The United States Postal Service

Recent Financial

On August 9, 2012, the United States Postal Service (the "Postal Service" or "USPS") publicly announced its financial results for its third quarter of fiscal 2012. The press release[a] announcing these results – which followed shortly after the Postal Service's much publicized decision to not pay a $5.5 billion pre-funding payment for future retiree health benefits which was imposed by Congress – highlighted the following:

- "A net loss of $5.2 billion, compared to a net loss of $3.1 billion for the same period last year…"
- "Current projections [showing] very low levels of cash, and no remaining borrowing capacity, at the end of the current fiscal year and through October 2012."
- "[L]arge losses [that] are expected to continue until legislative changes are made in line with the Postal Service Business Plan to return to financial stability."

Earlier this year, Lazard issued a report which outlined our views of both the current situation and what is required to return the Postal Service to long-term viability. In that report, we acknowledged the significant challenges facing the Postal Service. However, we were careful: (i) to distinguish between the current financial challenges, which in fact have almost nothing to do with the Postal Service's operations, and its very real long-term challenges; and (ii) to make clear that the Postal Service's Business Plan would, if implemented, not likely arrest but instead accelerate the Postal Service's long-term decline.

The Reality of the Postal Service's Situation and the Shortcomings of Its Proposed Solution

A closer look at the Postal Service's third quarter results, as well as results for the first ten months of fiscal 2012, supports our earlier analysis and recommendations. A set of highlights for this period that would have been equally accurate but far more revealing might have read as follows:

- "USPS operating revenue was stable and operating losses were smaller than forecast and improved from the same period last year."
- "Decline in First-Class Mail volume and revenue was smaller than expected; Shipping Services achieved dramatic record growth."
- "Large net losses were due almost entirely to the accounting for pre-funding of retiree medical benefits imposed by Congress and which has no known parallel at any public or private enterprise in America."

(a) Consistent with Lazard's obligations under its non-disclosure agreement with the Postal Service, all of the factual statements contained herein are based on the press release ("Postal Service Ends Third Quarter with $5.2 Billion Loss") and the Third Quarter Fiscal 2012 Form 10-Q issued by the Postal Service on August 9, 2012, as well as other public statements and disclosures of the Postal Service, including its public financial statements, the public testimony of its leadership and the "Plan to Profitability – 5 Year Business Plan" publicly disclosed by the Postal Service on February 16, 2012, and other public documents. In connection with its work, Lazard has also met with and/or interviewed outside postal experts and users of Postal Service products and services as well as conducted its own independent financial analysis of the Postal Service based on its public statements and disclosures.

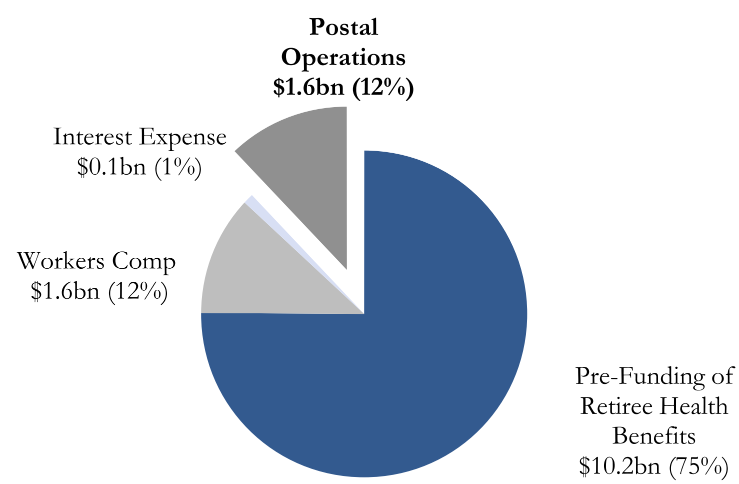
Here are the facts underlying the key messages emphasized by USPS management:

- **The Postal Service's announced net loss of $5.2 billion for the third quarter:**

  Of the "$5.2 billion" loss described by the Postal Service for 3Q12, $3.7 billion was expense associated with retiree health benefits (the large majority of which was pre-funding of retiree health benefits that Congress has required the Postal Service to make since 2006) and $1.5 billion was expense associated with changes in assumptions associated with workers compensation liability. Backing out these non-operating items leaves the Postal Service's operations as "breakeven." These results are far from optimal, but do not constitute the crisis that the Postal Service highlights.

