

INTEGRATED FINANCIAL PLAN

FISCAL YEAR 2004



Operating Plan



Capital Plan



Financing Plan

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PREFACE

The FY 2004 Integrated Financial Plan (IFP) was developed in an environment of continued uncertainty for the U.S. economy and the Postal Service. The economy is recovering slowly from the 2001 recession and unemployment remains high. This economic softness has manifested itself in a third consecutive year of declining mail volume, and the second straight year of significant declines in First-Class Mail. Revenue growth in 2003 was achieved only as a result of the June, 2002 rate increase. The principal financial challenge we expect to face in 2004 is the continuation of this volume and revenue weakness.

One recent and significant event is the implementation of Public Law 108-18, Postal Civil Service Retirement System Funding Reform Act of 2003 (PL 108-18). Signed by the President on April 23, 2003, this law immediately affects the 2003 and 2004 financial results. Without PL 108-18, the Postal Service was projected to over-fund its pension obligations for its CSRS covered employees and retirees by as much as \$78 billion.

Prior to its passage the Office of Personnel Management (OPM) took the total of each year's pay increases granted to postal employees and, based on actuarial assumptions and estimates, calculated their effect on future retirement benefits. OPM then "billed" the Postal Service and, by law, the Service paid each annual estimate over 30 years at 5 percent interest. Likewise, when all Civil Service retirees received the annual cost-of-living increase to their annuity, OPM would segment out postal employees and calculate the future cost of that additional benefit for service by postal employees since 1971 (Postal Reorganization Act). By law the Postal Service would pay these retirement obligations over 15 years at 5 percent interest. On September 30, 2002, total unpaid postal liability for these obligations was \$32 billion. A special OPM analysis conducted in late 2002 identified that the interest earned from postal contributions, lower than assumed outlays, and other factors meant that the postal obligation was \$4.8 billion, rather than \$32 billion. This amount will be recalculated annually. The Administration proposed PL 108-18 to correct the situation.

PL 108-18 makes several changes to the way the Postal Service funds its CSRS benefit obligations. Effective in 2003, the Postal Service no longer makes either the 30-year payments or the 15-year payments, which would have totaled \$3.9 billion in FY 2003. However, PL 108-18 created other retirement-related payments. Effective in May, 2003, the Postal Service pays 17.4 percent of current CSRS employees' wages to the retirement fund rather than the 7 percent previously paid. This replaces the 30-year and 15-year payment process and ensures full funding. In FY 2004, the Postal Service must make the first of 40 annual payments of about \$423 million each to liquidate its remaining unfunded retirement liability estimated at \$4.8 billion as of September, 2002. Included in the computation of this supplemental liability is the full value of retirement benefits attributable to military service of Postal Service CSRS employees. Pursuant to PL 108-18, this application of military service to the supplemental liability will be reviewed. The final outcome may have a direct impact on Postal Service expenses. Without PL 108-18 impacts, expenses in FY 2003 and FY 2004 would be substantially higher. Over the first three years affected by this legislation, Postal Service expenses are expected to be \$8.5 billion less than under the previous law.

The net savings resulting from PL 108-18 in FY 2003 and FY 2004 must be used to reduce outstanding debt to the U. S. Treasury. The Postal Service plans to exceed the required debt reduction. More on this can be found in the Financing section along with the impact of debt restructuring undertaken in FY 2003. Savings in FY 2005 will be used to hold postal rates steady until 2006. Savings accruing to the Postal Service after FY 2005, until otherwise provided for by law, will be placed in escrow. The Postal Service is required to submit to the President, Congress, and the General Accounting Office (GAO) a proposal by September 30, 2003, outlining how the escrow should be used. PL 108-18 calls for Congress to revisit the issue of post-2005 savings after it receives the Postal Service's proposal and the GAO's evaluation of the proposal.

Finally, on July 31, 2003, the President's Commission on the Postal Service released its final report. The Commission's work represents a serious and constructive effort to address the future of the Postal Service and its mission to provide affordable, universal mail service to every home and business as the Postal Service continues its transformation. The Postal Service will be reviewing the Commission's recommendations and looks forward to continuing its work with the Administration and Congress to evaluate the

Commission's proposals. Any Commission recommendations impacting finances would require legislation. This IFP does not assume such legislation.

October 1, 2003 begins a new era in financial reporting for the Postal Service. After 46 years of reporting performance on a 28-day, accounting period basis, the Postal Service will convert to reporting performance on a monthly basis. The annual reporting, on which this plan is based, will not change since annual results have always been reported on a federal government fiscal year (October 1 to September 30). The Postal Service will also begin using its new General Ledger system on October 1, 2003. This state of the art commercial "off-the-shelf" system will allow easier access to postal financial data.

INTEGRATED FINANCIAL PLAN

FISCAL YEAR 2004

OPERATING PLAN

The FY 2004 Operating Plan was developed under the four phase *CustomerPerfect!_{sm}* management cycle. The Establish Phase began in December, 2002 followed by the Deploy Phase in March, 2003. The Implementation Phase will begin with the new fiscal year and the Review Phase is ongoing.

