March 2010

Ensuring a Viable Postal Service for America

An action plan for the future

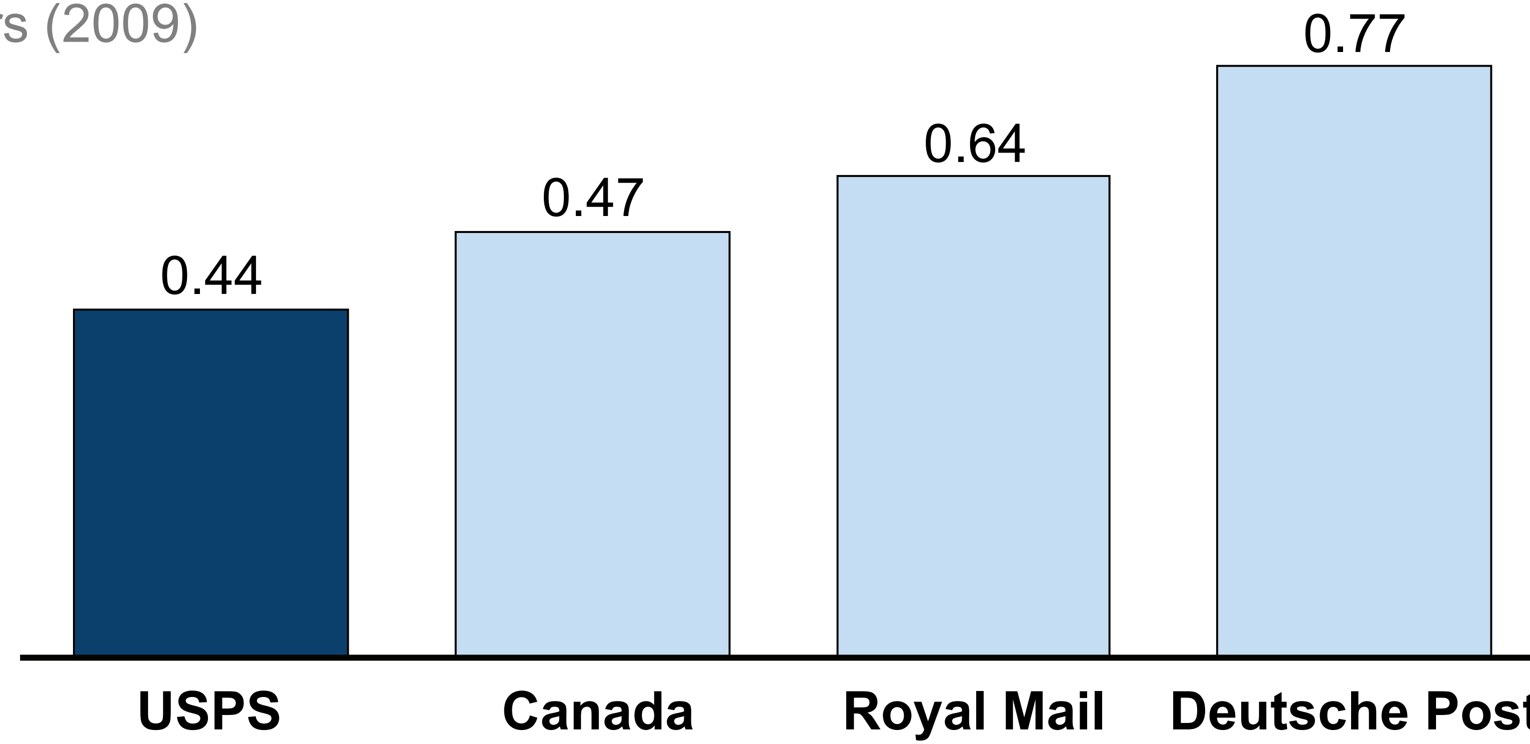
UNITED STATES POSTAL SERVICE ®

Outline for discussion

- Discuss the current challenges of maintaining postal services for the United States of America
- Describe the deepening crisis that will impact the business of mail over the next 10 years
- Detail specific actions that will allow the Postal Service to adapt to changing customer behavior and technology

USPS delivers a universal, affordable service

Stamp price, domestic First-Class letter
US dollars (2009)



	USPS	Canada	Royal Mail	Deutsche Post
~Addresses **Million**	150	14	28	42
Delivery days	6	5	6	6

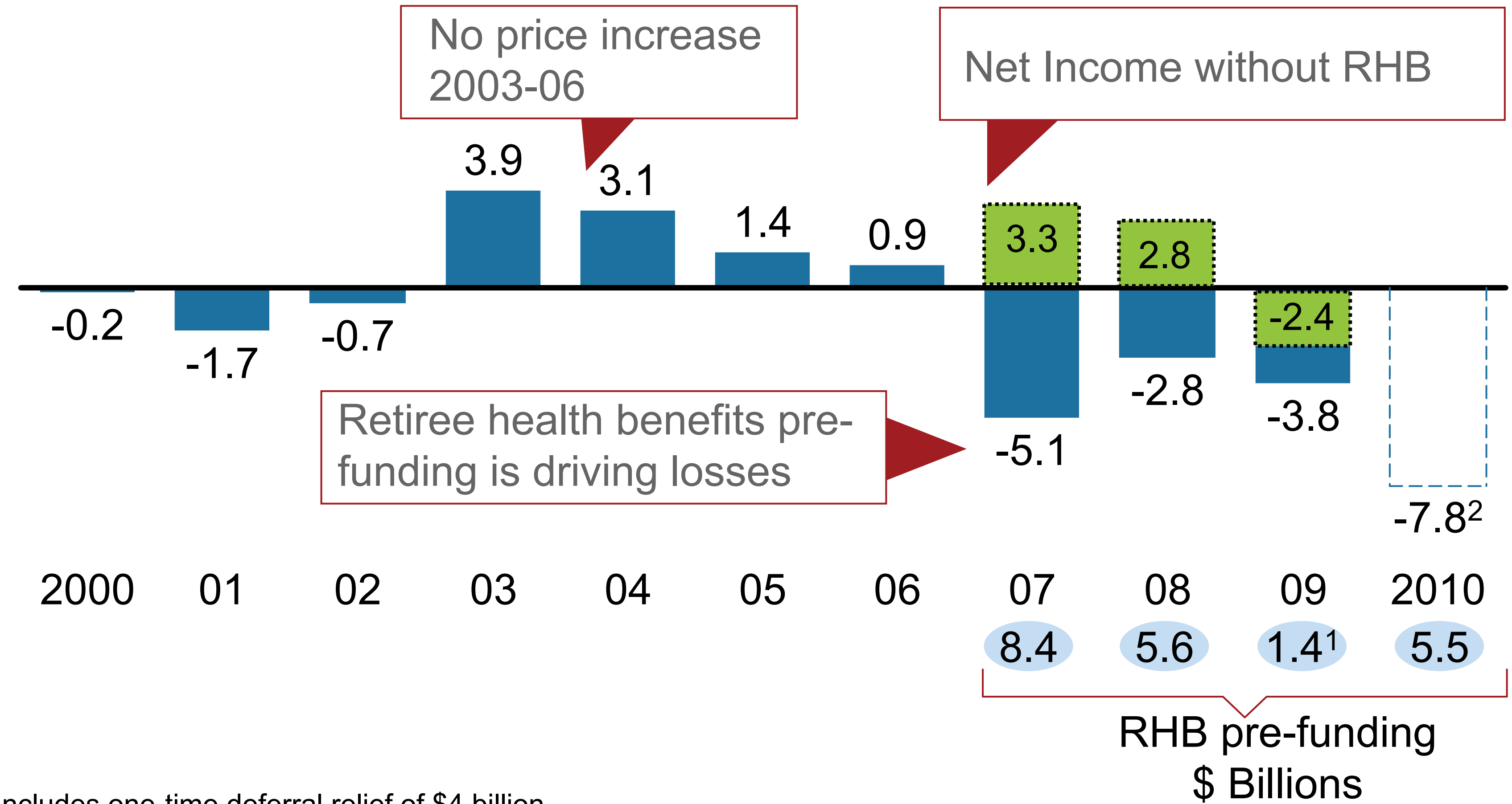
USPS delivers a universal, affordable service

