USPS Future Business Model

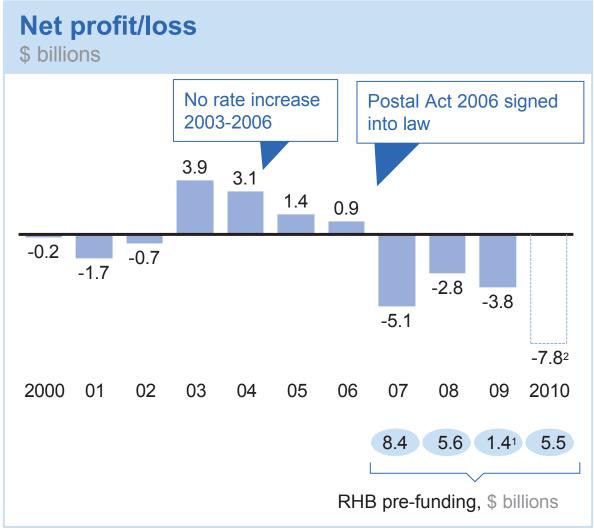


March 2, 2010

Contents

- Recent context
- Base case minimal management actions
- Addressing the challenge
- Short term requirements

USPS is experiencing unprecedented losses



Key drivers

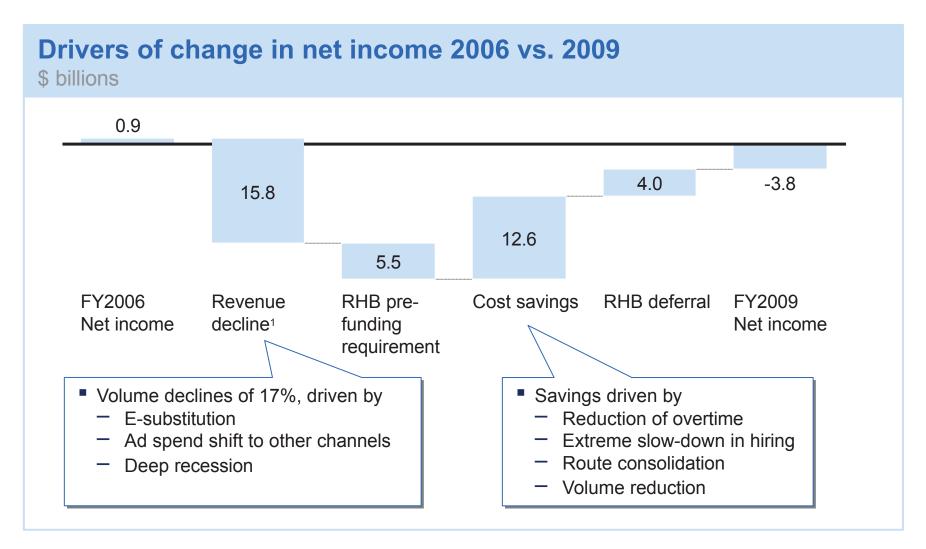
- Revenue declines due to:
 - E-diversion of First-Class Mail
 - Down-trading from First-Class to Standard Mail
 - Losses of advertising mail due to the recession
- RHB pre-funding requirement introduced by the PAEA
- Cost savings, while substantial, have beeness than revenue declinesdue to high fixed costs of the network

Note: All years in this document refer to Fiscal Years ending on Sept 30

1 Includes one-time \$4 billion deferral

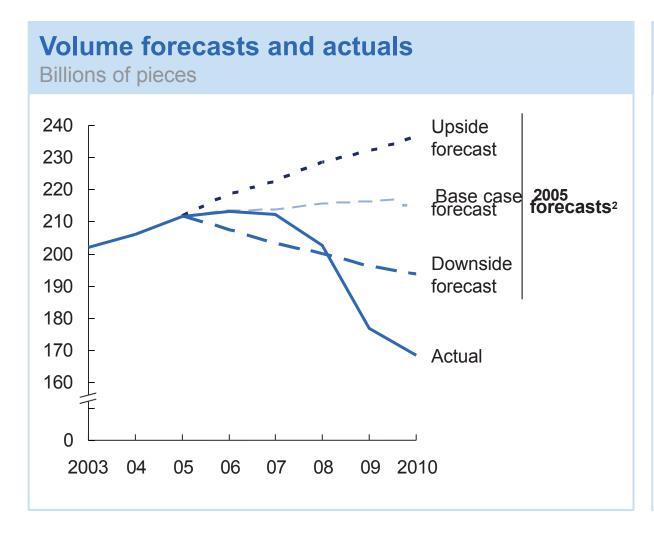
2 Per 2010 Integrated Financial Plan (January Year-to-Date results are favorable to Plan)

Losses have been driven by volume declines, RHB pre-funding requirements and limitations on cost savings



¹ Revenue declines calculating by applying 2009 prices against 2006-09 volume declines

Volume declines have been worse than expected when the current legal and regulatory framework was established



PAEA implications¹

- When PAEA was passed, volume projections did not anticipate the current scale of declines
- PAEA introduced some additional product flexibility, but also two crucial restrictions:
 - Price increases capped at CPI by class
 - Significant pre-funding requirements for Retiree Health Benefits (RHB)