FY 2003 BASELINE ESTIMATES

Volume growth in FY 2003 was forecasted to be adversely affected by competitive forces and the carryover impact of rate increases implemented on June 30, 2002. Total volume is estimated to have declined by 0.3 percent or 0.6 billion pieces in FY 2003 compared to FY 2002. The planned volume growth was 1.4 percent. Actual volumes were less than plan primarily due to the weak “jobless” economic recovery, and an unexpected decline in workshare First-Class Mail volume.

High contribution classes including First-Class Mail and Priority Mail experienced significant volume declines. First-Class Mail declined an estimated 3.2 billion pieces or 3.1 percent. This is the second straight year of significant First-Class Mail volume decline and is the first time that the “workshare” First-Class Mail classifications experienced a year-over-year volume decline. Over the 25-year history of workshare discounts this category had been a positive influence on total First-Class Mail volume growth. Priority Mail volume dropped an estimated 13.4 percent and over the last three years Priority Mail volume has declined almost 30 percent. Standard Mail, which has a lower contribution per piece, was the only significant source of volume growth, increasing by 3 billion pieces, or 3.4 percent over FY 2002.

Revenues grew an estimated \$2.4 billion in FY 2003 over the previous year. This revenue growth was entirely the result of rate increases that went into effect in late FY 2002. Revenues would have declined for the second straight year, if it were not for the rate increases implemented on June 30, 2002.

FY 2004 REVENUE AND VOLUME

Strong economic recoveries in the aftermath of recession have been typical in the U.S. economy but such a recovery is not occurring in this business cycle.

The most recent recession officially ended in November, 2001, according to the National Bureau of Economic Research’s dating committee. However, employment levels are still 2.5 million jobs below their pre-recession peak and weaknesses in other economic indicators such as retail sales, industrial production and personal income overhang the economy. Employment is an important driver of mail volume growth because 79 percent of mail volume originates or destines at households. Household members who are not employed are unlikely to generate new mail volume. They are also unlikely to receive increasing numbers of the bills, financial statements and advertising materials that dominate the business-to-household mailstream.

Gross Domestic Product (GDP) growth rates during this recovery have been about half the growth rates during typical economic recoveries. This most recent experience has tempered our selection of economic assumptions to drive the FY 2004 plan. To be conservative, we have used Global Insights’ pessimistic economic growth scenario to forecast volumes and revenues.

The FY 2004 volume plan is for 1.3 percent total volume growth over the estimated FY 2003 volumes. Total volume is expected to bounce back from the small decline in FY 2003 because the year-over-year growth rates will no longer be adversely affected by the rate increases that were implemented in June, 2002, and because even the pessimistic Global Insights forecast assumes acceleration of the economic recovery, including a gradual buildup of employment.

Volume				
	FY 2003 Estimate	FY 2004 Plan	Change	% Change
First-Class	99,189	97,867	(1,322)	-1.3%
Priority	865	836	(29)	-3.3%
Express	55	54	(1)	-1.5%
Periodicals	9,357	9,222	(135)	-1.4%
Standard Mail	90,201	94,390	4,189	4.6%
Package Services	1,137	1,162	25	2.2%
International	916	821	(95)	-10.3%
Other*	482	531	49	10.1%
Total	202,202	204,885	2,683	1.3%
<i>(Pieces in Millions)</i>				
* Postal volume, mailgrams, and free mail for the blind and handicapped are included in the Other category				

Looking at the individual classes of mail in the table above, First-Class Mail volume is expected to decline for the third straight year, reflecting the continued impact of electronic diversion and sluggish economic growth. Priority and Express Mail declines are projected to persist as well, as the market turns to lower-priced ground shipment alternatives. Standard Mail and Package Services volumes have grown in FY 2003 and are projected to grow again in FY 2004. Standard mail volume growth may benefit from the telemarketing regulations known as the "do not call" list restrictions that will be implemented in the fall of this year, although this is not factored into the forecast. Long term declines in Periodicals and International Mail are projected to continue.

We do not project any revenue growth between FY 2003 and FY 2004. Our forecast models produced an estimate that revenues would decline by \$196 million, or 0.3 percent in FY 2004. However, the FY 2004 planned revenue was adjusted upward by this amount in order to challenge the organization to match FY 2003's estimated revenue. Revenue growth rates by class, as shown below, roughly track the volume growth rates by class except for package services revenue which declines due to mix shifts (primarily an increase in destination entry parcel post mail).

Revenue				
	FY 2003 Estimate	FY 2004 Plan	Change	% Change
First-Class	\$ 37,172	\$ 36,606	\$ (566)	-1.5%
Priority	4,529	4,388	(141)	-3.1%
Express	880	858	(22)	-2.4%
Periodicals	2,255	2,230	(25)	-1.1%
Standard Mail	17,215	18,028	813	4.7%
Package Services	2,231	2,159	(72)	-3.2%
International	1,607	1,554	(53)	-3.3%
Other*	3,017	3,081	64	2.1%
Total	\$ 68,906	\$ 68,906	\$ -	0.0%
<i>(\$ Millions)</i>				
* Postal volume, mailgrams, and free mail for the blind and handicapped are included in the Other category				

DELIVERY NETWORK

The delivery network is estimated to grow from 139.5 million deliveries to 141.2 million in FY 2003, an addition of 1.7 million new deliveries. The same number of deliveries are expected to be added in FY 2004 bringing the network total to 142.9 million deliveries. This is consistent with the delivery growth rate of recent years.

