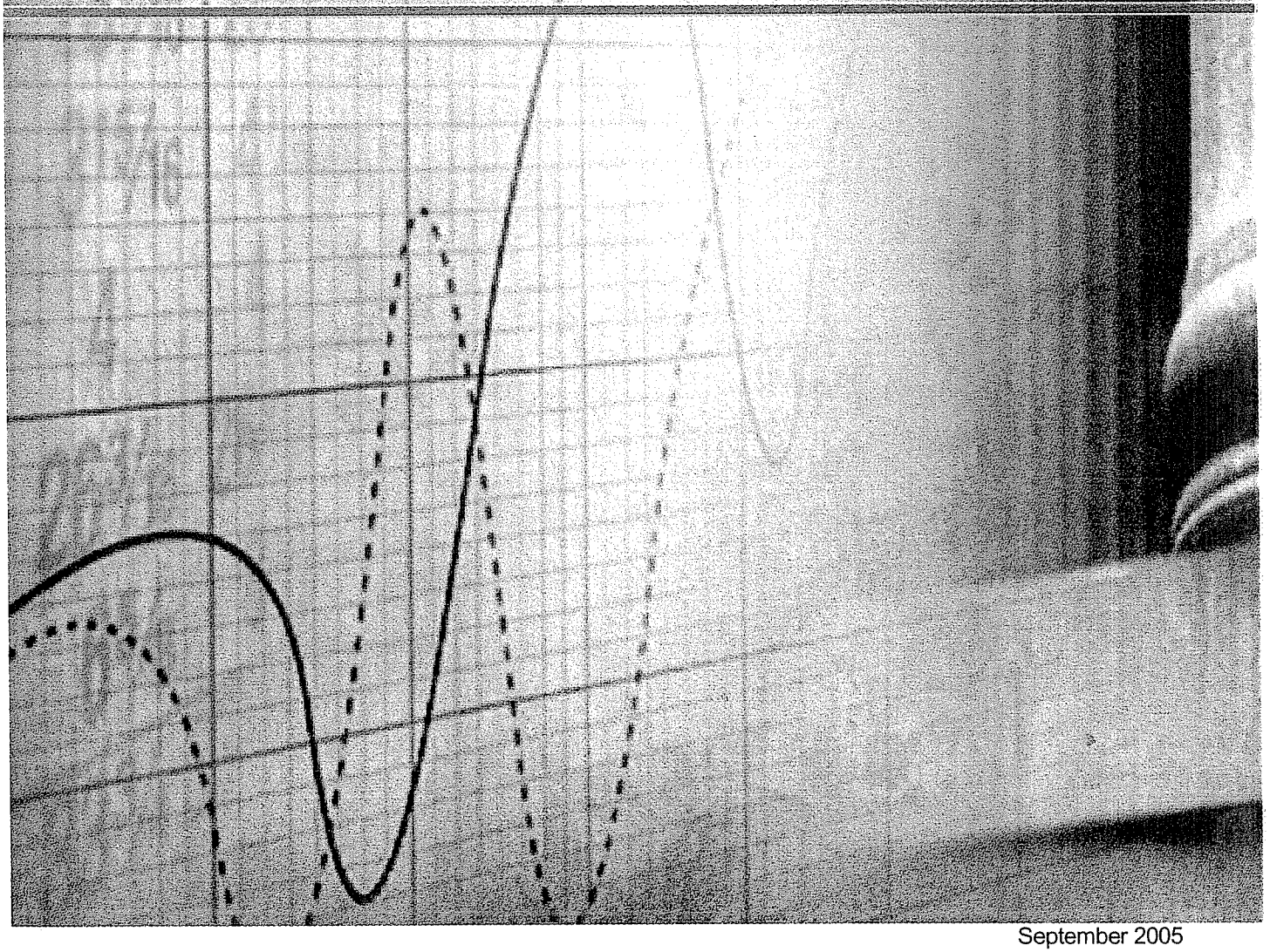
UNITED STATES POSTAL SERVICE

Integrated Financial Plan

Fiscal Year 2006



September 2005

PREFACE

The United States Postal Service Integrated Financial Plan (IFP) for Fiscal Year (FY) 2006 has been developed by management and is hereby submitted to the Board of Governors.

This annual planning document provides the Board the primary benchmark of the Postal Service's estimated business needs and results as they regularly review, evaluate and decide upon issues relating to the organization's financial condition and operations during the year.

The IFP integrates three distinct annual plans for: the Operating Plan, the Capital Plan and the Financing Plan. Each of these plans has been constructed from the basis of estimated FY 2005 operating results and each is dynamically linked to another. These plans were developed under a four phase management cycle: Establish, Deploy, Implement and Review. The Establish Phase, setting organizational indicators and targets for the fiscal year, began in December 2004. The Deploy Phase, calling for plans to achieve the targets and negotiating resources, began in March 2005. The Implementation Phase will begin with the new fiscal year and the Review Phase is ongoing. The Capital Plan allocates funds for construction and purchase of facilities and equipment that will improve service and infrastructure and generate future efficiencies and service improvements. For FY 2006 these investments are planned to be funded by cash flows generated from operations.