- Delivers to approximately 150 Million addresses, six days a week
- Is more affordable than comparative international posts
- Customer service satisfaction and on time delivery are at all time highs
- Voted the "Most Trusted Government Agency" five years in a row

USPS self-sustaining nature is under threat

Postal Service net profit/loss

$ Billions



1 Includes one-time deferral relief of $4 billion
2 Per 2010 Integrated Financial Plan (January Year-to-Date results are favorable to Plan)
Note: All years refer to Fiscal Years ending on Sept 30

SOURCE: USPS

USPS self-sustaining nature is under threat

- Significant profitability declines between 2006 – 2009, driven by:
  - A 17% contraction in volume due to e-diversion, ad spend shift and the economic recession, resulting in $16 billion less revenue
  - RHB pre-funding requirements cost over $5 billion per year (excluding a $4 billion deferral in 2009)

- While these declines were significant, they were mitigated by aggressive cost savings of $13 billion during the same time period:
  - Reduced overtime by 94 million hours
  - Aligned work hours with volume declines
  - Consolidated delivery routes
  - Froze hiring and executive pay

Four trends will worsen the problem to 2020

Revenue trends	Cost trends
Volume *Declining steadily*	**Universal Service Obligation** *Large fixed cost base*
Price *Rising but capped*	**Workforce costs** *Rising cost per hour*

Four trends will worsen the problem to 2020

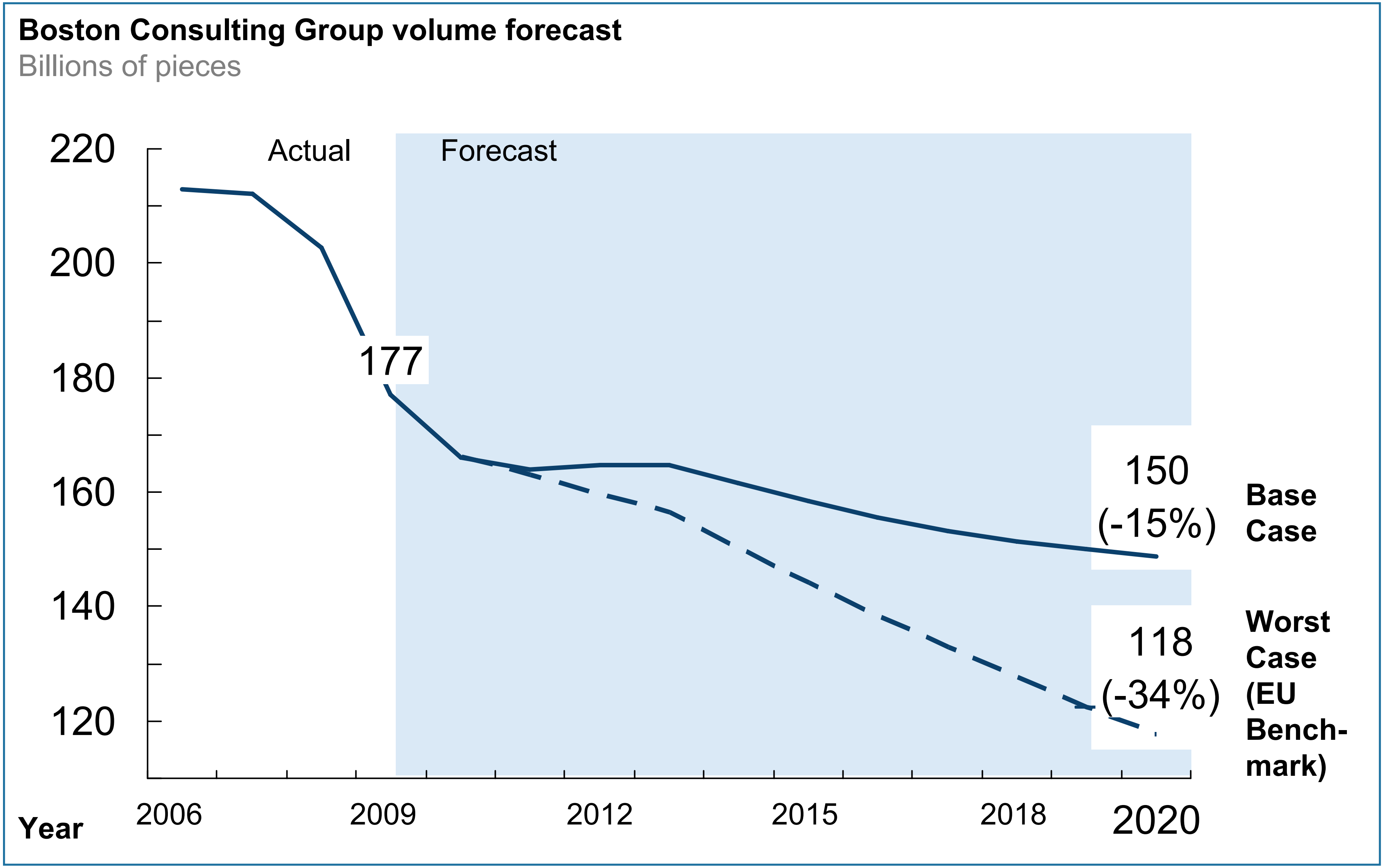
- Volumes are projected to steadily decline, driven by a 37% 2009-2020 drop in First-Class Mail, primarily due to electronic alternatives

- Prices will rise, but are capped at the rate of consumer inflation by class

- The Universal Service Obligation will remain large due to fixed costs of existing requirements (e.g., delivery frequency) and will expand with more addresses each year