  Looking at results for the first ten-months of this fiscal year, the case is equally compelling. Of the $13.5 billion USPS net loss so far in fiscal year 2012 (10 months through July), only $1.6 billion (~12%) was from operations.

EXHIBIT A: FY 2012 NET LOSS THROUGH JULY (10 MONTHS)



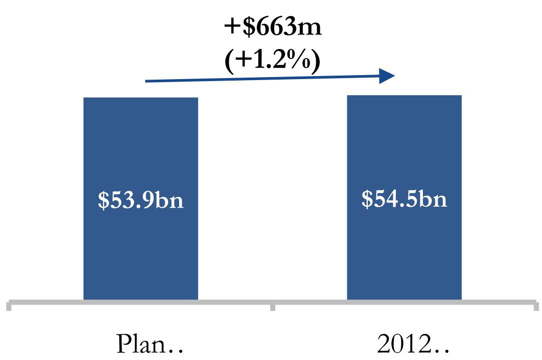
FY 2012 Net Loss through July: $13.5 billion

Source: Preliminary Financial Information (unaudited) for July 2012 as provided to the Postal Regulatory Commission.
Note: USPS fiscal year ends in September

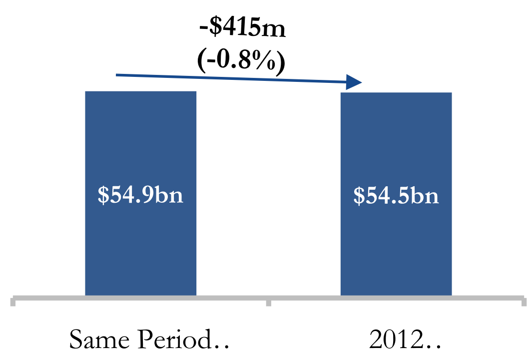
The facts on volume and revenue also contradict the narrative of a dying institution. 2012 year-to-date revenue of $54.5 billion was ~$650 million above USPS's plan, and ~$400 million (less than 1%) below the same period in 2011. And shipping services, which includes Priority Mail, Express Mail, Parcel Select and certain other parcel products, saw volume increase by 56.3% and revenue by 21.9%.

Exhibit B: FY2012 Revenue Through July (10 Months)

vs Plan



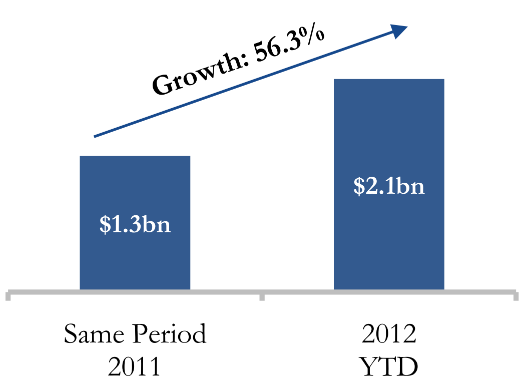
vs Same Period 2011



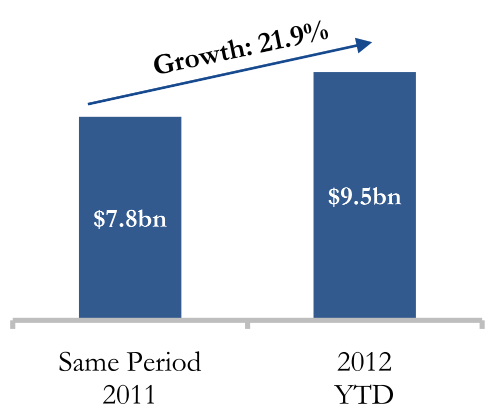
Source: Preliminary Financial Information (unaudited) for July 2012 as provided to the Postal Regulatory Commission.
Note: USPS fiscal year ends in September.

