



Fiscal Year 2020 Integrated Financial Plan

United States Postal Service

EXECUTIVE SUMMARY

In 2019, the Postal Service reported a controllable loss of \$3.4 billion. The net loss for the year was \$8.8 billion. Our Annual Report on Form 10-K, which was filed with the Postal Regulatory Commission (PRC) on November 14, 2019, contains a detailed analysis of the 2019 financial results and provides a baseline for understanding our projected 2020 results.

The 2020 Integrated Financial Plan (IFP) anticipates continued financial challenges for the Postal Service, resulting in a projected controllable loss of \$4.0 billion and a net loss of \$7.6 billion in 2020.

Statement of Operations		
In Billions	FY2019 Actual	FY2020 Plan
Revenue	\$ 71.3	\$ 71.8
Controllable Expenses ^{1, 2}	<u>74.7</u>	<u>75.8</u>
Controllable Income ^{1, 2}	\$ (3.4)	\$ (4.0)
RHB Normal Cost Actuarial Revaluation & Amortization ^{3, 4}	(0.6)	(0.9)
Workers' Comp. Fair Value and Other Non-Cash Adj.	(2.1)	-
FERS Unfunded Liabilities Amortization ³	(1.1)	(1.1)
CSRS Unfunded Liabilities Amortization ³	<u>(1.6)</u>	<u>(1.6)</u>
Net Loss	<u>\$ (8.8)</u>	<u>\$ (7.6)</u>
Mail Volume (Pieces)	142.6	138.1

1. Before Retiree Health Benefits (RHB) amortization and actuarial changes to RHB normal cost, Federal Employee Retirement System (FERS) and Civil Service Retirement System (CSRS) unfunded liability amortization, and non-cash adjustments to workers' compensation liabilities.
2. The RHB normal cost for 2019 totaled \$3.8B, of which \$4.0B was considered controllable. Controllable expenses for 2019 include only the portion that was estimated based on information from OPM prior to the issuance of the FY2019 IFP.
3. This represents the amortization expense related to the FERS, CSRS, and Postal Service Retiree Health Benefit Fund liabilities. These are based on the invoices from OPM.
4. Includes effect of estimated \$0.2B decrease in RHB normal cost due to actuarial adjustments.

Revenue is projected to grow by \$0.5 billion in 2020. This increase is driven primarily by strategic price increases on packages, which offset decreasing package volume. Market-Dominant revenues are expected to fall, as price increases capped at CPI are insufficient to offset continuing volume losses.

Controllable expenses in 2020 are expected to increase by \$1.1 billion over 2019, with \$0.3 billion of that increase due to higher contribution rates for Federal Employees Retirement Systems (FERS) normal costs mandated by the U.S. Office of Personnel Management (OPM). Transportation costs are expected to increase by \$0.3 billion, driven by increased air volumes, supplier cost increases for both air and ground transportation, and higher costs for jet and diesel fuel. Excluding the impact of transportation and FERS normal costs, the remaining controllable expenses in 2019 are planned to increase by approximately \$500 million, or 0.8 percent, below the projected rate of inflation.

Beginning in 2017, the 10-year retiree health benefit (RHB) pre-funding schedule was replaced with a requirement that the Postal Service fund the normal costs of RHB earned by current postal employees, as well as a requirement to make amortization payments to pay down the unfunded liability of the Postal Service Retiree Health Benefits Fund (PSRHBF). These are calculated by the Office of Personnel Management (OPM). The estimated RHB amortization expense for 2020 is \$0.9 billion. The 2020 amortization expenses to pay down the unfunded liabilities of the Civil Service Retirement System (CSRS) and FERS are estimated by OPM to be \$1.6 billion and \$1.1 billion, respectively. These expenses are not included in controllable expenses because they are highly sensitive to actuarial assumptions outside of our control. For example, a one percent increase in the discount rate applied to the RHB liability would decrease the liability amount by \$15.3 billion and decrease the annual amortization payment by \$0.8 billion, while a one percent decrease in the rate would increase the liability and amortization payment by \$18.4 billion and \$0.9 billion, respectively. Discount rate changes could also lead to large changes in the actuarial liabilities and amortization expenses associated with CSRS and FERS.

The IFP does not project the non-cash portion of workers' compensation expense, because it is dependent on actuarial assumptions, interest rates, and other factors that are outside of management's control and extremely difficult to predict. For example, a one percent increase in the discount rate would decrease the September 30, 2019 workers' compensation liability and related expense by approximately \$2.0 billion.

