USPS-FY12-39

FY 2012 Competitive Products Fund Reporting Materials

I. PREFACE

A. Purpose and Content

USPS-FY12-39, Competitive Products Fund Reporting Materials, includes a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2011(i), and other Competitive Products Fund materials provided in accordance with Commission Rules 3060.20 through 3060.23. Specifically, this year that other material includes PRC Forms CP-01, CP-02, CP-03, and CP-04.

B. Predecessor Document

USPS-FY11-39

C. Methodology

These materials draw upon cost and revenue data reported throughout the Postal Service's FY 2012 ACR, and therefore are implicitly based on the methodologies upon which the ACR is based. For purposes of specifically developing the PRC Forms, the procedures employed track those previously endorsed by the Commission.

D. Input/Output

For PRC Forms CP-01 and CP-02, inputs are from the FY12 CRA and last year's PRC Forms CP-01 and CP-02. Inputs for PRC Forms CP-03 and CP-04 come from accounting records.

II. ORGANIZATION

USPS-FY12-39 consists of one PDF file, which includes this Preface, and four Excel files.

The Postal Service's Annual Report to the

Secretary of the Treasury

Regarding the Competitive Products Fund

For Fiscal Year 2012,

Required by 39 U.S.C. § 2011(i)

CORPORATE TREASURY
FINANCE

UNITED STATES
POSTAL SERVICE

December 28, 2012

Mr. Richard L. Gregg
Department of the Treasury
1500 Pennsylvania Avenue, NW
Room 2112 MT
Washington, DC 20220-2112

Dear Mr. Gregg:

Pursuant to 39 U.S.C. 2011(i)(1), the United States Postal Service hereby submits the enclosed *Competitive Products Fund Report* (CPFR) for the fiscal year ending September 30, 2012.

Additional information regarding the Postal Service is available elsewhere. The *2012 United States Postal Service Annual Report* on form 10 – K is available on http://about.usps.com/who-we-are/financials/. In addition, we file an *Annual Compliance Report* with the Postal Regulatory Commission within 90 days of the end of each fiscal year. We expect to discuss aspects of these reports with management of the Federal Financing Bank in the coming weeks.

Sincerely,

Elizabeth M. Schafer
Treasurer

Enclosures

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Competitive Products Fund Report
For Fiscal Year Ending
September 30, 2012

BACKGROUND

On December 18, 2008, the Postal Regulatory Commission (PRC) issued Order No. 151, Docket No. RM2008-5 Order Establishing Accounting Practices and Tax Rules for Competitive Products. With respect to the Competitive Products Fund (CPF), a fund established in the United States Treasury, the PRC rules are based on a theoretical, on-paper-only enterprise. Necessarily, the PRC's rules are distinct from generally accepted accounting principles (GAAP).

In Fiscal Year 2012, the Competitive Products Fund generated pretax earnings of $808.6 million, which produced a tax obligation of $283.0 million. As required by law, this amount will be transferred to the Postal Service Fund by January 15, 2013.

As discussed in our *2012 United States Postal Service Annual Report ("Annual Report"),* the law divides our services into two broad categories: Market-Dominant and Competitive. Market-Dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals, and certain parcel services. Price increases for these services are subject to a price cap by class of mail based on the Consumer Price Index–All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Parcel Select and Parcel Return Service, Bulk Standard Post, and some types of International Mail have greater pricing flexibility and are commonly referred to as "Shipping and Package Services". New pricing for Market-Dominant and Competitive services will go into effect January 27, 2013, at an average overall price increase of 4%, pending the compliance review of the PRC.

Postal Service prices for Market-Dominant services are set by the Board of Governors and reviewed by the PRC for legal compliance. We have provided, and anticipate continuing to provide, at least 90 days advance notice of new prices for Market-Dominant services. There was a 1.7% price increase for Market-Dominant services in April 2011; and a January 2012 price increase averaging 2.1%. The price of a one-ounce First-Class Mail stamp is currently $0.45 after increasing from $0.44 in January 2012. New pricing for all Market-Dominant services will go into effect on January 27, 2013 at an average increase of 2.6%, pending the compliance review of the PRC. The price of a one-ounce First-Class Mail stamp will increase to $0.46 at that time. A First-Class Mail Global Forever Stamp will be available for the first time in early 2013.

Prices for Competitive services, by law, must cover costs attributable to each product, as well as an appropriate share of the institutional costs of the Postal Service. The required share of institutional costs to be covered by Competitive market services as determined by the PRC is 5.5% of total institutional costs. By law, changes in prices for our Competitive market services must be announced at least 30 days prior to the implementation date. Prices for these Competitive market services – including Express Mail, Global Express Guaranteed, Express Mail International, Priority Mail, Priority Mail International, Parcel Select, and Parcel Return Service – increased an average of 3.6% in January 2011, and again in January 2012 at an average rate of 4.6%. New pricing for Competitive market services will go into effect on January 27, 2013 at an average increase of 9%.