Exhibit C: FY2012 Shipping Services Results Through July (10 Months)

Volume



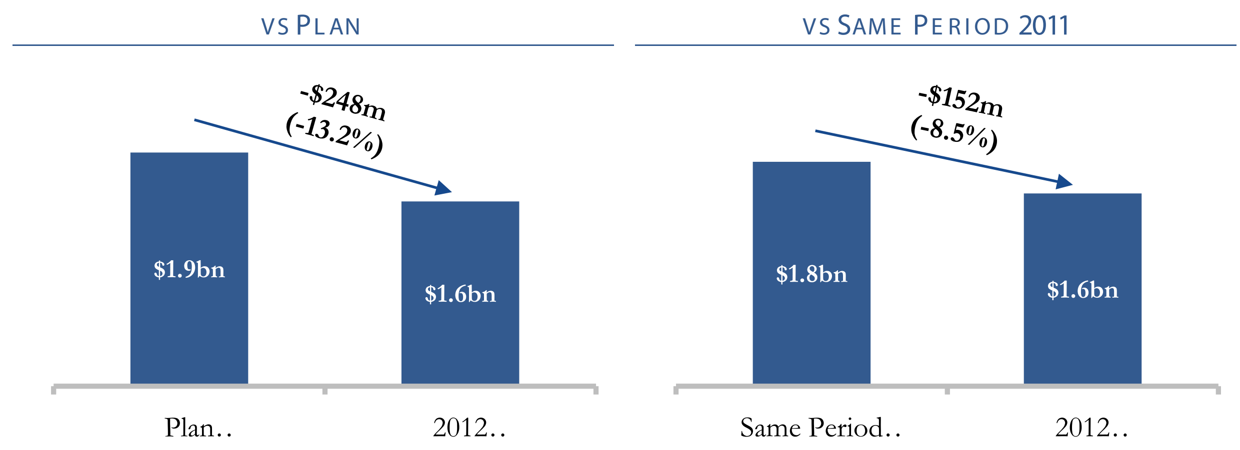
Revenue



Source: Preliminary Financial Information (unaudited) for July 2012 as provided to the Postal Regulatory Commission.
Note: USPS fiscal year ends in September.

Declining revenue has been offset by improved cost control, and reduced compensation and benefit costs in particular. Compensation costs are down 0.7% year-over-year (~$300 million) and workhours are down 2.1%. The net result is that the loss from operations so far in 2012 is actually ~$150 million lower than the loss in the same period last year.

EXHIBIT D: FY2012 CONTROLLABLE OPERATING LOSS THROUGH JULY (10 MONTHS)



Source: Preliminary Financial Information (unaudited) for July 2012 as provided to the Postal Regulatory Commission.
Note: USPS fiscal year ends in September.

- **"Current projections [showing] very low levels of cash, and no remaining borrowing capacity, at the end of the current fiscal year and through October 2012":**

  This is not the first time that the Postal Service has sounded the alarm of a liquidity crisis. One year ago, in its press release announcing results for the third quarter of fiscal 2011, the Postal Service predicted that "current financial projections indicate the Postal Service will have a cash shortfall and will have reached its statutory borrowing limit by the end of the fiscal year" – neither of which proved accurate. The Postal Service's near-term liquidity is entirely in the hands of Congress. Indeed, the third quarter 10-Q acknowledges that, "it is unlikely that, in the event of a cash shortfall, the Federal Government would cause or allow the Postal Service to significantly curtail or cease operations."

- **"[L]arge losses [that] are expected to continue until legislative changes are made in line with the Postal Service Business Plan to return to financial stability":**

  The Postal Service continues to tie its viability, its liquidity and its long-term survival to the implementation of its "Plan to Profitability – 5 Year Business Plan" (the "Business Plan") that it announced publicly in February 2012. As we stated in April, many of the assumptions of the Business Plan, including the continuing secular decline of First-Class Mail, appear reasonable and generally consistent with recent historical experience. And several of the proposed initiatives in the Business Plan – such as removal of the current legislative requirement that the Postal Service pre-fund its retiree health obligations, refunding the billions of dollars of Postal Service surplus that is currently contained in the FERS pension fund and changes to the Postal Service's health care plans – may well make sense if part of a more balanced and comprehensive plan.