- Workforce costs, particularly health benefits, will grow above inflation

Volume: Forecast declines are sizeable and may be as much as 34% from 2009-2020



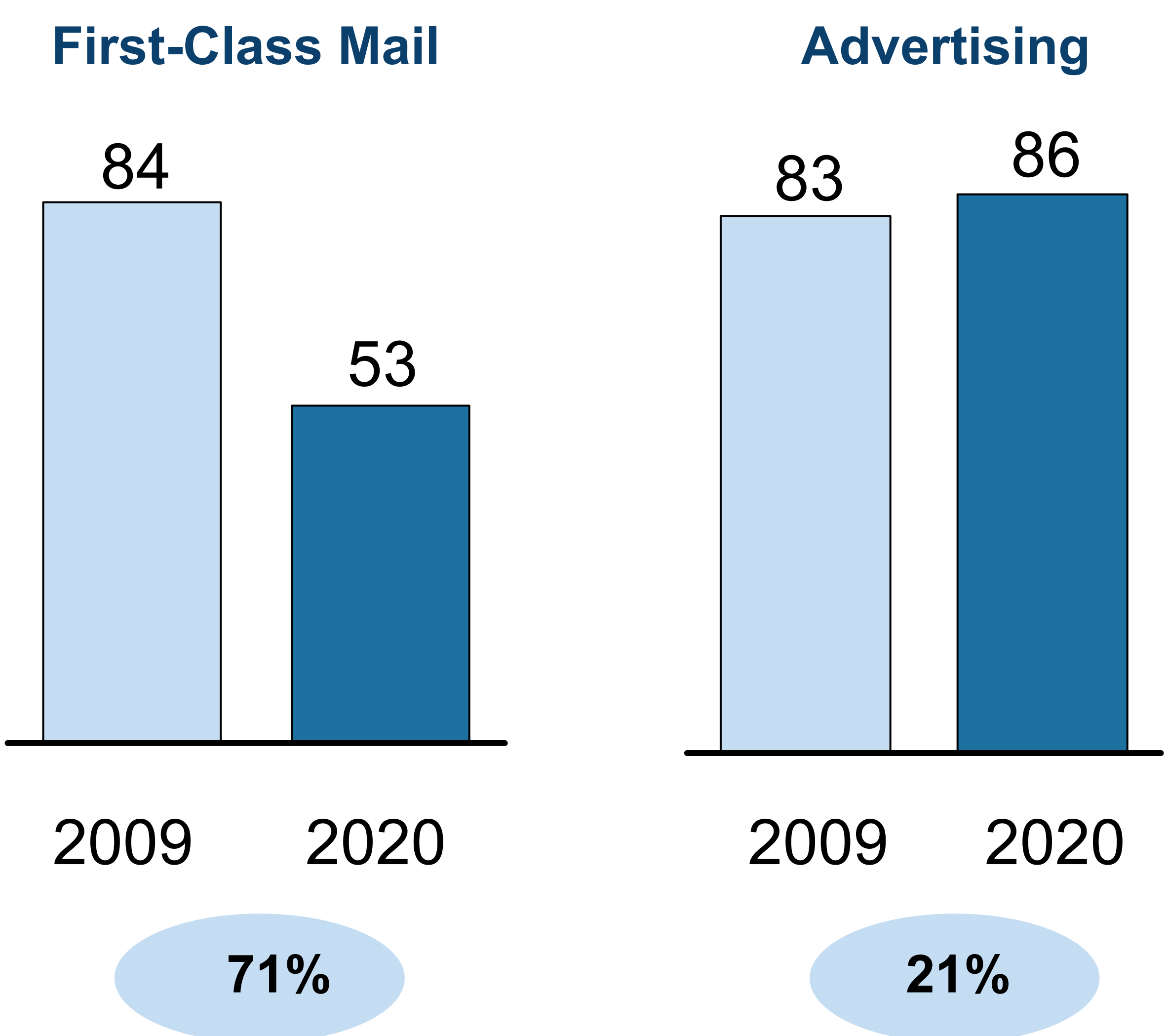
Volume: Forecast declines are sizeable and may be as much as 34% from 2009-2020

- Without any Postal Service action, total volume is projected to decline 15%, from 177 to 150 Billion pieces between 2009-2020

- More severe projections point to a 34% total decline, down to 118 Billion pieces in 2020, based on extensive broadband usage in the EU

Revenue: Declines focused in higher contribution First-Class Mail

Volume
Billion
Pieces
(rounded)



Portion of total margin available to cover fixed costs

SOURCE: USPS 2009 Annual Report, USPS 2009 CRA Report and BCG Analysis

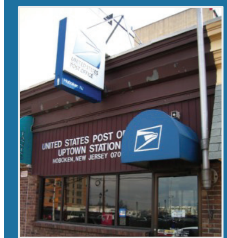
Revenue: Declines focused in higher contribution First-Class Mail

- First-Class Mail drives the overall decline due to e-diversion of bills, online presentments, extension of billing cycles and diversion to hybrid mail options

- Volume changes in Standard and all other mail classes will be relatively flat

- First-Class Mail accounts for 71% of the total margin available to cover fixed costs, and its decline will reduce the ability to cover fixed costs such as delivery and retail networks

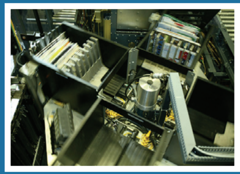
Universal Service Obligation: Network costs are large and growing



Post Offices
36,500 Post Offices, Stations and Branches[1]

Delivery network[2]
150M addresses growing at 1.2M year

Network historically built to provide high service levels to all citizens, regardless of volumes



Processing
600 facilities

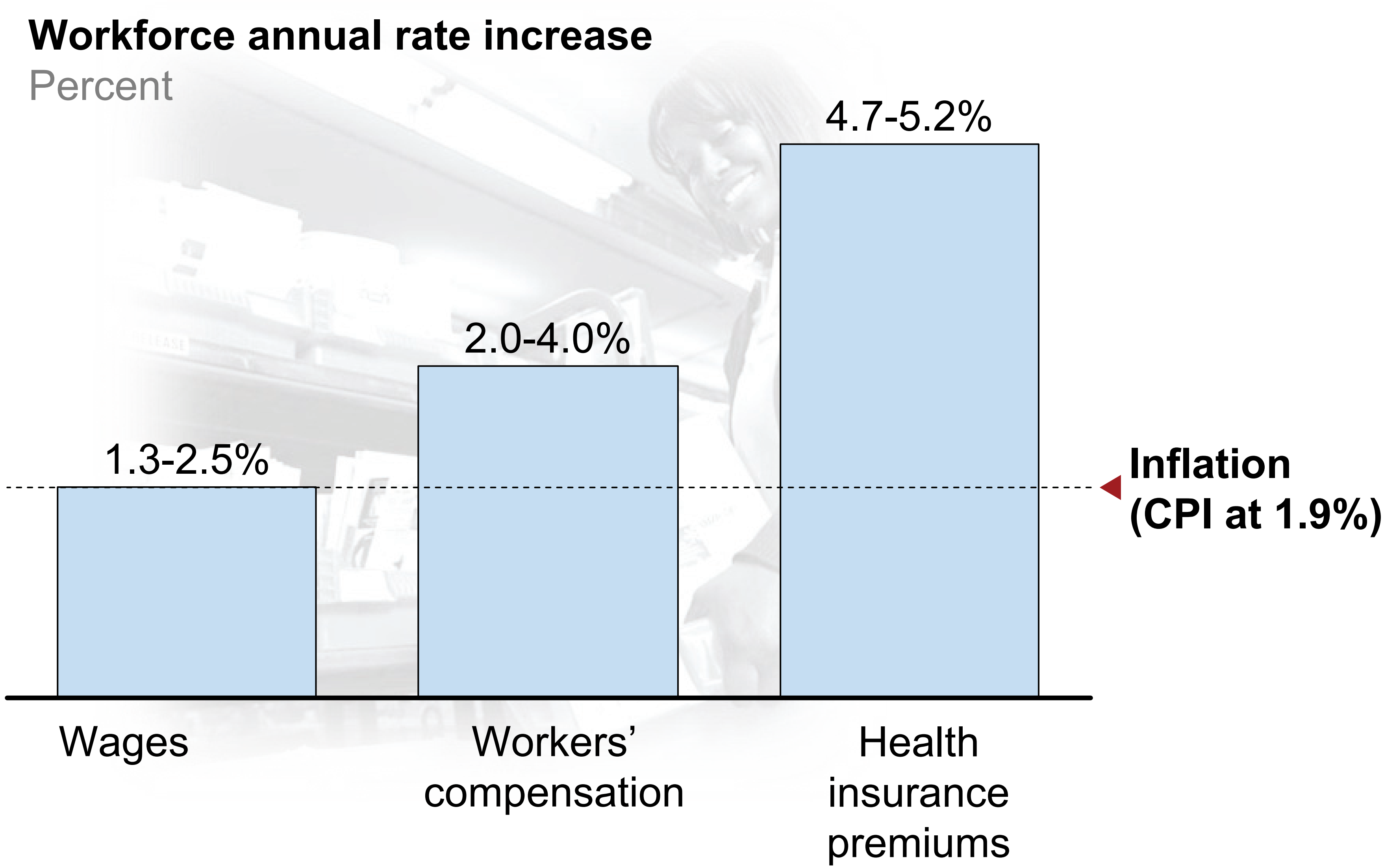
1 Includes Contract Postal Units
2 Includes approximately 20 million PO Boxes
SOURCE: USPS FY 09 10-K