We offer contract prices, rebates, online price reductions, and other incentives to encourage customers to increase their volumes and in turn increase Postal revenue.

Reclassification of Certain Postal Services

Periodic reclassifications and expansions of services from Market-Dominant to Competitive services, which require approval from the PRC, are necessary to rationalize service offerings, as the Market-Dominant category has constraints, such as price caps based on the Consumer Price Index (CPI). In other words, the additional flexibility provided in Competitive services allows us to better offer services that meet customer needs, to increase business for the Postal Service, and to allow us to price our products and services competitively within the markets in which we operate. The Postal Service's Competitive services generally include most of our shipping, package, and expedited delivery services.

In Quarter I, 2012, with the approval of the PRC, we reclassified certain lightweight commercial parcels previously classified in Market-Dominant as First-Class Mail Parcels. These parcels are now classified as First-Class Package Services and included in Competitive services. In addition, certain Post Office Box services were reclassified from Market-Dominant to Competitive. In Quarter II, Standard Mail parcels used for the fulfillment of customer orders were reclassified as part of Parcel Select which is a Competitive service. There were no new reclassifications in Quarter III or IV. On July 20, 2012, the PRC conditionally approved the transfer of Standard Post (formerly Parcel Post) from Market-Dominant to Competitive, effective January 27, 2013. On September 10, 2012, the PRC approved the transfer of First-Class Package International Service from Market-Dominant to Competitive, also effective January 27, 2013.

While there are distinct legal and regulatory classifications of postal services known as either Market-Dominant or Competitive, Postal Service management utilizes the following broad service categories to evaluate performance and manage the business: First-Class Mail, Standard Mail, Shipping and Packages, International, Periodicals, and Other. Throughout this document, operational measurements and financial data, such as revenue and volume, will be reported utilizing these categories.

RISK FACTORS

The risk factors identified in this section are discussed in our *Annual Report,* and they are particularly relevant to our Shipping Services.

- Adverse changes in the economy directly impact our business, negatively affecting our results of operations.
- Our ability to generate sufficient cash flows is substantially dependent on our ability to increase efficiency, reduce costs, and generate revenue, as well as on legislative change.
- Our business and results of operations are adversely affected by electronic diversion. If we do not compete effectively with electronic communications services, or grow marketing mail, package services, or revenue from other sources, this adverse impact will become more substantial over time.
- Adverse events may call into question our reputation for quality, reliability or our ability to deliver the mail, and could diminish the value of the Postal Service brand. This could potentially adversely affect our revenues and results of operations.
- Our need to restructure our operations in response to declining mail volumes may result in significant costs. It is possible that the measures being considered may be insufficient to reduce our workforce and physical infrastructure to a level commensurate with lower and declining mail volumes.

- Existing laws and regulations limit our ability to introduce new services or products, enter new markets, or generate new revenue streams, and thus grow and evolve as an important American institution.

- An unaffordable union contract arrived at either through negotiation or arbitration could have a significant impact on our future results of operations.

- Fuel expenses are a material part of our operating costs. A significant increase in fuel prices could adversely affect our costs and results of operations.

- We are subject to Congressional oversight and regulation from the Postal Regulatory Commission and other government agencies. We have a wide variety of stakeholders whose interests and needs are sometimes in conflict.

- We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results and manage our business. Disruptions in both our primary and secondary (back-up) systems could harm our ability to run our business and potentially result in significant losses of revenue or additional operating costs. In addition, such disruptions could impair our reputation for reliable service, which would also adversely affect results of operations.

- Due to our current cash constraints, our operational performance in the future could be at risk as a result of inadequate capital investment in transportation equipment, mail processing equipment, facilities, or information technology which are either essential to operations or to improve the quality of our services.

- The potential liability associated with existing and future litigation against us could have a material adverse effect on our business, results of operations, financial condition, and cash flows.

- A failure on our part to protect the privacy of information we obtain from customers could damage our reputation and result in a loss of business.

- International conflicts or terrorist activities and the effects of these events may have adverse impacts on business operations or our financial results. In addition, we are subject to the risk of biohazards and other threats placed in the mail.

- We may be adversely impacted by the legal or regulatory responses to actual or perceived global climate change.

- We are also subject to risks and uncertainties that affect many other businesses, including:

    - Market acceptance of new product and service initiatives;
    - Adverse weather conditions or natural disasters, such as hurricanes, which can damage property and disrupt operations;
    - Widespread outbreak of an illness or any other communicable disease, or any other public health crisis; and
    - Changes in interest rates and foreign currency exchange rates.