  However, we continue to have significant concerns about the wisdom and efficacy of the Business Plan's singular focus on cost cutting and a "shrink to survive" strategy. In our view, such a strategy and its hallmark initiatives – termination of Saturday delivery, a significant curtailment of "to the door" delivery and other reductions in service standards – could easily reduce demand by an amount equal to the asserted cost savings and may well hasten the long-term decline of the Postal Service and the network that is its greatest strategic asset.

The recent significant growth in shipping services validates this concern as those shippers are choosing USPS precisely because of its network.

A Better Solution – Leverage the Network

As we stated in April, we believe that a successful restructuring of the Postal Service must start with a plan to better leverage its unrivaled last-mile delivery network – a retail network that touches every city, town and neighborhood in America. Instead of focusing on shrinking its network and capabilities, the Postal Service needs an ambitious rethinking of its business model. For example:

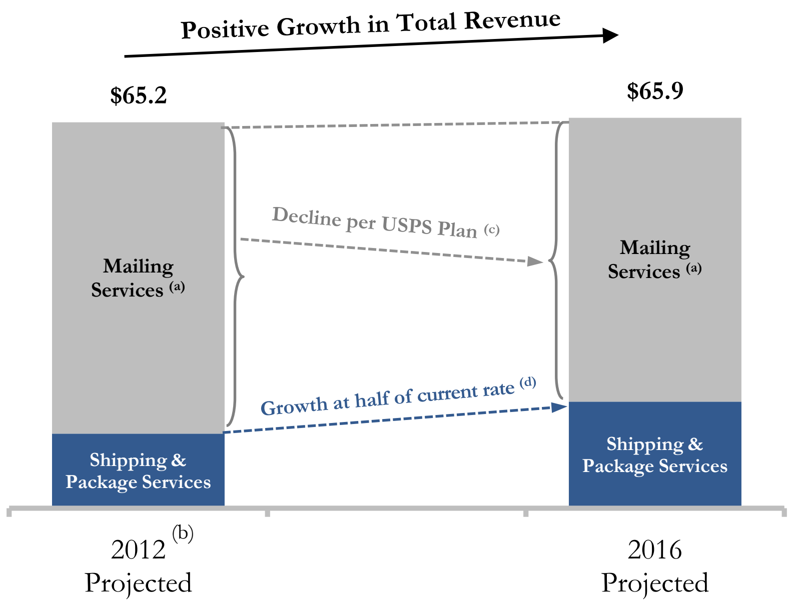
- **Better leverage last-mile delivery to grow the parcel service business:**

  Despite ever-increasing online retail purchases by consumers and rapidly growing e-commerce, the Postal Service's Business Plan assumes that volumes associated with shipping and package services will actually decrease from 2011 to 2016. As we observed in April, this assumption by Postal Service management struck us as pessimistic (if not defeatist) and the recent results suggest that our view was correct.

  Given the unparalleled strength of Postal Service's last-mile delivery network, the Postal Service could be exploring new and innovative delivery services that may add value for its customers. For example, the Postal Service expects to offer full "track and trace" capabilities by the end of this year. This could provide the Postal Service with the opportunity to add, among other things, more competitive ground and expedited products comparable to those that have been successful in the private sector. The Postal Service has also begun to test new mail products such as saturation mail and the expansion of direct mail offerings to small business customers. These initiatives are a start but will require far more aggressive roll-out and many more such ideas to better leverage the Postal Service's strengths.

  The opportunity here could be significant. The following table shows the potential impact on overall revenue, assuming that shipping and package services continue to grow at rates faster than USPS's projection of 3% growth. If mailing services decline at the rate projected by the USPS, and shipping and package services achieve only half of current growth rates, total USPS revenue will stabilize (and even grow slightly) over the next several years. This result is in stark contrast to the picture of a dying institution put forward by the USPS.