EXPENSE

In FY 2004, total expenses are budgeted at \$66.8 billion, which is 3.2 percent more than FY 2003 estimated expenses.

This expense growth needs further explanation due to unusual prior year circumstances. PL 108-18, (explained in the Preface) and the debt refinancing made in August, 2003 (discussed in the Financing Plan section), both greatly impact expense levels. Their impact also makes it more difficult to compare expenses between years. The table below presents three years of historical expenses and the impact of these two items on FY 2003 and FY 2004 expenses.

Historical Expenses & Impacts					
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Total Ongoing Expenses	\$ 64,780	\$ 67,549	\$ 67,364	\$ 67,689	\$ 69,728
Percent Change	3.8%	4.3%	-0.3%	0.5%	3.0%
Debt Refinancing Cost (Savings)				360	(280)
Total Expenses With Refinancing	\$ 64,780	\$ 67,549	\$ 67,364	\$ 68,049	\$ 69,448
Percent Change				1.0%	2.1%
PL 108 -18 Savings	-	-	-	(3,345)	(2,652)
Total Expenses	\$64,780	\$ 67,549	\$ 67,364	\$ 64,704	\$ 66,796
Percent Change	3.8%	4.3%	-0.3%	-4.0%	3.2%

(\$ Millions)

Before considering the impacts of PL 108-18 and debt refinancing, the FY 2003 estimated expenses of \$67.7 billion are only 0.5 percent above FY 2002 actual expenses of \$67.4 billion. Debt refinancing added \$360 million of expenses to FY 2003 and PL 108-18 provided savings of \$3.3 billion, reducing the FY 2003 estimated year-end expenses to \$64.7 billion, 4.0 percent below FY 2002.

In FY 2004, expenses would be 3.0 percent more than FY 2003 if the effects of debt refinancing and PL 108-18 were excluded. Interest expense savings of \$280 million emanating from the debt refinancing reduces the expense growth in FY 2004 to 2.1%. When the effect of PL 108-18 is taken into account, total expenses increase by 3.2 percent. The growth increases from 2.1 percent to 3.2 percent because the CSRS reform savings in FY 2004 are less than FY 2003. It should also be noted that FY 2004 is a leap year. An extra delivery day adds over \$170 million to FY 2004 expenses.

From 1971 through 1999, we had annual expense growth of less than 4.0 percent only twice. FY 2004 thus marks the fourth instance in the last five years of expense growth less than 4.0 percent.

Postal Civil Service Retirement System (CSRS) Funding Reform Act of 2003, Public Law 108-18

As discussed in the Preface, the impact of PL 108-18, as illustrated in the table on the following page, is significant in both FYs 2003 and 2004. Net savings in FY 2003 are \$3.3 billion and net savings in FY 2004 will be \$2.7 billion. The decrease in savings for FY 2004 compared to FY 2003, results from the fact that 2003 includes only a partial year implementation of higher employer contributions, while 2004 is a full year. Although the first payment for the residual unfunded liability is not due until September 2004, we are accruing a pro rata portion of the principle and interest expense in FY 2003.

Civil Service Retirement System Estimated Financial Impacts		
	FY 2003	FY 2004
Prior to PL 108-18		
USPS Contribution (7%)*	\$ 736	\$ 698
Salary Increase Payments	2,636	2,642
Retiree COLA Payments	<u>1,285</u>	<u>1,345</u>
Total	4,657	4,685
After PL 108-18		
USPS Contribution (17.4%)	1,188	1,734
40 Payments (remaining unfunded liability)	<u>124</u>	<u>299</u>
Total	<u>1,312</u>	<u>2,033</u>
Net Savings	\$ 3,345	\$ 2,652
<i>(\$ Millions)</i>		
* Employees' 7% contribution has not changed and is not included		

Expense Increase Overview

The table below provides additional expense detail including the impacts of PL 108-18 and restructuring of debt.

FY 2004 Expenses				
	FY 2003 Estimate	FY 2004 Budget	Change	% Change
Field	\$ 55,009	\$ 57,149	\$ 2,140	3.9
Corporate Transportation	2,675	2,575	(100)	-3.7
Programs/Corporatewide Activities	2,138	2,377	239	11.2
Interest on Borrowing	432	303	(129)	-29.9
HQ Administrative	1,245	1,300	55	4.4
OIG and PRC	120	137	17	14.2
Servicewide	<u>3,085</u>	<u>2,955</u>	<u>(130)</u>	-4.2
Total	\$ 64,704	\$ 66,796	\$ 2,092	3.2
<i>(\$ Millions)</i>				

Field Expense

Field expenses will increase by a net \$2.1 billion in FY 2004, or 3.9 percent, with most of the increase due to increases in salaries and benefits that are driven by CSRS employer contribution changes, health benefits and the normal increase in the number of deliveries next year. Approximately \$170 million of the total \$2.1 billion increase is due to one additional delivery day in FY 2004, which is a leap year. The growth in field costs is restrained by \$1,368 million in gross cost reductions. See "Cost Reduction Initiatives" on page 7 for specific details.

Headquarters Expense

Headquarters administrative expense includes headquarters organizations, field support units, and the Postal Inspection Service. Headquarters administrative costs of \$1.3 billion increase \$55 million (4.4 percent) from the FY 2003 estimate. There are three main drivers of headquarters expense growth.