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EXECUTIVE SUMMARY

The FY 2006 Integrated Financial Plan (IFP) consists of an Operating Plan resulting in a $1.3 billion net income; a Capital Plan that commits $2.9 billion in cost reduction and infrastructure investments; and, a Financing Plan with borrowing of $1 billion that minimizes interest expense. These plans allow the Postal Service to comply with the FY 2006 escrow funding requirement of Public Law (PL) 108-18, The Postal Civil Service Retirement System Funding Reform Act of 2003, estimated at $3.1 billion. The deficiency for the year, after the escrow, will be $1.8 billion.

There is more risk to the assumptions of this plan compared to other years. The plan assumes settlement and January implementation of the 5.4 percent across-the-board rate increase now pending at the Postal Rate Commission (PRC). This increase is necessary to generate funds to help meet the escrow requirement. The plan assumes continued economic growth and assumes that fuel price increases will moderate from their September 2005 high but the total FY 2006 average price will be greater than the total FY 2005 average price. The plan includes aggressive workhour reductions close to those achieved when mail volume was declining. Finally, the plan does not impute any financial implications of potential Postal Reform legislation. Further discussion of these issues is included in the next section.

All components of the plan flow from projected FY 2005 results.

Operating Plan - Revenue

FY 2005 revenue is estimated to increase $915 million over the previous year, or 1.3 percent based on projected mail volume growth of 2.7 percent. Most of this growth occurred in the first quarter of FY 2005, primarily in November 2004. The FY 2006 plan estimates revenue growth of 3.4 percent or $2.4 billion, due largely to a rate increase in January 2006. This rate increase and external economic factors will dampen FY 2006 volume growth to a modest 0.6 percent.

Operating Plan - Expense

Total FY 2005 expenses are estimated to be $68.8 billion and FY 2006 expenses are planned to increase by $2.3 billion, or 3.4 percent. Expenses have been held at a 3.4 percent increase through cost reductions of $1.1 billion, generated primarily by workhour reductions of 42 million.

Net Income

This plan is based on a projected net income of $1.2 billion in FY 2005. This estimate has a range of plus or minus $300 million and is subject to year-end audit. The FY 2006 operating plan results in a net income of $1.3 billion prior to providing for the estimated $3.1 billion escrow fund. The escrow fund amount cannot be recognized as an expense under generally accepted accounting principles. Were the escrow amount to be recognized as an expense, the FY 2006 operating plan would result in a loss of $1.8 billion.

Capital Plan

The FY 2006 capital commitment plan is $2.9 billion, an increase of approximately $250 million from FY 2005. The capital plan funds projects that provide a return on investment and those necessitated by infrastructure requirements.

Financing Plan

Projected FY 2005 cash flow from operations of $4.3 billion will permit debt reduction of $1.8 billion, leaving a zero debt balance. The FY 2006 plan, with $3.9 billion in cash flow from operations, less $2.4 billion designated for capital outlays, provides an estimated $1.5 billion in net cash flow. This cash flow, combined with an estimated $1 billion in financing and $600 million reduction in cash at year-end, will fund the $3.1 billion escrow fund on September 30, 2006.

ASSUMPTIONS AND UNCERTAINTIES

The Economy

The economic data and forecasts that underlie the Integrated Financial Plan were developed by Global Insight, Inc., a respected and independent economic forecasting firm.

Since the detailed planning process began earlier in the summer, the Postal Service used Global Insight's July 2005 baseline forecast. The most recent forecast estimates that FY 2006 Gross Domestic Product (GDP) growth will moderate from FY 2005 levels. Retail sales and nonfarm employment growth, both key drivers of mail volume growth, will also abate. The reduction in growth in these economic drivers, as well as a rate increase, will tend to slow volume and revenue growth.

Economic Assumptions

	FY 2005	FY 2006
Gross Domestic Product (% Growth)	3.6%	3.4%
Retail Sales (% Growth)	5.3%	2.5%
Nonfarm Employment (% Growth)	1.8%	1.6%
Consumer Price Index (% Growth)	3.3%	3.1%

Source: Global Insight, Inc. – September Baseline Forecast

Increases in mail volume and Postal Service revenue depend on economic growth, the demand for postal products and services, and the attractiveness of competitive alternatives. On the basis of these economic assumptions, FY 2006 mail volume is projected to grow 0.6 percent for FY 2006. The overall increase in mail volume will occur despite the continuing decline of First-Class Mail, as Standard Mail and Package Services grow to more than offset those volume declines.

More recent events, including Hurricane Katrina, suggest a significant downside risk to economic growth in FY 2006. A leading cause of concern is that increases in energy costs have led to a perceived decline in disposable income and, therefore, consumer confidence. Additional concerns are the federal budget deficit, the U.S. trade deficit, a potential speculative bubble in the housing market and rising interest rates. As interest rates edge upward, personal savings, now at a historically low level, could accelerate and further slow retail sales growth.

Inflation directly affects Postal Service compensation costs. The increase in the Consumer Price Index, the standard measure of inflation, determines the amount of the cost-of-living adjustments (COLAs) received by bargaining unit employees. For example, the September 2005 COLA increases costs by $568 million in FY 2006, of which over 60 percent is energy related. This is the highest payment since 1980. The COLA scheduled for March 2006 will be based on a CPI which will still reflect substantial increases in fuel costs incurred since July 31, 2005, as well as inflation in heating related energy costs. Its impact in FY 2006 is planned to be $260 million.