Similarly, a one percent decrease in the discount rate would increase the September 30, 2019 workers' compensation liability and related expense by approximately \$2.5 billion.

The IFP projects that 2020 work hours will be approximately sixteen million lower than in 2019. This is in spite of the continued growth in delivery points and the addition of two delivery days compared to 2019. These work hour reductions will be realized by achieving efficiency improvements in all aspects of processing, delivery, retail, maintenance, and transportation operations, in order to better align our infrastructure with mail volume declines. However, these work hour savings will not be sufficient to offset inflationary and other cost increase drivers.

We continue to pursue financial stability through product development and innovation, pricing strategies, improved operational efficiencies, and cost reductions. However, it will also take significant legislative reforms, and additional regulatory pricing flexibility, to eliminate our net losses, re-balance our assets and liabilities and eliminate the accumulated net deficiency.

ECONOMIC ASSUMPTIONS

At the time this plan was developed, the economy was projected to show continued, albeit slower, growth in 2020, driven by growth in employment, wages and real disposable income, leading to continued growth in consumer spending and Gross Domestic Product (GDP). Growth in online shopping, emerging technologies, low inflation, and stable interest rates could have a further positive influence on economic growth in 2020. The slower anticipated pace of GDP growth in 2020, on the other hand, reflects an expectation of lagged negative effects of tariffs, a cessation or reversal of the 2019 monetary easing by the Federal Reserve, and a continuing slowdown in nonresidential fixed business investment growth.

Economic Drivers		
	FY2019	FY2020 Forecast
Gross Domestic Product	2.8%	1.9%
e-Commerce	12.2%	11.4%
Consumer Price Index for All Urban Consumers	1.8%	2.2%
Consumer Price Index for All Wage and Clerical Workers Consumers	1.8%	2.2%
Employment	1.9%	1.1%
Investment	4.7%	0.8%
Transportation	2.1%	2.5%

The Postal Service's financial position and results of operations will also continue to be impacted by the state of the economy, which is now in its 11th straight year of expansion. This is a historically long period of growth, which some economists believe may leave the country vulnerable to an economic slowdown or recession. Beyond these broad economic factors, significant business-specific risks remain. Market-Dominant mail volumes continue to decline, as mailers migrate to digital solutions for communication, transactional and advertising needs, while competition in package delivery is increasing quickly, portending a decline in package volumes in 2020.

In developing the IFP, we consider factors such as multi-year trends in our product sales (with greater weight on more recent trends), expected market growth, competitive market dynamics, changes in prices and marketing programs, the expected rate of migration of hard-copy mail to digital media, and the expected state of the overall economy. Any significant slowdown in economic growth would adversely affect our volumes, revenues and financial results.

A. Volume

The 2020 IFP projects total mail and package volume of 138.1 billion pieces, a decline of 4.5 billion pieces, or 3.1 percent, from 2019.

For First-Class Mail, the IFP projects a decline of approximately 1.0 billion pieces, or 1.8 percent, from 2019, reflecting the ongoing migration of communications and transactions out of First-Class Mail into electronic media, partially offset by some additional volume due to the 2020 Census. Bill and statement volumes are expected to continue their pattern of modest diversion, as customers increasingly accept bills and statements electronically, often on their mobile devices, and often in response to incentives by companies for making the switch. First-Class Mail single-piece volumes are also expected to decline, continuing a trend that has been evident for a number of years as consumers and businesses find alternatives.

Volume		
Billion pieces	FY2019 Actual	FY2020 Plan
First-Class Mail	54.9	54.0
Marketing Mail	75.7	72.7
Periodicals	4.6	4.4
Shipping and Packages	6.2	6.0
International	0.9	0.7
Other	0.3	0.3
Total Volume	142.6	138.1

USPS Marketing Mail volume is expected to decline about 2.9 billion pieces compared to 2019, primarily due to a 1.3 billion piece reduction from the political and election mail gained from the strong mid-term election in October 2018 (FY2019). This loss will be partially offset in FY2020 Q3-Q4 by increases in political and election mail leading up to the Presidential election in November, 2020. Overall, we expect political and election mail volume to decline by approximately 0.6 billion pieces. The remaining decrease is primarily due to increased competition from electronic media. Marketers continue to leverage technology to better target customers and increase their investment in digital advertising at the expense of hard-copy media. However, USPS Marketing Mail continues to provide proven value and return on investment. We intend to continue efforts to further improve the value of USPS Marketing Mail by enhancing it with innovations such as Informed Delivery.

Periodicals volume is expected to decline by approximately 0.2 billion pieces as newspaper and magazine readership continues to migrate to online media.