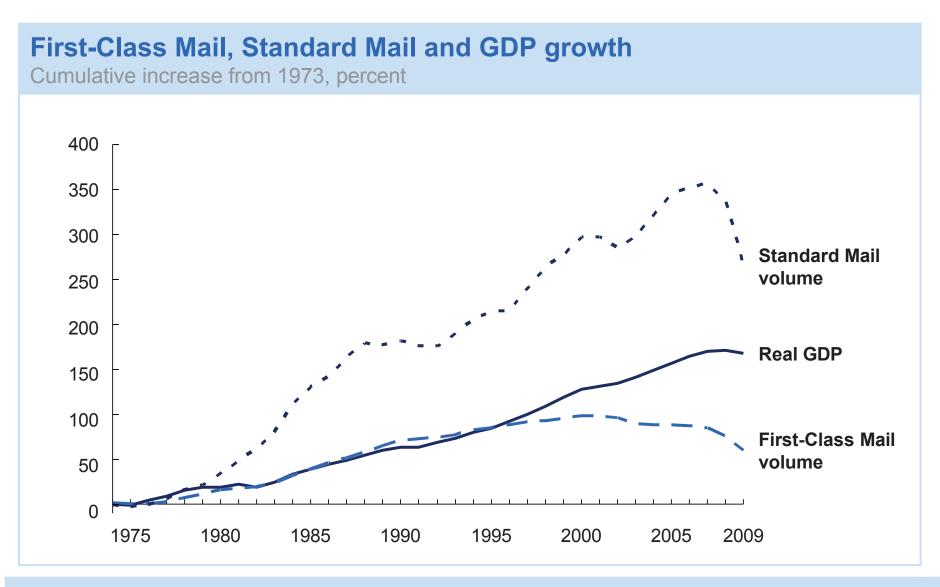
1 Postal Accountability and Enhancement Act, 2006

2 Forecasts from "USPS Strategic Transformation Plan", 2005

SOURCE: USPS McKinsey & Company | 4

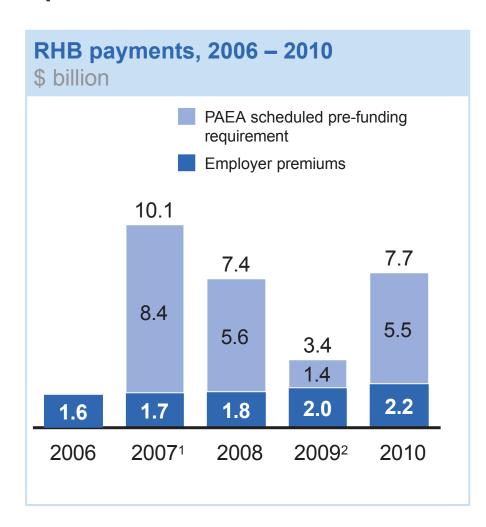
Recent Context

The recession has exacerbated volume declines, but mail has reached an inflection point, with e-diversion now driving long term decline



SOURCE: USPS McKinsey & Company | 5

Retiree Health Benefit funding requirements are a significant burden, equal to 12% of total revenue in 2010

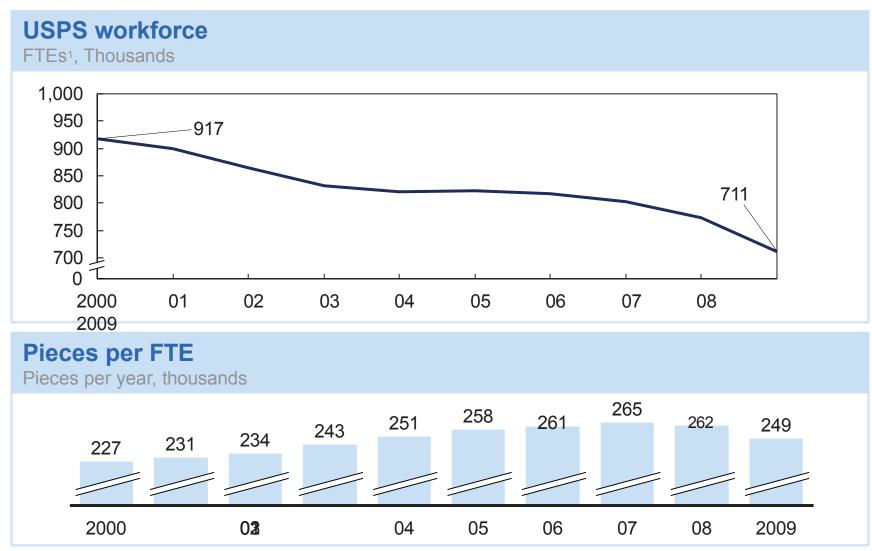


Drivers of RHB requirements

- Pre-funding is unique to USPS within the public sector, and rare (and not required) within the private sector
- Schedule of pre-funding requirements is accelerated in the first 10 years of the 50 year liability
- Actuarial estimates of total RHB liability vary widely based on differences in discount rates, future health care costs, the size of the workforce, and period of pre-funding

1 \$8.4B scheduled payment includes \$3B legacy payment from CSRS 2 \$1.4B scheduled payment includes \$4B deferral from Congress

Recent reductions in workforce usage have been significant, but pieces per FTE still declined in 2009