Universal Service Obligation: Network costs are large and growing

- As part of its Universal Service Obligation, the Postal Service maintains 36,500 U.S. retail locations, more than McDonald's, Starbucks, Walgreens and Wal-Mart combined[1]. The Postal Service is prohibited from closing retail locations solely for economic reasons
- 600 processing facilities allow for overnight delivery of local mail and experience decreased economies of scale with volume declines
- A robust delivery network delivered to 150 million addresses per day in 2009, a number expected to increase by ~1.2 million a year.

1 U.S. Locations

Workforce costs: Projected rates increasing faster than inflation



SOURCE: Global Insights, McKinsey Analysis

Workforce costs: Projected rates increasing faster than inflation

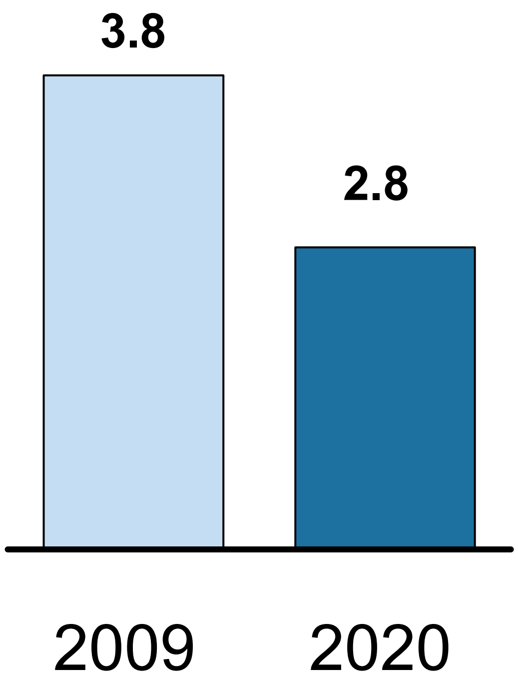
- Workforce costs are projected to increase faster than inflation, driven by health insurance premiums at 2.5 times CPI (Consumer Price Index) and other benefits, including workers compensation, at 2 times CPI

- Health care cost increases could be much higher -- for example, OPM forecasts health care costs to rise at 7% per year through 2020

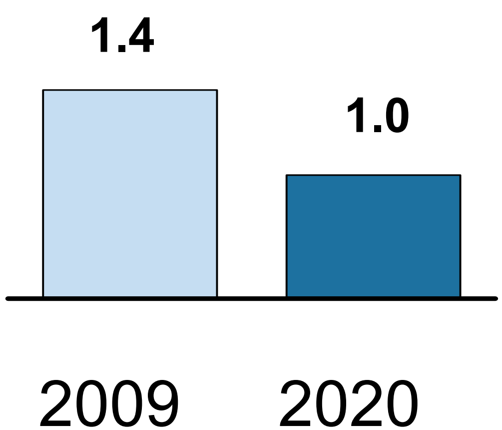
Network economics will get more challenging over time

Total Mail

Average Pieces per delivery point per day



Revenue per delivery point per day (in current $)



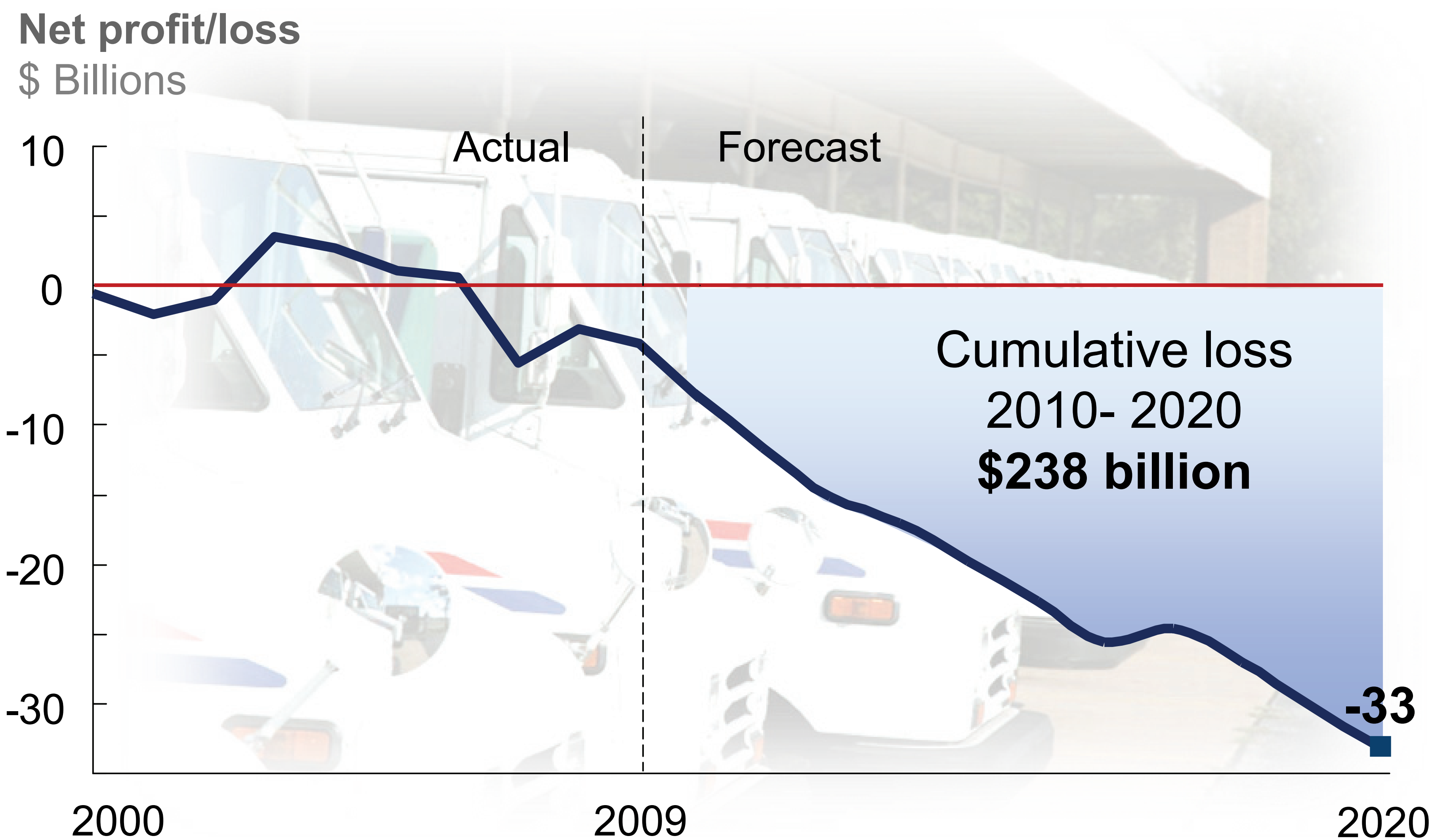
SOURCE: BCG Analysis

Network economics will get more challenging over time

- From 2009-2020 without action, the impact of declining First-Class volumes, capped prices, fixed network costs and increasing workforce rates will cause revenue and volume per address to fall, while costs per address rise

- Likewise, overall volume, price and cost trends combined with fewer retail transactions drive retail revenue down 40% while costs rise by 31%.