EXHIBIT E: ILLUSTRATIVE 2012 TO 2016 REVENUE GROWTH IN MAILING AND SHIPPING & PACKAGE SERVICES



Source: Preliminary Financial Information (unaudited) for July 2012 as provided to the Postal Regulatory Commission.
Note: USPS fiscal year ends in September.
(a) Mailing services excluding package services.
(b) Based on fiscal year 2012 year-to-date revenue decline of 4.6% for mailing services (excluding package services) and growth of 18.7% for shipping and package services on a year-over-year basis, applied to 2011 revenues.
(c) Based on USPS Business Plan.
(d) Calculated as 50% of fiscal year 2012 year-to-date revenue growth of 18.7% for shipping and package services

We would note that the current growth is occurring without significant new initiatives or focus. We believe an all-out effort by Postal Service management in this area would likely produce better – possibly dramatically better – financial results.

- **Explore expansion of services that the Postal Service can provide:**

The Postal Service operates under constraints imposed on its business by the Postal Accountability and Enhancement Act of 2006. In the interest of ensuring that the United States has a postal institution that is self-sustaining and capable of fulfilling its public mission, we believe that the Postal Service and policymakers must consider expanding the products and services that the American people would most value. Most leading postal services in the world (and their governments) have embraced some level of business diversification in a manner that is consistent with the postal mission but adequately protective of the private sector. In Germany, for instance, the postal service has privatized and expanded into businesses such as logistics and freight forwarding. And in the United States, as recently as the late 1960s, the Postal Service operated a postal savings system that provided depositories for working class citizens and immigrants accustomed to similar programs in their native countries.

- **Consider modifications and greater flexibility to pricing of products:**

Notwithstanding a geographic footprint that is considerably more dispersed than other countries, the Postal Service provides Americans with unparalleled last-mile delivery service of both first class mail and parcels. With respect to first class mail, the Postal Service offers

Americans among the most affordable postage rates in the world – significantly lower than comparable foreign posts[(a)] and indexed at a rate of inflation considerably lower than the distribution cost index that its private-sector competitors use to adjust their own pricing. With respect to Postal Service parcel products, many offerings (both market dominant and competitive) are priced in a manner that frequently ignores the highly dynamic and fluid nature of the modern parcel delivery business. In the context of shared sacrifice and development of a truly comprehensive business plan, we believe that adjustments to the pricing of regulated products and greater flexibility in the pricing of unregulated products are variables that merit further evaluation.

Shared Sacrifice and a New Vision

A key theme of virtually every successful private-sector restructuring is shared sacrifice – by customers, creditors, management, employees, and all other stakeholders. We believe that this principle is equally applicable if there is to be a successful restructuring of the Postal Service.

The current Business Plan is one that is largely based on one-sided employee sacrifice leading to the loss of jobs and benefits and, critically, the degradation of the last-mile network. Delivering a vibrant and growing Postal Service requires a more balanced and independent assessment that would likely result in a more balanced mix of initiatives.

Consistent with a comprehensive rethinking of the Postal Service premised on shared sacrifice, the current governance and regulatory framework of the Postal Service should also be evaluated. The current governance structure, which has been in existence since 1971, does not appear to be consistent with a rapidly moving digital society and the need for bolder strategic thinking to better leverage this national asset. The restructuring of the Postal Service requires a rethinking of the institution that focuses on new opportunities instead of old problems and seeks to proactively leverage the strengths of its network rather than reactively shrinking to survive.

Background

Lazard is a preeminent international financial advisory firm that has long specialized in crafting solutions to the complex financial and strategic challenges of our clients. We serve a diverse set of clients around the world, including corporations, partnerships, institutions, governments and high-net-worth individuals. Lazard and its senior professionals have extensive experience in the reorganization and restructuring of troubled companies and have advised debtors, creditors, equity constituencies and government agencies in numerous complex financial reorganizations. Since 1990, Lazard's professionals have been involved in over 250 restructurings, representing over $1 trillion in debtor assets. Lazard also has over 35 years of government advisory experience involving over 40 sovereign assignments.

Lazard was retained by the National Association of Letter Carriers ("NALC") in November of 2011 in connection with issues relating to the Postal Service. A team of Lazard professionals with extensive experience in providing restructuring advice undertook due diligence of the Postal Service beginning in early 2012.

(a) In Canada, for instance, the current cost of a first-class stamp is $0.61/stamp (over 35% higher than the U.S.). In the United Kingdom, it is $0.72/stamp (60% higher than the U.S.). In other Western countries the current cost per first-class stamp is even higher.