These risks and others could clearly affect the liquidity of the Competitive Products Fund that is held within the U.S. Treasury.

RESULTS OF OPERATIONS

Using PRC methodology, Competitive Mail and Services revenue totaled $11.4 billion in 2012 and volume totaled 2.5 billion pieces. In 2012, Competitive Mail and Services accounted for 1.6% of total Postal Service mail volume and 17.5% of total revenue.

Before further discussion, it may be useful to define several terms that are part of our regulatory lexicon. Coverage is defined as the ratio of revenue to attributable costs, using PRC-determined methodology. Institutional costs are those costs that are not attributable. When a product's revenue exceeds its attributable costs, the difference represents contribution toward covering institutional costs.

In addition to covering attributable costs, Competitive Mail and Services are required, by the PRC, to bear 5.5% of postal-wide institutional costs. Total costs for Competitive Mail and Services are by definition equal to their attributable costs plus 5.5% of postal-wide institutional costs. In 2012, the contribution from Competitive Mail and Services equaled 7.49% of the institutional costs of the Postal Service. The difference between this 7.49% and the required 5.5% threshold is the "net income" for Competitive Mail and Services, and it is used to calculate the required tax transfer from the Competitive Products Fund in the U.S. Treasury to the Postal Service Fund, also within the Treasury. For 2012, this non-GAAP net income totaled $808.6 million. Tax due will be transferred from the Competitive Products Fund to the Postal Service Fund by January 15, 2013.

PRC Forms CP-01, CP-02, CP-03, and CP-04

For Fiscal Year 2012

Table 1
Proposed Competitive Products Income Statement
($ in 000s)

PRC Form CP-01

	FY 2012	FY 2011	$ Change from SPLY	% Change from SPLY
Revenue				
(1) Mail and Services Revenues (a)	11,425,730	8,996,400	2,429,330	27.0%
(2) Investment Income	516	290	226	77.9%
(3) Total Competitive Products Revenue	11,426,246	8,996,690	2,429,556	27.0%
Expenses				
(4) Volume Variable Costs	8,283,600	6,508,700	1,774,900	27.3%
(5) Product Specific Costs	99,700	171,400	(71,700)	-41.8%
(6) Total Competitive Products Attributable Cost	8,383,300	6,680,100	1,703,200	25.5%
(7) Net Income Before Institutional Cost Contribution	3,042,946	2,316,590	726,356	
(8) Required Institutional Cost Contribution	2,234,386	1,625,459	608,927	37.5%
(9) Net Income (Loss) Before Tax	808,560	691,131	117,429	
(10) Assumed Federal Income Tax *	282,996	241,896	41,100	17.0%
(11) Net Income (Loss) After Tax	525,564	449,235	76,329	

Line (1): Total revenues from Competitive Products volumes and Ancillary Services
Line (2): Income provided from investment of surplus Competitive Products revenues
Line (3): Sum total of revenues from Competitive Products volumes, services, and investments
Line (4): Total Competitive Products volume variable costs as shown in the Cost and Revenue Analysis (CRA) report
Line (5): Total Competitive Products product specific costs as shown in the CRA report
Line (6): Sum total of Competitive Products costs (sum of lines 4-5)
Line (7): Difference between Competitive Products total revenues and attributable costs (line 3 less line 6)
Line (8): Minimum amount of Institutional Cost contribution required under 39 CFR 3015.7 of this chapter.
Line (9): Line 7 less line 8
Line (10): Total assumed Federal income tax as calculated under 39 CFR 3060.40
Line (11): Line 9 less line 10

(a) Note: Mail and Services revenues have been adjusted to include gains from the sales and impairments of property and equipment. The gain for FY 12 was $5M with the amount allocated to Competitive Products (Building and Equipment allocation) of $630K. The loss for FY11 was $6M with the amount allocated to Competitive Products (Building & Equipment allocation) of $500K.

* Note: 2012 Assumed Federal Income Tax is estimated based on the 2012 and 2011 Federal corporate tax rates respectively.

Table 2 Annual Summary of Competitive Products Financials ($ in 000s) PRC Form CP-02				
		Beginning Value	Change from Prior Year	Ending Value
(1)	Cumulative Net Income (Loss) After Assumed Federal Income Tax *	$1,105,169	$525,564	$1,630,733
(2)	Total Financial Obligations (List of Financial Obligations)	$0	$0	$0
(3)	Total Financial Investments (List of Financial Investments)	$607,299	$449,751	$1,057,050
Line 1:	Beginning Value: Sum total of Net Income (Loss) as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Income (Loss) of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			
Line 2:	Beginning Value: Sum total of Financial Obligations as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Financial Obligations of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			
Line 3:	Beginning Value: Sum total of Financial Investments as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Financial Investments of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			

* Note: 2012 Assumed Federal Income Tax is estimated based on the 2012 Federal corporate tax rate.

