405
Rural Carrier Deliveries	709	723
Contract Delivery Services	46	47
Post Office Boxes	<u>42</u>	<u>42</u>
Total	1,200	1,216

(Deliveries in Thousands)

Cost Reductions

Postal management has aggressively reduced costs wherever possible to counter the effects of declining volume, and has done so while achieving record high levels of service performance. Management has identified \$4.7 billion in cost reduction opportunities and pulled them from internally allocated budgets throughout the organization. We are working to capture as much of these cost reduction opportunities as possible without negatively effecting service to our customers, but some cost reduction opportunities will not be fully realized until FY 2010.

FY 2009-2010 TARGETED COST REDUCTION OVERVIEW	
ACTIVITY	SAVINGS
Targeted Cost Reductions by Function	
Plant Operations	\$1.8
City Delivery Operations	1.3
Rural Delivery Operations	0.1
Customer Services Operations	0.7
Transportation Initiatives	0.2
Other Operational Initiatives	0.3
FY 2009-10 Operational Cost Reductions	\$4.4
Discretionary and Administrative Reductions	0.3
Total FY 2009-2010 Targeted Cost Reductions	\$4.7
FY 2009 Cost Reductions Planning Assumption	\$2.8
FY 2010 Cost Reductions Planning Assumption	\$1.9
(\$ in Billions)	

Specific information on targeted cost reductions are contained in the accompanying table.

Workhour Reductions

While cost reduction opportunities of more than 100 million hours have been deployed throughout the organization, the FY 2009 planning assumption calls for a reduction of 70 million workhours from FY 2008 usage, despite a projected increase of 1.2 million delivery points. The workhour reductions are a product of process and efficiency improvements, capital investment programs, and less volume. Achievement of this level of workhour reductions will require little or no hiring of employees to replace those who leave through attrition, and voluntary early retirements have been offered to eligible employees. Additionally, continued substantial reductions in overtime usage are needed to capture these planned savings.

EXPENSES BY COMPONENT

Examining expense growth by component provides another perspective on the FY 2009 Operating Plan. 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 6 percent for current employees in January 2009. Total health benefits expenses for current employees and retirees, including the required payment into the PSRHBF, are expected to exceed \$12.4 billion, or one-sixth of FY 2009 expenses. This growth in personnel expense is partially offset by planned workhour reductions. Even so, personnel costs will represent 78 percent of the total 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 2009 are driven by the carryover impacts of increased inflation, increased facility repairs, and forecasted increases in non-transportation fuel related expenses. Total transportation costs are expected to grow approximately \$300 million, due to contractual obligations and the expected carryover impact of increases in energy prices since the beginning of fiscal 2008.

CAPITAL INVESTMENT PLAN

FY 2008 CAPITAL COMMITMENTS

In FY 2008, the capital commitments were planned at \$3.0 billion and ended the year at \$2.3 billion. The underrun follows from the delay in construction and equipment projects. Several of the planned equipment projects such as Postal Automated Redirection System (PARS), Phase III and PARS for Flats were delayed.

Noteworthy projects approved in FY 2008 are:

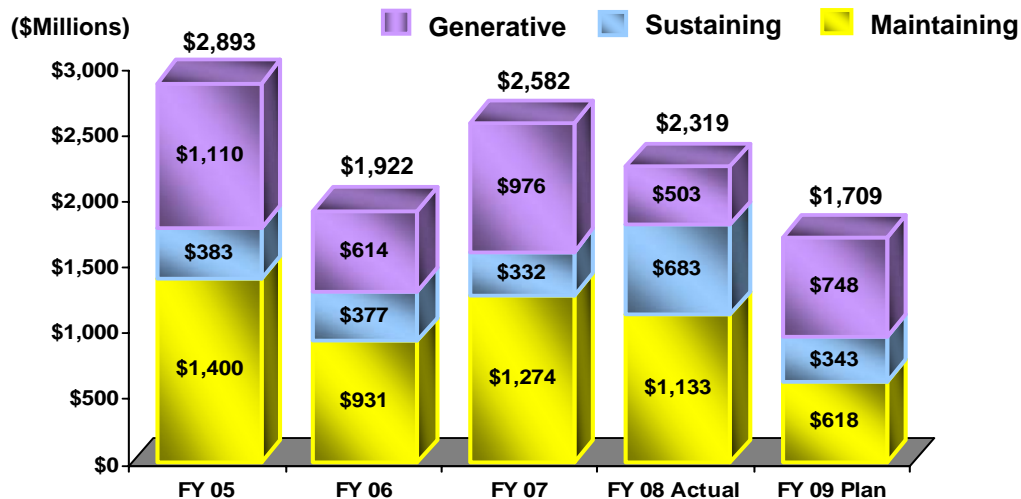
- The Advance Facer Cancellor 200 (AFCS 200) project will deploy 550 AFCS 200 machines. This purchase will address end of life issues with existing cancellation equipment initially placed in service over 16 years ago. The new AFCS 200 will include features that improve mail processing operations and enhance service.
- The FY 2008 Carrier Route Vehicles project purchased 1,352 vehicles. These vehicles will be used to initiate the next planned phase of providing postal-owned right hand drive vehicles to rural routes per agreement with the National Rural Letter Carrier's Association.
- The purchase of 739 additional Delivery Bar Code Sorter Stacker Modules will be added to 110 postal facilities where they will provide a greater depth-of-sort to existing letter mail processing operations. The labor savings generated by this program are expected to produce a strong return on investment.

