FY2003 FIRST QUARTER REPORT

UNITED STATES
POSTAL SERVICE

FINANCIAL CONDITIONS & RESULTS

RESULTS OF OPERATIONS – FIRST QUARTER, FY 2003 COMPARED TO PLAN AND FIRST QUARTER, FY 2002

For the quarter beginning September 7, 2002 and ending November 29, 2002, the Postal Service realized a net income of $1,010 million compared to a planned net income of $809 million. The $201 million favorable net income variance was due to expense plan underrun of $512 million that more than offset a revenue plan underrun of $311 million.

OPERATING REVENUE AND MAIL VOLUME

In PQ 1, the Postal Service earned $16.3 billion in revenue on volume of 49.3 billion pieces of mail. FY2003 PQI revenue grew 6.2 percent reflecting higher rates and a 1.5 percent volume increase over FY2002 PQI. Revenue was $311 million or 1.9% below the plan. This marks the seventh consecutive quarter where volumes were below plan, but reverses four consecutive quarters of volume declines in FY 2002 caused by recession and sluggish recovery.

Although mail volume growth was above Quarter I last year, it was still below the PQI levels of FY's 2000 and 2001. In the first quarter of last year, volumes were deeply depressed. Increased political mail activity during this year contributed to the volume growth.

First-Class Mail revenue was $103 million, or 1.2%, below plan. Although higher rates, due to the June 30, 2001 increase enabled a 4.4 percent increase in revenue, First-Class volume declined by 2.7% compared to last year. The decline reflected continuing electronic diversion and economic weakness.

Priority Mail volume fell 13.2 percent and revenues were 1.4 percent below last year. Priority Mail revenue was under plan by 6.9%. Express Mail volume and revenue was also below plan by 2.4% and 2.8%, respectively. Express Mail revenue increased 3.7%. These products lines were affected by business cost pressures, the economy, and intense competition in the expedited delivery market.

Standard Mail grew a substantial 1.6 billion pieces or 7.0% over last year. This is the second quarter of growth compared to the same quarters last year. Last year's depressed volume levels and this year's election mail are the primary drivers. The main determinant of future Standard Mail growth will be the economy and the recovery of the advertising market. Standard Mail revenue saw 12.8% growth compared to the first quarter of last year, but was $69 million below plan.

Package Services revenue was $10 million under plan, or 1.9%, in spite of Package Services volume that was slightly over plan. The actual revenue per piece realized for Package Services during Quarter I was below expectations due to differences in the mix of retail packages vis-à-vis drop ship packages. Package Services mail volume was above first quarter volume of last year by 8.4 million pieces or 3.4%. Within Package Services, Parcel Post volume was 7.9% above last year. Parcel Post volume also exceeded plan by 2.1 million pieces or 2.2 percent. Although parcel post revenue was up, revenue per piece fell despite higher prices. Again, this was due to lower weight per piece and a greater proportion of drop shipped parcels.

INTEREST INCOME

Interest income for the first quarter totaled $11.7 million compared to the plan of $10.3 million. The $1.4 million favorable variance is attributed to reducing capital investment outlays, which resulted in a higher than projected portfolio balance.

OPERATING EXPENSE

Operating expense of $14.9 billion was $508 million or 3.3% below plan. Personnel compensation was $132 million under plan or 1.1%. Non-personnel expenses were $376 million below plan, or 11.5%. Interest expense was $4 million below plan, or 0.9%.

The personnel compensation plan variance was due to work hour reductions that were 3.2% greater than planned and attrition of over 5,000 career employees. Work hours for the period were 4.6 million under plan and 16.4 million below Quarter I of FY 2002.

Transportation expense for the quarter was $39 million, or 3.3% below plan. Supplies and services expense was $170 million or 27.7% under plan for the quarter. Supply chain management activities have greatly assisted in the control of our supplies and services expenses.