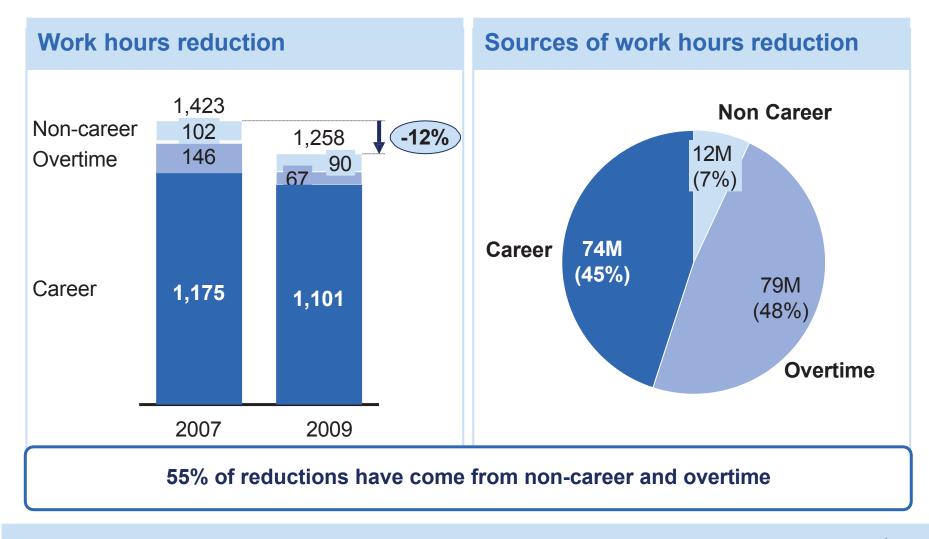


1 Full Time Equivalent, based on work hours (includes overtime)

SOURCE: USPS McKinsey & Company | 7

The USPS has been responsive to declining volume, but recent work hour reductions will become increasingly difficult to replicate

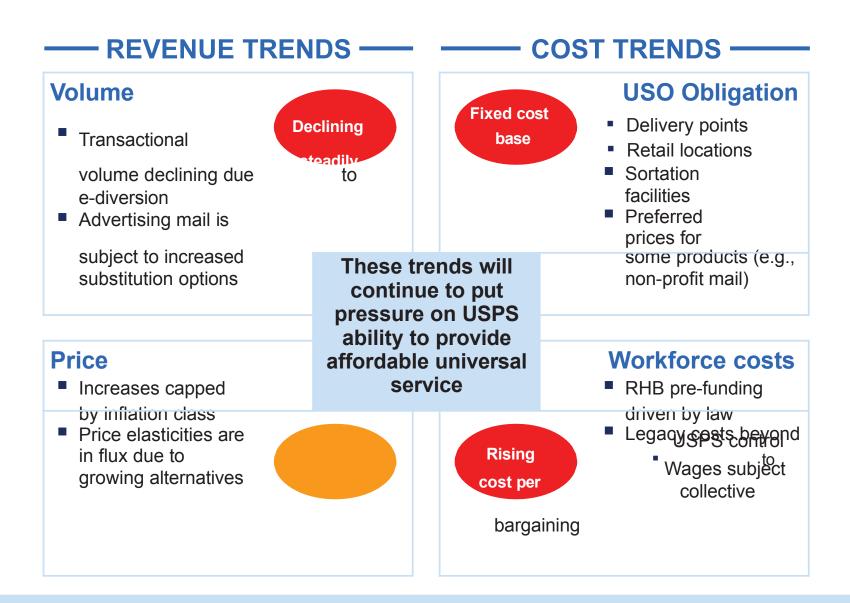
Millions of hours



Contents

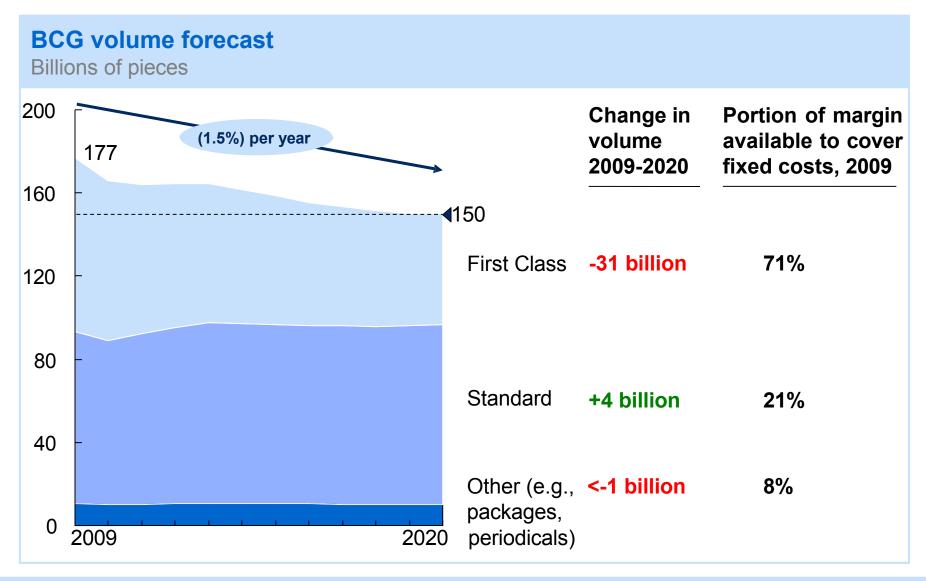
- Recent context
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Four trends will affect postal economics going forward