Without action, losses forecast to continue



Without action, losses forecast to continue

- Overall cost per piece will grow at a rate of 4.4% per year while revenue per piece grows at 1.9% per year, resulting in accelerating losses

- There is additional downside risk for even greater losses, including:
  – Health care costs rising at greater rates than projected
  – Inflation of costs, such as for fuel, outpacing capped price increases
  – The potential impact of “Do Not Mail” campaigns accelerating volume declines
  – Another recession and/or an extended recovery

USPS actions will save $18 billion annual, but will not close the gap

	Net annual income benefit (2020)
1 Products and services initiatives	~$2B
2 Productivity improvements	~$10B
3 Workforce flexibility improvements	~$0.5B
4 Purchasing savings	~$0.5B
Avoided interest and RHB costs[1]	~$5B
Total	**~$18B**
Cumulative impact 2010-2020	**~$123B**

1 Relative to base case. $3.8 B impact due to reduced interest payments, $1.1 B due to reduced RHB cost

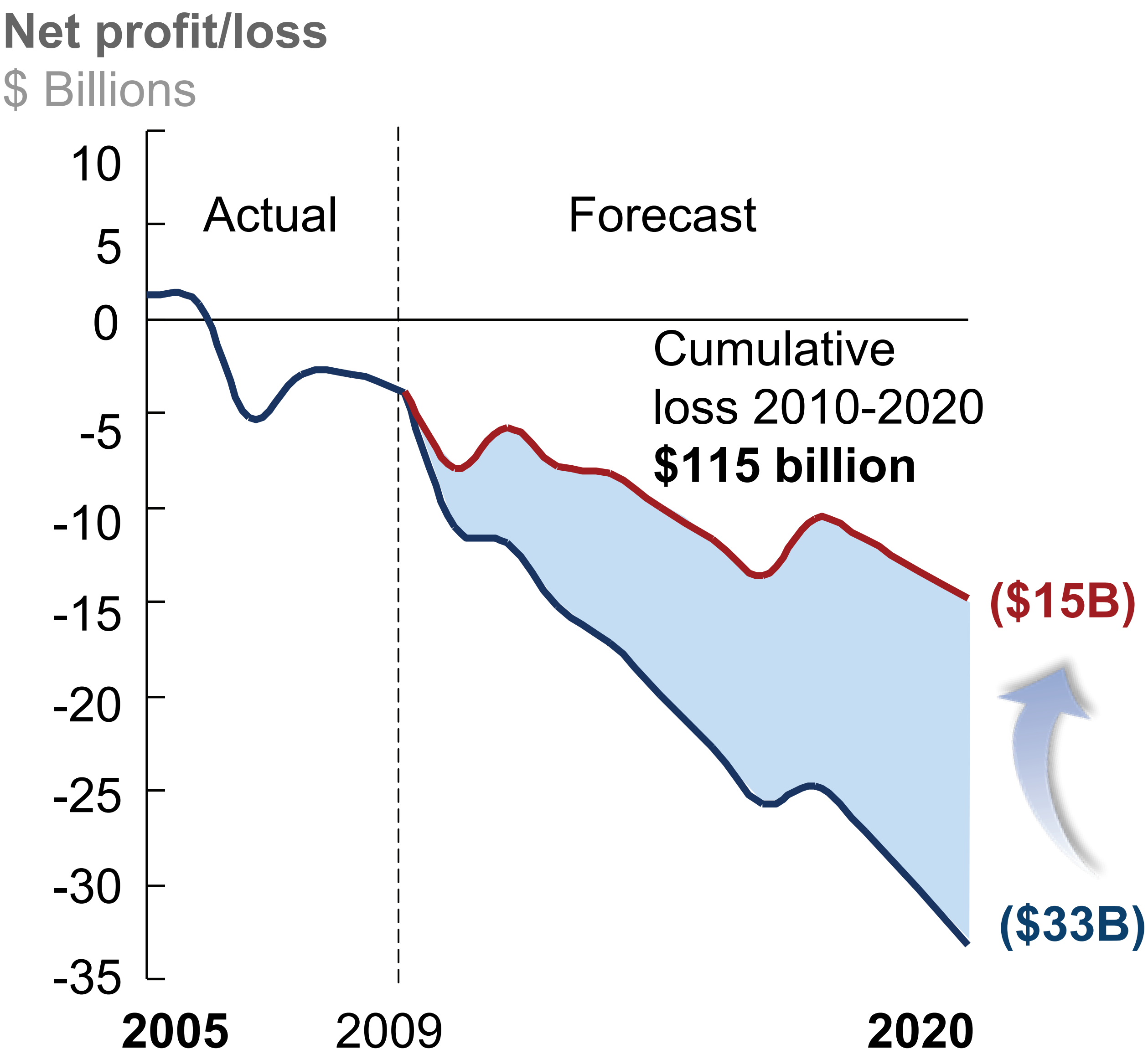
USPS actions will save $18 billion annually, but will not close the gap

Historically, USPS achieved profits from new revenue such as Priority Mail Flat Rate Boxes and productivity improvements. In particular, productivity through automation has made the USPS the most automated postal operator in the world with 91% of letters processed on automation

Going forward, USPS will take action across four areas to narrow the gap, pushing beyond its historical levels and achieving new revenue generation and productivity improvements including:

1. **Products and services initiatives** such as small business direct mail promotion and package growth
2. **Productivity improvements** such as delivery route restructuring, continuous improvement, and expanded customer service access
3. **Workforce flexibility improvements** through the use of non-career employees within contracted limits, and work assignments
4. **Purchasing savings** in transportation, supplies and services

Actions within USPS control reduce the cumulative loss to $115 billion



Actions within the Postal Service control reduce annual loss in 2020 to $15 billion, cumulative loss to $115 billion

Base case without product, service or productivity actions has annual losses of $33 billion, cumulative loss of $238 billion

Source: McKinsey analysis

Actions within USPS control reduce the cumulative loss to $115 billion

- Actions taken by USPS will reduce cumulative losses in 2020 to $115 billion
  - As a result, the 2020 loss will be reduced to $15B from $33B
  - The cumulative gap between 2010 and 2020 will be reduced by $123B, from $238B to $115B.
  - However, USPS's $123B target is highly aggressive; actual cumulative savings may range from $80 - $123B

We examined a range of options to close the remaining gap

50+ options considered

- Aggressive internal cost improvement options across the organization
- Products and services options from:
  - Foreign posts (banking, logistics)
  - Private sector firms
  - Other government entities
  - The Postal Service
- Other product and service extensions from existing assets
- Pricing actions
- Privatization

Filtered on criteria

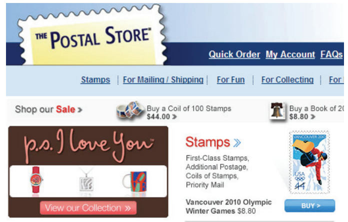
- Overall profit impact
- Impact on customers and mailers
- U.S. specific-industry dynamics
- Time and capital investment required
- Feasibility

We examined a range of options to close the remaining gap

- To close the remaining $115 billion cumulative gap, more than 50 different options were evaluated. Examples include offering financial services, commercializing network assets, and privatizing all or part of the business.