INTEREST EXPENSE

Interest expense for the first quarter totaled $467 million and was $4 million, or less than one percent, below plan. This figure includes interest expense on deferred retirement liabilities and on borrowings.

PRODUCTIVITY

Total Factor Productivity increased 3.2% in Quarter I compared to the same quarter last year versus a planned increase of 1.2% for the quarter. There was no net growth in workload in spite of 1.5% delivery workload growth compared to the same quarter last year. At the same time resource usage was reduced by 3.2% compared to a plan decrease of 0.9%. This marks the fifth straight quarter where resource usage was reduced by more than 3.0% through careful work hour management and tight cost controls. Output per labor hour was 3.4% versus planned productivity growth of 2.9% for the quarter.

CAPITAL COMMITMENTS AND EXPENDITURES

Actual capital commitments for Postal Quarter I of $406 million was $45 million less than planned. Commitments for the Automated Package Processing System (APPS) program accounted for $314 million and the Advanced Computing Environment program accounted for $27 million of the commitments during Quarter I. The remaining $65 million was spread over all other capital programs.

Actual capital cash outlays of $216 million were $44 million or 17% under plan. All categories except mail processing equipment were under the capital cash outlay plan.

The FY 2003 capital commitment plan reflects continued constraint on new capital commitments.

ASSETS

Total current assets declined by $365 million, to $1.915 billion. The decrease is more than accounted for by a decrease in cash and cash equivalents of $444 million, which is not an unusual change for a two-month time period. During the first quarter of each fiscal year, net positive cash flows typically permit debt reduction (discussed below) and reduced cash and cash equivalents.

The net decrease in fixed assets of $193 million represents the difference between the depreciation of existing fixed assets and the acquisition of additional fixed assets.

The net increase of $1.2 billion in deferred retirement costs consists of additional deferred costs as the result of general pay increases to CSRS employees and cost-of-living adjustments (COLAs) for retirees in the current fiscal year. Deferred retirement costs were reduced by amortization expense of $0.5 billion to produce the net $1.2 billion.

LIABILITIES

The increase in current liabilities of $651 million is due primarily to increases in payables and accrued expenses ($1.1 billion), and increases in prepaid permit mail and box rents ($71 million). The increases are offset somewhat by declines in accrued compensation and employee benefits expenses ($391 million), and decreases in outstanding postal money orders ($158 million).

Total debt declined by $2.52 billion to $8.6 billion during the period, due to strong net positive cash flows and the reduction in cash and cash equivalents. Strong cash flows were driven primarily by net income. As is typical for the first quarter of postal fiscal years, debt reduction was also facilitated by certain expense accruals which will not result in cash outlays until September 2003, mainly for workers' compensation and Civil Service Retirement. Year-to-date net cash flows were somewhat higher than projections based on this year's integrated financial plan.

Non-current liabilities increased by $1.8 billion. Of this total, retirement benefits liabilities increased $1.4 billion due to pay increases and retiree COLA adjustments. The workers' compensation liability increased $0.3 billion, reflecting the estimated cost of employee injuries. The $0.3 billion increase in other long-term liabilities was mainly offset by a $0.2 billion decrease in employees' accumulated leave.

The total debt balance of $8.6 billion represents an decrease of $2.5 billion from the previous quarter.

POSTAL EQUITY

The Quarter I equity balance closed the quarter at a negative $5.4 billion, versus a negative $6 billion on September 30. The net income from September 30th through November 29th produced a $683 million improvement in net capital deficiency at quarter's end..

SUMMARY

Revenue and mail volume growth remain sluggish through the first quarter. However, tight control over expenses and resource usage resulted in net income that was $201 million greater than planned.

OUTLOOK

In June, Global Insight, the macroeconomic forecasting service used by the Postal Service, forecasted GDP to grow 1.6 percent in FY 2002 and 3.3 percent in FY 2003. Since then, Global Insight's FY 2003, GDP growth forecast has fallen to 2.4 percent.