Shipping and Packages volume is expected to decline by 0.2 billion pieces, or 2.9 percent, to 6.0 billion pieces in 2020, driven by increased competition and price increases. Priority Mail and First-Class Package Service are expected to continue to show modest growth in 2020, driven by consistent, reliable service and price competitiveness. Parcel Select “last mile” volume is expected to decline due primarily to increased competition and announced insourcing strategies by large users of Parcel Select.

International volume is expected to decline by about 0.2 billion pieces in FY2020. However, there is considerable uncertainty regarding the International volume forecast as USPS is moving to self-declared rates in July 2020 for Inbound Letter Post small packages, which will result in large price increases for that product.

B. Revenue

Revenue in 2020 is expected to increase by \$0.5 billion compared to 2019. This 0.7 percent increase is driven primarily by growth in package revenue.

The prices of Market-Dominant products and services are set to increase by approximately 1.9 percent, and the prices of Competitive products and services are expected to increase by an average of approximately 4.7 percent in January 2020.

The continuing decline in mail volume is expected to result in \$0.4 billion less revenue from Market-Dominant products in 2020 than in 2019, despite price increases; First-Class Mail and Periodicals revenues are expected to remain flat. USPS Marketing Mail revenue is expected to decline by \$0.4 billion, due to lower volume.

Revenue		
In Billions	FY2019 Actual	FY2020 Plan
First-Class Mail	\$ 24.4	\$ 24.4
Marketing Mail	16.4	16.0
Periodicals	1.2	1.2
Shipping and Packages	22.8	23.6
International	2.5	2.4
Other	4.0	4.2
Total Revenue	\$ 71.3	\$ 71.8

The continued growth in e-Commerce coupled with a 4.7 percent average price increase is expected to generate an additional \$0.8 billion in revenues from Shipping and Packages in 2020. However, Shipping and Packages products generally have lower contribution margins than First-Class Mail and are subject to intense competition. In addition, the projected increase in revenues in 2020 is much smaller than the revenue increases from Shipping and Packages in recent years.

International mail revenues are expected to decline by \$0.1 billion. However, as with volume, there is considerable uncertainty with International revenue as USPS is self-declaring rates starting in July 2020 for Inbound Letter Post small packages. This could lead to larger than expected volume decreases, if substantial price increases drive away more volume than expected.

Other revenue is expected to increase by about \$0.2 billion, primarily as a result of price increases.

2020 OPERATING PLAN – WORK HOURS & EXPENSES

The 2020 IFP projects total work hours of 1,157 million, a reduction of sixteen million compared to 2019. The addition of two delivery days, compared to 2019, and the expected addition of 1.3M delivery points creates upward pressure on work hours. However, the additional efficiency improvements and continued work hour and complement management efforts necessitated by the ongoing volume declines will more than offset these upward pressures and enable the substantial work hour reduction.

Controllable expenses consist of costs, such as salaries, transportation and non-personnel expenses such as rent and utilities and supplies and services. They do not include the amortization of the FERS, CSRS, and RHB unfunded liabilities, and actuarial adjustments to the RHB normal costs and workers' compensation liability.

Controllable expenses are projected to increase by \$1.1 billion, or 1.5 percent, in 2020. Approximately \$0.3 billion of the increase is due to an increase in the FERS normal cost contribution rates and \$0.3 billion is due to an increase in transportation expenses. Increasing transportation costs adversely affected our financial results in 2019 and this upward pressure is expected to continue in 2020. In 2020, transportation expenses are expected to increase by \$0.3 billion, driven by increased air volumes, supplier cost increases, and higher costs for both jet and diesel fuel.

Excluding the impact of transportation and FERS normal costs, the remaining controllable expenses in 2020 are expected to increase by 0.8 percent. Salaries and benefits expenses are expected to increase by \$0.4 billion (0.8 percent) in 2019, driven primarily by anticipated general wage increases, step increases, and cost of living adjustments set forth in our collective bargaining agreements. The addition of 1.3 million delivery points and two delivery days, compared to 2019 add additional upward pressure on work hours, and therefore to salaries and benefits expense. These cost pressures are partially offset by the planned efficiency measures expected to result in a sixteen million work hour reduction and continued workforce attrition.

