POSTAL TRENDWATCH

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Postal TrendWatch
Q1FY10

Q1 FY 2010: With Losses Mounting, USPS Contemplates New Products

Executive Summary

The U.S. Postal Service suffered a net loss of $297 million in the first quarter of FY 2010. The loss represents a slight improvement over the loss posted in Q1 FY 2009. Total mail revenue declined by $740 million relative to Q1 FY 2009. Volume for all categories of mail also declined, resulting in a total volume reduction of nearly 4.5 billion pieces compared to the same quarter last year.

According to the Postal Service, these revenue and volume declines are expected to continue. USPS projects a net loss of more than $7 billion for FY 2010. USPS revealed that several of its categories failed to cover their costs in FY 2009. The Service has renewed its efforts to begin offering non-postal products and services in order to help reverse its revenue decline. Independent government analysts are less than sanguine about such a strategy.

Quarterly Highlights

Volume for First Class Mail and Standard Mail, which together make up 94 percent of USPS volume, dipped 8.8 percent compared to the same period last year. Meanwhile, revenue and volume for shipping services increased 6.8 percent and 2.5 percent, respectively, compared to Q1 2009. USPS points to this rise in usage of shipping services as an early sign of economic recovery. At the same time, the Service blames the recession for the continued slowdown in the use of other types of mail.

New GAO Report Questions Prudence of New Postal Products

On the eve of a major press conference to unveil a new business model to confront "serious and substantial challenges," Postmaster General John Potter has announced that the Service will seek greater flexibility and changes to the way it does business.

PMG Potter sees new lines of business as integral to rescuing the Postal Service's finances. At a congressional hearing in late 2009, Potter argued that "the time has come to allow the Postal Service to introduce new lines of business at its retail facilities." He highlighted the activities of other national posts that offered "banking, cell phone, [and] logistics" services.

But according to a November 2009 report from the Government Accountability Office, new nonpostal products are a risky venture, especially considering the "poor past performance" of previous product experiments.

In fiscal years 1995, 1996, and 1997, the GAO reports that the Postal Service lost almost $85 million on "19 new products, including electronic commerce services, electronic money transfers, and a remittance processing business."

Meanwhile, the financial success or failure of the Postal Service's current competitive products -- like passport photos and hybrid mail -- is difficult to gauge. Although USPS reports the revenue generated by these products and services, it maintains a strict policy of secrecy about the expenses, and thus the bottom line, associated with these products and services.

The GAO report also reveals that USPS has achieved "limited results" from the pricing flexibility granted it by the Postal Accountability and Enhancement Act of 2006. Rate increases for market-dominant mail and the recent summer and fall sales have done little to deliver increases in revenue -- particularly in light of the agency's growing deficits.

The report concludes that USPS must restructure within the confines of its current status as a postal operator. According to the report, "USPS has opportunities to generate new revenues from postal products and services that appear more promising than venturing into risky nonpostal areas, while also making significant reductions in its workforce and network costs."

If we're able to get increased flexibility from our union workforce -- over 500,000 of our employees are union employees -- that starts to save substantial amounts a year. We'd like to be able to be more efficient in moving an employee from one track to another and in getting lower cost on our benefit programs. If we can change those contracts, some of which are backed by federal laws, we'll be more efficient on the cost side.

-- USPS CFO Joseph Corbett

Severe Losses Create Mounting Problems for USPS

The economy has only exacerbated the major declines in revenue and volume that have plagued USPS over the past several years. In Q1 2010, mail volume declined in every single category; a net decrease of 4.5 billion pieces when compared with the first fiscal quarter of 2009.

The only category that fared well this quarter was shipping services, which experienced a modest uptick in revenue of $158 million and an increase in volume of 10 million pieces. This represents a 6.8 percent increase in revenue compared to Q1 2009.

The Postal Service lost $297 million this quarter. That's $87 million less than it lost in Q1 FY 2009. USPS leaders have warned that the agency may face difficulty meeting several large financial obligations this year.

