POSTAL TRENDWATCH

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Postal TrendWatch
Q3, FY08

Q3: USPS Addresses Billion-Dollar Losses with Reforms

Executive Summary

The United States Postal Service posted a net loss of $1.1 billion in Q3 FY 2008, bringing its year-to-date net loss to $1.13 billion. USPS attributed these losses to rising fuel costs and the ailing U.S. economy. The Service also felt the burden of a $1.4-billion contribution to the Postal Service Retiree Health Benefits Fund -- a requirement of the Postal Accountability and Enhancement Act of 2006 (PAEA).

In accordance with the PAEA, the Postal Service also submitted its "Network Plan" to Congress, outlining its strategy for modernization of its operations and for meeting the service standards it established in December 2007.

Overview

Compared to the same period last year, USPS operating revenue decreased by $437 million (2.4 percent), while expenses increased by $178 million (1.0 percent). Both revenue and volume for the First Class, Express, and Standard Mail categories declined in Q3 FY 2008 compared to the same period last year. However, revenue for Priority Mail rose slightly, by 2.5 percent.

USPS Posts "Greater than Expected" Losses in Q3

USPS took in $17.9 billion in revenue this quarter, a 2.4 percent drop from Q3 FY 2007. In line with recent trends, First Class Mail volume continued to decrease this quarter compared to the same period last year, dropping by 1.3 billion pieces, or 5.5 percent.

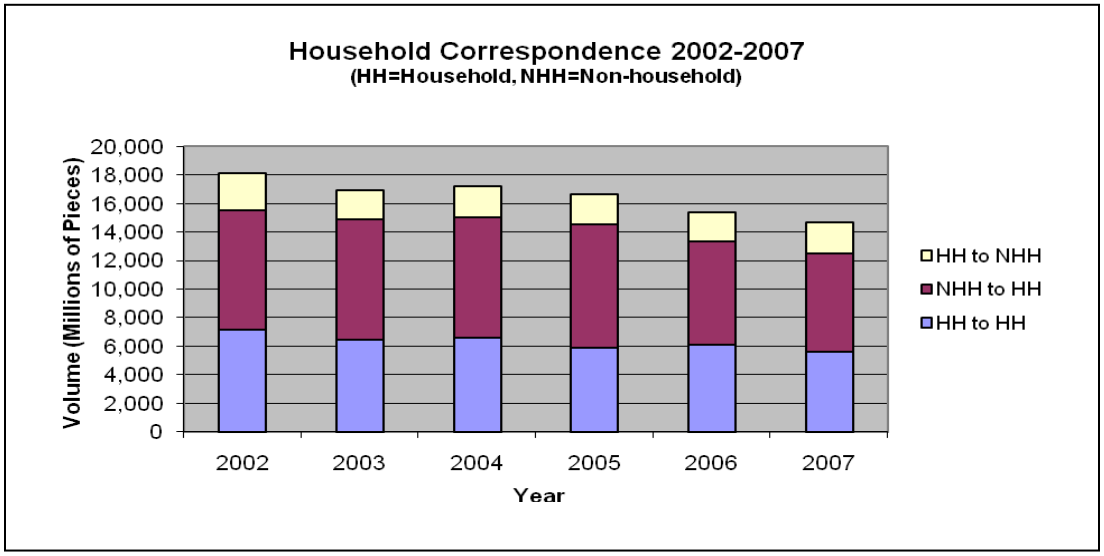
The volume of single-piece First Class Mail -- the class most often used by consumers -- was down sharply in Q3, by 9.8 percent. As the chart at the top of the next page shows, correspondence sent by households is down over the past six fiscal years. But the American consumer still relies on the mail -- nearly 15 billion pieces of mail were sent and received by households in FY 2007.

Revenue for First Class Mail broke with previous trends, falling by $190 million this quarter, or 2 percent compared to the same period last year. This marks the first time since Q2 FY 2007 that First Class Mail revenue has dropped compared to the corresponding period of the previous year.

Standard Mail volume and revenue declined by 5.5 percent and 3.2 percent, respectively, compared to the third quarter last fiscal year.