FY 2009 CAPITAL COMMITMENTS

The FY 2009 capital commitment of \$1.7 billion is the lowest level in several years due to the current economic environment. Capital commitments will be targeted toward projects that achieve improved service, provide a high return on investment, support the few key initiatives we must address, and basic infrastructure needs.

The approval process for Board level projects has changed in FY 2009. The Board approved the Capital Plan in November 2008. They also concurred with the individual projects presented, contingent upon the Capital Investment Committee and Postmaster General approval to fund projects during the fiscal year. Projects will no longer go to the Board for vote in FY 2009. The FY 2009 capital commitment plan will focus primarily on funding projects that provide high returns on investment, address infrastructure requirements, and improve network efficiency.

Capital Commitments by Category



Generative projects are based on financial opportunity, with projected returns on investment (ROI) in excess of 10%. Sustaining projects are based on service needs, with modest savings, and have a positive ROI of less than 10%. Maintaining projects are based on infrastructure needs, with little or no savings.

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

Facilities

In FY 2009, the planned commitment for facilities is \$663 million or 39 percent of the total plan. This portion of the plan reflects continued efforts to invest primarily in facility infrastructure repairs.

Equipment

The FY 2009 capital plan for equipment is \$681 million or 40 percent of the total plan. The majority of this is for programs that raise productivity and reduce operating costs.

FY 2009 Capital Commitments		
	FY 2008 Actual	FY 2009 Plan
Facilities	\$1,425	\$663
Equipment	472	681
Infrastructure and Support	336	353
Vehicles	<u>25</u>	<u>12</u>
Total	\$2,258	\$1,709
(\$ in Millions)		

Infrastructure and Support

The Infrastructure and Support category is planned at \$353 million. Investments in this category include information/communications network and system requirements. It will make it easier for our customers to transact business by creating a higher awareness of our online products.

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

FY 2009 CAPITAL CASH OUTLAY PLAN

The FY 2009 plan provides an estimated \$2.1 billion in cash outlays. The majority of the planned outlays in FY 2009 relates to commitments made in prior years.

FY 2009 Capital Cash Outlays		
	FY 2008 Actual	FY 2009 Plan
Facilities	\$1,052	\$946
Equipment	524	724
Infrastructure and Support	360	392
Vehicles	<u>39</u>	<u>16</u>
Total	\$1,975	\$2,078
(\$ in Millions)		

FINANCING PLAN

FY 2008 FINANCING ACTIVITY

The FY 2008 net loss of \$2.8 billion led to a cash flow from operating activities before RHBF payments of \$5.1 billion. Capital cash outlays were \$2.0 billion, leaving free cash flow of \$3.1 billion, prior to the legally required payment to the Postal Service RHBF of \$5.6 billion. Borrowing of \$3.0 billion on the last day of the fiscal year brought the year end cash balance to \$1.4 billion. Total debt outstanding at the end of the year was \$7.2 billion.

The debt balance reached its highest level on the last business day of the fiscal year, as a Worker's Compensation payment of \$1 billion and the PSRHBF payment of \$5.6 billion was made in September. Debt is in the form of short-term borrowing. Consistent with established practice, all available cash flow is applied towards debt reduction on a daily basis, minimizing both cash and debt during the course of FY 2008 and FY 2009.