They are: 1) the impact on payrolls of CSRS reform, 2) increases in salaries and benefits rates, particularly health benefits, and 3) the full implementation of the accounting shared services center project that transfers re-engineered field accounting transactions previously performed in the field to the field support units. FY 2004 budgets, as noted previously, reflect a full year of higher CSRS payroll contributions. Normal annual raises and expected 11 percent increases to health benefits costs also put upward pressure on headquarters budgets. Although the shared service project reduces total complement and expenses, implementation requires transferring 350 employee positions to the field support units, which are charged as headquarters expenses. Reduction of the field complement formerly performing this work is expected to be greater than 1,000 positions.

Despite these cost pressures, the 2004 budget for headquarters administrative expenses remains below FY 2000 levels.

Programs and Corporatewide Expense

Program and Corporatewide activity costs are budgeted at \$2.4 billion in FY 2004, which is slightly less than was originally planned for FY 2003. However, the FY 2004 program plan is an 11.2 percent increase over estimated FY 2003 spending reflecting the delay of some program expenditures until FY 2004 as discussed below.

FY 2004 Major Program Spending Ten Largest Programs				
Program	FY 2003 Estimate	FY 2004 Budget	Change	% Change
Mail Transport Equip Service Centers	\$ 289	\$ 221	\$ (68)	-23.5
Point of Service	106	135	29	27.9
Stamp Manufacturing	120	125	5	4.2
Advanced Computing Environment	92	114	22	23.7
Debit/Credit Card Fees	90	111	21	23.9
Corporate Advertising	99	92	(7)	-7.6
Mail Transport Equipment	62	88	26	42.0
Corporate Contact Management	79	87	8	10.3
Network Telecommunications	69	80	11	15.9
Expedited Supplies	86	79	(7)	-8.0
	\$ 1,092	\$ 1,132	\$ 40	3.7
<i>(\$ Millions)</i>				

FY 2003 program expenses are expected to end the year well below budget because of continued spending restraint in reaction to lower-than-anticipated revenues. These actions included taking advantage of some one-time opportunities to defer spending from FY 2003 to FY 2004. One example of this was the decision to reduce procurement of mail transportation equipment (MTE), such as sacks, sleeves, trays, pallets, and wheeled containers, in FY 2003. Continued wear and tear on MTE will require a larger purchase in FY 2004, however.

Some other significant changes to program budgets in FY 2004 include the following:

- The mail transportation equipment service centers contracted sites, where MTE is processed, repaired, stored, and distributed to internal and external customers, continue to be the most expensive program. Re-soliciting contracts on more favorable terms, however, has favorably impacted the FY 2004 budget.
- The Point-of-Service program is growing in FY 2004 due to Phase III deployment approved by the Board of Governors in November, 2002 and scheduled to continue through fiscal year 2005.

- The Advanced Computing Environment (ACE) deployment is being accelerated to capture benefits earlier than planned. In the long term, this program is expected to reduce or avoid systems-related costs throughout the network.
- Debit and credit card fees are the merchant fees paid to card companies. Although lower transaction fees have been successfully negotiated in recent years, debit and credit card usage has been increasing more than 20 percent annually.

Despite growth over FY 2003, the headquarters program and corporatewide expense budget for FY 2004 remains about \$150 million below FY 2000 levels.

Servicewide Expense

Servicewide expenses are national-level expenses that cannot be isolated and charged to individual operating units and are outside local management control. The \$130 million reduction in servicewide for FY 2004 is caused by the one-time debt repayment premium of \$360 million paid in FY 2003. Without the impact of this transaction, servicewide expenses would increase by \$230 million in FY 2004. This increase is entirely driven by annuitant health benefits and the anticipated operating cost of biohazard detection equipment, which will be managed centrally rather than allocated to the field.

Expense by Component

To gain a different perspective on the FY 2004 Operating Plan, expense growth can be examined by component. Personnel expense, including workers' compensation and all other employee and retiree benefits are expected to increase by \$2 billion, or 4.0 percent.

The growth in personnel compensation expenses is not a result of growth in workhours which, in fact, will be reduced by 25 million in FY 2004. The major drivers of the expense increase are the full year implementation of PL 108-18, contractual salary and benefits increases, and health benefits inflation. Health insurance premiums are assumed to increase by 11 percent in January, 2004. In addition, FY 2004 is a leap year and the one additional delivery day will add \$170 million to FY 2004 personnel expenses.

Non-personnel expenses consist of a wide variety of national, field and headquarters costs. The growth in FY 2004 is primarily due to investments in program initiatives to update and improve information technology capabilities, improve customer access and service, and rationalize our administrative support and logistics infrastructures. Transportation costs are expected to be held at essentially the same level as FY 2003, although any significant increase in fuel prices would place achievement of this objective in jeopardy.