Over the remainder of the year, revenue and volume growth should slow compared to Quarter 1, due to the much stronger quarters in the base comparison. It may be recalled that the Postal Service's Quarter 1 volumes last fiscal year plummeted by a record 5.5 percent in the aftermath of 9/11 and the anthrax attacks. Volume declines moderated in Quarters 2 though 4.

In Quarter 2, First-Class Mail volume is expected to remain unchanged from last years' level, due to continued weakness of the economic recovery and continuing inroads by electronic alternatives. Large declines in Priority Mail and Express Mail volumes are expected, as their year over year growth rates continue to be affected by the rate increase, and competitors. Periodical volume will decline for the 7th consecutive quarter, but the rate of decline is expected to decrease, consistent with the recent upturn of monthly advertising revenues in consumer magazines. Standard mail volume is projected to grow in Quarter 2 and may be the only significant source of volume growth. package services volume is expected to decline slightly, consistent with the overall domestic package market.

On the expense side, management is projecting favorable impacts in Quarter 2 from implementation of expense reduction plans, low inflation rates and continued stringent cost controls. As noted above, Quarter 1 expenses were well below plan and only slightly above last year. Similar results are likely in Quarter 2 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 unfavorable outlook on revenue and the favorable outlook on expense is neutral to favorable.

However this outlook is subject to considerable risk. For example, fuel and other input prices could become volatile and erode operating margins. Or extreme winter weather could drive operating expenses upward.

On the positive side, the analysis of the Postal Service's funding of the Civil Service Retirement System (CSRS), released by the Office of Personnel Management (OPM) in December, concluded that the Postal Service will contribute substantially more funds than necessary using the current funding formula. Under this revised formula, the Postal Service's scheduled FY 2003 contribution is estimated to be $2.9 billion less than the amount included in our current plan. Legislation has been drafted by the Administration, which, if passed into law, would correct the formula having a material impact on the Postal Service's financial position and operating results.

For more details, link to: http://www.usps.com/financials/_pdf/ap0303.pdf

Income Statement
Quarter I, 2003

($ in Millions)	Quarter Ending November 29, 2002*	November 30, 2002
Operating Revenue	**$ 16,329**	**$ 15,386**
Operating Expenses:		
Compensation and Benefits	11,974	$ 11,650
Transportation	1,128	$ 1,135
Other	1,762	$ 1,826
Total Operating Expenses	**14,864**	**$ 14,611**
Income From Operations	**1,465**	**$ 775**
Interest and Investment Income	12	$ 8
Interest on Deferrred Retirement	(372)	$ (378)
Interest Expense on Borrowing	(95)	$ (82)
Net (Loss) Income	**$ 1,010**	**$ 323**
Based on Postal Fiscal Year		