Public Law 108-18 – Escrow Requirement

This Act modified Postal Service funding of its obligations to the Civil Service Retirement System (CSRS). Beginning in FY 2006, the Act requires the Postal Service to place in escrow the difference in CSRS funding levels before and after its enactment. The R2005-1 rate case was filed to provide for funds for the FY 2006 escrow requirement. The final escrow amount, to be determined by the Office of Personnel Management (OPM), is currently estimated to be $3.1 billion, which must be escrowed on September 30, 2006.

Postal Service Reform Legislation

PL 108-18 transferred the cost of the CSRS retirement benefits earned through military service of postal employees from the Treasury Department to the Postal Service. Current legislation pending in Congress repeals this cost transfer. The FY 2006 Integrated Financial Plan does not take into account any potential impacts of the pending postal reform legislation.

Rate Case R2005-1

This plan assumes the PRC issues a recommended decision on the current R2005-1 rate case that will provide the 5.4 percent rate increase as requested by the Postal Service in time to implement in January 2006. Variance from that assumption will result in variance from the revenue projections and financial results of the plan.

Energy Prices

Higher energy prices have ramifications on two levels; the direct financial impact to the Postal Service, and the effect on the economy, particularly consumer and business spending, which in turn drives mail volume. It's estimated that the Postal Service uses 800 million gallons of fuel annually. The rapid rise in fuel costs in FY 2005 has created enormous upward pressure on expenses. In addition to directly impacting transportation costs, fuel inflation is felt in utility bills and employee wages, through cost-of-living allowances (COLAs). In 2005, expenses related to the dramatic rise in energy prices increased 13 percent. This plan provides for eight percent inflation in energy related costs. If energy prices escalate further, expenses will likely be greater than plan.

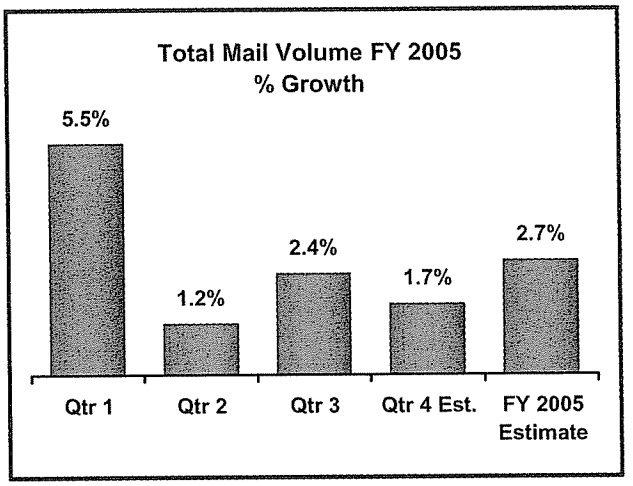
Aggressive Workhour Reductions

The FY 2006 plan is to reduce workhours by 42 million below the estimated FY 2005 total, assuming volumes match the FY 2006 forecast. Through FY 2005, the Postal Service has accumulated savings of 178 million workhours annually since FY 1999 at the same time twelve million delivery points have been added to the delivery network. Not since worksharing was introduced in the mid-1970s has the Postal Service achieved more than three successive years of workhour reductions. An additional reduction of this magnitude to what has already been achieved, in and of itself, makes the target extremely challenging. The workhour reductions in FY 2006 rely primarily on management's ability to develop and implement process improvements, rather than on capital investment programs.

The operating plan allocates resources to meet established goals and provides cash flow from operations to finance capital investments and contribute to funding the $3.1 billion escrow requirement. The FY 2006 plan calls for a revenue increase of 3.4 percent and expense increase also of 3.4 percent, despite planned cost reductions of approximately $1.1 billion. The result is a net income of $1.3 billion before allowances for the escrow. If recognized as an expense, the $3.1 billion escrow requirement would result in an net loss of $1.8 billion.

FY 2005 Baseline Revenue and Volume Estimates

Using actual data for the first three quarters, FY 2005 volume is projected to increase by 2.7 percent or 5.6 billion pieces over FY 2004. Most of the volume and revenue growth occurred in the first quarter when mail volume surged 5.5 percent and revenue grew 2.8 percent. This first quarter growth occurred primarily in November as a result of 1.3 billion additional pieces of Standard Mail and First-Class workshared letters. These and other lesser volume gains were partially offset by a decline in First-Class single piece letters. Volume growth for the remainder of the year has been more modest, as shown in the chart below.



Mail volume growth has accelerated due to four principal causes: three years of steady economic growth; volume rebounds after recovery from the unprecedented disruption to the mail system caused by anthrax attacks; three years of postal rate stability; and, changes in the package and expedited markets that have led to a turnaround in competitive products such as Priority Mail.

In FY 2005, Standard Mail volumes exceeded those of First-Class Mail for the first time in history. Although First-Class workshare letter volume is expected to grow 3.8 percent, these gains will be almost entirely offset by a reduction of 3.7 percent in First-Class single piece letters. Single piece letter volume has declined for eight consecutive years. In contrast, Standard Mail volumes have increased in each of the last three years. After declining for four consecutive years, Priority Mail volumes are projected to increase 3.9 percent. This turnaround is the result of several factors. Service has improved. Rates have remained constant while competitors have raised rates annually and imposed numerous surcharges. Also, a series of initiatives such as Click-N-Ship and the Flat Rate box, make Priority Mail easier to use. Express Mail and parcel post have experienced similar turnarounds for many of the same reasons.