FY 2004 Expenses By Component				
	FY 2003	FY 2004		%
	Estimate	Budget	Change	Change
Personnel	\$ 50,261	\$ 52,258	\$ 1,997	4.0
Non-Personnel	9,377	9,606	229	2.4
Transportation	4,634	4,629	(5)	-0.1
Interest	432	303	(129)	-29.9
Total	\$ 64,704	\$ 66,796	\$2,092	3.2
<i>(\$ Millions)</i>				

In FY 2004, benefiting from continued low interest rates, the August, 2003 debt refinancing (\$280 million), and sharply reduced debt levels (\$20 million), interest expense on debt is \$50 million, a decrease of \$300 million from FY 2003. In addition, the interest expense on Civil Service Retirement System (CSRS) deferred retirement liability is expected to increase by \$161 million to a total of \$277 million. This increase is due to a full year of operation under the new PL 108-18, rather than a partial year as in FY 2003

CONTINUED WORKHOUR REDUCTIONS

Total workhours in FY 2004 will be reduced 25 million from the FY 2003 year-end estimate, net of the impacts of an extra delivery and retail day due to leap year. This will be the fifth consecutive year that the Postal Service has reduced workhours. Workhours were reduced by 11 million in FY 2000, followed by a 23 million reduction in FY 2001, and a reduction of 78 million workhours in FY 2002. It is estimated that in FY 2003, workhours will be reduced by 53 million. The plan workhour reduction for FY 2004 will boost the five year total workhour reductions to 190 million. The FY 2004 workhour reduction target is equal to approximately 14,000 full-time equivalent employees.

Continued workload growth involving deliveries each year must be absorbed so these reductions are net, resulting in declines year over year.

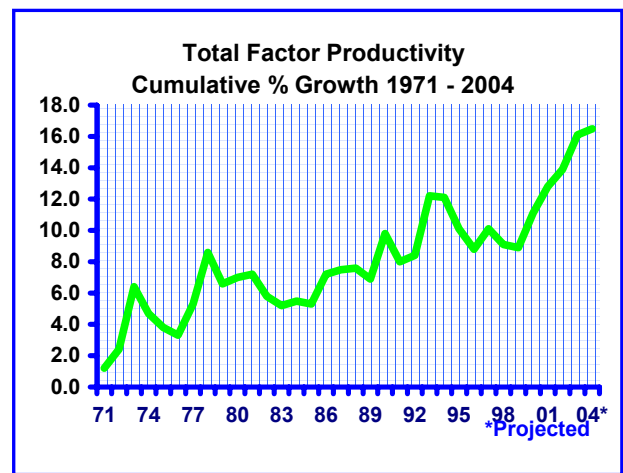
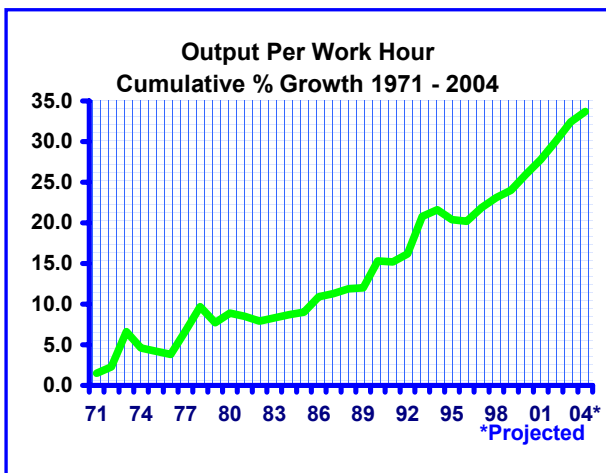
COST REDUCTION INITIATIVES

The FY 2004 expense budget includes \$1,368 million in gross cost reductions that are detailed in the table below, reflecting the reduction in workhours mentioned above. Under "operational efficiency" the benefits are spread across several operational programs and productivity initiatives including Breakthrough Productivity (BPI) and they total \$1,144 billion in cost reductions. Capital Investment Program reductions total \$224 million. Roughly 55 percent of the program savings in FY 2004 will come from automation improvements. An additional 26 percent will be the direct result of finance functional improvements.

FY 2004 Cost Reduction Overview	
Activity	Savings
Operational Efficiency Gains (Including BPI)	\$ 1,144
Capital Investments:	
Finance / Shared Services Accounting / Stats Prog. / ICG	\$ 59
Letter Recognition Enhancement	52
Flat Recognition Improvement DAR	24
Wide Field of View Camera	17
Low Cost Tray Sorter	9
Flat Remote Encode Sys	8
Postal Auto Redirection Sys	8
Feeder Enhancements for the AFSM 100	7
Other	40
Total Reductions From Capital Investments	\$ 224
Total Cost Reductions	\$ 1,368
<i>(\$ Millions)</i>	

PRODUCTIVITY

Output Per Workhour measures the change in the relationship between output, or workload, (mail volume and deliveries) and the labor resources used in producing those outputs. Total Factor Productivity (TFP) measures the change in relationship between outputs (workload) and all resources used in producing those outputs, which includes labor, materials, and capital. During FY 2003, Output Per Workhour will increase 2.4 percent and TFP is projected to grow 2.2 percent. Projected TFP growth is equivalent to \$1.6 billion in expense reductions. FY 2003 marks the fourth consecutive year of positive TFP growth, with equivalent expense reductions totaling almost \$4.8 billion over this time period. Productivity growth continues to be fueled by substantial reductions in resource usage. In earlier years, strong TFP growth was fueled largely by absorbing workload growth. The charts below show the cumulative growth since Postal Reorganization in Output Per Workhour and Total Factor Productivity for the years 1999 through 2004. Since 1971, Output Per Workhour and TFP will have grown 33.7 percent and 16.5 percent, respectively.