Statement of Operations		
In Billions	FY2019 Actual	FY2020 Plan
Salaries and Benefits	\$ 48.9	\$ 49.3
FERS Normal Cost	3.5	3.8
RHB Normal Cost ¹	4.0	4.0
Transportation	8.2	8.5
Depreciation	1.7	1.7
Supplies & Services	2.8	2.8
Rent / Utilities / Other	<u>5.6</u>	<u>5.7</u>
Controllable Expenses ¹	\$ 74.7	\$ 75.8
RHB Normal Cost Actuarial Revaluation & Amortization	0.6	0.9
Workers' Comp. Fair Value and Other Non-Cash Adj.	2.1	-
FERS Unfunded Liabilities Amortization ²	1.1	1.1
CSRS Unfunded Liabilities Amortization ²	<u>1.6</u>	<u>1.6</u>
Total Expenses	\$ 80.1	\$ 79.4

1. Before RHB amortization & actuarial revaluation, non-cash adjustments to workers' compensation liabilities and FERS and CSRS unfunded liabilities amortization, which are excluded from controllable expenses.

2. This represents the OPM amortization expense related to the Federal Employee Retirement System (FERS), Civil Service Retirement System (CSRS), and Postal Service Retiree Health Benefit Fund (PSRHB) liabilities. These are based on the invoices from OPM.

2020 CAPITAL PLAN

A. Capital Investments - Commitments

The 2020 capital plan calls for capital commitments of \$2.6 billion across four categories. Capital commitments provide a view of future capital obligations that ultimately lead to cash outlays, sometimes over a period of years. For 2020, there are a number of large programs that if approved may require an increase in the capital plan.

Capital Commitments				
In Billions	5 - Year Avg. (2014-2018)	FY2018 Actual	FY2019 Actual	FY2020 IFP
Facilities	\$0.5	\$0.7	\$0.9	\$1.0
Mail Processing Equipment	\$0.4	\$0.3	\$0.4	\$0.5
Vehicles	\$0.3	\$0.4	\$0.5	\$0.5
IT, Postal Support Equipment & Other	\$0.2	\$0.2	\$0.2	\$0.6
Total	\$1.4	\$1.6	\$2.0	\$2.6

Facilities

The 2020 capital commitment plan for facilities is \$1.0 billion and represents approximately 39 percent of the total capital commitment plan. These investments are primarily for building improvements, which include repairs and alterations to aging buildings, and facility modifications that are necessary to accommodate current and future operational needs. In addition, a small portion is for construction and building purchases.

Mail Processing Equipment

The 2020 capital commitment plan for mail processing equipment is \$0.5 billion and represents approximately 19 percent of the total capital commitment plan. These investments are focused on increasing productivity and reducing operating costs through the focused deployment of new equipment, improving existing equipment, or making necessary upgrades due to obsolescence of components. These investments will also support service performance for mailers and shipping and package services customers.

Vehicles

The 2020 capital commitment plan for vehicles is \$0.5 billion or 19 percent of the total commitment plan. These vehicle investments will replace existing vehicles that are well past their expected useful lives or where replacement is deemed necessary due to high maintenance costs. These investments will also expand the delivery fleet to cover additional rural routes with Postal Service vehicles. The new vehicles, which will consist primarily of delivery vehicles, will have better fuel efficiency and lower maintenance costs than those that are being replaced, which will result in cost savings.

The first Next Generation Delivery Vehicle (NGDV) production purchase is not included within the \$0.5 billion vehicle plan. The Postal Service anticipates awarding the contract(s) for the production phase of NGDV later in FY2020. After completing our processes, a separate request may be made to the Board of Governors for authorization to increase the Capital Plan to fund the program.

Information Technology and Postal Support Equipment

The 2020 capital commitment plan for the information technology (IT) and Postal Support Equipment category is \$0.6 billion, or approximately 23 percent of the total plan. Investments in this category include Cybersecurity-related investments, enhancements to mail scanning and tracking systems, systems updates, as well as upgrades and enhancements to computer hardware, servers, storage systems, and software development.

B. Capital Investments - Cash Outlays

Capital cash outlays are expected to increase over 2019 due to payments on commitments made in 2020 and prior years. Cash outlays for 2020 are for similar items as described on the prior page for capital commitments.

Capital Cash Outlays				
In Billions	5 - Year Avg. (2014-2018)	FY2018 Actual	FY2019 Actual	FY2020 IFP
Facilities	\$0.4	\$0.6	\$0.6	\$0.8
Mail Processing Equipment	\$0.4	\$0.3	\$0.3	\$0.4
Vehicles	\$0.2	\$0.3	\$0.3	\$0.6
IT, Postal Support Equipment & Other	\$0.2	\$0.2	\$0.2	\$0.5
Total	\$1.2	\$1.4	\$1.4	\$2.3

2020 DEBT LIQUIDITY AND FINANCING PLAN

We ended 2019 with unrestricted cash of \$8.8 billion and \$11.0 billion of debt. Our total theoretical unrestricted liquidity was \$12.8 billion, consisting of \$8.8 billion in unrestricted cash and \$4.0 billion of available borrowing capacity under our statutory debt ceiling of \$15 billion. This was a \$0.9 billion improvement over 2018. This level of liquidity was achieved only by defaulting on payments to the CSRS, FERS and RHB funds totaling \$55.4 billion from 2012 through 2019.