Total revenue is projected to increase $915 million in FY 2005 over the previous year. More than half of that growth or $580 million occurred in the first quarter. The increase is due to strength in advertising by mail, which generated volume and revenue increases in both First-Class workshare letters and Standard Mail; and to the rebound in package services and expedited products. Despite these gains, revenue per piece declined as the mail mix continued to move from higher yield products, such as First-Class single-piece letters, to lower yield products, such as First-Class workshare letters and Standard Mail. Mail volume is increasing faster than revenue for the same reason.

FY 2006 Revenue and Volume

The Postal Service expects to raise rates 5.4 percent in January 2006. This increase will slow volume growth to 0.6 percent. Most of the volume increase is in Standard Mail. However, the rate increase and a projected slowdown in FY 2006 retail sales will lead to a lower growth rate for Standard Mail volume and workshare First-Class Mail volume than in FY 2005. Overall First-Class Mail volume is projected to decline 2.4 percent.

Priority Mail, one of the most price sensitive Postal products, is expected to maintain its FY 2005 volume level for reasons discussed above. Demand for Express Mail is even more sensitive to price changes than Priority Mail; its volume is projected to decline in FY 2006. Periodicals Mail volume is projected to remain unchanged as technological and demographic changes hinder volume growth in the periodicals industry. The plan projects that Standard Mail will continue to grow as it continues to fill an important niche in the advertising industry. The plan assumes continued steady volume growth in Package Services products. International mail volume is forecasted to decline slightly.

Volume

	FY 2005 Estimate	FY 2006 Plan	Change	% Change
First-Class	98,227	95,884	(2,343)	-2.4%
Priority	882	883	2	0.2%
Express	55	54	(1)	-2.7%
Periodicals	9,116	9,117	1	0.0%
Standard Mail	100,697	104,309	3,613	3.6%
Package Services	1,173	1,207	33	2.8%
International	860	836	(23)	-2.7%
Other*	711	739	28	3.9%
Total	211,721	213,030	1,309	0.6%

(Pieces in millions)

* Postal volume, Mailgrams, and Free Mail for the Blind and Handicapped are included in the Other category

The plan projects total revenue to increase by $2,396 million, compared to FY 2005. Factors affecting projected revenue growth rates by class are: the impact of price increases and mail classes' sensitivity to price increases; mail mix changes; and, effects of the economy and technology.

The projections of FY 2006 volumes and revenues are based on estimates of FY 2005 results; actual FY 2005 year-end results may differ.

Revenue

	FY 2005 Estimate	FY 2006 Plan	Change	% Change
First-Class	$ 36,133	$ 36,424	$ 291	0.8%
Priority	4,599	4,795	196	4.3%
Express	869	880	11	1.3%
Periodicals	2,175	2,259	84	3.9%
Standard Mail	18,935	20,374	1,439	7.6%
Package Services	2,225	2,368	143	6.4%
International	1,793	1,815	21	1.2%
Other*	3,215	3,425	210	6.5%
Total	$ 69,944	$ 72,340	$ 2,396	3.4%

($ Millions)

*Special Services, Investment Income and Appropriations are included in the Other Category

DELIVERY NETWORK

The Postal Service delivery network is projected to increase by 2.0 million delivery points in FY 2005. The same level of increase is projected for FY 2006. Most of the growth continues to be in deliveries by rural carriers.

Delivery Growth

	FY 2005 Growth	% Change
City Carrier Deliveries	631	0.7%
Rural Carrier Deliveries	1,223	3.5%
Highway Contract Route Deliveries	87	4.0%
Post Office Boxes	62	0.3%
Total	2,003	1.4%

(Deliveries in thousands)

Financing the network growth depends on concurrent growth in mail volumes, especially in high contribution classes of mail. Yet, the long-term decline of single piece First-Class Mail volume makes this more challenging each year.

EXPENSE BY BUDGET CATEGORY

Total expenses are budgeted at $71.1 billion in FY 2006, an increase of 3.4 percent above FY 2005 estimated expenses. From 1971 through 1999, annual expense growth was below 4.0 percent only twice. With the FY 2006 plan, the Postal Service will have held expense growth below 4.0 percent in four of the last six years due to continuous gains in productivity. The following table details expense by budget category.

FY 2006 Expenses By Budget Category

	FY 2005 Estimate	FY 2006 Plan	Change	% Change
Field Operations	$ 58,994	$ 60,697	$ 1,703	2.9%
Corporate Transportation	3,029	3,224	195	6.4%
Headquarters Administrative	1,429	1,418	(11)	-0.8%
Programs/Corporatewide Activities	2,223	2,195	(28)	-1.3%
Servicewide	2,682	3,118	436	16.3%
OIG and PRC	141	154	13	9.2%
Interest	265	263	(2)	-0.8%
Total	$ 68,763	$ 71,069	$ 2,306	3.4%

($ Millions)

Field Expense

Field expenses are projected to increase by $1.7 billion, or 2.9 percent, in FY 2006. Most of the increase is in salaries and benefits: cost-of-living adjustments (COLAs), contractual increases, and health benefits premium increases. COLA expense alone is planned to be $928 million in FY 2006.