USPS blamed rising fuel expenditures for its sizeable fleet of vehicles for some of the losses. The sluggish economy also contributed to declines in mail volume and therefore USPS revenue. Postmaster General John Potter predicted that "when the economy does rebound, mail volume may not return to previous levels."

USPS also felt the burden of a $1.4-billion contribution to its Retiree Health Benefits Fund. This payment was required by the PAEA and represents a portion of the $5.6 billion total to be paid to the fund by September 30, 2008.



USPS's poor financial standing could mean that another rate increase is imminent -- perhaps as soon as May 2009. According to American Business Media Washington Counsel David Strauss, "you could be looking at periodicals rates going up 5 or 6 percent for some publications -- about double the 2.9 percent increase we saw in May." Prices for stamps would no doubt follow suit.

Former Director of the USPS Office of Economics and Strategic Planning Charles Guy does not think that a rate increase is the answer. "A reliance on postage rate increases to solve the large and growing revenue shortage problem will only accelerate the decline of mail volume and most likely make the financial condition worse," he said. "Postage increases are simply not a viable alternative to cost reduction."

Impact of Express Mail Discounts Yet To Be Seen

Last quarter, USPS announced a series of price discounts intended to counteract steep declines in the usage of Express Mail and to put USPS pricing for expedited delivery products more in line with the pricing structure of competitors. Individuals and businesses that purchase postage for Express Mail online are now eligible for a discount of 3 percent. Express Mail customers can receive a price reduction of up to 7 percent by meeting quarterly volume minimums. Priority Mail is available at an average discount of 3.5 percent to customers who use electronic postage and meet other requirements.

The discounts went into effect halfway through Q3, on May 12, but any effects have been slow to take root. Express Mail volume plunged once again this quarter, down 14.3 percent compared to the same quarter in 2007.

The discounts did not appear to have much of an impact on Priority Mail either, but the category did post a 2.5-percent revenue increase in Q3 FY 2008 compared to the same period last year. This revenue increase is a continuation of recent trends. Volume in the category dropped by 12.8 million pieces, or 5.9 percent compared to last fiscal year's third quarter.

> ***"The American consumer still relies on the mail -- nearly 15 billion pieces of mail were sent and received by households in FY 2007."***

USPS Rolls Out Much-Anticipated "Network Plan"

In accordance with the PAEA, USPS has put together a plan to rationalize the postal network and establish baseline performance targets and service standards for market-dominant products. The PAEA required that USPS develop new performance goals as well as a long-term plan for updating its infrastructure, workforce, and facilities.

The Network Plan, which was delivered to Congress on June 19, 2008, consists of five fundamental elements:

1) The "operationalizing" of service standards by improving the consistency of internal mailflow.

2) Network rationalization -- including the closure of redundant postal Airport Mail Centers, a retooling of the mail processing network, and the transformation of the Bulk Mail Center (BMC) network.

3) Workforce rationalization.