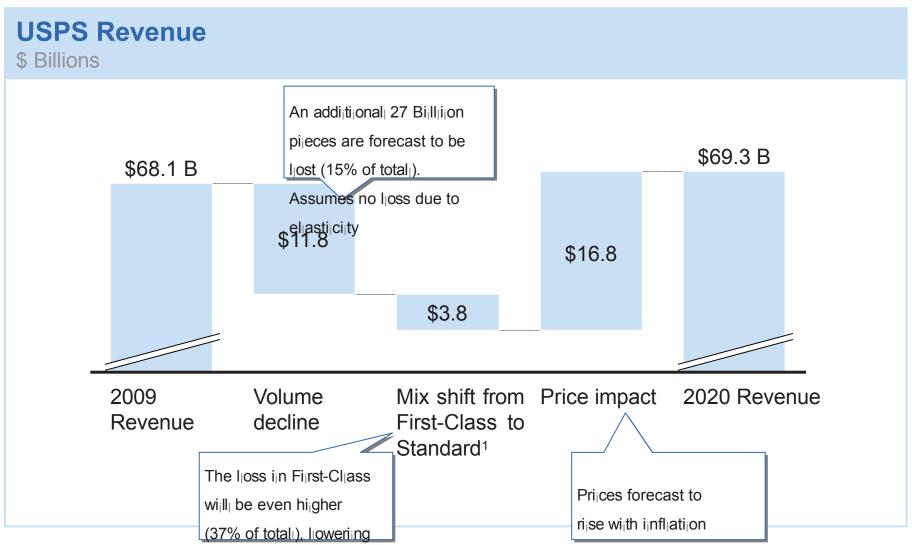
Base Case: Volume Declines

Volume will decline significantly over the next decade driven by a steady decline in First-Class Mail, the most profitable segment



Base Case: Revenue Projection

Overall revenue will slightly increase, as inflation-driven price increases will offset the volume decline and shift to Standard Mail



¹ Calculated by applying the 2009 First-Class/Standard mix to 2020 prices. Excludes mix shift in any other categories the average price

Base Case: Fixed Cost of USO

Costs, from a workforce standpoint, are largely fixed to fulfill the universal service obligation and other service requirements



Post Offices

(36,500 Post Offices, Stations and Branches¹)

- Built so that Americans have nearby access
- Continued urban sprawl and growth puts pressure to increase retail
- Significant resistance and administrative burden to closing existing Post Offices
- Prohibited by law from closing Post Offices for economic reasons

Delivery network

(~150 million delivery points²)

- Required to deliver to almost every address in America
- 6-day delivery to every delivery point



Network historically built to provide high service levels to citizens, on the basis of growing volumes



Sortation plants

600 processing facilities)

- Built to ensure overnight delivery of local mail
- Network largely fixed unless service standards change
- Significant political resistance and administrative burden to closing plants

Transportation

(220,000 vehicles)

- Large vehicle fleet
- \$2.6 billion in air transportation expenses



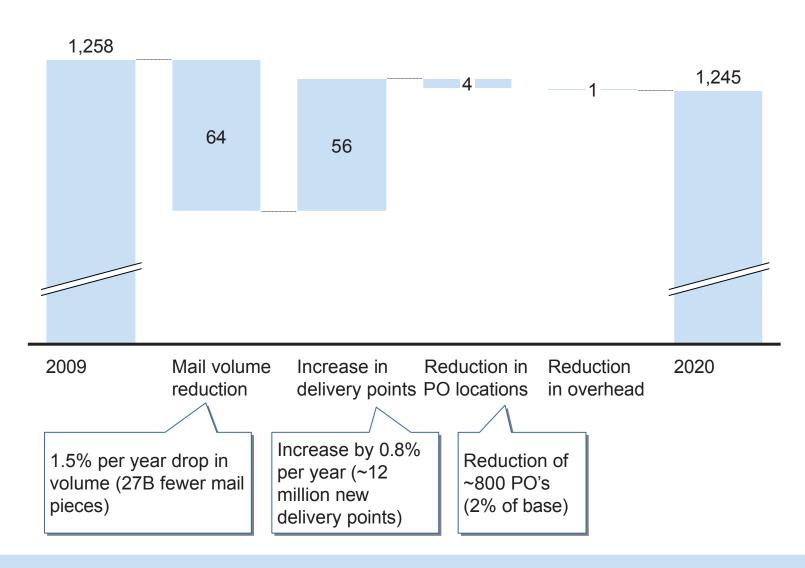
1 Includes CPUs

2 Includes approximately 20 million PO Boxes

SOURCE: USPS FY 2009 10-K

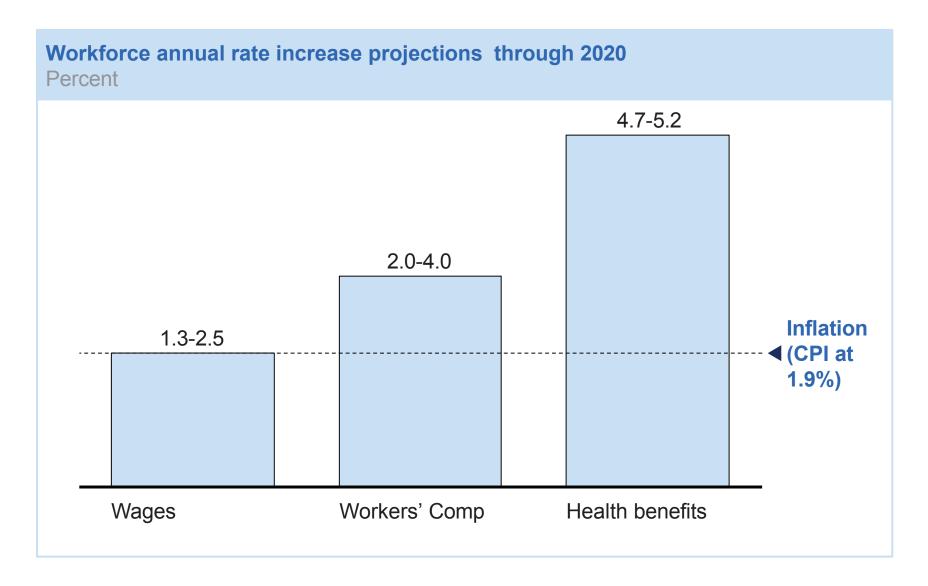
Without aggressive management cost-cutting, work hours will remain flat with volume decline countered by more delivery points