The FY 2004 Integrated Financial Plan results in 1.3 percent increase in Output Per Workhour and a 0.4 percent TFP growth rate, a fifth straight year of positive TFP increases. This is in spite of a small increase in workload (0.6 percent), which is primarily driven by the expanding delivery network.

NET INCOME

Total revenue is estimated to remain at the FY 2003 level of \$68.9 billion. Total expenses, net of cost reductions, will increase 3.2 percent, from \$64.7 billion to \$66.8 billion. Net income for FY 2004 is estimated to be \$2.1 billion.

FY 2004 Operating Budget				
	FY 2003 Estimate	FY 2004 Budget	Change	% Change
Revenue	\$ 68,906	\$ 68,906	\$ -	0.0
Expense	<u>64,704</u>	<u>66,796</u>	<u>2,092</u>	3.2
Net Income	\$ 4,202	\$ 2,110		

CAPITAL INVESTMENT PLAN

FY 2003 CAPITAL COMMITMENTS

In FY 2003, the capital commitment plan was \$2.5 billion and the year-end estimate is \$2.2 billion. Projects of note include: the Philadelphia Processing and Distribution Center and Vehicle Maintenance Facility project; enhancements to the letter and flats mail processing equipment; Finance transformation projects, such as Shared Services/Accounting and General Ledger Redesign; and efforts to support customer service including the Sales Support System.

The Emergency Preparedness Plan (EPP) includes projects that address biohazard detection and ventilation filtration systems to provide a level of protection for our employees and customers from potential contamination. The Biohazard Detection System (BDS) and the Ventilation Filtration System (VFS) projects have been approved by the Board of Governors. Each of these projects is planned for deployment during FY 2004. A portion of these investments has been funded under the Homeland Security authorization in the 2002 Department of Defense Appropriations Act. The remaining funding for these projects will be allocated from the FY 2004 capital plan as necessary.

FY 2004 CAPITAL COMMITMENTS

The FY 2004 capital commitment plan will continue to focus on funding projects that provide a return on investment, and address infrastructure requirements. The plan of \$3.2 billion reflects the priorities outlined in the Transformation Plan:

Capital Commitments		
	FY 2003 Estimate	FY 2004 Plan
Mail Processing Equipment	\$ 849	\$ 1,690
Facilities	435	637
Infrastructure and Support	180	328
Retail	187	65
Vehicles	142	190
Emergency Preparedness Plan	415	247
Total	\$ 2,208	\$ 3,157
(\$ Millions)		

According to their bylaws, the Board of Governors must approve the capital budget each year. This approval represents a general concurrence with the capital investment plan. In addition, each individual investment greater than \$10 million requires approval of the Board.

All projects in the approved plan are subjected to an in-depth review and approval process that ensures each is fiscally sound or service oriented. Supply chain management concepts are used to achieve the best possible price and reduce overall costs. Accountability for the results the project is expected to produce is established and the project is analyzed using a discounted cash flow methodology to ensure that projections are reasonable. On a quarterly basis, the status of each of the Board approved projects is reported in the Investment Highlights Report and includes investment costs, deployment schedules, metrics, and any special issues. Finally, interim and post-implementation studies are conducted on selected projects, to determine whether financial and operating goals are achieved and to provide valuable lessons learned for future investment decisions.

The Capital Investment Plan major categories are summarized below.

Mail Processing Equipment

The FY 2004 capital plan for equipment is \$1.7 billion or 54 percent of the total plan, for programs that generate reduced operating costs.

Automated equipment not only saves work hours and associated indirect costs but also improves efficiency and service quality. Automation provides data gathering capabilities that can be used in future information based services. For example, the Optical Character Reader (OCR) Enhancements for Letter Automation program replaces outmoded Multi-line Optical Character Reader Machines. The program includes the removal and disposition of the Multi-line machines. The benefits include significant reduction in facility space requirements for the equipment, improved productivity, and significant reduction in maintenance costs.

The second phase of Postal Automated Redirection System (PARS) for letter mail volume is included in the plan to continue the focus on automating processing operations. PARS is designed to automate processing of Undeliverable-As-Addressed (UAA) mail and greatly reduce the number of handlings required to process this mail.

The same PARS technology will be leveraged for flat mail volume processing as part of the overall strategy to automate this volume.

Facilities

In FY 2004, the planned commitment for facilities is \$637 million. Management will optimize the use of existing space whenever possible and invest in new construction only to address infrastructure requirements. This portion of the plan reflects an increase in expected commitments as it includes investments for customer service facility infrastructure replacements as a result of a national prioritization effort for these types of facilities.

With average annual growth of 1.7 million delivery points, the customer service facility infrastructure will be maintained via ongoing repair and alteration projects and high priority replacement projects. Also, included are commitments for major mail processing or airport mail facilities.

Infrastructure and Support

The Infrastructure and Support category is estimated at \$328 million. These investments include information/communications network and system requirements. For example, the Human Capital Enterprise and Human Resources Shared Services project replaces outdated systems and promotes employee self-service for benefits selection, reducing staff in field personnel offices.