Table 3
Competitive Products Property and Equipment Assets (FY 2012)
(Actual $)

PRC Form CP-03

Finance Number	Finance Location	Asset Identifier	Asset Description	Cost	Accumulated Depreciation	Net Book Value
ClickNShip	475 L'Enfant Plaza, Wash, Dc 20260	1916084	Shredder	$3,673.92	$642.93	$3,031
ClickNShip	475 L'Enfant Plaza, Wash, Dc 20260	1057123	Micro Computer System	$4,812.00	$4,812.00	$0
ClickNShip	475 L'Enfant Plaza, Wash, Dc 20260	1147567	Micro Computer System	$23,138.00	$23,138.00	$0
ClickNShip	475 L'Enfant Plaza, Wash, Dc 20260	1147568	Micro Computer System	$23,138.00	$23,138.00	$0
ClickNShip	475 L'Enfant Plaza, Wash, Dc 20260	1147569	Micro Computer System	$23,138.00	$23,138.00	$0
Total			Total	$77,899.92	$74,868.93	$3,031

Table 4 Statement of Allocated Assets and Liabilities for Competitive Products ($ in thousands)				
	FY2012		FY 2011	PRC Form CP-04
Total Net Assets	**USPS Annual Report**	**Corp. Fin. Reporting - Competitive Products**	**Corp. Fin. Reporting - Competitive Products**	**Distributed on Basis of:**
Cash and Cash Equivalents	2,319,000	406,057	210,254	Revenue
Net Accounts Receivable	918,000	160,742	147,093	Revenue
Supplies, Advances, and Prepayments	126,000	22,063	16,956	Revenue
Total Current Assets	3,363,000	588,861	374,304	
Property and Equipment				
Buildings	24,452,000	3,618,896	2,744,145	Depreciation cost for Buildings
Leasehold Improvements	1,208,000	178,663	125,656	Depreciation cost for Leasehold Improvements
Equipment	20,143,000	1,824,956	1,079,636	Depreciation cost for Equipment
Land	2,919,000	432,012	333,871	Depreciation cost for Buildings
Accumulated Depreciation	30,187,000	3,941,594	2,604,101	Depreciation cost for Bld/Eq/Leasehold/Vehicle
Construction in Progress	328,000	48,529	70,549	Depreciation cost for Buildings & Leaseholds
Total Property and Equipment, Net	18,863,000	2,161,463	1,749,757	
Appropriations and Receivables - Revenue Forgone	385,000	0	0	Non Competitive
Total Assets	22,611,000	2,750,324	2,124,061	
Total Assets Determined from Section 2011(e)(5)		3,959,186	3,308,257	
Total Net Liabilities	**USPS Annual Report**	**Competitive Products**	**Competitive Products**	**Distributed on Basis of:**
Liabilities:				
Current Liabilities				
Compensation and Benefits	1,856,000	248,704	231,228	Labor
Retire Health Benefits	11,205,000	1,501,470	692	Labor
Workers' Compensation	1,337,000	179,425	124,371	Workers' Comp Expense
Payables and Accrued Expenses	1,835,000	321,309	256,036	Revenue
Customer Deposit Accounts	1,210,000	211,871	195,842	Revenue
Deferred Revenue-Prepaid Postage	4,014,000	702,851	494,126	Revenue
Outstanding Postal Money Orders	677,000	852	6,545	Actual International Money Orders Outstanding
Prepaid Box Rent and Other Deferred Revenue	475,000	202,357	2,729	Actual Competitive Deferred Box Rents
Debt	9,500,000	1,245,450	679,500	Volume Variable Interest Expense
Non-Current Liabilities				
Workers' Compensation	16,230,000	2,178,066	1,376,202	Workers' Comp Expense
Employee Accumulated Leave	1,855,000	248,941	206,326	Repriced Annual Leave
Deferred Appropriation and Other Revenue	194,000	0	0	Non Competitive
Long-Term Portion of Capital Lease Obligation	410,000	60,639	51,980	Leasehold Depreciation
Deferred Gains on Sales of Property	313,000	39,448	29,365	Depreciation cost for Buildings & Equipment
Contingent Liabilities and Other	846,000	113,364	75,955	Labor
Long-Term Portion Notes Payables	5,500,000	0	0	Non Competitive
Total Liabilities	57,457,000	7,254,748	3,730,897	