The projected growth in field costs has been restrained by $1.1 billion in cost reductions. Specifics of cost reductions are presented in the Cost Reduction Initiatives section.

Corporate Transportation Expense

The FY 2006 plan projects corporate transportation expense to increase to $3,224 million, a 6.4 percent increase over FY 2005. The major driver of rising transportation expenses are high fuel costs and a scheduled escalation in the FedEx transportation contract costs.

Headquarters Administrative Expense

Headquarters administrative expense includes headquarters organizations, field support units, and the Postal Inspection Service. The field support units and the Inspection Service constitute roughly 70 percent of headquarters administrative expenses. Despite rising health benefits costs and normal

salary adjustments, headquarters administrative costs will be held below the FY 2005 levels. All inflationary cost increases will be absorbed. Position vacancies will be held open to facilitate adherence to the planned no-growth budget.

Programs and Corporatewide Activities Expense

Program and Corporatewide Activities are budgeted at $2,195 million in FY 2006, which is 1.3 percent below the year end estimate for FY 2005. Achieving this overall reduction required dramatic cuts in some programs in order to fund required increases in others. This table lists the largest expense programs and is followed by a discussion of the major changes in these program budgets.

The only program planned to have a significant large spending increase is **Human Capital Enterprise/ HR Shared Services**; the program to replace legacy human resources systems and processes with a more modern and efficient shared services system. The Greensboro Shared Service Center has opened and three clusters will be pilot tested in the shared services environment early in FY 2006. As more human resource operations become centralized, offsetting saving will occur beginning in FY 2007.

FY 2006 Program Spending
Major Program Impacts

Program	FY 2005 Estimate	FY 2006 Plan	Change	% Change
Mail Transportation Equipment Service Ctrs	$ 216	$ 185	$ (31)	-14.3%
Debit/Credit Card Fees	119	127	8	6.6%
Corporate Advertising	135	125	(10)	-7.4%
Stamp Manufacturing	100	100	0	0.0%
Mail Transportation Equipment	135	90	(45)	-33.4%
Point of Service	109	95	(14)	-12.8%
Telecommunications/Network Operations	89	88	(1)	-1.0%
Human Capital Enterprise/HR Shared Svcs.	34	88	54	161.8%
Corporate Contact Management	75	80	5	5.6%
Expedited Supplies	92	79	(13)	-13.8%
Advanced Computing Environment	75	63	(12)	-16.5%
All Other Programs (774 Programs)	1,044	1,075	31	3.0%
Total All Programs	$ 2,223	$ 2,195	$ (28)	-1.3%
($ Millions)				

The Postal Service's second largest expense program is the payment of **Debit And Credit Card** fees to card companies. Although the Postal Service has negotiated lower transaction fees in recent years, the use of debit and credit cards in postal transactions has been increasing at double digit rates for the last several years.

To enable funding of these major programs and to restrain the growth in expenses, the FY 2006 plan required action to reduce budgets of other programs. Some significant examples of these reductions include the following:

- The **Mail Transportation Equipment Service Center** (contracted) sites account for the largest program expense. These are sites where mail transport equipment is processed, repaired, and stored and then distributed to internal and external customers. The FY 2006 budget for this program was significantly reduced as a result of a redesigned Material Distribution and Inventory Management System (MDIMS), better demand forecasting, inventory reduction, and order shortage reduction.
- The purchasing of **Mail Transportation Equipment** is a centralized function for acquiring all new rolling containers, sacks, trays, lids, and pallets to contain all classes of mail for processing, transporting, and delivering. Spending in FY 2005 is higher than normal, as a result of two prior years of deferred purchases. Purchases in FY 2006 will return to more normal levels.
- **Corporate Advertising** is aimed at enhancing revenue growth for Postal Service products and services. In FY 2005 advertising spending was increased to incorporate a much-

expanded fall campaign. The FY 2006 plan reduces the advertising budget in order to offset other spending increases.

- The "**All Other**" category in the table above includes 774 programs totaling just over $1.0 billion for FY 2006. Of these programs, 34 will be new in FY 2006 and are projected to contribute $60 million of additional expenses that were absorbed by reductions in other programs.

Returning to the budget category chart on page 6:

Servicewide Expense
Servicewide expenses are national-level expenses that cannot be isolated and charged to individual operating or administrative units and are outside the control of local management.

The largest component of this category, retiree health benefits, are projected to increase by 16.2 percent or $242 million to a total of $1.7 billion in FY 2006. The increase is driven by continued increases in premiums, growth in the number of retirees and survivors covered, and by increases in the average post-1971 service of the covered annuitants.

In addition, Emergency Preparedness Programs (EPP) account for $215 million of planned FY 2006 servicewide expenses, approximately $105 million more than estimated FY 2005 expenses for this category. The majority of EPP expenses is for the depreciation of Biohazard Detection Systems (BDS) and Ventilation and Filtration Systems (VFS) and for the purchase of consumable cartridges for BDS. These are essential components of the Postal Service's safety system for the protection of postal employees and the public from biological agents that could be introduced into the mail stream.