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

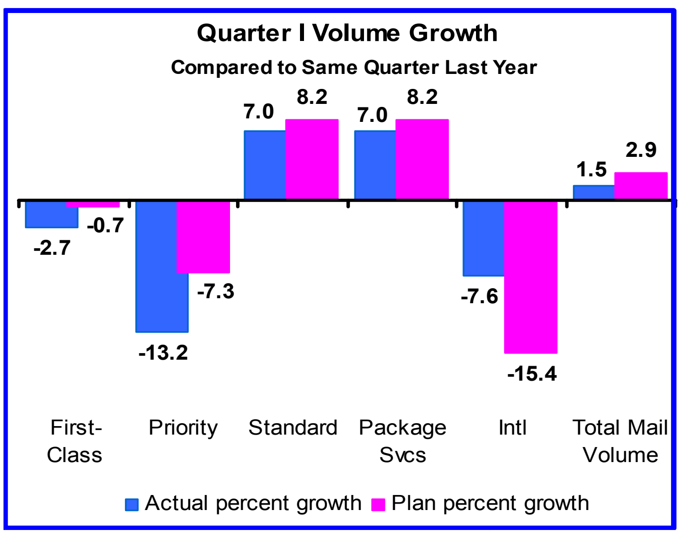
($ in Millions)	Nov. 29, 2002*	Sept. 30, 2002		Nov. 29, 2002*	Sept. 30, 2002
ASSETS			**LIABILITIES**		
Current Assets			Current Liabilities	12,422	11,771
Cash & Cash Equiv.	$ 706	$ 1,150	Total Debt	8,595	11,115
Other Current Assets	1,209	1,130	Other Liabilities	40,953	39,131
Total Current Assets	1,915	2,280	**Total Liabilities**	**$ 61,970**	**$ 62,017**
			EQUITY		
Property Plant & Equipment - Net	23,943	24,136	Government Capital Contributions	$ 3,034	$ 3,034
Deferred Retirement Costs	33,424	32,231	Deficit Since Reorganization	(5,353)	(6,036)
Other Assets	369	368	**Total Equity (Capital Deficiency)**	**$ (2,319)**	**$ (3,002)**
Total Assets	**59,651**	**59,015**	**Total Liabilities & Equity**	**$ 59,651**	**$ 59,015**
Based on Government Fiscal Year					

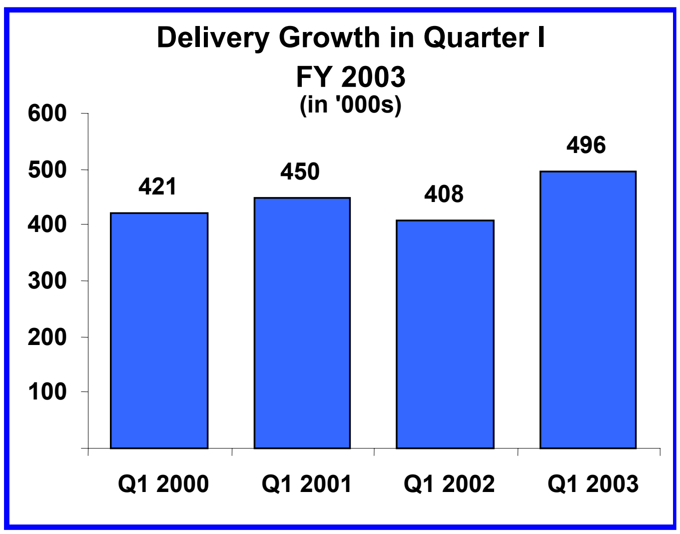
* Unaudited

Statement of Cash Flows
October 1, 2002 through November 29, 2002

($ in Millions)	Nov 29, 2002*	Sept. 30, 2002
Cash Flows from Operating Activities:		
Net Income (Loss) (Government Fiscal Year)	$ 683	$ (676)
Depreciation and Amortization	514	2,296
Changes in Non Current Assets & Liabilities	629	892
Changes in Current Assets & Liabilities	571	(1,081)
Net Cash Provided by Operating Activities	**2,397**	**1,431**
Cash Flows from Investing Activities:		
Sale/Purchase of U. S. Government Securities - Net	-	(1,705)
Purchase of Property and Equipment - Net	(321)	42
Net Cash Used by Investing Activities	**(321)**	**(1,663)**
Cash Flows from Financing Activities:		
Increase/(Decrease) in Long-term Debt	(2,520)	383
(Increase)/Decrease in Other Non-current Assets	-	-
Net Cash Used by Financing Activities	**(2,520)**	**383**
Net Change in Cash and Cash Equivalents	**(444)**	**151**
Cash & Cash Equivalents at Beginning of Period	1,150	1,005
Cash & Cash Equivalents at End of Period	**$ 706**	**$ 1,156**

Based on Government Fiscal Year
* Unaudited





ANALYSIS OF FIRST QUARTER FINANCIAL CONDITION AND RESULTS