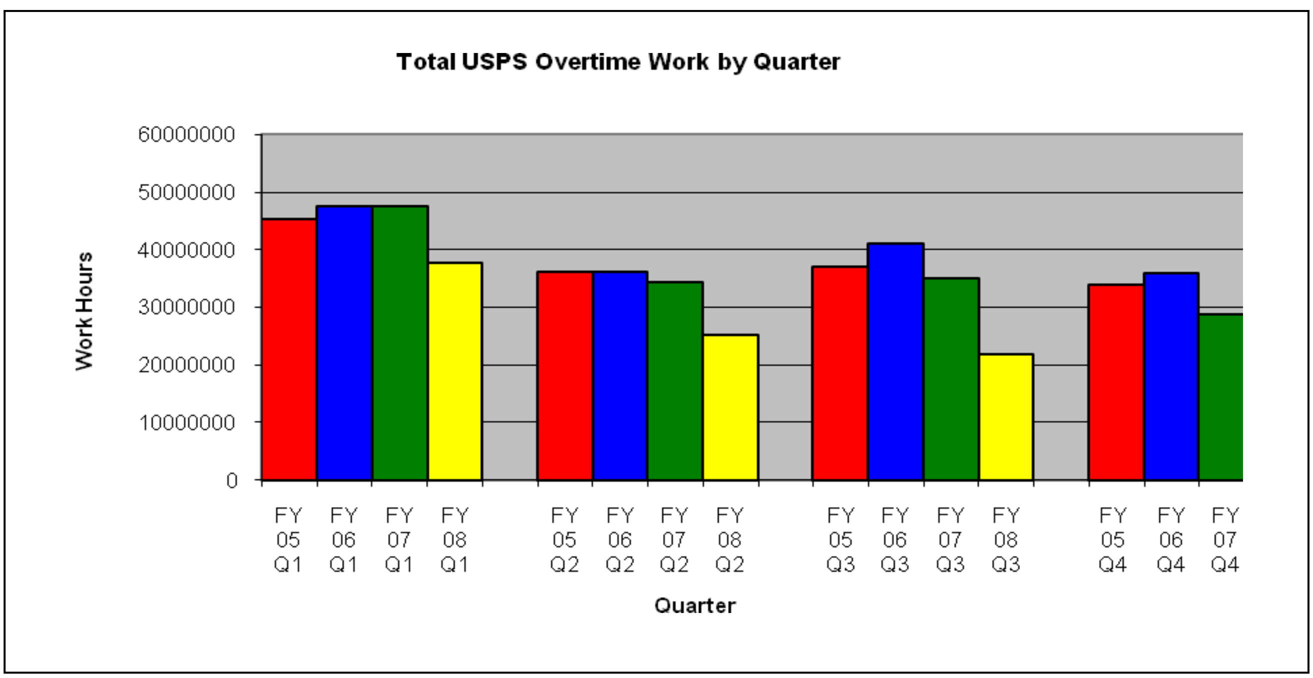
4) Exploration of alternate retail venues for postal products.

5) A new performance goal of "continuous improvement" in accordance with a timetable of specific performance targets.

USPS has made progress on certain aspects of the Network Plan. In the last five years, the agency has closed about 50 airport mail centers and remote encoding centers, consolidated processing and distribution at 12 locations, and outsourced the functions of 13 airport mail centers.

Last quarter marked the beginning of sharp cutbacks in work hours for USPS employees. These cuts were responsible for a significant $247-million decline in compensation expenses -- a drop of 5.5 percent from Q3 FY 2007.

As the chart below shows, USPS has also cut costs due to overtime work. In the first three quarters of this fiscal year, overtime hours are down significantly compared to the corresponding period of the previous year.



USPS attempted to cut labor costs further by offering early retirement to clerks, mail handlers and supervisors. As many as 130,000 employees may be eligible. The Postal Service is facing billion-dollar losses this year, so trimming costs is essential.

Despite these reforms, USPS noted that its planned consolidations have been restricted by congressionally imposed delays. These delays and the threat of further congressional interference are not helping the Service's long-term financial viability.

According to the Network Plan filing, USPS's usage of the 21 Bulk Mail Centers has declined significantly. In fact, these centers now have excess capacity. The floor space currently idle could represent valuable real estate for its planned Phase II deployment of Flats Sequencing System equipment. Some have even argued for outsourcing the Bulk Mail network entirely to make room for the Flats Sequencing machines.

On July 24, the House Subcommittee on Federal Workforce, Postal Service and the District of Columbia Service held a hearing entitled to discuss the Network Plan and its "potential impact on the public, the postal workforce, the mailing industry and the future economic health of the Postal Service."

Among the many panelists at the hearing was John Waller, Director of the Postal Regulatory Commission's Office of Accountability and Compliance. Waller stated in his testimony that the PRC found that "the final draft of the Network Plan lacked specific performance goals for most postal products, and thereby lacked a vision of how the activities described in the plan would meet certain performance goals."

He went on to say that "the Commission now expects to see proposed achievement percentage goals for all services before the end of the fiscal year."

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USPS Inspector General David Williams characterized the Network Plan as "more of a strategy document than a tactical plan."

William Burrus, President of the American Postal Workers Union, has expressed disapproval for the Network Plan. He believes the plan "relies almost exclusively on reducing work hours as a means of remaining financially solvent." According to Burrus, "[t]his is a failed strategy and it cannot sustain America's mail service."