- Possible actions were then filtered based on their potential impact and feasibility, resulting in a narrowed list of strong options

Increased flexibility across seven areas is needed to close the remaining gap



Expanded Access

Workforce

Delivery frequency

Remaining 2020 gap = $15 billion

Pricing

Retiree Health Benefits Prefunding

Oversight

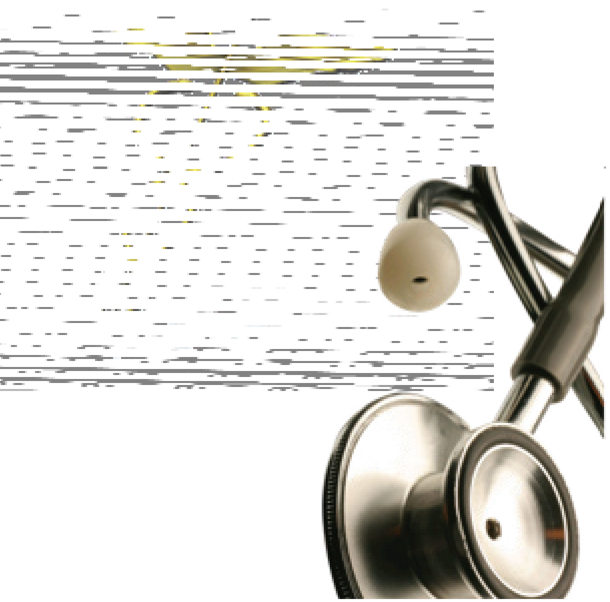
Expanded Products and Services

Increased flexibility across seven areas is needed to close the remaining gap

USPS needs flexibility to ensure that it can continuously adapt to a changing environment while meeting evolving customer needs. Changes include:

1. **Retiree Health Benefits Prefunding**: return to a "pay-as-you-go" comparable to the rest of the public sector
2. **Delivery Frequency**: increase the ability to adjust frequency to meet changing customer usage, shifting to 5-day delivery
3. **Expanded Access**: expand customer access while also increasing the ability to manage costs
4. **Workforce**: take advantage of natural attrition (mainly retirement) to build a more flexible and less costly future workforce
5. **Pricing**: modify current price cap to a global, change preferred class pricing, and institute a modest exigent increase
6. **Expanded Products and Services**: broaden the definition of postal products and streamline the corresponding review process
7. **Oversight:** build a more flexible oversight model that can react quickly in a fast changing environment

Returning RHB to a PayGo system frees up $5-6 billion annually in near term cash flow



Annual Retiree Health Benefit funding, 2010-2016

Prefunding and Premiums → **$63 billion**

Premiums only → **$24 billion**

Increased cash flow 2010-16 from switching to PayGo

→ **$39 billion**

+ $11B in interest savings through 2020

Returning RHB to a PayGo system frees up $5-6 billion in near term cash flow

- Shifting RHB to a “pay-as-you-go” system would have significant benefits in the near term
  - Unlock $5-6 billion in annual cash flows to fund operations
  - Reduce debt and save annual interest costs of $2 billions by 2020

- At current levels, the RHB fund can already provide health benefits for 466,000 retirees

- Transferring the $75 billion CSRS overpayment (as determined by the Postal Service Inspector General) would make this fund fully or nearly fully funded

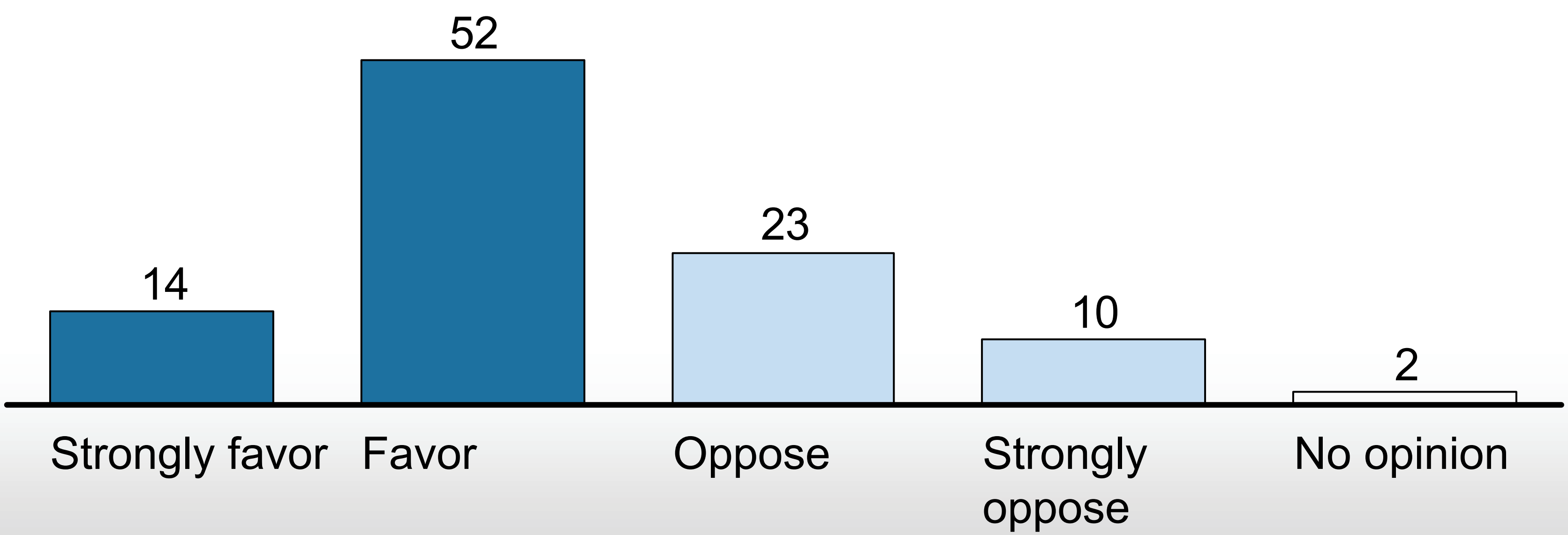
- Both of these changes require legislative change

5 day delivery saves ~ $3 B annually and is supported by 66% of consumers

Mon	Tues	Weds	Thurs	Fri	Sat
					$3 B savings annually

66% of consumer support shifting to 5-Day deliver versus other options

Share of respondents supporting 5-Day delivery versus other options, percent



SOURCE: Gallup Poll June 17-18, 2009

5 day delivery saves ~ $3 billion annually and is supported by 66% of consumers

- The financial impact of shifting eliminating Saturday delivery would result in annual savings of approximately $3 billion (in 2009 dollars)
- Implementing 5-day delivery would return 2009 average daily volumes to 2007 levels
- 66% of Americans would prefer 5-day delivery over using taxpayer dollars and other options
- It is imperative that this change happen soon, as it will take some time to communicate and ease implementation with customers
- This change requires legislative action