Millions of work hours

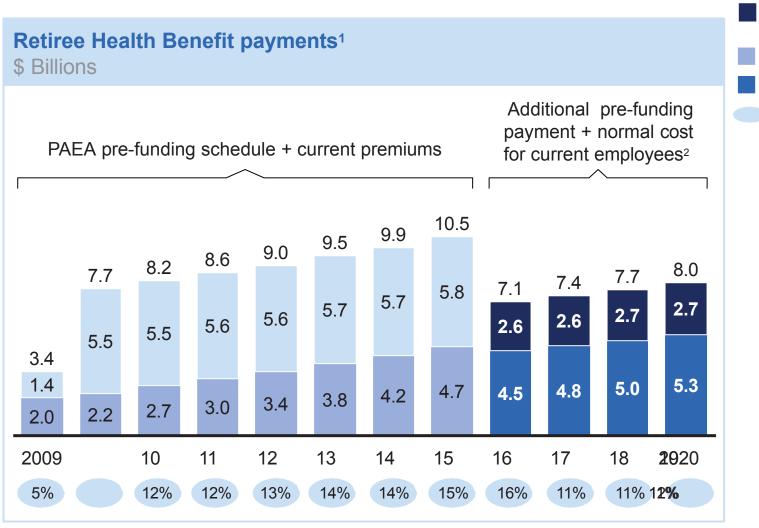


SOURCE: USPS McKinsey & Company | 14

Workforce costs continue to rise faster than inflation through 2020



While payments in 2017-2020 drop, RHB funding will continue to be greater than 10% of gross revenues through 2020



¹ Based on OPM estimates of future liability, including RHB pre-funding and annual premiums

PAEA scheduled

pre-funding

funding

Premiums

Percent

of total

revenue

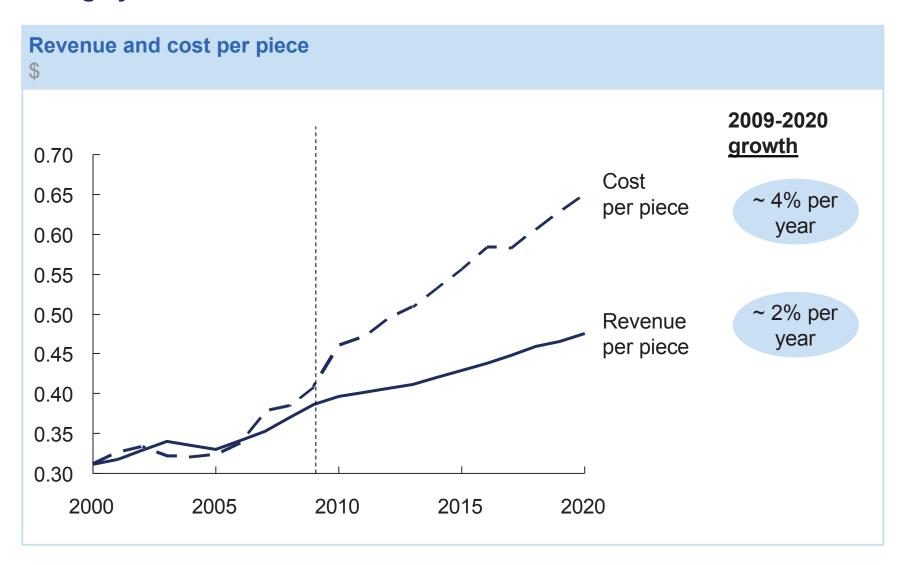
Normal costs

Additional pre-

² Current retiree health premiums in 2017-2020 are paid directly out of the fund, resulting in no operating expense

Base Case

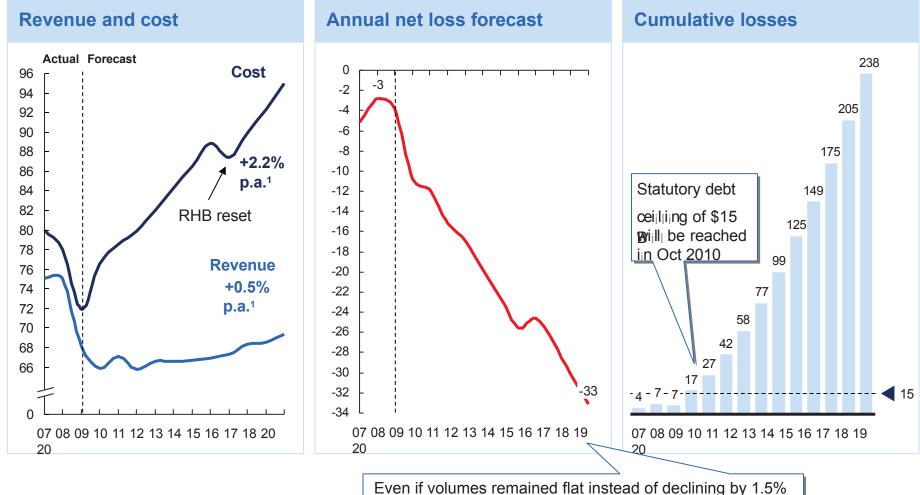
The combination of the trends will put extreme pressure on USPS given it is a largely fixed-cost network business