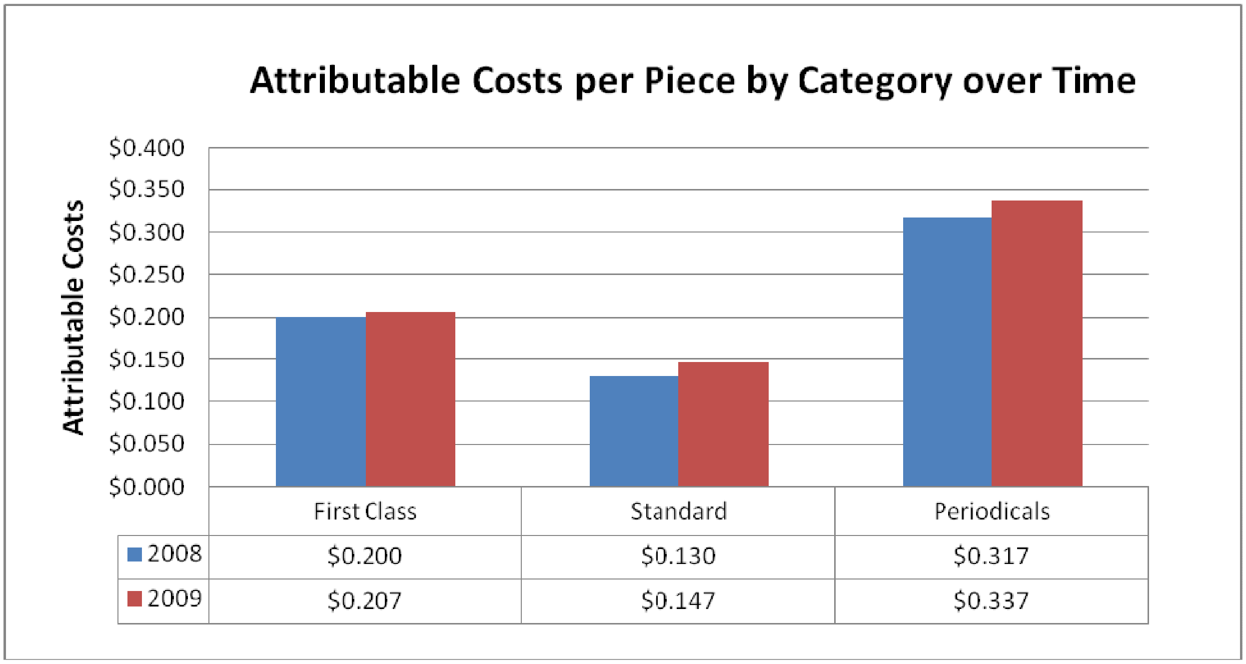
USPS noted in its 10-Q report that its $15 billion debt ceiling will become insufficient by 2011"absent legislative action."