Access: Expanding access channels both improves convenience and costs

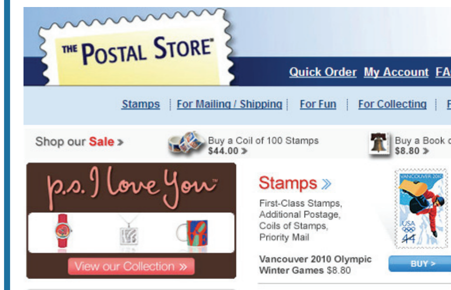
Average retail cost per dollar postage/ parcel revenue	**$0.23**[1]
Hours of operation	**Mon-Fri 9am – 5pm, limited weekends**

Other access channels cost less than Post Offices and are more convenient

79% of consumers are open to expanded, higher convenience channels[2]

Online

$0.08-$0.12 **24/7**



Partner

$0.02-$0.07 **~7am-9pm**

Self Service

$0.12 **24/7**

1 Average retail cost for all retail transactions (not just postage and packages) is $0.31-0.39 per dollar retail revenue
2 McKinsey consumer survey research

Access: Expanding access channels both improves convenience and costs

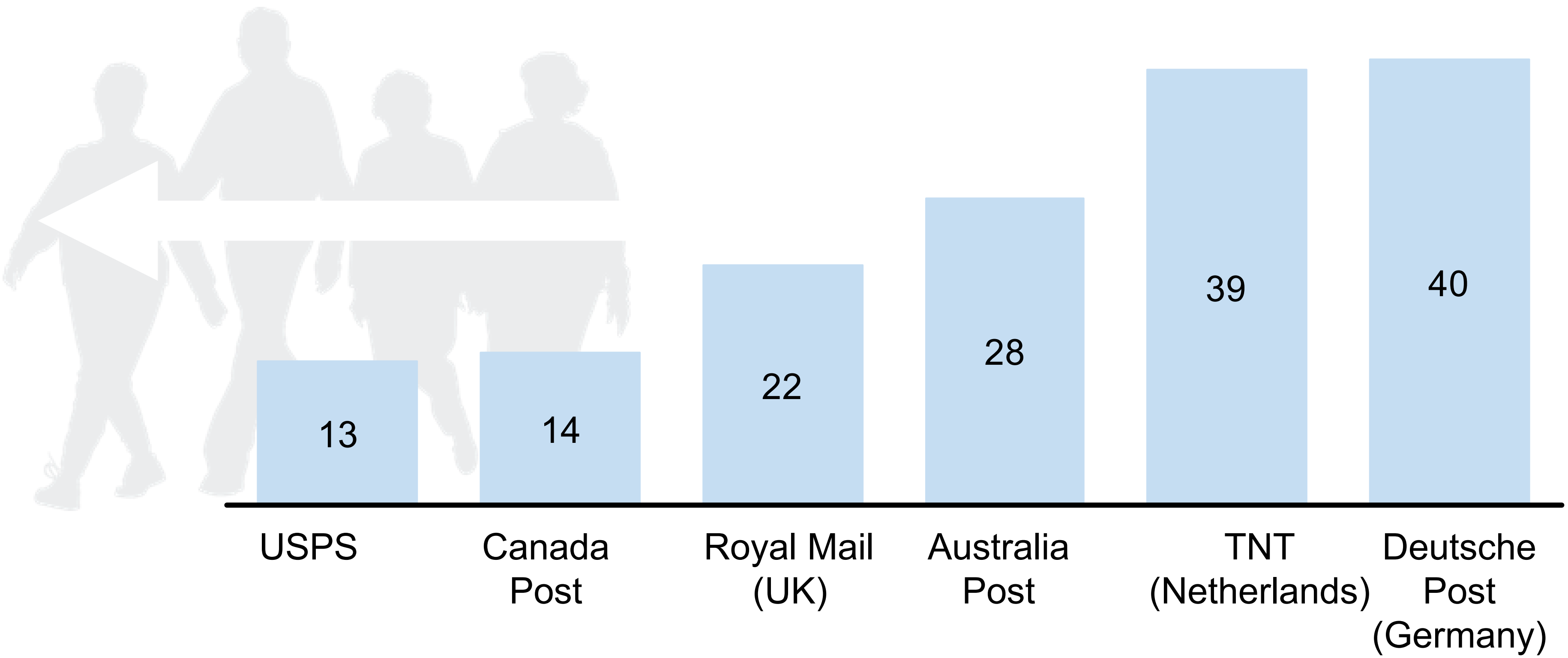
- The Postal Service will expand customer access where it is convenient for them, online and where they shop.

- Post Offices are often less convenient for customers in terms of hours of operation and accessibility, and cost two to three times more than alternative channels

- Access can be expanded through new partnerships with retailers and with other medium such as kiosks. Requires:
  - Elimination of the statutory limitation that prevents the closure of Post Offices solely for economic reasons
  - Reduced political interference in the decision making process
  - Changes to the regulatory review process

Increasing workforce flexibility will bring USPS in line with its peers

Percentage of employees who are part-time (2007)
Percent



Over 300,000 employees will leave or retire by 2020, allowing USPS to adjust its workforce mix

SOURCE: Team analysis, client data, UPU, Deutsche Post Sustainability report

Increasing workforce flexibility will bring USPS in line with its peers

- USPS has a unique opportunity to take advantage of natural attrition (e.g., retirements and voluntary departures) to build a more flexible workforce for the future
- The workforce is declining by ~30,000 per year over the next 10 years, primarily due to retirements. A more flexible workforce would bring USPS more in line with foreign posts
- A flexible and cost effective work force must be developed through the collective bargaining process
- The financial health of USPS and the affordability of products should be key factors in any arbitration ruling

Pricing: Flexibility is needed to align pricing with demand and costs

Changes to existing pricing structure

Single price cap – apply cap to market dominant products as a whole

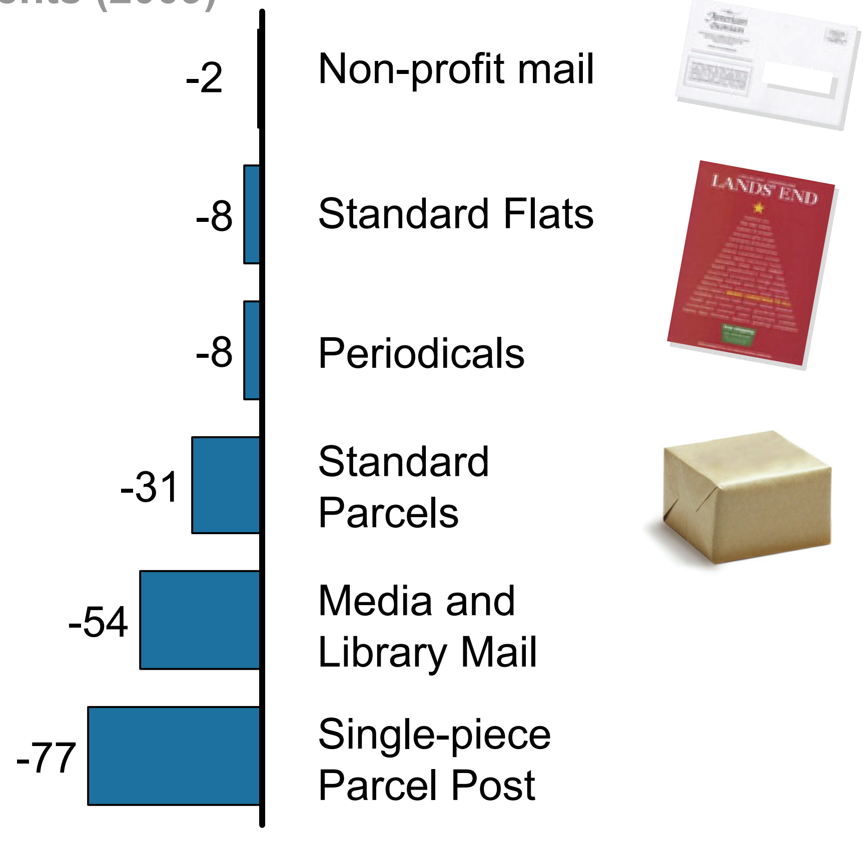
Preferred product pricing – address the fact that preferred product prices do not cover their costs