Base Case

The "Base Case" leads to a loss of \$33 billion and cumulative losses of \$238 billion by 2020

\$ Billions



1 Per Annum: Compound annual growth rate, 2010 to 2020

annually, the loss in 2020 would still be \$21 billion

Base Case

The financial outlook for the Postal Service is highly dependent on trends in the general economy

Potential upside

- Rapid economic recovery
- Greater than expected rebound in **Advertising Mail**
- Flattening of e-diversion
- Government-led decrease in health care cost inflation
- Non-career employee increase

Potential downside risks

- Greater than expected volume declines due to:
 - Accelerated e-diversion
 - Further ("double-dip") recession
- Health care uncertainty
 - Greater than expected health care cost inflation
 - Legislation to require provision of full medical benefits to noncareer employees
- Input cost inflation outpacing prices, especially in fuel costs

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USPS can pursue two sets of actions to address the challenge

Description

Actions Within Postal Service Control

- Actions being taken or planned by USPS to grow and improve productivity
- May be challenging to achieve

Fundamental Change

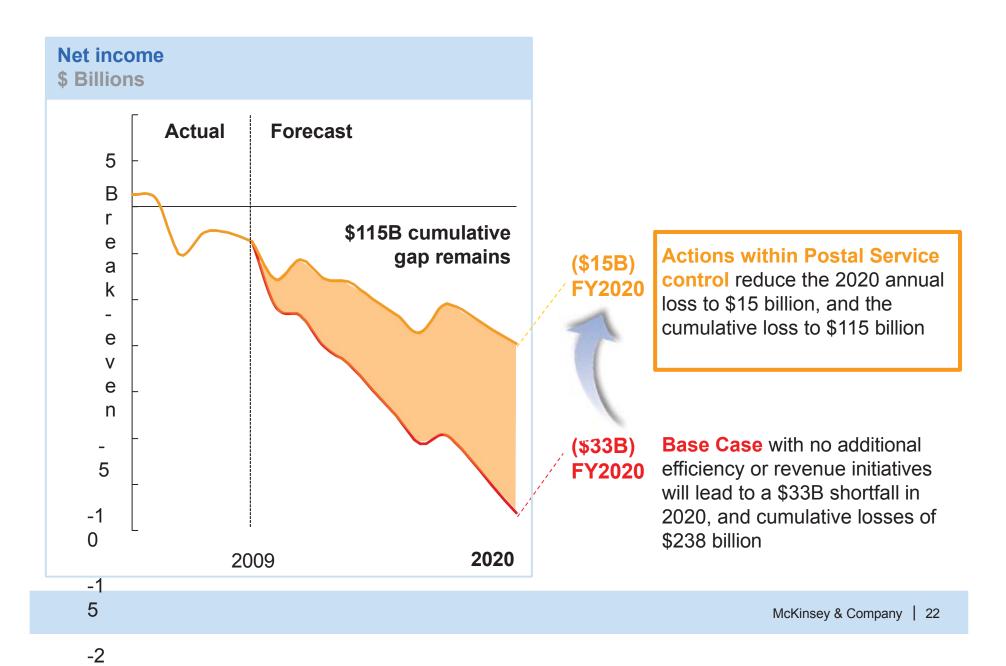
Nonlegislative

Legislative

- Actions within USPS authority
- No legislation required, although stakeholder support/approval needed
- Most options require PRC approval, collective bargaining, or political support
- Actions requiring legislative change

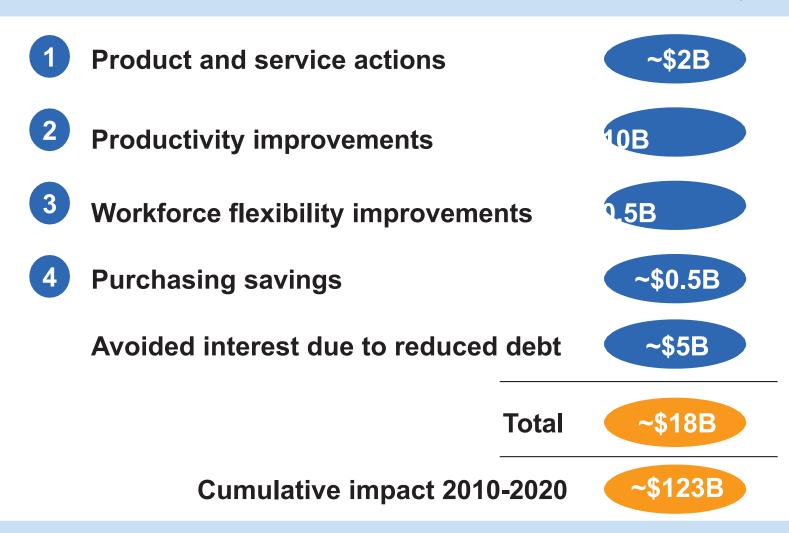
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USPS can pursue actions within its control to reduce the FY2020 gap