Improvement to the operating networks infrastructure is included in the plan. The next phase of the Surface-Air Support System will continue to improve our ability to control air and surface transportation costs. Additionally, Transportation Optimization Planning and Scheduling is a network optimization and management system that enables the Postal Service to actively plan, and dynamically dispatch and execute its transportation processes.

The plan is to replace the Accounts Payable system. A commercial-off-the-shelf (COTS) package will be used in its stead and the system will be integrated with the other Finance network systems. Investments for the Enterprise Data Warehouse (EDW) which provides a single source of accurate data across the organization to a wide variety of users are included in the plan. Several functions have already migrated data to the warehouse while others are in the process of transitioning their data to this single source repository for reporting and analysis.

Finally, this category includes day-to-day operations and administrative requests such as forklifts and office equipment.

Retail

In FY 2004, \$65 million is expected to be committed on retail capabilities. Included in the retail category is the Self Service Platform (SSP) project. SSP is a self-service kiosk that offers customers a range of postal products and services via a graphical, touch-screen interface.

Vehicles

In FY 2004, the planned commitments for vehicles represent funds in the amount of \$190 million for the purchase of cargo vans and truck tractors. The cargo vans are the 7-9-ton vehicles used for transporting large volumes of mail between processing mail centers as well as between processing centers and delivery units. City mail volume is also transported via truck tractors. The cargo vans and truck tractors are part of the five-year vehicle replacement plan.

FY 2004 CAPITAL CASH OUTLAY PLAN

The FY 2004 plan calls for approximately \$2.2 billion in cash outlays. Approximately \$1.2 billion of the planned outlays in FY 2004 relate to commitments made in prior years. The remaining \$1 billion planned cash outlays are attributed to new commitments in FY 2004.

FY 2004 Capital Cash Outlays		
	FY 2003 Estimate	FY 2004 Plan
Mail Processing Equipment	\$ 597	\$ 862
Facilities	257	402
Infrastructure and Support	158	237
Retail	76	169
Vehicles	137	170
Emergency Preparedness Plan	27	314
Total	\$ 1,252	\$ 2,154
<i>(\$ Millions)</i>		

FINANCING PLAN

FY 2003 Debt Reduction

The FY 2003 Integrated Financial Plan (IFP) projected net income of \$600 million, cash flow from operations of \$3.4 billion, capital outlays of \$2.0 billion, and an unchanged cash balance. The cash flow from operations assumed disbursement of the remaining balance of emergency appropriations that were received in FY 2002. Based on these assumptions, it was estimated that debt could be reduced by \$800 million.

The plan was formulated before introduction of CSRS funding reform legislation. Public Law 108-18 not only changed net income and cash flow from operations but also mandated that debt will be reduced by at least the amount of the savings, estimated to total \$3.5 billion in FY 2003.

FY 2003 Financing Plan		
	IFP FY 2003	Estimate FY 2003
Cash From Operations	\$ 3.4	\$ 7.0
- Capital Cash Outlays	2.0	1.2
- Cash Increase	0.0	1.9
- EPP Cash Outlays	<u>0.6</u>	<u>0.1</u>
= Borrowing (Repayment)	(0.8)	(3.8)
Debt Outstanding	\$ 10.3	\$ 7.3
(\$ Billions)		

Anticipating the passage of the Civil Service Reform legislation, the Postal Service began repositioning the debt portfolio for the potential of legally-mandated debt reduction. In two separate debt repurchase transactions in January, a total of \$777 million of long-term debt was retired without the payment of a premium or penalty. Following the passage of Public Law 108-18, a similar transaction was conducted in late July, retiring another \$547 million prior to maturity without paying a premium.

On August 7, 2003, after consultation with the Governors, the Postal Service repurchased the remaining \$6 billion of long-term debt and reissued the same amount of debt with maturities of less than one year. The premium paid to retire this debt before maturity was \$360 million and is charged against FY 2003 net income. The debt portfolio is now structured so that cash flows in excess of current needs can be efficiently applied to debt reduction whenever practical to do so.

The FY 2003 net income estimate is \$4.2 billion and cash flow from operations is estimated to reach \$7.0 billion. Capital outlays, net of the sale of assets, should approximate \$1.2 billion. The emergency preparedness appropriations disbursement is projected to total \$145 million this year. Under these projections, debt will be reduced by \$3.8 billion to an outstanding balance of \$7.3 billion, and the cash balance is projected to increase \$1.9 billion.

FY 2004 Debt Reduction

Net income for FY 2004, after factoring in the savings from the CSRS funding reform legislation, is estimated to total \$2.1 billion. Capital cash outlays, including emergency preparedness capital outlays, are expected to increase from the FY 2003 level to \$2.2 billion. In this scenario, cash flow from operations will approximate \$5 billion. Using the new debt repayment flexibility obtained from the recent \$6 billion debt refinancing, debt can be reduced beyond the \$2.8 billion minimum

FY 2004 Financing Plan		
	Estimate FY 2003	Plan FY 2004
Cash From Operations	\$ 7.0	\$ 5.0
- Capital Cash Outlays	1.2	2.2
- Cash Increase (Decrease)	1.9	(1.6) to (2.1)
- EPP Cash Outlays	<u>0.1</u>	<u>0.2</u>
= Borrowing (Repayment)	(3.8)	(4.2) to (4.7)
Debt Outstanding	\$ 7.3	\$ 2.6 to \$3.1
(\$ Billions)		

required by PL 108-18 legislation. From this, an estimated \$4 billion in debt can be retired, bringing the debt balance to between \$2.6 billion and \$3.1 billion by the end of FY 2004.