In 2020, we anticipate keeping our debt at \$11.0 billion. This will allow us to minimize interest expense, while maintaining sufficient liquidity to fund day-to-day operations and continue to make essential capital investments.

As shown in the table to the right, our retirement and RHB programs continue to be relatively well-funded, with the CSRS and FERS obligations both approximately 85 percent funded and the RHB program approximately 39 percent funded.

Our liquidity position in 2020 will be greatly impacted by the state of the economy and the success of our revenue growth and expense management initiatives. If financial results conform to plan, our year-end 2020 unrestricted cash is estimated to be roughly \$7.5 - \$8.0 billion, prior to making any decision regarding the lump sum payments of approximately \$7.6 billion for CSRS, FERS and RHB, due by September 30, 2020 and assuming no change in debt. The Board of Governors will decide whether or not to make the year-end payments at the end of 2020, based on the facts and circumstances at that time.

Unless there is a fundamental change in our financial condition, we will not have sufficient liquidity to pay down debt, fully fund retirement and RHB obligations, and invest in equipment and technologies to fulfill our statutory mission. We will continue to pursue aggressive management actions, cost reductions, and additional ways to generate revenue in 2020, but will also need legislative and regulatory changes to resolve protracted, structural issues with our pricing and cost structures. Many of the structural reforms needed to ensure long-term viability, such as full integration of RHB with Medicare, can only be achieved with legislative change to our unsustainable business model. It is also necessary for the PRC to confer additional pricing flexibility as part of its 10-year pricing system review.

Balance Sheet (including retirement accounts) As of September 30, 2019

- Total liabilities, including retirement obligations exceed assets by ~\$135 billion.
- It would take RHB legislative change and decades of annual profits to remedy this level of excess liabilities and unfunded retirement obligations.

Assets		Liabilities	
CSRS Fund Balance ¹	\$152.3B	CSRS Actuarial Liability ²	\$181.3B
FERS Fund Balance ¹	\$122.5B	FERS Actuarial Liability ²	\$143.4B
RHB Fund Balance ³	<u>\$45.0B</u>	Retiree Health Benefits Obligation	<u>\$114.4B</u>
Total Retirement-Fund Assets	\$319.8B	Total Retirement-Related Liabilities	\$439.1B
Unrestricted Cash	\$8.8B	Workers' Compensation Debt	\$18.5B \$11.0B
Land, Buildings & Equipment, net	\$14.4B	Accrued Compensation, benefits, and leave	\$4.6B
Other Assets	<u>\$2.4B</u>	Deferred Revenue	\$2.2B
Total Assets	\$345.4B	Other	<u>\$5.3B</u>
		Total Liabilities	\$480.7B

1. OPM projections as of September 30, 2019 includes amortization payments due by 9/30/18. Asset balances have been adjusted to reflect that payments were not made.
2. OPM projections as of September 30, 2019.
3. OPM valuation as of September 30, 2019

CONCLUSION

The 2020 IFP reflects the Postal Service's continued efforts to achieve financial health and stability, within the limits of current laws and regulations. The IFP projects \$0.5 billion growth in revenue, primarily due to increases in package revenue. This revenue growth is reflective of a rapidly changing mailing and shipping environment, which requires us to manage costs.

Despite modest revenue growth and aggressive cost-containment initiatives, the Postal Service continues to have insufficient liquidity to fulfill its universal service obligations, fully fund all legally-required financial obligations, maintain a margin of safety in the event of an economic downturn to deal with contingencies, and make necessary capital investments. Our 2020 controllable loss, as shown on page one, is estimated to be \$4.0 billion and our consolidated balance sheet reflects liabilities that exceed assets by approximately \$135 billion. There are significant risks such as negative economic developments, accelerated declines in volumes, and inflation in fuel or wages that could worsen the controllable loss.

We continue to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues we face and the legislative and regulatory changes that would help provide financial stability. Given the vital role the Postal Service plays in the U.S. economy, a financially healthy and stable Postal Service should continue to be a top priority for all stakeholders from legislative and regulatory bodies to management, employees, and customers. Our financial situation is serious, but solvable.