USPS will continue to take aggressive action to drive revenue and control costs





1

The "Actions within Postal Service control" case includes product and service initiatives above the baseline to grow volume

Postal Service product and service initiatives

Key actions

Mail services

- Grow under-penetrated segments and access latent demand through:
 - Increasing Small Business direct mail
 - First Class/Standard mail promotions

Package services

- Leverage network to grow aggressively through:
 - Priority Mail Flat Rate Box expansion
 - Commercial contracts
 - Parcel Select and Returns, including recycling
 - Product samples

Retail services

- Maximize profitability by store segment within a plan to reduce costs and increase access though:
 - PO Boxes
 - Consumer products
 - Passport growth

Total 2020 income impact

~ \$2 billion

SOURCE: USPS McKinsey & Company | 24

Aggressive productivity improvements in the "Actions within Postal Service control" case are worth ~ \$10 billion

Postal Service productivity initiatives

Key actions

Processing plant operations

- Continuous improvement/ Lean Six Sigma
- Incremental network consolidation

Delivery

- Flats Sequencing System
- Route restructuring

Customer service

- Continuous improvement/ Lean Six Sigma
- Transactions moving to alternative access points through customer demand

Admin

 Restructuring and consolidating administration, supported by technology enablers

Increasing world-class productivity

USPS already processes 91% of mail through automation, the best in the world. Further improvements will be highly challenging

Total 2020 income impact

~ \$10 billion



3/4 Increasing workforce flexibility and improving procurement add ~ \$1B in the "Actions within Postal Service control" case

Postal Service workforce flexibility and procurement improvements

Key actions

Workforce flexibility

- As career employees leave, replace with non-career employees up to bargaining limits
- Takes advantage of natural attrition

Total 2020 income impact

~ \$0.5 billion

Procurement

- Increase transportation efficiency
- Improve vendor management for supplies, services and other costs (e.g., IT)

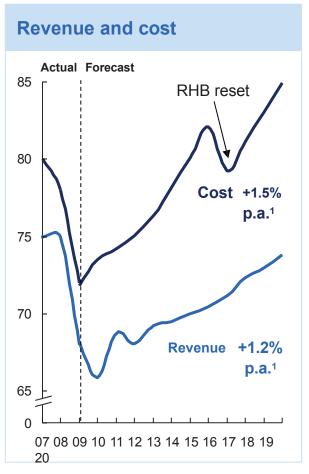
Total 2020 income impact

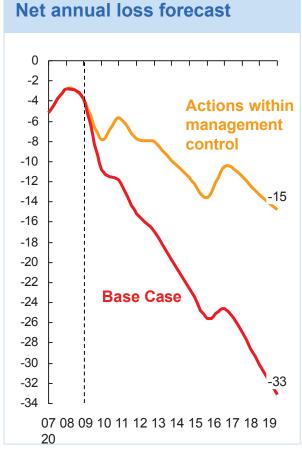
~ \$0.5 billion

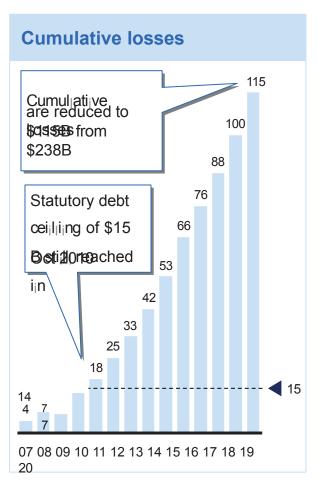
Actions within Postal Service control

The "Actions within Postal Service control" case leads to a loss of \$15 Billion and cumulative losses of \$115 Billion by 2020

\$ Billions



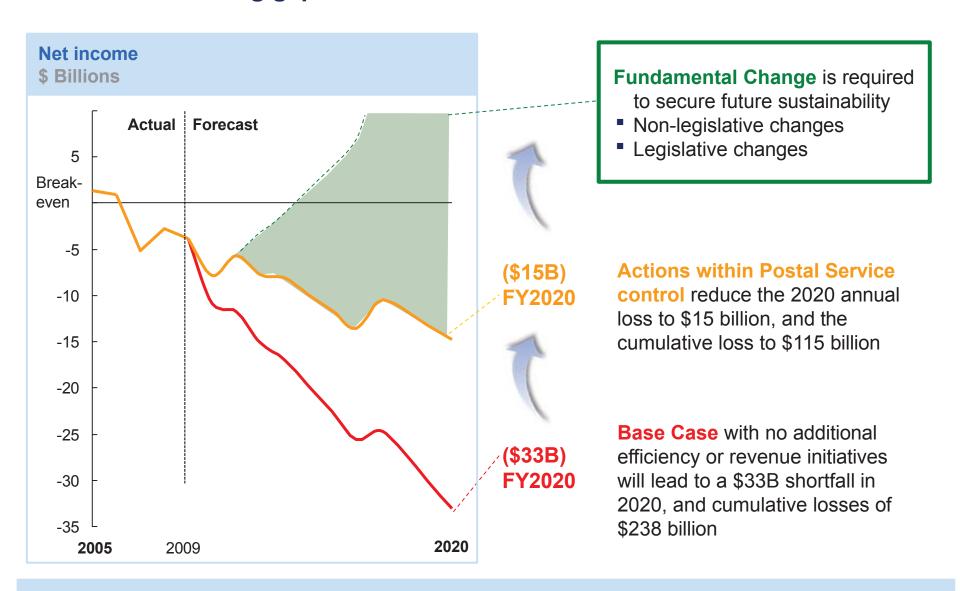




¹ Per Annum: Compound annual growth rate, 2010 to 2020

Fundamental Change

"Fundamental Change" that increases USPS flexibility will be required to close the remaining gap