Office of the Inspector General (OIG) and the Postal Rate Commission (PRC)
The budgets of the OIG and the PRC are developed by those organizations and, though borne by the Postal Service, are not subject to the control of postal management. The FY 2006 plan includes the budget requests for an increase of 9.2 percent, or $13 million in OIG and PRC expenditures. Nearly all of this increase is attributable to the OIG budget.

EXPENSE BY COMPONENT

Examining expense growth by component provides a different perspective on the FY 2006 Operating Plan as reflected in the following chart. The FY 2006 plan projects that personnel expense, including salaries, employee and retiree benefits, and workers' compensation, will increase by $1.8 billion, or 3.3 percent.

FY 2006 Expenses By Component

	FY 2005 Estimate	FY 2006 Plan	Change	% Change
Personnel	$ 54,875	$ 56,660	$ 1,785	3.3%
Non-Personnel	8,622	8,812	190	2.2%
Transportation	4,974	5,305	331	6.7%
Interest & CSRS Liability	292	292	-	0.0%
Total Expenses	$ 68,763	$ 71,069	$ 2,306	3.4%
Escrow – Restricted Cash		3,081		
Total		$ 74,150		

($ Millions)

This growth in personnel compensation expenses is being offset to a great extent by planned significant reductions in workhours, as discussed below. The major drivers of the personnel expense increase include COLAs and increases to health benefits costs. Health insurance premiums are assumed to increase by seven percent for current employees in January 2006. Health benefits expense totaling $7.1 billion, for both current employees and retirees, account for 10.1 percent of total FY 2006 expense.

Non-personnel expenses consist of a wide variety of national, field and headquarters costs. Their projected growth in FY 2006 is primarily due to increases in emergency preparedness expenses

($105 million). Total transportation costs are expected to grow approximately $331 million. Substantially all of that increase is attributable to projected fuel cost increases.

The plan's interest and CSRS liability expense consists of all interest expense and an estimated CSRS deferred retirement liability principal of $27 million and $29 million for fiscal years 2005 and 2006, respectively.

Continued Workhour Reductions

The FY 2006 plan reduces workhours by 42 million below the estimated FY 2005 total. This will be the sixth out of the last seven years in which the Postal Service has reduced workhours. The FY 2006 planned workhour reduction target is equal to approximately 20,000 full-time equivalent employees. The workhour reductions rely primarily on process improvements, rather than on capital investment programs. Mail volume is projected to increase slightly in FY 2006 and sizeable efficiency gains have already been realized through workhour reductions. Therefore, the FY 2006 workhour plan will be relatively greater and more challenging.

Cost Reduction Initiatives

The initiatives which enable the workhour and cost reductions totaling $1.1 billion in the FY 2006 plan are detailed in the following table. Operational efficiency benefits are spread across all functions, including transportation and headquarters. These initiatives employ several programs and productivity initiatives, including Breakthrough Productivity Improvement (BPI) and supply chain management. Capital investment programs are projected to provide cost reductions totaling $354 million, primarily from automation improvements.

FY 2006 Cost Reduction Overview

Activity	Savings
Operational Efficiency Gains (Including BPI)	$ 471
Periodicals Cost Reduction	150
Headquarters and Administration	115
	$ 736
Capital Investments:	
Automated Package Processing System (APPS)	$ 65
Integrated Dispatch & Receipt Program	55
Automated Postal Centers (APC)	38
Point of Service (POS) One: Stage 3	34
Flats Recognition Improvement	27
Flats ID Code Sort	25
OCR Enhancements for Letter Automation	24
Letter Recognition Enhancement	22
354 Automatic Tray Handling for AFSM 100	17
Automatic Induction Systems for AFSM 100	14
Postal Automated Redirection System (PARS)	12
All Others (12 programs range $100K to $7M)	21
Total Reductions From Capital Investments	$ 354
Total Cost Reductions	$ 1,090

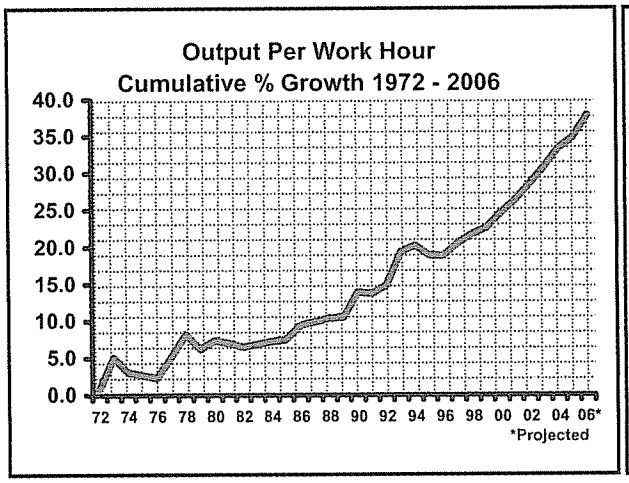
($ Millions)