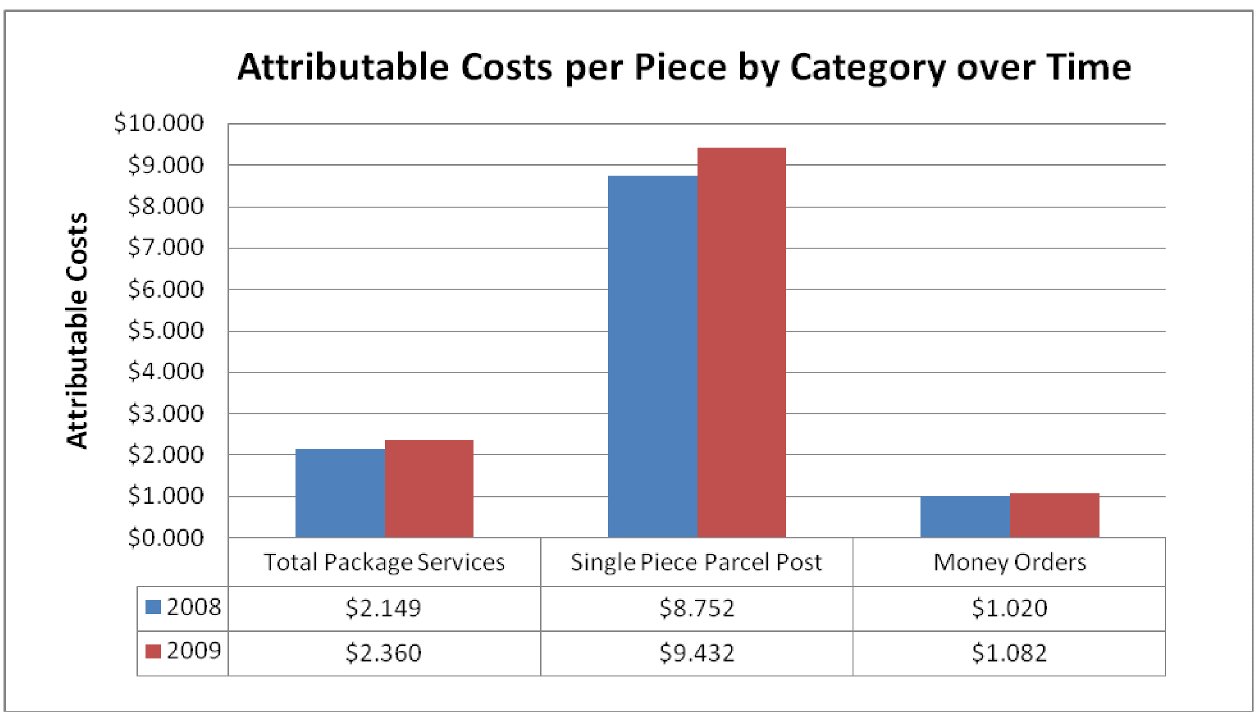
In particular, the Post Office has admitted that it "may be unable" to make its $5.5-billion scheduled payment to the Postal Service Retiree Health Benefits Fund (PSRHBF) due on September 30, 2010. Nor is it likely that the Service will be able to pay the $1.1 billion due in October of this year to the Department of Labor for workers' compensation liability.

In response to dwindling volumes, USPS reduced work hours by 28 million, or 8.5 percent, in the first quarter of 2010 relative to the same period last year. The goal is to reduce work hours by a total of 90 million, or 7.2 percent, in 2010.

Falling Volumes Yield Cost-Coverage Issues

USPS's annual compliance report for FY 2009, released late in Q1 2010, revealed that attributable costs per piece increased in several important categories between 2008 and 2009 (see chart below).





The Compliance Report also revealed that several categories of mail were struggling to generate enough revenue to cover the cost of handling them. Periodicals, Package Services, and Single-Piece Parcel Post all failed to cover their costs. Standard Mail and Money Orders both posted their lowest cost-coverage figures in at least six years. Standard Mail's contribution to overhead has declined nearly 32 percentage points less to overhead since 2004.

First Class Mail continues to be USPS's prize revenue generator. Although the category's cost coverage figure is down about 20 percentage points since 2004, First Class Mail still covers nearly 200 percent of its costs.

Facing a Bleak Future, USPS Requests Legislative Action

The downward trends in volume and revenue aren't likely to reverse themselves in the near future. After a 177 billion piece drop in volume in 2009, "[v]olume is expected to further decrease by approximately 10 billion pieces in 2010," according to the Postal Service's most recent Financial Conditions and Results report.

In order to cope with the cash shortfalls expected as a result of these precipitous declines in volume, USPS has requested that Congress restructure the PSRHBF payment schedule. The agency has also asked Congress to consider relieving it of the obligation to deliver six days a week. According to USPS, a 5-day delivery schedule could provide cost savings as early as 2011.