Fundamental Change

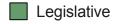
Definition of non-legislative and legislative change

	Description	Examples
Non-legislative	 Actions within USPS authority No legislative changes required, but will impact some stakeholders and is challenging to implement Many options require PRC approval All labor changes subject to collective bargaining 	 New product innovations such as hybrid mail Exigent price increases
Legislative	 Actions requiring legislative change Includes changes to the base legislation as well as issues that have historically been attached as annual riders (e.g. additional restrictions on closing Post Offices) 	 Significant change in the retail network through a combination of increased access with partners and eventual franchising and/or closure existing locations Eliminating/reducing subsidies non-profits

Fundamental Change

USPS will need to pursue multiple "Fundamental Change" options to close the remaining gap





Products and services



- Hybrid mail
- Advertising product
- R Products and services flexibility

Pricing

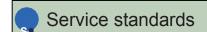


- Exigent price increase
- Cover costs of unprofitable products
- Price cap modification

Service levels



Changes to



- **Delivery location**
- S Delivery frequency
- S4 Access

Workforce



- Changes to:
- Workforce flexibility
- Benefits requirements

Public policy considerations



- RHB
- **USO** subsidies
- Streamlined oversight

Options for USPS consideration

Products and services opportunities were identified through a screen for potential feasibility and impact in the near term



Fundamental Change: Products and services opportunities

Source of ideas

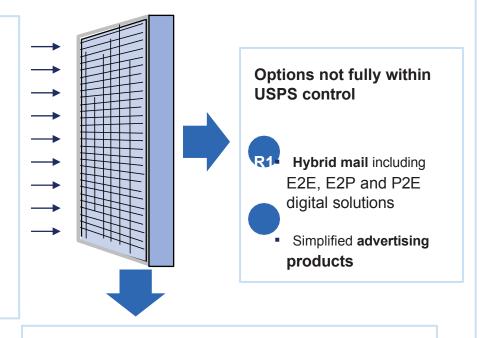
Existing USPS ideas

- Foreign post examples from Accenture
- Other ideas from McKinsey

~30+ revenue initiatives

Examples include...

- Financial services (e.g., Banking, Insurance)
- Transportation services (e.g., 3PL, warehousing)
- Business and government services
- Asset commercialization (e.g., truck advertising)
- New mail products (e.g., hybrid mail)
- Retail products (e.g., vending)



Ideas with low profit impact or low feasibility

- High barriers to entry
- Significant upfront capital investment required
- Current labor cost structure unsuitable
- Low U.S. market feasibility
- Extremely low industry margins

Products and services opportunities for USPS

Non-legislative



Legislative

Fundamental Change: Products and services opportunities

Hybrid Mail Products

- Create a suite of hybrid mail products the integrate electronic and physical mail
 - E2E and electronic postmark
 - E2P and P2E mail and print solutions

Advertising products

 Simplify advertising product for direct marketers looking to reach households

Products and R3 Services **Flexibility**

 Develop new products and services consistent with **USPS** mission

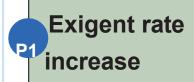
Pricing opportunities for USPS

Non-legislative



Legislative

Fundamental Change: Pricing opportunities



Apply for exigent price increase

P2 Cover costs

- Increase prices on select products to cover costs:
 - Periodicals
 - Nonprofit mail
 - Media and Library mail

Price cap modification

- Set a global cap across all market dominant products, rather than by class
- Automatically adjust cap based on volume triggers

Service level opportunities for USPS

Non-legislative





Fundamental Change: Service level opportunities

Service standards Change service levels from 1-3 day to 2-5 days for First-Class Mail enabling simplified and standardized mail flows with minimal impact on consumers/businesses

Delivery location

Change delivery location to curbside or cluster mailboxes

Delivery frequency Reduce delivery frequency to 3 or 5 days per week

S4 Access

- Expand access through alternative channels
 - Private sector partnerships
 - Kiosks
 - Direct (e.g., online, mobile)

Workforce opportunities for USPS

Non-legislative





Fundamental Change: Workforce opportunities



- Implement initiatives to
 - Improve workforce flexibility and leverage natural shift in employee mix due to 5% annual attrition rate
 - Align workforce costs with overall market trends



Bring federally-mandated benefits payments more in line with private sector

Public policy considerations

Non-legislative





Fundamental Change: Public policy considerations

G1 RHB

- Defer payments
- Shift to a "pay as you go" system comparable to other federal agencies and private sector companies
- G2 USO subsidies
- Receive Universal Service Obligation subsidies through federal appropriations

Streamlined G3 oversight

- Increase flexibility and speed to market by
 - More clearly defining roles of oversight bodies
 - Moving toward after-the-fact review
 - Defining time limits for all reviews

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In the short run, USPS will violate its statutory financing requirements in October 2010

- Only a limited subset of options will take effect quickly enough to address the short term financing requirement
- Options available to maintain solvency in October 2010:
 - RHB restructuring by Congress (deferral or relief)
 - Receive an increased debt limit (does not resolve core issues)
- Options available to maintain solvency in September 2011:
 - RHB restructuring
 - Receive an increased debt limit
 - Exigent price increase
 - 6 to 5 day delivery