FY 2009 FINANCING ACTIVITY

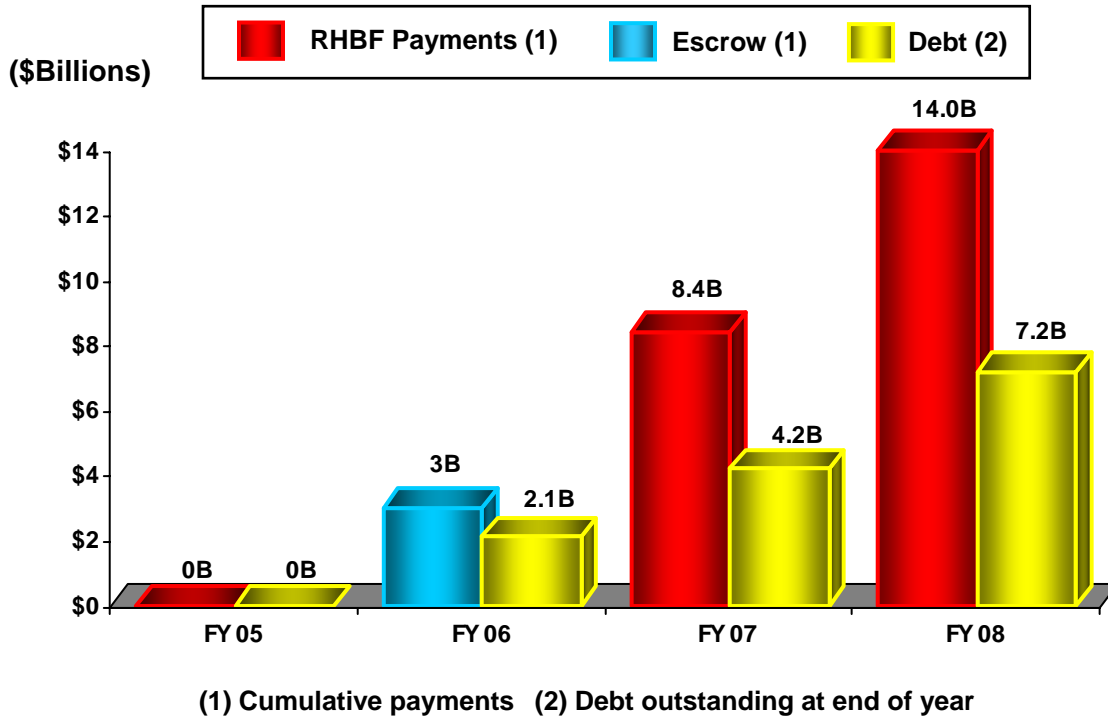
Based on an operating plan with a net loss of \$3.0 billion, the projected cash flow from operations for FY 2009 is \$5.2 billion. Capital cash outlays are expected to be \$2.1 billion, providing free cash flow of \$3.1 billion, prior to the legally required payment to the Postal Service Retiree Health

FY 2009 Financing Plan		
	FY 2008 Actual	FY 2009 Plan
Beginning Year:		
Cash	\$0.9	\$1.4
Cash Flow from Operations (Before HB Payment)	\$5.1	\$5.2
+ Capital Cash Outlays	<u>-2.0</u>	<u>-2.1</u>
= Free Cash Flow	\$3.1	\$3.1
+ Cash from Financing (U.S. Treasury)	3.0	3.0
- Payment to HB Fund	<u>5.6</u>	<u>5.4</u>
= Change in Cash	\$0.5	\$0.7
End of Year Cash	\$1.4	\$2.1
Debt Outstanding at Year End <i>(\$ in Billions)</i>	\$7.2	\$10.2

Benefit Fund of \$5.4 billion. Borrowing of \$3.0 billion in FY 2009 will increase the year-end cash balance by \$0.7 billion, which is needed for increased liquidity and as a hedge against the risks inherent in this plan. Cash on hand at the end of FY 2009 will amount to \$2.1 billion. Debt outstanding on the last day of fiscal years 2008 and 2009 is \$7.2 billion and projected to be \$10.2 billion, respectively.

The current economic climate has put additional pressure on the Postal Service's ability to fully fund payments to RHBF and escrow from operations and cash flow. The continuing decline in overall mail volume has significantly impacted our cash flow position and as a result, our debt capacity has been utilized to fund primarily the RHBF. The chart below compares cumulative payments made to the RHBF and escrow against year-end debt levels since 2005.

Outstanding Debt and Cumulative RHBFB Payments



As can be seen in the chart above, the accelerated payments into the RHBFB have caused all of the debt since FY 2006. The 10-year payment schedule mandated by the PAEA has put significant pressure on our cash flow position in the last three years and will continue to impact our financial performance unless we obtain a restructuring of this obligation. Since FY 2007, we have contributed over \$31 billion into the RHBFB either via direct payments or other transfers. The average annual RHBFB payment of \$5.6 billion represents 7.5% of our operating revenues and is significantly higher than any annual net income the Postal Service has attained throughout its history. In FY 2008 for example, the \$2.8 billion in operating income was not sufficient to cover the \$5.6 billion in RHBFB payments, resulting in a net loss of \$2.8 billion. Even after the current economic recession ends and our mail volume improves, the size and term of these payments will not be a favorable factor toward the achievement of a positive net income that can allow the Postal Service to grow and meet the challenges of the 21st century.