Exigent increase – apply a moderate increase

Example: Ensuring costs are covered

Contribution to covering cost per piece

Cents (2009)



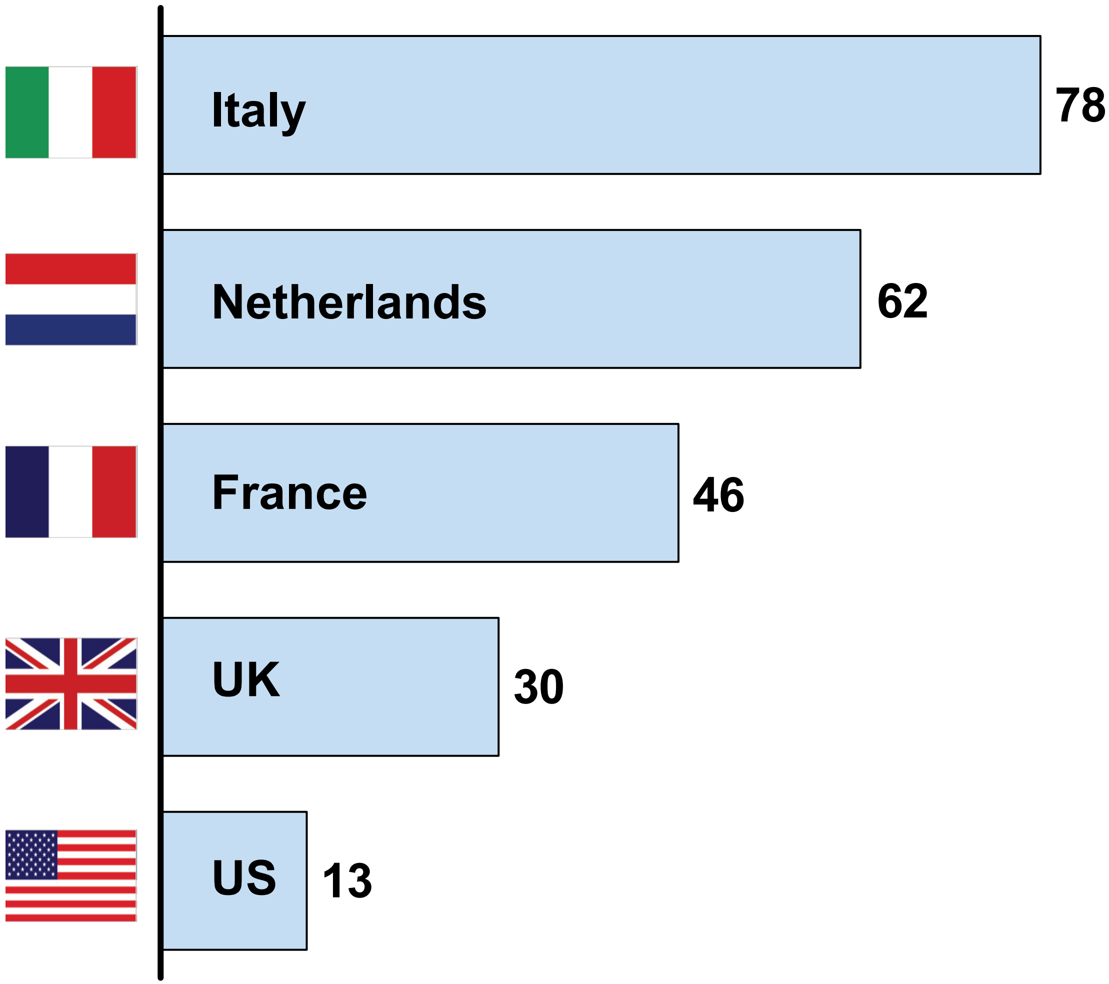
Pricing: Flexibility is needed to align pricing with demand and costs

- Current pricing processes and price caps across each class not responsive to customer needs
  - Demand varies by customer segments
  - Select products have capped prices that do not cover costs
  - While current price caps were put in place at a time when volume was growing, USPS now experiencing the largest volume declines since the Great Depression

- Increasing pricing flexibility requires legal and regulatory action in three areas:
  - **Single price cap** - apply price cap to Market Dominant products as a whole, rather than to each class of mail individually
  - **Preferred pricing** – address the fact that preferred classes of mail do not presently cover their costs
  - **Exigent price increase** - apply a moderate price increase in 2011

Increasing USPS's ability to manage products will allow it to meet market needs

Non-mail revenue as percent of total revenue
Percent



Contributors to low USPS non-mail revenue:

- Prohibition on offering "non-postal" products
- Before-the-fact review process slows time to market

"The Postal Service needs to be more innovative about the products it offers, and its regulatory structure needs to let it happen."

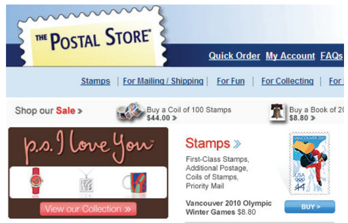
– *Major direct marketer*

Sources: 2003 & 2008 Accenture High Performance Post; Operators' 2003 & 2008 annual reports (where available); IPC website; USPS FY2009 RPW

Increasing USPS's ability to manage products will allow it to meet market needs

- Although USPS is one of the world's largest posts, it is also one the least diversified within its peer group
- Current regulatory requirements limit USPS's ability to quickly respond to the market and leverage its assets to diversify into more non-mail products and services that support its core mission.
- The current regulatory framework also slows down competitive product contract reviews and creates a competitive disadvantage
- Improving the process will allow USPS to respond to market opportunities quickly.
- Requires regulatory and legislative changes

Summary: A solution is possible



Expanded Access

Workforce

Delivery frequency

Long Term Sustainability through Fundamental Change

Pricing

Retiree Health Benefits Pre-funding

Oversight

Expanded Products and Services

Summary: A solution is possible

- There is a solution if action is taken now to ensure America can continue to enjoy quality, universal postal service at no cost to the taxpayer.
- Solution must have a comprehensive, balanced approach– aggressive internal improvements must be made in tandem with regulatory and legal changes.
- Critical to act quickly. Delay increases the challenge and deepens the crisis.
- This is a historic opportunity – to lay the foundation for a leaner, more market-responsive Postal Service that can thrive well into the future.