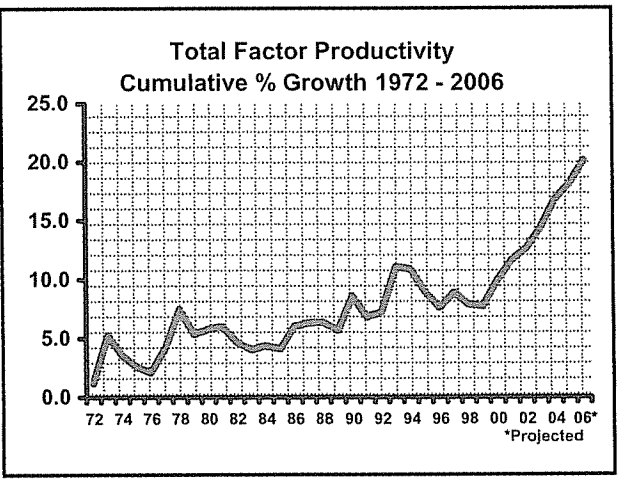
Productivity

Output Per Workhour measures the change in the relationship between output, or workload (mail volume and deliveries), and the labor resources used in producing those outputs. Total Factor Productivity (TFP) measures the change in relationship between outputs (workload) and all resources used in producing those outputs, including labor, materials, and capital. Output Per Workhour is estimated to increase 1.5 percent and TFP is projected to grow 1.3 percent in FY 2005 over the previous year. This projected TFP growth is equivalent to $1.1 billion in expense reductions.

FY 2005 marks the sixth consecutive year of positive TFP growth, equivalent to expense reductions totaling almost $6.9 billion over this time period. Productivity growth was fueled by substantial reductions in resource usage through FY 2004 while FY 2005 productivity growth was driven by absorbing workload growth. Productivity growth in FY 2006 will again be driven by resource reductions. The following charts show the cumulative growth in Output Per Workhour and Total Factor Productivity from the date of Postal Reorganization through the projection for FY 2006. In that time, Output Per Workhour and TFP will have grown 37.8 percent and 20.1 percent, respectively.

Achieving the FY 2006 Integrated Financial Plan will result in a 3.0 percent increase in Output Per Workhour and a 2.0 percent TFP growth rate, a seventh straight year of positive TFP. These productivity rates are based on estimates of FY 2005 results; actual results may differ. The TFP gains projected for FY 2006 are to be realized through planned labor and cost reduction programs.





NET INCOME (LOSS)

The FY 2006 operating plan results in a net income of $1.3 billion and contributes cash to create a $3.1 billion escrow fund. Under generally accepted accounting principles, the escrow fund is not recognized as an expense, however, funding the escrow results in a year-end deficiency of $1.8 billion.

FY 2006 Operating Budget

	FY 2005 Estimate	FY 2006 Plan	Change	% Change
Revenue	$ 69,944	$ 72,340	$ 2,396	3.4%
Expense	68,763	71,069	2,306	3.4%
Net Income	$ 1,181	$ 1,271	$ 90	
Escrow – Restricted Cash		(3,081)		
Deficiency after Escrow		$ (1,810)		

($ Millions)

FY 2005 CAPITAL COMMITMENTS

In FY 2005, $2.6 billion of the $3.3 billion capital commitment plan is expected to be committed. Commitments less than plan are attributable to various delays in the development process; many of these have been deferred to FY 2006.

Approved noteworthy FY 2005 projects which will be placed in operation in FY 2006 are:

- The enterprise Intelligent Mail Data Acquisition System (IMDAS) (Delivery data collection scanners);
- Optical Character Reader Enhancements;
- Automated Package Processing System Phase I; and
- Emergency Preparedness – Biohazard Protection/Ventilation Systems.

FY 2006 CAPITAL COMMITMENTS

The FY 2006 capital commitment plan of $2.9 billion continues the focus on funding projects that provide a return on investment and address infrastructure requirements. Major categories of the plan are identified below.

FY 2006 Capital Commitments

	FY 2005 Estimate	FY 2006 Plan
Mail Processing Equipment	$ 1,070	$ 1,606
Facilities	680	1,118
Infrastructure and Support	625	162
Vehicles	249	4
Total	$ 2,624	$ 2,890

($ Millions)

Mail Processing Equipment

The FY 2006 capital plan for equipment, at $1.6 billion, represents 56 percent of the total plan and provides for productivity improvements and cost reductions.

The second phase of the Automated Flat Sorting Machine (AFSM) 100 - Automated Induction project is included in the plan. This program automates the preparation and induction of flat shaped mail into the existing AFSM 100s. Each system provides automated container handling, including four preparation stations, vertical lifts and conveyors and eliminates the need for two operators per machine.

Additional DBCS machines will be purchased to enhance the already efficient letter processing operation by increasing the amount of mail sorted in delivery point sequence. These machines will be placed in the plants; the added efficiency and throughput will allow for the replacement of existing Customer Service Bar Code Sorters in delivery units.

Focusing on customer and employee safety, the plan also provides for the Biohazard Detection Systems to be attached to the Advanced Facer-Canceller Systems (AFCS) and Flat Cancellers to detect potential biohazards at additional sites. During AFCS operation, this system collects and tests samples, providing results to the unit's site controller.

Facilities

In FY 2006, the planned commitment for facilities is $1.1 billion, or 39 percent of the total plan. Two major mail processing facilities to be constructed account for $400 million of the total. In addition, $450 million in building improvements is earmarked to extend the life of existing facilities. Finally, investments in delivery facility infrastructure will also be required, primarily in high growth areas.