FINANCIAL SUMMARY

The chart below shows the critical elements of the financial condition for FY 2003 and FY 2004. The first four lines of this chart reflect the generation of cash from operations as outlined in the Operating Plan. Cash flow from operations is projected to total \$5.0 billion in FY 2004. The next line in the chart shows anticipated capital cash outlays. The difference between cash flow from operations and capital cash outlay, net of any planned changes to cash on hand, is the amount needed to borrow, or the amount available to repay debt. The remainder of this chart provides additional information on the Postal Service's financial condition. Debt represents the expected outstanding debt at the end of the fiscal year. The capital commitment plan reflects the estimated new capital commitments. The equity amount is the sum of contributions from the federal government and prior years' losses/earnings.

FY 2004 Financial Summary		
	FY 2003 Estimate	FY 2004 Plan
Net Income	\$ 4.2	\$ 2.1
Depreciation	2.3	2.4
Adjustments	<u>0.5</u>	<u>0.5</u>
Cash Flow From Operations	\$ 7.0	\$ 5.0
Capital Cash Outlay & EPP	(1.3)	(2.4)
Cash Reductions (Increase)	(1.9)	<u>1.6 to 2.1</u>
Debt Repayment	<u>\$ 3.8</u>	<u>\$ 4.2 to \$ 4.7</u>
Debt Outstanding	\$ 7.3	\$ 2.6 to 3.1
Capital Commitment Plan	\$ 2.2	\$ 3.2
Equity	\$ 1.2	\$ 3.3
Prior Years' (Losses) Earnings	\$ (1.8)	\$ 0.3
<i>(\$ Billions)</i>		

Board Resolution 95-9, concerning restoration of equity and recovery of prior years' losses, established a policy of planning for net incomes that "equal or exceed the cumulative prior years' loss recovery target" set in the last omnibus rate proceeding. Although the Postal Service entered FY 2003 with cumulative unrecovered losses of \$6.0 billion, the projected net Income of \$4.2 billion in FY 2003 combined with net income of \$2.1 billion in FY 2004 will allow the Postal Service to fully recover all prior years' losses.

RISKS

The FY 2004 Integrated Financial Plan is the product of an extensive development process, during which numerous scenarios were examined. Management has established a solid foundation for achieving the plan. Aggressive actions to manage expenses in response to the declining volume during FY 2003 have been successful. However, the \$2.1 billion net income in FY 2004 represents only about a three percent margin over costs. Therefore, risk factors must be acknowledged.

Economic Risk

To control the degree of economic risk in this plan, we have used a pessimistic economic forecast to drive forecast volumes and revenues. Global Insights, the economic forecasting service used by the Postal Service, describes this as a "protracted sluggishness" scenario. Even this pessimistic scenario, however, projects that economic growth will ratchet up to 2.8 percent in 2004, and that payroll jobs will halt their two year decline, then increase. There remains a concern that there could be unresolved structural problems in the U.S. economy that keep growth and employment at lower levels. The uncertain direction of the U.S. economy presents the greatest external risk to achieving the plan.

Inflation

Inflation has generally been moderate in recent years, except for a spike in fuel costs in FY 2001. Fuel costs, of course, are subject to wide fluctuations due to world-wide political and economic events. Any significant upward movement in fuel costs will adversely affect our financial results. Most of our bargaining employees receive cost-of-living adjustments based on changes in the consumer price index. Since most economists are forecasting low levels of inflation for the foreseeable future, there is a relatively low risk that inflationary pressures will impact labor costs.

Health Benefits Costs

Health care cost inflation continues to be a significant driver of increased employee compensation costs. Health benefits premium increases for the Postal Service have been about 11 percent each year since FY 2000. The plan for FY 2004 incorporates an expected increase of 11 percent, or \$280 million. The actual will not be known until January 2004.

Continued Workhour Reductions

The FY 2004 operating budget calls for a fifth consecutive year of workhour reductions. Since FY 1999, the Postal Service has eliminated over 165 million workhours. It is expected that workhours will be reduced by 25 million more in FY 2004. During this same time period, over eight million daily deliveries have been added to the delivery network. Workhour reductions in FY 2004 rely primarily on process improvements, rather than capital investment programs.

As always, the potential for the occurrence of unplanned events, such as natural disasters which could adversely impact the Postal Service's finances, must be acknowledged as a risk.

President's Commission

On July 31, 2003, the President's Commission on the U.S. Postal Service released its final report. The Commission's work represents a serious and constructive effort to address the future of the Postal Service and its mission to provide affordable, universal mail service to every home and business as the Postal Service continues its transformation.

The Postal Service will be reviewing the Commission's recommendations and looks forward to continuing its work with the Administration and Congress to evaluate the Commission's proposals. Although the work performed by the Commission, and legislative changes that may come as a result of that work, will undoubtedly have an impact on Postal Service financials at some time, this IFP does not assume any substantive impact during FY 2004.