Infrastructure and Support
$162 million is planned for Infrastructure, Support, and Retail, including investments in information and communications networks and system requirements such as the Surface Visibility program. The Surface Visibility program uses barcodes to identify and track mail transportation containers; and supports automating data collection on docks. This provides real time quality checks to avoid misloads and misrouting of mail and to enhance operational decision making.

Funds are also provided for the Transportation Planning and Scheduling (TOPS) system. This system relies on information captured by the Surface Visibility program and identifies lowest cost transportation options that meet service goals.

Finally, minimal funds are provided for retail lobby refurbishing projects. This level of commitments is enabled by the successful completion of the Automated Postal Center program.

Vehicles
With commitments for tractor and spotter replacements in FY 2005 as well as required rural carrier vehicles, the FY 2006 Vehicle commitment plan includes a minimal $4 million for the purchase of administrative vehicles and auxiliary vehicle equipment such as tow-hitches, lift gates, and snow removal equipment.

FY 2006 Capital Cash Outlay Plan

The FY 2006 plan provides for $2.4 billion in cash outlays. Approximately $1.8 billion of this amount relates to commitments made in prior years. The remaining $600 million is for FY 2006 commitments.

FY 2006 Capital Cash Outlays

	FY 2005 Estimate	FY 2006 Plan
Mail Processing Equipment	$ 1,194	$ 883
Facilities	515	791
Infrastructure and Support	218	596
Vehicles	121	119
Total	$ 2,048	$ 2,389

($ Millions)

FY 2006 FINANCING PLAN

The FY 2005 Integrated Financial Plan (IFP) projected a net loss of $192 million, cash flow from operations of $2.8 billion, and capital cash outlays of $2.0 billion. The plan assumed that there would be no change in cash and that year-over-year debt outstanding would be reduced by $800 million, bringing the fiscal year ending debt balance to $1.0 billion.

Increased cash flow from operations for FY 2005, driven by higher net income, enabled the repayment of all $1.8 billion in debt outstanding after paying for capital investments. This is the first time since postal reorganization that the Postal Service has ended the fiscal year without outstanding debt obligations.

FY 2005 Financing Plan

		FY 2005 IFP	FY 2005 Estimate
	Cash From Operations	$ 2.8	$ 4.3
-	Capital Cash Outlays	2.0	2.0
-	Cash Increase	0.0	0.5
=	Borrowing (Repayment)	$ (0.8)	$ (1.8)
	Debt Outstanding	$ 1.0	$ 0.0

($ Billions)

FY 2006 Debt Reduction

For FY 2006, assuming a net income of $1.3 billion, cash flow from operations is projected to total $3.9 billion. Capital cash outlays, including those for emergency preparedness, are expected to total $2.4 billion. The FY 2006 cash flow from operations, less cash outlays for capital, provides a projected $1.5 billion of net cash flow. This net cash flow, combined with an estimated $1 billion in financing and $600 million reduction in cash at year-end, will be needed to fund the escrow requirement of $3.1 billion on September 30, 2006. Year-end debt will likely increase to $1.0 billion. Interest expense on debt will be essentially unchanged in FY 2006, totaling less than $200 thousand.

In the event that net income for FY 2006 is substantially less than predicted, the cash balance entering the fiscal year is lower than forecast, or there is an unfavorable outcome for postal legislation, a re-evaluation of the planned FY 2006 year-end level of debt may be necessary.

FY 2006 Financing Plan

		FY 2005 Estimate	FY 2006 Plan
	Cash From Operations	$ 4.3	$ 3.9
-	Capital Cash Outlays	2.0	2.4
=	Net Cash Flow	2.3	1.5
-	Debt Repayment	1.8	0.0
+	Cash From Financing	0.0	1.0
=	Change in Cash Before Escrow	$ 0.5	$ 2.5
+	Reduction in Cash From Prior Year		$ 0.6
=	Restricted Cash (Escrow)		$ 3.1
	End of Year Cash (9/30)	$ 1.4	$ 0.8
	Debt Outstanding (9/30)	$ 0.0	$ 1.0

($ Billions)

FY 2006 SUMMARY

The chart below summarizes the key financial elements of the Postal Service for FY 2005 and FY 2006. Cash flow from operations is projected to total $3.9 billion in FY 2006 and capital cash outlays are estimated to total $2.4 billion. Cash will need to be increased in order to fund the escrow required on September 30, 2006. Debt outstanding at year end 2006 is forecasted to total $1.0 billion versus a zero balance at the end of FY 2005.

FY 2006 Financial Summary

	FY 2005 Estimate	FY 2006 Plan
Net Income	$ 1.2	$ 1.3
Depreciation	2.1	2.2
Adjustments	1.0	0.4
Cash Flow From Operations	$ 4.3	$ 3.9
Capital Cash Outlay	(2.0)	(2.4)
Change in Cash	0.5	2.5
Cash From Financing	0.0	1.0
Debt Repayment	$ 1.8	$ 0.0
End of Year Cash	1.4	0.8
Restricted Cash – Escrow		3.1
Debt Outstanding	$ 0.0	$ 1.0

($ Billions)